

# INTERNATIONAL FINANCIAL INSTITUTIONS AS CROSS POINT OF SEVERAL THEORIES

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**Abstract:** *The main objective of this report is to identify theories applicable to international financial institutions. In an environment of revolving crises of varying nature, they continue to adapt to events and develop responses on an urgent basis. The intersections between them are found and an independent theory is identified, which defines their essence for their already over 80 years of unusual activity.*

**Keywords:** *International financial institutions, Political economy, theories*

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## Introduction

In order to explore the nature of international financial institutions, the starting point is the widely used concept in the literature of international financial architecture, which refers to the framework of institutions, rules, regulations, agreements and practices that govern international financial transactions and the interaction between states and global financial markets. It covers diverse aspects, including global monetary systems, exchange rate mechanisms, financial regulations, international financial institutions, cross-border capital flows, debt management and crisis prevention and resolution mechanisms.

The year 1945 or the end of the Second World War is considered to be the beginning of the use of this definition (UN, 2023). Before it was named financial architecture, the term international monetary system was used to summarize the global financial system (Goldstein, 2002).

The establishment of the IMF and the International Bank for Reconstruction and Development is a historic moment in the international economic and financial relations for several reasons. With their creation, the previously known international monetary system was fundamentally changed. They contribute to the shaping of the global financial architecture, built by the public and private sector, and they contribute through the extraordinary resource at their disposal and the political mandate for development (development mandate) of



international economic and commercial relations. It is important to understand their existence from different perspectives in relation to their long-standing unusual role in the financial architecture. They have a variety of tools according to the environment in which they operate and have developed managerial, technical, financial and scientific capacity.

### **Theoretical foundations**

The purpose of this paper is to define the economic and political theories relevant to IFIs and to find the intersection between them. They are considered according to the following selection criteria:

**First** of all, their emergence is a precedent - historically, they have no analogue as a type of institution, as a form of activity and as a financial intermediary. By their nature, they combine qualities and functions of well-known financial and government organizations and institutions, but go beyond the known through their mandate for recovery and development. **Secondly**, from an institutional point of view, they are the subject of research, since they are institutions and this theory largely determines their form of action in relation to the functions they perform. They create a supranational institutional and legal framework that legalizes their establishment. Thirdly, their sphere of action, geographical unlimitedness and promotion of international economic cooperations, as a result of which they contribute to globalization in its modern form, are a precedent. They operate in territories of developing countries that are in dire need of financial, regulatory and managerial resources and foreign investment. They grant loans in sectors that are high-risk and conventional bank financing is unprofitable or has no return (financing against reforms). They create the conditions for and are themselves the engine of globalization through the policies of the Washington Consensus. In the fourth place, they are also the subject of research from the theory of development, on the basis of which they stand, but at the same time they develop. In fifth place is their form of action and management - they are strictly financial institutions, which are also considered by international finance and banking theory. They allocate resources to both the public and private sectors. Each member state has representatives who are part of the political and national banking system. Each country has the right to vote according to the amount of its shareholding in the capital of the respective development bank. Rating agencies evaluate their activity according to strictly defined criteria with a credit rating.

The adopted approach is from the aspects listed so far, in order to gain a broader idea of their nature and place in the modern economy. They combine the dual nature of development agencies and financial institutions (Bobeva, 2018), which operate in the conditions of a changing macroeconomic environment. The analysis of the theories determines the contribution of each of them to their conceptualization. Special attention is paid to the World Bank and the International Monetary Fund as prototypes of IFIs and a starting point for the formation of new supranational financial institutions.

In the theory of them, several approaches are applied (Sanford, 1975) - project, macroeconomic and socially oriented. Proponents of the first approach believe that IFIs should apply the method of expanding output and promoting development in order to direct financing to efficient investments and institutions. This approach ensures that the funds will be used for exactly the purposes defined in the project and monitoring of its effect on development can take place. Among the macroeconomic theories of development, the development quality approach, applied mainly by the World Bank, stands out, according to which the goals of sustainable development must be followed. From the social perspective of income distribution theories, IFIs are expected to help reduce poverty and ensure equity in income distribution.

### **Institutional theories**

Institutional theory has been identified as providing a definition of the parameters of IFIs. The literature review on it observes how institutional isomorphism conditions the creation of new IFIs. Although countries initially found an answer to their needs in the establishment of new institutions, in practice they tended to become more similar over time. The resource dependence theory fully suits the financial institutions under consideration, as they must meet the expectations of the member states. However, IFIs are not limited in meaning and functions to it alone. The theory of both approaches, and more specifically rationalist institutionalism, overlaps with the political nature of international development banks to provide cooperation between interested states, while reflexive institutionalism emphasizes the ways in which institutions can shape state preferences and identities to promote long-term stability and cooperation in international relations.

### **Crises theories**

Next among the applicable theories of IFIs is that of crises. Created precisely after the greatest economic and military crisis in the 20th century, namely the Great Depression and the two World Wars, their role in the financial architecture is determined by the need to provide resources in various forms to countries to overcome economic and social inequalities and challenges.

There is a strong link between the activities of international financial institutions and crisis management. After the fulfillment of their initial mission, IFIs enter the role of stabilization policy generator, developing specific programs and policies for developing countries. They take on a new mission to build their capacity and make efforts in the scientific research field to predict the emergence of crises. Development banks are an interesting subject of research because they have an important role, given the resources at their disposal, in helping affected countries recover from a crisis. The abundance of specific crises over the past decade has put IFIs to the test after their failure to anticipate the global financial crisis dealt a major blow to their reputation as institutions of high macroeconomic and forecasting expertise.

### **Bank theories**

Banking theories have several points of intersection with IFIs, but at the same time differ from traditional banking institutions. Their capital structure is different in that they raise their capital from member states and do not pay interest or dividends on it. The focus of IFIs is to achieve the mandate through the granted loans, while simultaneously observing the solvency of the borrowers and the return on the loan, but not profit maximization. The project approval procedure is much longer than with commercial banks. They grant loans, but in sectors and for projects of high social and environmental importance, in priority economic and social sectors, respecting the principle of complementarity of financing and non-competition with commercial banks.

In the theory of IFIs, those of development, of institutions, of the banking and financial sector, of crises and of globalization simultaneously intersect. The activity and role of these institutions is determined by the various theoretical directions, but they are not exhaustive in order to fully define the nature and essence of development banks. They are part of each of them, combining their philosophy and principles, but also transcending them with their specific mandates.



Their role has long exceeded its original format and given the potential they develop and the importance of the financial and managerial resources at their disposal, they are permanently positioned in the international financial architecture. They are an invariable part of the modern financial and political environment, which is supported by the political will of the countries that participate in them.

### **Globalization and deglobalization theories**

The contribution of international financial institutions to the removal of trade barriers, the liberalization of markets, the promotion of international cooperation and the implementation of neoliberal policies greatly stimulates the processes of modern globalization and is its driving force. The effect of the First and Second World Wars on global relations, trade and economics and the ideological alliances outlined was significant, including the period after the end of the Second World War when, with the creation and development of the Bretton Woods Institutions, processes of globalization developed and expanded.

The negative effects of the activities of international corporations also cast a shadow on the activities of development banks, which are associated with increasingly interconnected economies. Public scandals involving multinational companies such as Enron discredit multinationalism and foreign direct investment, the main catalyst of which is development banks.

The World Bank and IMF were demonized for the policies they "forced" developing countries to adopt in the 1980s and 1990s in South America, Africa and Asia. Their activities have given rise to serious anti-globalist demonstrations during their meetings. Development banks and international corporations become the collective image of all the negative effects of globalization. The protests and anti-globalization movements of the 1990s criticized the activities of these institutions, but did not oppose the process of globalization itself.

There is no single and overarching theory of deglobalization, with political expansion outpacing theory. The global financial crisis of 2007-2008 contributed to the deglobalization trend by promoting actions to stimulate local production and local consumption, pursuing protectionist policies, and directing countries' attention to self-dealing with economic challenges and crises. States are driven by the desire to prevent the transmission of global economic imbalances to the regional level.



The deglobalization debate continues as examples of policies aimed at limiting globalization proliferate. It is unusual that it is the international financial institutions, as the main driver of globalization, that support policies such as the global minimum tax of 15% on the activities of multinational companies with revenues of more than 750 million euros. Its introduction was ratified by 135 countries in 2021 and will enter into force in 2024 (OECD, 2024). Another signal that the world is moving towards deglobalization is that a huge number of countries, especially those that have been extremely liberal (US, Canada, EU), are introducing the so-called screening of foreign direct investment (European Commission, 2020). The aim of the EU regulation, introduced in 2020, is for the Union to be well prepared to identify, assess and mitigate potential risks to security or public order, while at the same time continuing to be among the most open investment areas in the world. This measure remains a restriction on investment from third countries due to national security concerns.

More examples of acts of deglobalization are at least 210 public actions taken to limit social and trade relations with China during Donald Trump's tenure. These include tariff and non-tariff measures, restrictive actions such as the visa regime, diplomatic actions, measures by the Ministry of Defense to ensure freedom of navigation and transit through the Taiwan Strait, blocking the import of articles produced through forced labor, including designating China as an adversary.

Such measures have not been taken only by the Trump administration and only with regard to China. Recent years have seen significant dynamics in trade tariffs imposed on trade in steel, aluminum and other goods between the US, Canada, Turkey, the European Union, Russia and Japan. The Biden administration is imposing various tariffs on steel and aluminum imports with respect to Canada in 2020, on aircraft trade with the European Union that will not be suspended until 2021, and a number of other restrictions on the free movement of capital, which are imposed through international trade relations. In fact, the donor countries advocate a liberal policy in international relations, but they themselves impose a number of highly restrictive measures.

### **Development theories**

Development theories are closely related to the essence of IFIs, given their pursuit of the concept of economic development, which refers to the process of improving the welfare of countries.



They aim to explain the causes of poverty, inequality and backwardness in the development of some countries, trying to find universal and specific formulas for achieving sustainable and equitable development. The beginnings of research can be traced back to the post-World War II period, when the process of decolonization was underway and the newly independent countries sought to achieve economic prosperity and modernization (Rapley, 2007). Schumpeter's theory also made a significant contribution, preceding this period. The need to assimilate the causes of backwardness and to identify applicable strategies to promote economic growth and social progress provoked extensive research resulting in a range of approaches.

Some of the popular development theories include modernization theory, dependency theory, creative destruction theory, human development theory, neoliberalism and post-development theory. They reflect different historical moments and ideological contexts, being enriched by the emergence of new challenges and perspectives. Each has its own assumptions, strengths and limitations and provides a different framework for understanding and policy development.

### **Conclusions**

Several conclusions emerge from the historical review of the economic and political context in which IFIs were created and operate. They are institutions with the primary objective of sustainable development and economic prosperity by promoting international cooperation and the free movement of goods and capital. Despite the political influence exerted on them, they continue to operate as financial institutions and occupy a specific place in the international financial architecture, guided by good banking practices for risk assessment and management.

Throughout the period of activity, they are an important political and financial tool in the allocation of resources in the pursuit of economic prosperity and in the realization of modern global goals such as sustainable development through initiatives for the inclusion of the private sector, providing technical assistance in the transition from a planned to a market economy, poverty reduction by promoting vulnerable groups and women's entrepreneurship, combating climate change, developing medicine and a number of other sectors recognized by IFIs as key ones.



Capitalize on their experience, knowledge and skills to carry out their mandates. One of the challenges facing IFIs is how the neoliberal theory of public spending restraint fits into the generous financial instruments during the COVID-19 pandemic that institutions are providing. An interesting phenomenon is how they manage to adapt more and more quickly to the type of crises and finance to a greater or lesser extent the public and private sectors.

There is a change in the neoliberal paradigm, which they applied most prominently in the early 1980s and 1990s. The global financial crisis of 2007-2008 is the moment that clearly reports the degree of globalization. IFIs are the engine in realizing the ideas, goals and theory for it and are one of its main tools. According to the degree of openness of the economy and susceptibility to external shocks, countries are affected to varying degrees. During the crisis, it turns out that advanced economies fail, but have sufficient mechanisms to counteract its consequences, while for developing countries it deepens the dependence on foreign aid.

The recent history of IFIs has seen a reverse wave towards deglobalization and the implementation of more and more policies and actions in the implementation of their projects. In an environment of revolving crises, the Bretton Woods institutions, dominated by the neoliberal paradigm, become a catalyst for sustainable development, adopting the 17 Goals for sustainable development, stimulating small and medium-sized enterprises, agriculture, green energy, gender equality, combating climate changes and a number of others.

At the global level, there is an erosion of the policy of free movement of goods and capital. It is increasingly limited by the introduction of a number of tariff and non-tariff restrictions in the US, Europe and Asia, expressed in a global tax on the activities of multinational companies, trade sanctions on trade with Russia and other countries, the introduction of trade tariffs on trade with certain goods between the US, Canada, the EU, Japan and Turkey, for example.

The events of deglobalization outpace the theory of it. At the same time, IFIs are also changing the focus of their activity. They are becoming much "greener" in their policies based on the Paris Agreement and combining regional realities with international technologies in implementing projects for regional sustainable development.

International financial institutions face new challenges to maintain their political neutrality in the face of the war in Ukraine. There was a clear division and strong opposition to the war by the World Bank Group, the European Bank for Reconstruction and



Development, and to a lesser extent the regional Black Sea, Asian and African banks. On the other hand, the New Development Bank does not even mention Russia's invasion of Ukraine in its annual reports.

An exceptional dynamic is observed in the activity of international financial institutions. They manage to stick to financing infrastructure projects in developing countries to build transport arteries, provide access to drinking water and health care, and at the same time provide a response to political, economic, social and health crises and disaster situations due to hurricanes, earthquakes and other natural disasters.

After the review of the various theories related to IFIs, an intersection between each of them and the activities of development banks, which are part of the creators of global policies, is outlined. Each of the examined theories covers a part of their mission, but is insufficient to explain the essence, the role and the place they distinguish with their presence in the international financial, social and economic arena.

The institutional framework at the global level, the development policies that they implement through good banking practices in conditions of revolving crises and the contribution to globalization determine to the greatest extent the modern theory of their activity. By developing a research arsenal and their contribution to the research fields, they show that they adapt to the events and remain an up-to-date institutional format of financial institutions that is applicable to the dynamic environment of operations. Their apolitical essence is revealed with the position they take on the war in Ukraine. Member states are leaving institutions that are dominated by Russia, such as the International Monetary Fund, and the existence of the Black Sea Bank remains in question. Efforts are being made to provide additional capital to finance projects in priority industries and the green transition. They are responsible to the member states for achieving the goals set in the annual reports.

Contemporary IFIs theory is the intersection of theories of institutions, crises, banks, development, and globalization and deglobalization, summarizing the reasons for the role they play in the modern financial architecture. If in 1944 their actions were on a two-dimensional surface, then in 2024 they are enriched and represent a multidimensional prism with different dimensions. They respond with equal commitment to diverse crises and model the course of events with their presence. They continue to be a sought-after voluntary tool for implementing global policies.



At the same time, the nature of development banks is a precedent, and each of the examined theories can explain only a part of their nature, but contributes to broadening the understanding of their role in the modern financial architecture.

The analysis of the historical context and the neoliberal paradigm are the starting point for explaining the nature of development banks, and on this basis the changes are identified - from the pillars of globalization, they come out of the identity of the Washington Consensus and there is reason to talk about a new paradigm of IFIs.

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