ARTECO Journal. Socio-Economic Researches and Studies
Vol. 2, No. 1, July 2019, pp. 23–28
ISSN 2602-0599, ISSN-L 2602-0599

www.arteco-journal.ro

International financial Institutions and their Cooperation with the Republic of Moldova

Serghei STUPACHEV [1]

[1] Academy of Economic Studies of Moldova (University) Chisinau, Moldova

Correspondence: Serghei Stupachev, Academy of Economic Studies of Moldova (University) Chisinau, Moldova, E-mail: stypachev@mail.ru

Abstract

This article examines the fundamentals of the world's international financial institutions: the International Monetary Fund and World Bank Group. It shows that during the recent global economic crisis of 2008 these organizations were not fully ready to implement their stated goals and objectives in terms of assistance to developing countries in particular and the governance of the world economy as a whole. Taking into account the experience of the recent economic crisis and the increasing economic influence of countries with emerging market economies have revealed the need to reform the financial structures of these organizations on the basis of the interests not only of advanced countries, but also taking into account the interests and characteristics of economic development in countries with emerging market economies. It demonstrates that the cooperation of the Republic of Moldova with International Monetary Fund and World Bank Group takes place in all the financial and economic aspects, which are at the disposal of these organizations. In the process of cooperation of the Republic of Moldova with the International Monetary Fund all major special credit mechanisms used by the Fund are involved, and the World Bank Group participates in almost the entire spectrum of lending projects in the country. The result of the reforms conducted by the Government of the Republic of Moldova following the cooperation with those organizations could be much greater if the efficiency of use of the financial resources increased.

Key words international financial institutions, international finance, international capital movements, international financial assistance, emerging markets, reforming the economy

JEL Codes: E 69, F 21, F 33, F 35.

Introduction

The processes of globalization of the world economy are objectively accompanied by the increase of the role of the international financial institutions (IFIs). At their creation IFIs were invested with the respective resources and powers for solving the problems of the international cooperation with a view to provide stability and sustainable development of the world economic system. The main IFIs are considered to be: International Monetary Fund (IMF) and World Bank Group (WBG), which International Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Multilateral Investment Guarantee Agency, International Centre for Settlement of Investment Disputes [16].

The Republic of Moldova, as other transition countries, is currently in the process of transformation into the system of world economic and financial relations. Its membership in the respective structures of IFIs allows it to use their financial resources and intellectual potential for the intensification of this transformation process. The last economic crises, especially the World economic crisis of 2008, caused a serious rethinking of the policy of IFIs in maintaining the sustainability of the world economy.

As the history has shown, IFIs, which were set up to regulate the international economic relations with the basic aim — to provide the sustainable development of the world economy, in general proved to be insufficiently ready to prevent the spread of global crisis phenomena. Due to this fact it became necessary to reform the institutional grounds of the world financial system and, first of all, IFIs, without only considering the interests of the advances countries, but also considering the interests and peculiarities of the economic development of the transition countries. In the time of acute crisis it was these countries found themselves in a very difficult economic and financial situation, so their transformation into the market economy and integration into the world economy objectively require a close interaction with the leading IFIs. Due to this fact, the Republic of Moldova, being in the process of reforming its economy, undoubtedly needs borrowings from IFIs on its acceptable conditions and the related recommendations on the development of its economic system.

1. Literature review

Among the scientific works that render the essence of the international flow of capital and foreign direct investments, one is mostly familiar with the works of the following economists Kojima, K. A., Porter, and also the works of such contemporary researches as Dunning, J. H., Markusen, J. R., Helpman, E., Tobin, J. Effective strategies of carrying on economic activities for regions and countries were analyzed by M.E. Porter [13]. K.A. Kojima [8] analyzed the macroeconomic theory of direct investments on the basis on the neoclassical theory of the international trade and the migration of the production factors in the Heckscher-Ohlin theorem — the flying geese paradigm (the model of a “catching up” development of a country) and the experience of Japan, whose economy is export oriented, and other Asian countries. Eclectic paradigm, as the base for understating the essence of direct foreign investments (FDI), was presented by J.H. Dunning [3]. The authored analyzed two main approaches for the interpretation of the essence of FDI:

- The first approach is based on the features of the company that show its advantages when making FDI.
- The second approach shows the features of the country that affect the decision of the company intending to invest in the economy of the said country.

J.R. Markusen [11] analysed the model of the knowledge capital, including the models of vertical FDI (resource oriented, export oriented, cost minimizing, outsourcing FDI, made by a company with the view to get access to cheap production factors) and horizontal FDI (market oriented, import substituting, tariff-skipping FDI, made by a company with the view to get into specific markets). E. Helpman [7] considers the mechanisms determining how the trade affects the distribution of income within a country.

Trade flows are not analyzed by the sectors of the economy, but from the company’s point of view, considering the increasing role of the multinational corporations, offshoring and outsourcing in the international labour relocation. In compliance with the theory of portfolio selection by J. Tobin [18] investors when taking their decisions about their investments are guided by the ratio of the profit margin and the risk of its loss combining investments with high level of risk with less risky in order to optimize them.

The leading Moldovan scientists have dedicated their studies to role of IFIs in the development of the economic system of the Republic of Moldova and other transition countries as well. The article by G. Belostechnik and N. Perchinskaya [20] analyzes positive and negative consequences of Moldova participating in the globalization process. The authors show some definite ways of improving Moldova’s competitiveness with the help of increasing the “innovation” factor. The most important mechanisms used by the EU countries in the area of innovation, which can be helpful and applicable to Moldova as well, have been analyzed in another work by G. Belostechnik [2] and also by G. Belostechnik and C. Gutu [1].

2. Research methodology, data and hypotheses

The article uses empirical and theoretical research methods: decomposition and synthesis, comparative economic analysis, induction and deduction methods, empirical research, analogy, statistical data analysis. The study used the principles of system analysis to reveal the essence of economic processes; generalization and identification of relationships and patterns. Laws and regulations, statistical data, analytical reviews, specialized periodical and reference publications of foreign countries and international organizations were used as factual and informational data for this study. Among the IFI data was that of the International Monetary Fund and the World Bank Group [14,16].

The basis of this article is a scientific hypothesis about the possibility of improving the efficiency of the use of financial resources received from IFIs to ensure the sustainable development of the economic system of the Republic of Moldova.

3. Results and discussions

Basics of the activities of international financial institutions, their cooperation with the Republic of Moldova

The work studies IFIs that are formed on the basis of interstate treaties and agreements operating in the field of international finance to regulate monetary and financial relations in order to ensure the stabilization of the world economy and the economies of particular countries. IFIs are organizations with multilateral international financial relations that have permanent supranational government and regulatory bodies. In order to carry out their activities, IFIs cooperate both with governments and economic entities in particular countries. The main IFIs cooperating with countries with developing market economies, including the Republic of Moldova, are the International Monetary Fund and the World Bank Group.

Nowadays, IMF is a global organization whose members include 189 countries with a global goal of sustainable economic growth of the world economy, and also for the following purposes [14]:

- development of international cooperation in the monetary and financial domain;
- ensuring financial stability in the world;
- promoting international trade, high employment and poverty reduction worldwide.

The basis of the IMF concept, elaborated in 1944 at the UN Conference in Bretton Woods by the founding countries, is the principle of economic cooperation of all states in order to prevent situations that lead to the Great Depression of the 1930s. After the end of the Second World War in the period from 1944 to 1971 IMF was accomplishing the formation of a new post-war world economy on the basis of the control and management of the international monetary system and the elimination of currency restrictions that hinder free trade. Following the formal abolition in 1971 of the Bretton Woods financial system of fixed exchange rates, IMF contributed to the transition of countries to freely convertible currency schemes. During the transformation of the economic system of the countries of the former Soviet Bloc from centralized planning to a market economy, the IMF participated in financing programs to launch market-based price mechanisms for liberalizing economic relations and macroeconomic stabilization of the financial system. In spite of the macroeconomic programs supported by the IMF, the transition to a market economy in all those countries was accompanied by severe economic shocks: the inflation growth and industrial production declined by an average of about 40% [9]. The world financial and economic crisis of 2008, which according to some estimates, was not finally overcome until 2015, showed that the IMF was not fully prepared to manage the global economy under crisis conditions of this scale and therefore needed to be reformed.

After the G20 summit in London in April 2009, the IMF was reformed in the following main directions [4]:

1. The increase in reserves for lending their programs due to the receipt of additional financial resources from the member states (over $ 500 billion) under bilateral agreements.
2. Reforming the governance structure of the IMF that was caused by the need to consider the growing economic potential of emerging market countries.
3. Reforming the IMF credit system that was necessary to increase the support of countries during the global economic crisis.
4. Changing the credit terms of the IMF. Structural implementation criteria for all IMF loans were eliminated. Structural reforms were focused on those areas that were of fundamental importance for the recovery of the economy.

In 2017, the activity of the IMF was focused on solving the following pressing problems of the world economy and finances [6]:

- developing trade and taking measures for its positive impact on the economy;
- increase in the rate of growth of labour productivity, which is one of the main reasons for the increase in incomes;
- ensuring general economic growth by eliminating inequalities, mainly caused by technological changes;
- countering gender inequality in order to realize this potential for the development of the world economy;
- debt management, in order to adapt countries to reduce revenues from commodity exchange transactions.

The World Bank Group, and the International Monetary Fund as well, was established as a result of the Bretton Woods conference. Its initial objective was to rebuild the destroyed world economy after the Second World War. Nowadays, the main purpose of this international financial organization is financial and technical assistance to developing countries. Since its foundation in 1944, WBG structures have provided financing in the form of traditional loans, interest-free loans and grants to 13,339 economic development projects in 173 countries [14]. As it was mentioned above, the WBG group includes five international financial institutions established in the period since 1944. The World Bank Group is one of the world's largest international financial institutions that provides financing and knowledge transfer for developing countries. In order to solve crucial issues in economic development, the WBG attracts both the public sector, which provides the foundation for private investment, and the private sector, which operates on the basis of this foundation. The complementary functions of the international financial organizations that make part of the World Bank Group give it a unique opportunity to combine global financial resources, knowledge and innovative solutions with the specific needs of transition countries.

If in 2008 WBG financed projects in different countries in the amount of $ 24.7 billion, then in 2009 and 2010 $46.91 and $58.75 billion respectively were spent for this purpose [14]. The latest (in 2017 and in 2018) total cumulative funding to countries in need ($42.07 and $47.01 billion respectively) [14] considerably exceeds those indicators of pre-crisis financing, which indicates that crisis phenomena in the global economy continue to take place. The WBG pays special attention to assistance to the countries of the former socialist system (including the Republic of Moldova), which were formed in the late 80s and early 90s as a result of the collapse of the USSR and the entire socialist system. These countries fall into the category of emerging markets and are currently making the transition from a command economy with central planning to a market economy. At the same time, the activities of the IMF and the WBG have recently been subjected to valid criticism by various people, including well-known economists, government leaders, politicians and the employees of these organizations themselves. For example, the Nobel Prize winner in economics, Joseph Stiglitz, considers the policies pursued by the IMF and the WBG regarding developing countries to be erroneous. As a justification of his arguments, he cites the example of Russia and China. In the 1990s, Russia followed the recommendations of these organizations and experienced a recession and a sharp decline in real incomes of the population, and China rejected these recommendations and as a result experienced an economic boom [19].

After the Republic of Moldova adopted the Charter of the IMF on July 28, 1992, it became its member [21]. From August 12, 1992, the National Bank of Moldova (NBM) began to carry out all operations and transactions on the basis of the adopted IMF Charter as a fiscal agent of the Republic of Moldova. The last increase in the share of the Republic of Moldova in the IMF occurred on February 17, 2016, when the respective government agencies increased their previous quota to 172.5 million Special Drawing Rights (SDR), which amounted to 0.04% of the total capital of the IMF [12].

In order to support the ongoing economic stabilization programs, the Republic of Moldova has concluded the following agreements on special credit facilities with the IMF [12]:

- Compensatory and Contingency Financing Facility, CCFF.

It is intended for crediting countries where the balance of payments deficit is caused by temporary and external reasons beyond their control;

- Systemic Transformation Facility, STF. Introduced in April 1993 as a temporary special mechanism in order to support countries transitioning from a command to a market economy through radical economic and political reforms;
- Stand-By Arrangement (SBA), provided for specific purposes agreed with the IMF on the bases of Stand-by agreements;
- Extended Fund Facility, EFF. It is intended to provide foreign currency funds for longer periods and in larger amounts in relation to quotas than it is stipulated within the framework of ordinary credit shares. The basis for granting a loan is a serious breach of the balance of payments caused by adverse structural changes in production, trade or price mechanism;
- Poverty Reduction and Growth Facility, PRGF. Since 2009, renamed to Extended Credit Facility (ECF). This mechanism is a preferential lending mechanism, which is usually provided with an annual interest rate of 0.25% and repaid over 10 years with a grace period of 5.5 years for the payment of the principal amount.

During the cooperation of the Republic of Moldova with the IMF, practically all special credit mechanisms used by the fund were involved. The IMF also provides annual advice in the field of financial and economic policy in the Republic of Moldova, including providing relevant technical assistance in a number of economic sectors. Currently, the World Bank Group in the Republic of Moldova is implementing loans to 105 different projects for a total of $ 1,629.27 million [15]. The following chart (figure 1) on the financial liabilities of the Republic of Moldova (in millions of US dollars) to the WBG was constructed based on the data as of October 11, 2018 [17].

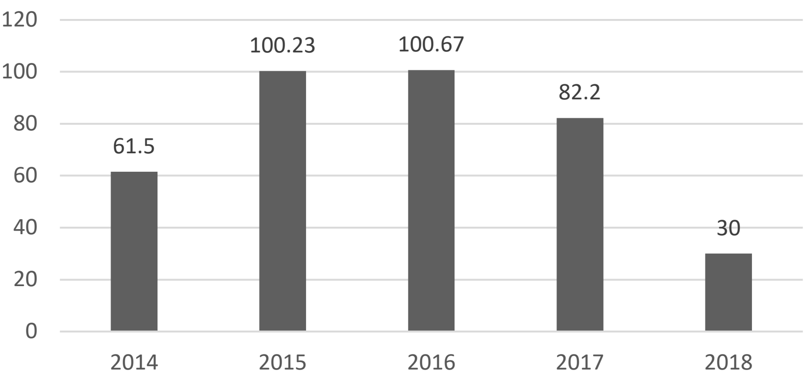

Figure no. 1. Moldova's liabilities to WBG by fiscal years (US millions)

Source: The World Bank [17]

However, the reforms undertaken by the government were not tangible. An unstable political system, an extremely polarized society, an unfavourable external environment and low-qualified labour force, and also a lack of transparency and corruption are the biggest economic problems of the Republic of Moldova. The GDP grows annually by an average of 5% mainly due to consumption and money transfers of the Moldovan citizens working in other countries [17]. The volume of the money transfers is about a quarter of the GDP, which is one of the highest rates in the world. The fall in the birth rate and the migration of people from the country leads to a large-scale decrease in the number of the working population and an increase in people of retirement age. All these factors have a negative impact on the pension system and the country's long-term competitiveness. At the same time, the external financial assistance of the IFIs has a rather high level of conditionality.

Conclusions

The analysis of the development and basic activities of the main IFIs shows that during the last global economic crisis, the International Monetary Fund and the World Bank Group were not fully prepared to fulfil their objectives and goals in terms of helping developing countries in particular and managing the global economy as a whole. At the same time, the economic influence of countries with emerging market economies has recently increased in the world. Therefore, in order to pursue a policy which is adequate to the current world economic realities, it is becoming necessary to reform the IFI structures. The cooperation of the Republic of Moldova with the IFIs takes place in all financial and economic aspects that are at the disposal of these organizations. Currently, in the process of cooperation of the Republic of Moldova with the IMF, all the main special credit mechanisms used by the fund are involved; and the WBG is involved in lending to almost the entire spectrum of country projects. At the same time, the result from cooperation with these organizations could be much more significant provided the efficiency of the use of the financial resources offered by the IFIs is improved.

References

Belostecinic, Gr. & Gutu, C. (2008). Premises and Opportunities of the Republic of Moldova for Sustainable Development in European Context. *Roumanian Journal of Economix, Nr. 1 (35)*.

Belostechnik, G. (2010). The innovation Economy as a Growth Factor in the Post-Crisis Development Period. *National Economy Archive,year LXIII, book 3,* Svishtov, Bulgaria. 5.

Dunning, J. H. (1988). *Explaining International Production.* London: Unwin Hyman.

International Monetary Fund. (2009). London Summit – Leaders' Statement 2 April 2009. Retrieved from https://www.imf.org/~/media/Websites/IMF/Imported/external/np/sec/pr/2009/pdf/_g20040209pdf.ashx.

International Monetary Fund. (2017a). About the IMF. Retrieved from https://www.imf.org/en/About.

International Monetary Fund. (2017b). IMF Annual Report 2017. Retrieved from https://www.imf.org/external/pubs/ft/ar/2017/eng/pdfs/IMF-AR17-English.pdf.

Helpman, E. (2011). *Understanding Global Trade Cambridge.* MA: Harvard University Press.

Kojima, K. A. (1975). Macroeconomic Theory of Foreign Direct Investment. *Toward a New World Trade Policy: the Maidenhead Papers. L.,* 75—101.

Loungani, P. & Sheets, N. (1997). Central Bank Independence, Inflation and Growth in Transition Economies. *Journal of Money, Credit and Banking, August 1997,* 381–399.

Lybek, T. (1999). Central Bank Autonomy, and Inflation and Output Performance in the Baltic States, Russia, and Other Countries in the Former Soviet Union. *IMF Working Paper 99/4, January 1999*.

Markusen, J. R. (2002). *Multinational Firms and the Theory of International Trade*. Boulder: MIT Press.

National Bank of Moldova. (2016). Relations with the International Monetary Fund (IMF). Retrieved from https://www.bnm.md/en/content/relations-international-monetary-fund-imf.

Porter, M. E. (1990). *The Competitive Advantage of Nations.* Basingstoke, New York: PalgraveMacMillan.

The World Bank. (2017a). World Bank Operations at a Glance. Retrieved from http://projects.worldbank.org/.

The World Bank. (2017b). Projects. Retrieved from http://projects.worldbank.org/search?lang=en&&&searchTerm=&countrycode_exact=MD.

The World Bank. (2018a). World Bank Group Retrieved from http://www.worldbank.org/en/who-we-are.

The World Bank. (2018b). Country Context. Retrieved from http://www.worldbank.org/en/country/moldova/overview.

Tobin, J. (1966). *National Economic Policy.* Yale University Press.

Stiglitz, J. (2000). *Globalization and its discontents.* Great Britain: Allen Lane The Penguin Press.

Белостечник, Г. Л. & Перчинская, Н. П. (2013). Конкурентоспособность и инновации Молдовы в процессе глобализации. *Инновации. № 11,* 79-85.

Министерство Юстиции Республики Молдова. (1992). Постановление Nr. 1107 от 28.07.1992 о вступлении Республики Молдова в Международный валютный фонд, Международный банк реконструкции и развития и его филиалы. Retrieved from http://lex.justice.md/viewdoc.php?action=view&view=doc&id=307333&lang=2