Globalization and International Financial Institutions: Liberalization Policies and Sovereignty loss for Developing Countries

With the growing phenomena of Globalization which can essentially be indicated as the tendency of investments, business and commerce to cross national barriers and move to other countries and increase their interconnection and thus international trade, governments saw the necessity to regulate or balance those new economic interactions taking place. The Wall Street crash of 1929 and the great recession combined with Second World War confirmed that necessity and created also a necessity to fund the European countries reconstruction. It took place then in Bretton Woods in 1944 the Conference that would result in the creation of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IRBD and later on the World Bank). In 1947 it took place the General Agreement on Tariffs and Trade (GATT) that would enter into force in 1948 and become the World Trade Organization (WTO) in 1995. Those financial Institutions would now on play a major role in the international economy regulation, which presumes following an economic thinking, and in this case, from 1980 and on those institutions would presumably follow the so-called “Washington Consensus”. The question that we try answer here is: in what measure this economic path proposed by the Financial Institutions are suitable for the developing countries? Do they lead towards a loss of sovereignty if taken in account the conditions imposed when loaning money?

The IMF had as main mission to ensure stability of exchange rates of other currencies in relation with the dollar through short-term loans to finance macroeconomic stabilization programs and resolve balance of payments issues for countries in debt. After Europe’s reconstruction the IMF reoriented his activities mainly towards Developing Countries, with the mission to promote international cooperation, to facilitate the expansion of international trade and the stability of those changes, to establish a multilateral system of payments and make its resources available to countries with debt issues. Its main tools to achieve those goals would be loans, technical assistance and “surveillance” of those economies. The World Bank follows the same lead as the IMF but its focus were mainly financing projects to reconstruct Europe and after projects to “develop” the so called “third world countries” through the facilitation of capital flow, technique assistance and also loans. IMF focus its activities mainly in the financial sector while WB focus mainly in infrastructure projects. Then there is also the WTO, which focuses more in promoting free trade, the growth of exchanges, the reduction of protectionism but also the management of trade agreements and litigation resolution.¹

We can easily conclude by those missions that the main reason of those institutions in the liberalization of the economy in a context of Globalization, especially after the 70’s with two oil crisis and subsequently the “failure” of the Keynesian Consensus² and its structuralism. In this context, and in the necessity of a new lead to the international economic practice, rises a combination of practices held by the IMF and WB aiming to integrate developing countries in the new world capitalist market, this new thinking was synthesized by Olivier Williamson in ten points

¹ Dembik, Ruimy, 2016. Pg 240
² Dembik, Ruimy, 2016. Pg 90
under the name of “Washington Consensus”. Those proposed measures include “Fiscal discipline; redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution; Tax reform (to lower marginal rates and broaden the tax base); Interest rate liberalization; A competitive exchange rate; Trade liberalization; Liberalization of inflows of foreign direct investment; Privatization; Deregulation (to abolish barriers to entry and exit) and Secure property rights”.

At a first glance, those points have considerable economic validity, as would state Tejvan Pettinger, Economics teacher at Greenes College, Oxford. What we see instead is that it “has become a lightning rod for dissatisfaction amongst anti-globalization protestors, developing country politicians and officials, trade negotiators, and numerous others. It is often used interchangeably with the phrase ‘neoliberal policies’.” Those claims come from the fact that the IFI (International Financial Institutions) impose conditions in exchange for the loan or for the project to be put into action in the country, which can be very well understood due to the fact that if a country has problems to pay its debts and regulate its exchanges and accounts it’s very likely it has structural problems that must be solved. We can firstly raise the question if those conditions, inspired in the same economic thinking should be applied to all different countries, knowing that they have their own economical specificity and that they all lend money for different reasons. However, what inspire the critics is the fact that the IFI went way beyond the original points from Williamson in those conditions, what D. Rodrik illustrated as “Augmented” Washington Consensus, which, in addition to previous points, include: “Corporate governance, Anti-corruption, Flexible labor markets, WTO agreements, Financial codes and standards, “Prudent” capital-account opening, Non-intermediate exchange rate regimes, Independent central banks/inflation targeting, Social safety nets and Targeted poverty reduction”.

Thinking critically the IFI and their recommendations towards developing countries, we may find that they are very often not suitable to the countries to whom they are imposed. For example, the privatization of national companies can be a big relief to the budget, but specificity must be taken in account. In 1997 Bolivian government privatized its water system under the World Banks pressure, which led to a major cut in the water supply for many of the poorest. Perhaps fundamental sectors to society should not be a straight target of budget cuts. In addition, implementing fiscal rules for countries already in crisis can lead to cuts in important welfare programs, causing population, already suffering with crisis, to take an additional hit, exactly how it went in 2011 in Egypt, which led to the “bread revolution”. We also had the case of Indonesia, where a subsidy cuts agreed between the government and the International Monetary Fund contributed to the downfall of a government in 1998. Therefore, we can question the liberalization policies in itself, even more after 2007, with a major international crisis created by financial deregulation and spread to all the other countries by means of a growing liberalized world

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3 Center for International Development at Harvard University
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5 IMF conditionality can be checked at: https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/28/IMF-Conditionality. Consulted the 15/11/2016
6 Center for International Development at Harvard University
7 SHULTZ Jim, The Politics of Water in Bolivia, The Nation, 2005
8 GUTNER Tamar, 1999
9 O’Brien et al. 2000. P.4
economy, which illustrates the potential of free markets to also create high instability and unemployment. To make another counterpoint against the dominant thinking that interventionism is bad, we can think about the case of the Chinese economy, that opened its market just enough to make it grow\textsuperscript{10} (see chart 1).

As for the sovereignty of the developing countries and what concerns the IFI, D. Rodrik raises some important points. For this author “Globalization has deepened the economic and cultural divisions between those who can take advantage of the global economy and those who don’t have the resources and skills to do so”. We can interpret this phrase by the power that developed countries possess in international organizations such as the IMF (Image 1) and the World Bank (Image 2) when comparing to developing countries (who actually have to form voting blocks and share interests to be able to have a barely significant representativeness). Those countries on top have completely different economic agendas than the emerging ones, while the first ones need to “address domestic concerns over inequality and distributive justice”, the latter must “restructure their economies and promote new industries”\textsuperscript{11}, but still only one of those groups can set the rules for international economic regulation.

Rodrik also criticizes the loan conditions imposed to developing countries, as many of them have to sign investment treaties that create special rights for foreign companies, reduce corporate taxes and make concessions. Jeffrey Sachs, the head of the Harvard Institute for International Development reinforce this thinking in his statement where he says that “In Korea the IMF insisted that all presidential candidates immediately ‘endorse’ an agreement which they had no part in drafting or negotiating, and no time to understand. The situation is out of hand…It defies logic to believe the small group of 1,000 economists on 19th Street in Washington should dictate the economic conditions of life to 75 developing countries with around 1.4 billion people.”\textsuperscript{12}.

For Rodrik the “elimination of barriers to trade and finance became an end in itself, rather than a means toward more fundamental economic and social goals”\textsuperscript{13}, and according to him the purpose of international economic negotiations should be to increase domestic policy autonomy, and not the other way around. Paradoxically we have here a situation where developed countries can then impose liberal measures to emerging economies, but they are the ones that rise more protectionist barriers (image 3).

In the light of the evidences seen previously, we have International Financial Institutions working under a liberal point of view, which we will not judge here as good or bad, but simply unfit as a universal way of treating all the economic issues that appear in the international community. A major proof of this is the miscalculation of demanding cuts in subsidies for food in countries where poverty reaches very high levels, as it was the case of Egypt, Indonesia or water in Bolivia, they all lead to popular uprisings and even contributed to the downfall of the government in Indonesia. In sequence, we’ve seen the huge difference of power among countries within the Financial Institutions, so we have no illusion here of who sets the “rules of the game”, which means that the policies decided were chosen for a reason. Conveniently, the liberalization of the economy of developing countries benefits way more the developed ones, who already have a modern


\textsuperscript{11} RODRIK Dani. Op cit.

\textsuperscript{12} SACHS Jeffrey. 1997

\textsuperscript{13} RODRIK Dani. Op cit.
industry and produce manufactured goods in large scale and lower costs (so now they have access to new markets) than the developing ones, which struggle to improve their industry and will certainly be condemned to stay in that position. The belief in free trade suggests the theory of comparative advantages, which states that developing economies should stick with primary products. If we analyze it, this attitude is even contradictory in the point of view of the main mission of the IMF and WB, which is to help regulating the balance of payments and developing the countries. First because we just saw how the austerity, budget cuts and liberalization tend to keep the country underdeveloped, secondly because in that position, when exporting primary products and importing manufactured ones the propensity to keep the balance of payments in deficit is very high (except when we talk about oil).

We’ve also seen how often it is that countries have to accept conditions for borrowing money or being financed, even if it’s a crisis situation that we are talking about. Those conditions include concessions, tax cuts, cut in subsidies, redirection of sectors of investment, resetting state priorities, etc. All of those elements emanate from a country’s Sovereignty, which means in this case its power to decide when and how the money will be spent and where it will come from. A country can give up, or transfer a part of its sovereignty when signing a treaty for example, where it agrees to give something to get something in return. Although, what is asked from the Financial Institutions in that borrowers “have to” accept the conditions before having access to the loans. If the aim of the institutions is to regulate the international economy and by regulating they impose a set of rules that would originally emanate from the country’s sovereignty and power of choice, then yes, we may have a loss of sovereignty, especially if we are talking about emerging economies. The main argument to counter this one is that the governments have the choice of asking or not for the loans, and thus it’s consensual that they give up part of their power over their economy. The problem with this kind of argument is that generally the loans are taken when the country is on the edge of a financial collapse, or an economic crisis, that could menace even the existence of the government itself (we must remind that most countries only borrow from IFI as last resort\(^\text{14}\)), so it doesn’t really seem as an option, but more as sacrifice or obligation.

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\(^{14}\) DOBLER et al. 2016

Image 1

Countries’ quotas in IMF

Each country’s IMF quota determines how much it contributes, how many votes it has and how much it can borrow.

EU member states 32%
US 17%
Japan 6.1%
China 3.7%
Saudi Arabia 3.2%
Canada 2.9%
Russia 2.7%
India 1.9%
Switzerland 1.6%
Australia 1.5%
Mexico 1.5%
Brazil 1.4%
Korea 1.4%
Others 23.2%

Sources: International Monetary Fund, Graphic News
Graphic by Kinyen Pong

**Image 2**

<table>
<thead>
<tr>
<th>DIRECTORS APPOINTED BY:</th>
<th>NO. OF VOTES</th>
<th>PERCENT OF TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. UNITED STATES (MCGUIRE)</td>
<td>384,362</td>
<td>15.51</td>
</tr>
<tr>
<td>2. JAPAN (KOSUCHI)</td>
<td>166,120</td>
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</tr>
<tr>
<td>3. CHINA (YANG)</td>
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<td>4. GERMANY (MUELLER)</td>
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<td>5. FRANCE (DE VILLEROCH)</td>
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<tr>
<td>UNITED KINGDOM (ROBINSON)</td>
<td>91,083</td>
<td>3.91</td>
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**Image 3**
Consulted the 15/11/2016
**Bibliography:**


