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Conceptualizing the Role of International Financial Organizations in Post-Communist Economic Transformations

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Abstract Since the decline of communist dominance, political and economic transformations of newly established states were viewed as a natural continuation of international liberalization rather than a thing in itself. For that reason, international financial organizations undertook a leading role in promoting market-oriented reforms in respective states. This paper reviews theoretical, strategic and procedural aspects of the World Bank and the International Monetary Fund packages and questions the role the respective organizations played in post-communist marketization. Despite a declared need in reformation, few changes have actually been made in international financial organizations, and this paper claims that reasons behind it remain unclear.

Keywords Post-Communist economic, Economic transformations and reforms, Organizational policy

1. Introduction

The decay of communist rule delivered a belief in a wholesale victory of liberalism and ‘the end of history’ (Fukuyama, 1989). Communist ideology retreated in the face of advancing market, and international financial organizations took a leading role in conducting *laissez faire* principles. The results were, nevertheless, controversial.

Supporters of liberal paradigm explained the roughness of liberalization by transitioning states’ doing not enough for the success of reforms (Kazakevitch & Smyth, 2005; Murphy, Shleifer, & Vishny, 1992; Popov, 2007), others called for more ‘weighted’ approach towards reformation and criticized neoliberal model as a whole (Birch, 2010; Koford, 1997; Rodrik, 2006, 2008). Such a controversy has set up a long-lasting debate between the proponents of different theoretical approaches (Alam, Nguyen, & Majumdar, 2009; Pickel, 1997), drawing a divide between domestic (Horowitz, 2004) and international factors of economic transition and pointing out to the importance of democratization for market transformations (Åslund, 2009; Pickel, 1993).

The agreement could be found in that both domestic preconditions and external assistance were decisive for the success of post-communist economic transition, and international financial organizations play a vital role in this process as the agents of internationalization. Their ability to promote post-communist reforms and to make these reforms beneficial for their recipients remains very important.

This paper reviews the instruments which the World Bank and the International Monetary Fund use for marketization of transitioning states. For that the paper distinguishes three levels, at which the respective organizations act: the first one relates to theoretical backbone behind the packages of reforms they work out, the second — delivers on the particular processes and procedures launched by the respective programs, and the third one refers to the features of the World Bank and the International Monetary Fund’ organization and decision-making.

2. The Theory of Post-Communist Marketization

Post-communist marketization was not the first phenomenon spotted by economists. Economic development, preceding the dissolution of communist system, provided empirical grounds for various theoretical elaborations, and three schools of economic thought became particularly powerful. These are: classical economics, Keynesianism, and monetarism.

The roots of classical economics lie in XVIII-XIX centuries’ theoretical developments, with Adam Smith having firstly introduced an idea of a market as of a self-regulating system. He called the forces that lead to a market equilibrium the ‘invisible hand’ and advocated for liberalization of international trade (Smith, 1776).

A paradigm shift took place at the beginning of the XX

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century, with the outburst of the Great Depression, when John Maynard Keynes questioned the postulates of free market economy by stressing the importance of state regulation and government interventions, especially during recessions. Practical implementation of Keynesian economics resulted in expansionist fiscal and monetary policies, which allowed the state to stimulate demand and, further on, resulted in desired economic growth (Jahan, Mahmud, & Papageorgiou, 2014).

Stagflation, which affected industrial states in 1970s', made Keynesianism powerless in the face of new economy challenges. A takeoff of the prices on oil led to the leap of cost on industrial goods, transportation and, as a result, caused strong drop of demand. Under such conditions, an increase of governmental spending (widely used mechanism in Keynesian approach) could have resulted in a greater inflation and further economic decline. Solution was found in a strict monetary policy, offered by representatives of neoliberal approach. Milton Friedman (1970) stressed that control over money supply affected pricing and production, and the establishment of real prices was a key precondition for market equilibrium (Friedman, 1970).

The governments of stagflating countries adopted monetarist developments and produced policies that signified a new approach towards economic regulation. 'Reaganomics' in the United States and 'that cherism' in the United Kingdom symbolized the abolishment of governmental intervention, followed by tightened budget control, large-scale privatization, reduced money supply, and control over inflation. Similarly to the success of Keynesian economics after the Great Depression, economic neoliberalism was backed up by real policies and became a proponent theoretical school since then and on (Peck & Tickell, 2007).

Whole scale liberalization declared by the proponents of monetarism added onto the spread of globalization around the world, with international financial organizations, such as the World Bank and the International Monetary Fund, playing an outstanding role in it. The former supported long-run investment and developmental programs, while the latter promoted macroeconomic stabilization for the sake of sustainable economic growth (IMF, 2002).

In the wake of the growth of internationalization, Williamson (1989) consolidated a set of market-oriented policies elaborated for the states of Latin America into a package of reforms know as 'the Washington Consensus'. This package represented both a legacy of successful macroeconomic policies ("reaganomics", "tatcherism") and a manifesto of globalization, completed by developing economies. In such a way, a set of neoliberal policies declared in the Washington Consensus became a model for post-communist marketization.

Williamson (1993) mentioned Soviet economic system as the one incompatible with market but he didn't assert the Washington Consensus to be a pathway for post-communist economic transition (Williamson, 1993). Nevertheless, the Washington Consensus was set up as a roadmap for transition. Furthermore, it was chosen by supporters of radical reformation due to "speed and comprehensiveness" (Aslund, 2007, 2013), drawing a demarcation line between 'shock' therapy and gradual reformation.

'Shock therapy', or 'cold turkey' model involves radical liberalization in the shortest period of time, while 'gradual' approach views the development of institutions as a core of economic transition (Tridico, 2006). "Shock" therapists claim that success in transition depends fully on the speed and scale of liberalization, which, followed by macro-economic stabilization, leads to economic growth in future (De Melo, Denizer, & Gelb, 1996). They underline that rapid reforms promote better coordination, which is particularly important for complex transition, and limit political leadership in its impact on reforms' implementation (Krueger, 1992; Murphy et al., 1992). 'Gradualists' on contrary stand for more 'weighted' approach towards economic transition. They stress that different markets require different time to adjust to reforms and react on them, respectfully, in different ways (Little, Scitovsky, & Scott, 1970). Moreover, some measures (such as control over inflation and monetary expansion) are mutually exclusive. Finally, disruption of reforms in one field may lead to an overall failure of reformation (Rodrik, 1989) due to a complex and interdependent character of reforms.

The debate between radical reformers and gradualists seemed to have faded (Popov, 2000), but is still continuing, with the ongoing revision of international financial organizations work. What remains stable is, as the history of economic thought demonstrates, that none of existing approaches theorizes on the nature of transition as a whole and the nature of post-communist transition, in particular. In a most common sense, a choice of a 'shock' or 'gradual' strategy for transition derives from a political choice made by political leaders in a particular period of time. But is there room for international financial organizations to maneuver then?

3. The Logic behind the Reforms

When it comes to the choice of transition strategy, the key barrier for sovereign states decision-making lies in search of financing for reforms implementation. For that they need to turn to G7, or the World Bank, or International Monetary Fund (Pettman & Papava, 2005): 83 that back 'shock therapy' and the Washington Consensus (Taylor, 1997). Therefore, the main critique, which international financial organizations receive in dealing with transition, refers primarily to conceptual and theoretical gaps, which neoliberalism and its quintessence, the Washington Consensus, have.

From theoretical prospective, neoliberalism does not deal with a transition as a change from one system to another. Neither it is 'a theory of economic change' (Pickel, 1997): 224. Then why was it chosen among others as the only cure from planned economy? There is no clear answer on this question, as is no clear evidence in favor of other theoretical schools as a tool of transition, for that none of them was developed in a response to a transition quest.

From strategic prospective (Pickel, 1997), 'shock therapy', or the Washington Consensus with its stabilization and structural reforms (Williamson, 1994), is introduced by the IMF within the following stages:

1. Liberalization of prices, which leads to high inflation.
2. Macroeconomic stabilization, which includes budget restrictions (reducing the tax burden) and monetary expansion (crediting small and medium enterprises) to cope with inflation and economic recession.
3. Small-scale privatization.
4. Large-scale privatization and legal/institutional reforms, which define a role of state in new market economy ("Transition Economies: An IMF Perspective on Progress and Prospects," 2000).

In its turn, the World Bank expands IMF policies with an accent on economic development and economic growth (Taylor, 1997). It similarly stands for greater economic openness and market liberalization: elimination of trade barriers, increasing export and trade volumes, prevalence of services share in GDP, closeness of prices level to international one and increased number of privatized enterprises (Linn, 2002), thus, supporting the key theses of the Washington Consensus.

The need in liberalization is a source of agreement between the representatives of different theoretical approaches. Even the proponents of gradualism don't question marketization as a whole despite being anatomists of neoliberal reforms. Still they prefer evolution to the rapid transformation and don't mind the interlacement of old economic system with a new one. Further on, gradualists stand for a more case-oriented approach in working out policies for transforming societies, including the factors of endogenous character that refer to their socio-political and economic determinants as well as previous transformation experiences (Pickel, 1997).

The efficiency of such an approach with unclear goals and indicators, may be questioned, as well as doubted its efficiency in shifting from 'bad' practices of communism-backed system to market rules. But at the end, a comparison of transition experiences demonstrates that 'any transition in post-communist countries' was 'lengthy and gradual no matter what' (Kozminski, 1992): 331, while all successful transitions were backed up by state apparatus, promoting political changes and market regulation (Alam et al., 2009).

Procedural implementation of the Washington Consensus delivers even more questions. Thus, the balancing between budget restrictions and monetary expansion as well as between reduced taxes and broadened tax base is very complex. How monetary expansion will be combined with a struggle against inflation? How credit expansion will add to the development of small and medium entrepreneurship under conditions of economic deterioration and social vulnerability?

'World Development Report 1996: From Plan to Market' stated that 'Consistent policies, combining liberalization of markets, trade, and new business entry with reasonable price stability, can achieve a great deal even in countries lacking clear property rights and strong market institution' (Barr, 1996): 142. Theory handles financial burden from business to society, assuming that provided credits will result in efficient reformation (Danforth, Jenkner, & Rozenov, 2015), while foreign aid will automatically flow into transforming societies, bringing innovations, technologies and employment opportunities, as soon as investors get informed about IMF-backed reformation in a respective state (IMF).

Nevertheless, fiscal and monetary reforms can do very little in terms of real economy, economy of production. Inflation control doesn't intersect with financial globalization output (Spiegel, 2009), and the most negative consequences of such a policy refer to a period of economic recession, which follows liberalization of prices. Liberalization is believed to result in sustainable growth after successful macroeconomic stabilization, while the causes of declined output are viewed in 'distortions in industrial structure and trade patterns accumulated during the period of central planning', with endogenous factors of transition being the key determinants of liberalization speed and efficiency. On contrary, the following period of economic growth is positively affected by liberalization, though with a remaining dependence on 'institutional capacity and reasonable macroeconomic policy' (Popov, 2007).

In line with a liberalization logic, it is assumed that the Washington Consensus didn't work in former Soviet republics because of the absence of radical reformation (Kazakevitch & Smyth, 2005) — the liberalization's own 'counterfactual', which was not viewed apart from the 'shock' therapy policies. Similar claims refereed to the countries of Latin America and turned out to be false. Despite states that implemented radical reforms performed better in terms of economic growth and democratization, they experienced higher volatility, inequality and poverty (Huber & Solt, 2004) : 158, while 'sustainable development has to be based on a balanced approach between social demands and environmental limits' (Hopwood, Mellor, & O'Brien, 2005) : 51. Moreover, the ongoing growth that follows the macroeconomic stabilization results from state's withdrawal from the IMF programme and is still lower than it could be if the country didn't participate in the program et al (Przeworski & Vreeland, 2000). Similarly, 'compliance with IMF conditionality mitigates this negative effect, while the overall impact [of the IMF], however, remains negative' (Dreher, 2006).

Gradualists' explanations of the failure of neoliberalism in post-communist marketization on contrary refer to deeper structural constraints and institutional dimension of transition. They believe that successful liberalization was impossible in post-communist societies, as former administratively planned economies had no market institutions at all. In this respect, institutions were viewed as a core of economic transformation (North, 2006; Tridico, 2006), and, even being created artificially, were limited in operating for that they needed suitable environment for "transplantation" (Roland, 2008), a bottom-up mechanism of institutionalization (democratic regime), and, elementary, time to evolve and develop (Klaus, 2012).

Institutional critique was crucial at the beginning of post-communist transformations, but is it as valuable now as it was then? Popov (2007) claims that yes: institutional capacities are decisive for successful economic performance. Still, the degree of institutionalization in former communist states now is much greater than it was at the beginning of transition, when markets didn't exist at all.

Despite an observable change in post-communist market institutionalization ("Transition Report 2013: Stuck in Transition?," 2013), the key concepts underpinning neoliberal paradigm remain unchanged. The IMF is still advocating for 'broadly-defined market economics, and, in this respect, alternative models have little or nothing to offer" (Figliuoli & Lissovolik, 2002). In case of transformational failure the blame is still put onto the governments of transitioning states(Joseph E Stiglitz, 2003), and despite the calls for reforms in international financial organizations, few measures have been undertaken in this respect (Griffiths & Todoulos, 2014).

4. Decision-Making and Bureaucracy

Apart from theoretical and strategic gaps, the programs of international financial organizations undergo through particular procedures and decisions, which can be of an additional concern for those who study their efficiency. Thus, Stiglitz (2004) stresses the problem of IMF accountability (Joseph E Stiglitz, 2004), which derives from poor linkage between the Fund and the public, the Fund's policies and the needs of the real world.

Transparency and non-bias nature of IMF dealsare also questioned. Research shows that IMF programs depend strongly on the United States' political decisions, realized in voting power, the number of national economists in organization, and the political proximity of other IMF members to the U.S. (Barro & Lee, 2005). The U.S. alone own 16.75% of votes, while the share of G7 in organization (including the U.S.) makes up 43.08% ("IMF Members' Quotas and Voting Power, and IMF Board of Governors," 2015). Therefore, geopolitical interests of powerful members affect the decisions of the Fund, though the use of neoliberalism could also be explained by successful implementation of monetarist policies in the past of capitalist states.

Despite having declared the aim of lessening the bureaucratic burden, the IMF still hasn't achieved it. The Fund has introduced a non-conditioned credit line for developing states, but the majority of its borrowers do not fit into the category of eligible candidates. Moreover, global financial crisis has magnified the number of total loans issued and led to the increase of conditionality demands attached to them. The number of structural conditions imposed by the IMF is also increasing, thus, strengthening the effect it has on the economies of affected states. These conditions often relate to 'politically sensitive economic policy areas, particularly those that affect tax and spending policies' (Griffiths & Todoulos, 2014): 7, 12, 14. Therefore, 'the IMF uses its significant influence in countries wracked by crisis to promote controversial austerity and liberalization measures, with potentially severe impacts on the poor.' (Griffiths & Todoulos, 2014): 17. Moreover, cross-conditionality between IMF and World Bank programs leads to a their collusive work as well as to their cooperation with other international financial organizations in pushing neoliberal policies in states which at first refused from them (Griffiths & Todoulos, 2014; Kovach & Lansman, 2006).

Worked out on the experience of advanced economies, the IMF and the World Bank reformation strategy is intruded as the only way of transition that proved its efficiency (in Poland, Chili, Ethiopia). But the list of succeeded states cannot be a reason for its inflexibility as it often has been criticized and cannot be perfect by definition.

5. Conclusions

Research on economic transition has become of a trend in the end of the XXth century, though no common idea on what transition is has appeared since then and on. Papava (2005) underlines that 'the modern economic theory is still unable to give... answers to many important questions relating to the transition to market economy' and that 'there is no economic theory of transition at all' (Pettman & Papava, 2005): 78. Moreover, by transitioning economy one should not view only marketizng planned economies, but rather various transitions, which include conversions between capitalist, socialist, post-industrial and other types of economies (Pettman & Papava, 2005): 79.

In this respect, Zhu's (2007) claim of that China succeeded in its economic reforms primarily because it didn't rely on a particular theoretical model but rather used practices, suiting its context, is of a particular interest (Zhu, 2007). Particularly, because instead of combining the best of developed practices in economic transformations, former communist states under the aegis of international financial organizations keep on promoting a one-way strategy of neoliberal marketization.

Although the Washington Consensus has been debated for years, and such terms as 'new Washington Consensus', 'post-Washington Consensus' etc. derived from a long-lasting discussion on its efficiency, 'there is no consensus' among the academicians except for 'that the Washington consensus did not provide the answer' on how to foster economic development (J. E. Stiglitz, 2008). And, thus, the debate on the Washington Consensus will continue, while the policies of international financial organizations will keep on following a course to 'shock' therapy.

Despite the vocal critique towards the work of the World Bank and the International Monetary Fund (Kolodko, 1999; Lavigne, 2000; Joseph E Stiglitz, 1999), they remain the only international organizations the governments in need can turn to. And existing bureaucratic and geopolitical bias does not demolish the fact that the aims declared in their founding documents as well as the instruments they offer to transitioning states do not necessarily pose a threat to economic security of the respective states (Pettman & Papava, 2005). As the first post-communist liberalization ‘shock’ tails off, the focus in reforms packages is slowly passing onto the development of institutional capacities. Still the strategies, which international financial organizations approach the developing states with, should be individualized. In this respect, an importance of political economy for economic transition should similarly apply to the work of international financial organizations. One cannot stress the importance of democracy for economic equality without observing this rule on its own case.

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