# Response of the IMF and the World Bank to the Great Recession and the Euro Sovereign Crisis in a Globalising World

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# Declaration

I, **Tankiso Abel Thibane** (Student Number: **213518333**), hereby declare that the dissertation for Master of Commerce in Economics (Research) is my own work and that it has not previously been submitted for assessment or completion of any postgraduate qualification to another University or for another qualification. However, the following articles, based on this research, were presented:

- Thibane, T.A. and Wait, C.V.R. (2017a). *Revisiting the Origins of Globalization: A Comparative Study Between the Drivers of Globalization During the Earlier and Current Period*. Presented at the Biennial Conference of the Economic Society of South Africa. Grahamstown: Rhodes University, 30 August-1 September 2017.

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# Abstract

The International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) now the World Bank, were created in the mid-1940s. The IMF was tasked to manage the post-war international monetary system, while the World Bank's role during its early years was to provide development finance to war-torn Europe. These institutions reformed some of their roles to make them relevant to the globalising world over the years and also responded to several post-war crises. Since these two institutions carry out their roles in a globalising world, this study has revealed that globalisation has different interpretations as many researchers refer to the economic and non-economic explanations of its meaning. Globalisation is also a historical process as it traces back several years ago.

Since approximately the mid-2000s, the global economy experienced two economic crises, namely the US sub-prime financial crisis that later became the Great Recession and the Euro sovereign crisis. The two economic crises spread to other countries globally that were interconnected into the global economy regarding international trade, investment and banking. These two crisis events required responses from the IMF and the World Bank.

The two institutions displayed a variety of strengths and weaknesses in dealing with the recession and the Euro crisis. The lending of both these institutions has been their strength as they have managed to expand their lending capacity during the two crisis periods examined. The IMF's crisis intervention time frames have also been its strength, as the speed in which it has approved financial assistance requests has been within reasonable time frames.

The IMF's new lending instruments have been its weakness, as the success of these instruments has not been fully tested so far. This is because of the little use of the IMF's new lending instruments. The IMF's crisis prevention efforts through the use of its surveillance tools have also been its flaw. This is based on the fact that it has failed to prevent the US financial crisis (later the Great Recession) and the Euro sovereign crisis.

Overall, this study found that these institutions played a significant role in responding to the Great Recession and Euro sovereign crisis as their strengths outweigh their weaknesses. However, the weaknesses of the IMF confirm that it needs to reform its role and learn from its flaws in the future.



**Key words:** Euro sovereign crisis, Globalisation, Great Recession, IMF, World Bank

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# Glossary

**Adjustment/conditional lending-** lending subject to a country's adjustment of economic policies that led it to seek financial assistance from the international community.

**Concessional lending-** lending below-market interest rates.

**Non-concessional lending-** lending at market-related interest rates.

**Special Drawing Right-** interest-bearing reserve asset created to supplement members' reserve assets. SDR holdings can also be exchanged with other members for freely usable currency.

## Abbreviations

BIS- Bank for International Settlements

BoP- Balance of Payment

BRIC- Brazil, Russia, India and China

ECF- Extended Credit Facility

EFF- Extended Fund Facility

ENDA- Emergency Natural Disaster Assistance

EPCA- Emergency Post-Conflict Assistance

ESAF - Enhanced Structural Adjustment Facility

ESF- Exogenous Shocks Facility

ESF- HAC- Exogenous Shocks Facility-High Access Component

ESF- RAC- Exogenous Shocks Facility-Rapid Access Component

EU- European Union

EZ- Euro Zone

FCL- Flexible Credit Line

FDI- Foreign Direct Investment

FSB- Financial Services Board

FY- Financial Year

GATT- General Agreement on Tariffs and Trade

GDP- Gross Domestic Product

GFRP- Global Food Crisis Response Program

GFSR- Global Financial Stability Report

IBRD- International Bank for Reconstruction and Development

ICSID- International Centre for Settlement of Investment Disputes

ICT- Information and Communications Technology

IDA- International Development Association

IEG- Independent Evaluation Group

IEO- Independent Evaluation Office

IFC- International Finance Corporation

ILOLR- International Lender of Last Resort

IMF- International Monetary Fund

MIGA- Multilateral Investment Guarantee Agency

NAFTA- North American Free Trade Agreement

OECD- Organization for Economic Cooperation and Development

PCL- Precautionary Credit Line

P4R- Program-for-Results

PLL- Precautionary and Liquidity Line

PRGF- Poverty Reduction Growth Facility

PRGT- Poverty Reduction and Growth Trust

RCF- Rapid Credit Facility

RFI- Rapid Financing Instrument

SAF- Structural Adjustment Facility

SALs - Structural Adjustment Loans

SARB- South African Reserve Bank

SBA- Stand-By Arrangement

SCF - Standby Credit Facility

SDR- Special Drawing Right

SLF- Short-Term Liquidity Facility

SRF - Supplemental Reserve Facility

SSALs - Special Structural Adjustment Loans

UK- United Kingdom

UN- United Nations

UNCTAD- United Nations Conference on Trade and Development

US- United States

WEO- World Economic Outlook

# 1. Chapter One: Introduction

## 1.1 Introduction

This research project focuses on two international institutions, namely the International Monetary Fund (IMF) and the World Bank[1] that were established more than seventy years ago. A notable number of publications between the 1990s and 2016, report on the early history and original objectives of these institutions. These reviews of the history serve as the background to the analyses undertaken by the researchers concerned and will serve to introduce this research project.

Preceding the First World War of 1914-1918, the global economy had few international institutions and Pax Britannica supported them (Baldwin, 2016:97). These institutions included the International Committee of the Red Cross (1863) (Palmieri, 2012:1274), the International Telecommunication Union (1865) and the Universal Postal Union (1874) (VanGrasstek, 2013:9).

The period before the war was also associated with unprecedented economic growth in regions such as Europe (Chilosi & Federico, 2015:1). Trade increased rapidly as the growth of international trade averaged 3.5% per annum between 1870 and 1913 (Bairoch & Kozul-Wright, 1996:5).

After the First World War and leading up to the Great Depression of 1929-1933, there was increasing international economic instability. Markets were shrinking through competitive devaluation of currencies (Fritz-Krockow & Ramlogan, 2007:4) and many countries adopted ‘beggar-thy-neighbour’ policies that restricted international trade. These policies meant that while countries desired to export their products, they did not wish to import products from other countries (Pradhan, 2012:75).

[1] The World Bank was known as the International Bank for Reconstruction & Development (IBRD) when it was established in 1944.

In the early 1930s, there were efforts aimed at lifting the global economy out of the depression. These efforts included the World Monetary and Economic Conference held in June 1933 in London. This conference was made possible by the League of Nations later replaced by the United Nations (UN), where sixty-six countries met to discuss the future of the global economy. Regrettably, their efforts were in vain because the United States (US) disagreed with the European idea of returning to the fixed exchange rate system (Viju & Kerr, 2012:1366-1368).

Towards the end of the Second World War of 1939-45, forty-four countries, headed by the US and the United Kingdom (UK), entered into negotiations in July 1944 at Bretton Woods, New Hampshire. This was to restore international economic relationships after the war (Eichengreen *et al*. 1993a:593; Weiss, 2010:108). These negotiations are described as the most ambitious economic negotiations in history (Conway, 2014:ix).

The negotiations were successful as two institutions were formalised, namely the IMF and the World Bank (Peet, 2009:36). The broader mandate of these institutions was not only limited to the restoration of the war-disrupted international economic relationships, as it included measures to prevent the Great Depression from being repeated (Milner, 2005:836; Ahmad, 2012:125-126).

The primary objective of the IMF was to manage the post-war international monetary system and to ensure that it worked well (Bordo & James, 2000:13). The World Bank was responsible for the post-war reconstruction of Europe (Peet, 2009:127) and to address the developmental problems of the global economy (Clemens & Kremer, 2016:53).

The above historical facts are meant as the background to the formulating of the problem statement, research question and research objectives.

## 1.2 Problem statement

The role the IMF and the World Bank play in the global economy gives rise to two opposing views, first, in respect of the developing countries and second, regarding the developed countries.

The first view is that these institutions are responsible for mainly determining the course of the globalisation process. They are seen to assist the developing countries, as they are the driving force behind the policy reforms that the developing countries are expected to apply to be supported by these two institutions (Bigman, 2000:28). They are also understood to have exposed the developing countries to strict policy measures that contributed to the recurrence of financial crises in the global economy (Woods, 2006a:374). The lending of the IMF is, in addition, observed to keep the developing countries in debt for prolonged periods (Khatkhate, 2008:37).

The second view is that these institutions promote the interests of the developed countries. This is because the developed countries have the majority of voting rights in these institutions. The voting rights in the IMF and the World Bank are based on the global economic importance of member countries (Wolff, 2013:84-89).

Because of the claims regarding the disparities in the role played by these institutions in the global economy, this study investigates whether fairly or not these two institutions performed a role in responding to the Great Recession[2] and the Euro sovereign crisis[3]. The investigation aims not only to describe their respective roles, but also to identify the strengths and weaknesses of these institutions displayed during these two crisis events.

## 1.3 Research objectives

The primary objective of the study is to determine the role of the IMF and the World Bank in responding to the Great Recession and the Euro sovereign crisis in a globalised world. To achieve this objective, it is necessary to find the facts in respect of the following secondary objectives:

- The different ways in which globalisation is defined and its historical roots.
- The historical and changing roles, and the criticisms of the two institutions until the Great Recession.

[2] The Great Recession was a later event that started with the US financial crisis of late 2007.
[3] The Euro sovereign crisis was a later event that started with the Greek fiscal crisis of late 2009.

- The causes and spread, as well as the impact of the Great Recession and the Euro sovereign crisis on the global economy.

- The responses of the IMF and the World Bank to the Great Recession and the Euro sovereign crisis.

- The strengths and weaknesses of these institutions as demonstrated by their responses to the two international economic crises studied.

## 1.4 Research methodology

The research method undertaken is what Salkind (2000:188) calls a descriptive research of a historical nature. This kind of research proceeds through six main steps, namely:

- A research problem like for any other type of research is identified.

- A hypothesis is formulated. For a descriptive historical research, the hypothesis is often not in the form of one that can be tested statistically, but rather in the form of a question.

- A variety of documented sources are found and analysed.

- The evidence obtained from such an analysis is evaluated for authenticity and accuracy. This forces the researcher to adopt a critical and evaluative attitude. Through the evaluation of the evidence, the answer to the hypothesis is found and the extent of the answer is determined.

- The documented sources gathered are synthesised, which allows conducting comparative analyses in such a way that trends and patterns are identified.

- The last step involves interpreting the results based on the research objectives and questions formulated when the research commenced.

## 1.5 Importance of the study

The international institutions such as the IMF and the World Bank have an essential role to play in the global economy, similar to that of governments of individual countries (Dutt & Mukhopadhyay, 2009:323). This is because, in the currently globalised world, there are risks of a crisis spreading to other countries, particularly if there is no rapid intervention (Schmukler *et al*. 2003:25; Copelovitch, 2010:1).

Some authors in this field are of the view that where there is a crisis in a globalised world, intervention needs to come from international institutions. For example, regarding the IMF, Presbitero and Zazzaro (2012:1945) stated that "the reform of the lending framework has been directed at improving the Fund's capacity to prevent and manage liquidity crises, providing the Fund with resources and instruments to credibly play the role of International Lender of Last Resort (ILOLR)".

A role beyond intervention during times of crises is assigned to these two institutions by authors who argue that these institutions ought to provide the optimum framework governing globalisation (Liebscher, 2004:2). The governing task is assigned in such a way that globalisation's benefits are internationally endorsed, as these institutions have assisted mainly developing countries in adopting trade and investment policies with the aim of facilitating the developing countries' prosperity (Pradhan, 2012:75-76).

## 1.6 Scope of the study

Several studies have been conducted on the role of the IMF and the World Bank. These studies have, however, not simultaneously focused on the in-depth response of these institutions to the Great Recession and the Euro sovereign crisis. For example, scholars have investigated the evolving role of the IMF and the World Bank since their creation, and over the last almost quarter of a century, such reviews appeared quite regularly as indicated by the sources named (Owen, 1994; Krueger, 1998; Bird, 2007; Rajan, 2008; Reinhart & Trebesch, 2015; Clemens & Kremer, 2016; Ravallion, 2016).

In the case of the IMF, the focal point of few scholars has been on its role in global financial crises (Weiss, 2010; Xafa, 2010; Eichengreen & Woods, 2015), while the focus on the World Bank is on its expanded agenda (Vetterlein, 2007; Pereira, 2016).

In an earlier study, the strengths and weaknesses of the IMF and the World Bank in managing the challenges posed by globalisation were assessed. The study was, however, only for the period 1945-2006 (Thibane & Wait, 2015). A recent survey by Kahler concentrated on the effectiveness, legitimacy and adaptability of these institutions. The study highlighted the role of these institutions during the Great Recession, but it did not go into depth as far as analysing their performance in responding to the recession (Kahler, 2016).

Given the limitations of previous studies, this study focuses mainly on investigating the role of IMF and the World Bank in responding to the challenges of the Great Recession and the Euro sovereign crisis. The emphasis of this study is on these two institutions because some of their roles and functions, such as their crisis lending are complementary. This has been supported by studies which have revealed the response of each of these institutions to earlier crises such as the 1980s debt crisis (Sanford, 1988:261; Boughton, 2000b; Güven, 2012:873) and the 1990s crises (Bordo & James, 2000:33; IEG, 2009a:5; Kabir & Hassan, 2009:409-426).

The period for this study is from 2007 to 2014. This closing date is based on the time when this research was first contemplated. The duration of the study encompasses the Great Recession and the Euro sovereign crisis events.

## 1.7 Organisation of the study

- Chapter Two concentrates on the definitions of the globalisation concept and provides a summary of the history of globalisation.

- Chapter Three discusses, respectively, the historical and changing roles, as well as the criticisms of the IMF and the World Bank.

- Chapter Four explains the causes of the Great Recession and the Euro sovereign crisis. It also shows the impact of these crises and how they spread to other countries globally.

- Chapter Five analyses the responses of the IMF and the World Bank to the Great Recession and the Euro sovereign crisis, as well as the extent to which their strengths and weaknesses are revealed.
- Chapter Six provides conclusions based on the above analysis and indicates areas for future research.

The definitions of globalisation and its history is the topic of the next chapter.

# 2. Chapter Two: Definitions and history of globalisation

## 2.1 Introduction

The IMF and the World Bank fulfil their roles in a globalised world. It is necessary to provide a synopsis of how the globalisation concept is defined and to briefly mention the timeline of globalisation, as this is the first secondary objective of this study.

This chapter, firstly, focuses on the definitions of globalisation. Secondly, it presents the origins of globalisation and lastly, it provides a summary of the chapter.

## 2.2 The definitions of globalisation

Scholars who seek to understand the evolving global economy regularly use the term globalisation. A review of the literature of this concept since the middle 1990s reveals two main approaches. The first approach is one that describes the term within a global setting, while the second approach narrows the use of the word to what one can equally call regionalisation.

Some researchers who propound the first approach produce definitions with a wide scope, while others who promote the second approach narrow their definitions down to the field of economic activities. These economic activities are then of a real, as well as of a financial nature. From the real perspective, the international movement of goods and services and of the production factors of entrepreneurship and labour are included in the definitions and descriptions. From a financial standpoint, the focus is on capital movements, which results in analyses of foreign direct investments (FDI).

The work by Kellner (2002), Al-Rhodan (2006) and the IMF (2008a), follow the route of a wide-scoped definition of globalisation.

Kellner wrote about the term ‘globalisation’ to encompass aspects such as capitalist markets, sets of social relations, as well as ideologies and cultural models which are transmitted globally (Kellner, 2002:287). Al-Rhodan (2006:2) states that “Globalization is a process that encompasses the causes, course, and consequences of transnational and transcultural integration of human and non-human activities”.

The IMF casts the net equally wide by writing that globalisation does not only refer to economic integration, but there are also cultural, political and environmental aspects attached to it (IMF, 2008a:2).

The views expressed by the authors who consider the globalisation concept to be of a wide scope are supported by Fischer (2003), as well as Flynn and Giraldez (2008).

Fischer acknowledges that some of the challenges of globalisation are real and relate to the field of economics, while some are concerning the non-economic aspects of life (Fischer, 2003:3). Flynn and Giraldez add that the globalisation notion is fundamentally interdisciplinary and that the explanations of economic globalisation should merge with the non-economic ones, which are widely debated throughout several disciplines (Flynn & Giraldez, 2008:361).

The literature which belongs to the category in which globalisation is only seen to be narrow in respect of economic activities, is to be found in the work by Frankel (2000), Mrak (2000), Shangquan (2000), Hay and Marsh (2001), Seliger (2004), Lee and Vivarelli (2006), Aisbett (2007), Easterly (2007) and Mills (2009).

First, globalisation means a process by which different countries of the world become as one country (Askari, 2004:57). This is where there is a partial eradication of differences between countries, such as separate national currencies and financial regulation systems (Hay & Marsh, 2001:21).

Second, globalisation means a promise of participation and wealth in a new global economic environment (Seliger, 2004:5).

Third, the process of globalisation is defined to involve the free movement of the three factors, namely FDI, people, goods and services (Easterly, 2007:111).

Authors such as Frankel (2000), Mrak (2000), Shangquan (2000), Lee and Vivarelli (2006), Aisbett (2007), as well as Mills (2009) have defined globalisation beyond the movement of FDI, people, goods and services to include technology, transport costs, and internationalisation of production and markets.

Frankel, Shangquan, Lee and Vivarelli, and Aisbett give the credit of globalisation to the role and influence of technological advancements and reduced transport costs (Frankel, 2000:2; Shangquan, 2000:1; Lee & Vivarelli, 2006:2; Aisbett, 2007:35).

Mrak alludes to the internationalisation of production that is associated with the changes in the production structure, to be one of the features of globalisation (Mrak, 2000:v).

Mills states that globalisation means the internationalisation of markets, which include changes in laws, institutions, or practices that make various economic transactions easier across national borders (Mills, 2009:3). This view sees the role of the state in managing economic activity, to have declined under the pressures of globalisation (Bairoch & Kozul-Wright, 1996:4).

This study has further observed the view that merges globalisation with regionalisation. By way of example, Trifu regards globalisation and regionalisation to be parallel processes. This is based on the explanation that regionalisation is driven by countries who seek alternative trading arrangements, because of the fear that the multilateral negotiations may fail globally (Trifu, 2010:89).

Some authors argue that often globalisation actually means regionalisation. International trade has taken a regional direction in the sense that trade within regions has increased rapidly compared to trade between regions (Kapur & Webb, 2007:584). Glenn augments this perspective by referring to the fact that the vast bulk of manufacturing and service activities take place regionally rather than globally (Glenn, 2007:78).

In light of the wide scope attached to the globalisation concept, as well as the similar approach by the IMF, the analysis of this study in Chapter Five will be conducted with the IMF’s view in mind.

## 2.3 The origins of globalisation

The review of literature written on the origins of globalisation reveals that its history originated around five central themes, namely the movement of people, international trade, technological advancements, commodity price convergence and FDI.

### 2.3.1 Migration (movement of people)

The first theme on the birth of globalisation refers to the time since *homo sapiens* started moving. According to Chanda (2008:119) "In a *longue durée* historical perspective, globalization has been growing ever since homo sapiens settled into sedentary cultures in river valleys".

Some authors claim that globalisation started during the 1490s when Columbus and da Gama sailed from Europe to other parts of the world. The early 1490s is often mentioned as the 'Voyages of Discovery' by Columbus and da Gama in 1492, which initiated a process that led to a significant transfer of technology, plants, animals and diseases that have never been experienced before (Lindert & Williamson, 2001:1-2). Dunne supplements that Columbus' discovery exerted an influence which transferred European values to other Western civilisations (Dunne, 1999:17).

Mittelman shares similar sentiments to Lindert and Williamson that globalisation may have evolved in the fourteenth century during the origins of civilisation (Mittelman, 2002:18).

Baldwin showed that since the beginnings of human civilisation, every village had to produce what it would consume. This is because the movement of goods, ideas and people involved enormous costs. Globalisation is about lowering the costs of moving goods across national borders, which would in turn increase international trade (Baldwin, 2014:213).

Since the sixteenth century, the travelling of people across national borders marked another period of globalisation. The Europeans travelled the world before making colonial movements into Africa and Asia (Held *et al*. 1999:484). Grant and Short agree that since the beginnings of colonialism, globalisation became increasingly significant (Grant & Short, 2002:9).

There is, however, a different view expounded by Flynn and Giraldez, although they do not dispute that globalisation became prevalent in the sixteenth century. They refer to the sixteenth century as the re-birth rather than the original birth of global human history. They state that before the sixteenth century humans had already migrated to most of today's densely populated parts of the world. The 'de-globalisation' preceding the sixteenth century can be attributed to global warming, which caused oceans to rise and disconnected countries of the world. It was only during the sixteenth century that countries of the world were reconnected, via both the Atlantic and Pacific Oceans that the globalisation process was resumed (Flynn & Giraldez, 2008:361-382).

Since the 1850s, the migration policies in the countries, such as New Zealand, the United States, Argentina and Canada were mostly liberal. Between 1850 and 1913, many people from Europe migrated to countries in Australia, New Zealand, North and South America. During the inter-war period, a tendency developed for countries to limit migration inflows. The migration since the 1850s can be regarded as the signs of globalisation during that time (WTO, 2008:19).

After the Second World War, people moved which also indicates globalisation. During 2005, the number of international migrants stood at 195 million. This is regarded to be the highest achieved in the post-World War Two period of migration compared to the 75 million in 1960 (Fix *et al*. 2009:1). The movement of people in the 2000s is stated to have increased considerably after the Millennium Development Goals were adopted during the year 2000 (IOM, 2013:38). Time will tell whether this is going to be the case under the influence of the seventeen Sustainable Development Goals adopted for the period 2016-2030 (UN, 2015:12).

In assessing the argument that the beginning of migration also marked the beginning of globalisation, raises the question of whether the earlier migration is a uniquely western phenomenon? In answering this question, Bade refers to the earlier European and non-European immigration history. He mentions the time when Africans and Asians, mainly the Arabs and Turks, when they expanded into the southern parts of Europe during 600 and 1500, as an indication that migration was not unique to Western civilisations (Bade, 2001:9811).

### 2.3.2 International trade

The second theme around which the history of globalisation is written, is about the growth of international trade. Within this broad theme of international trade, there are three separate time periods that authors refer to as the start of globalisation. The first period relates to trade liberalisation of the 1780s, while the second period is based on the international trade during both the nineteenth and twentieth centuries. The last period focuses on the post-war emergence of the globalisation terminology and the expansion of the European global trade.

Some researchers such as Morrison have observed the first era of trade liberalisation, thus, globalisation to have taken place in the 1780s since the so-called 'American Revolutionary War'. This is based on Britain's pursuance of free trade with other countries. Between 1785 and 1793, Britain had approximately ten reciprocal international trade agreements. During the 1780s, Britain's economic policy also shifted from mercantilism to Adam Smith's laissez-faire ideology. The laissez-faire system meant that government control would be reduced and the 'invisible hand' of the market would take over. The 'invisible hand' referred to a free market where demand and supply of goods and services would automatically augment an economy towards market equilibrium (Morrison, 2012:396-407).

Higgins provides evidence of the growth of international trade between 1870 and 1940, and such growth can be regarded as an indicator of globalisation. By way of example, the Indonesian growth of exports was ten times greater in the year 1920 than the year 1880. Malaysia also witnessed the growth of exports to be nearly fourteen times more in the year 1950 when compared to 1906. Other countries like Burma and Thailand, achieved a considerable increase in exports between 1870 and 1900 (Higgins, 1959:345-346).

The link between the economic orientation in the definition of globalisation and its history is shown by Temin (1999:76), Scholte (2002:4) and Al-Rodhan (2006:6). They refer to the appearance of the globalisation term in the dictionary during the early 1960s.

The presence of the globalisation term in a dictionary since the 1960s can be ascribed to the European expansion and the proliferation of the growth of international trade after the Second World War, which exceeded that experienced just before the First World War (WTO, 2008:15).

During 1948-1960 the total value of merchandise exports excluding that of communist countries increased from $53 billion to $112.3 billion. This increase was at an annual average growth rate of approximately 6%, while in the 1960s this number was higher at 8% per annum. In the 1970s after the collapse of the Bretton Woods system and the crises that followed, international trade increased at a much slower rate (Terborgh, 2003:3).

The growth of international trade after the Second World War can be attributed to the role of the General Agreement on Tariffs and Trade (GATT) in liberalising the international trade policies of several developed countries. The first five GATT rounds (1947-62), the Kennedy Round (1964-67) and the Tokyo Round (1973-79) produced the weighted tariff reductions by the developed countries of approximately 36%, 37% and 33% respectively (Subramanian & Wei, 2007:153).

While the term "globalisation" first appeared in the Oxford Dictionary in the 1960s, the terms 'globalise' and 'globalism' were coined in the 1940s (Glenn, 2007:1). This shows that globalisation related terminology gained acceptance during the 1940s.

### 2.3.3 Technological advancements

The third theme on the origins of globalisation is regarding the impact of technological advancements over time. Writers have concentrated mostly on the role of technology in introducing new inventions aimed at reducing barriers to the accelerated drive of economic activity.

This section is presented in two parts; first, it focuses on the developments during the British Industrial Revolution and second, on the uprising of information technology communications (ICTs) in the 1990s.

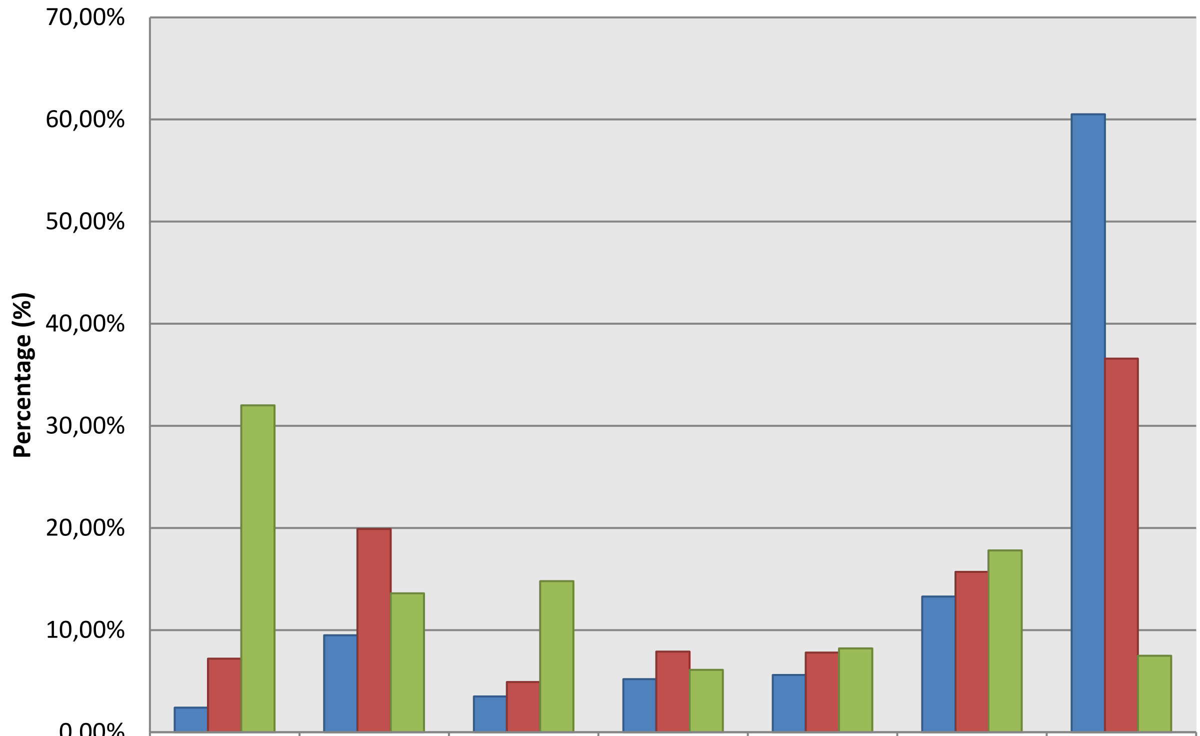
The first view is that globalisation became prevalent during the middle of the nineteenth century and lasted up to the outbreak of the First World War, particularly during 1870 to 1913 (Srinivasan, 2002; Jacks *et al*. 2010:128).

Crafts and Venables explained that globalisation is about changing costs of economic connections across distance and the impact this has on the geographical distribution of economic activity. This came about by the technological advancements resulting from the British Industrial Revolution, such as steamships and railroads that contributed significantly to the decline in land and ocean transport costs. The decrease in transport costs since the 1870s promoted economic relations through the narrowing of international price gaps and increasing migration flows (Crafts & Venables, 2003:323-325).

The technological advancements furthermore transformed the way in which production took place during the Industrial Revolution (Hudson, 1992:3). Britain, which comprises of England, Scotland, Ireland and Wales, became the first industrial nation in the eighteenth century. Britain had several favourable internal conditions, such as affordable energy that aided its development (Spear, 2014:85-87). In the case of international trade, it had minimal internal barriers such as tariffs and tolls (Mokyr & Nye, 2007:55).

Figure 2.1 below is presented to show the distribution of the world's manufacturing production between 1830 and 1913.

**Figure 2.1 Distribution of the world's manufacturing production 1830-1913 (in %)**




| | United States | United Kindom | Germany | France | Russia | Other developed countries | Other countries |
|---|---|---|---|---|---|---|---|
| 1830 | 2,40% | 9,50% | 3,50% | 5,20% | 5,60% | 13,30% | 60,50% |
| 1860 | 7,20% | 19,90% | 4,90% | 7,90% | 7,80% | 15,70% | 36,60% |
| 1913 | 32% | 13,60% | 14,80% | 6,10% | 8,20% | 17,80% | 7,50% |

Source: Author's interpretation based on data by Bairoch & Kozul-Wright (1996:15).

Figure 2.1 provides evidence that Britain has been a dominant force of industrial development since the 1830s. It was not until 1913 that Britain ceased to be an industrial power, as large countries such as the United States and Germany took the lead in this regard. For example, in 1913 the United States, Germany, and France combined, contributed to about over 50% of the world's distributed manufacturing production.

The globalisation process during the process of industrialisation was halted or nearly arrested by two World Wars and the Great Depression of the late 1920s and early 1930s (Fischer, 2003:3-4; Broadberry & Harrison, 2005:3).

The second view is that globalisation became increasingly significant during the 1990s (Seliger, 2004:5). Since the early 1990s, the ICT revolution has made globalisation possible through the rapid spread of vast amounts of information worldwide (Spilerman, 2009:74). Innovations such as the advent of the Internet and mobile technology have brought about changes in the way people interact, communicate and work. By way of example, the number of the world's internet users and mobile phone subscribers, respectively, increased from 3 million to more than 3 billion and from 11 million to more than 6 billion between 1990 and 2014 (Jorgenson & Vu, 2016:383-384).

There has also been an upsurge of approximately 7.3% to 28.8% (on a per-capita basis) in the number of minutes spent on cross-border telephone calls between the period 1991 and 2006 (IMF, 2008a:2).

### 2.3.4 Commodity price convergence

The fourth theme on the beginnings of globalisation indicates the global commodity price convergence since the 1870s until the First World War. The price convergence was about the spread of prices in one market to other markets and the decline in the international price gaps for commodities such as rice, cotton, textile, coal, coffee, iron, wool and copper. The price convergence was driven by the decline in international transport costs[4] of moving commodities beginning in 1820, which in turn increased international trade (O'Rourke & Williamson, 2002:35-39).

Relating the birth of globalisation to price convergence was heavily criticised. This critique is based on the fact that price convergence is not an influential event in the globalisation history. The critics argued that it is a later event which took place during the Industrial Revolution that led to globalisation. The convergence or divergence was about whether people, products or activities that occurred in one country caused permanent and universal effects in other countries globally. Where such permanent and universal effects were observed, it was regarded as convergence and thus, as signs of globalisation (Flynn & Giraldez, 2008:360-368).

[4] The decline in the transport costs was powered by transport innovations.

### 2.3.5 FDI

The last theme on the roots of globalisation is that it was witnessed during the 1980s (Mills, 2009:3). The rise of globalisation during the 1980s is explained by the increases in FDI movements. For example, the compound yearly growth rate of world FDI outflows was 28.9% between 1983 and 1989, when compared to 9.4% of world exports and 7.8% of world GDP during the same period (UNCTAD, 1991:3-4).

The acceleration of FDI growth was a result of the substantial reforms undertaken by several countries, such as the OECD countries concerning the governance of FDI in the 1970s and early 1980s. The developing countries followed suit and started reforms towards the late 1980s and 1990s, as they came to accept the importance of FDI for their economic development (Thomsen & Mistura, 2017).

This section has shown that the globalisation events are during different periods. The process of globalisation is also driven by factors such as migration, international trade, technology, price convergence and FDI.

## 2.4 Summary

This chapter has provided evidence that there is no universally-accepted definition of the globalisation concept. Section 2.2 revealed that while economists have confined the meaning of globalisation to the field economics, others have extended its meaning beyond this.

Section 2.3 indicated the globalisation determined by the movement of people to have occurred since the time *homo sapiens* started moving. The globalisation events other than migration were observed during the later periods.

From this chapter, it is also observed that the definition used for the term globalisation, determines the time when the phenomenon originated. To ascertain the actual beginnings of globalisation, there has to be a consensus in its definition.

Given the fact that globalisation became prevalent during different periods as indicated in this chapter, the following chapter provides an overview of how the process of globalisation coincided with the historical roles of the IMF and the World Bank.

# 3. Chapter Three: The historical and changing roles, and criticisms of the IMF and the World Bank

## 3.1 Introduction

Chapter Three is aimed at the second secondary objective of the study. Since their inception, the IMF and World Bank have constantly evolved as they deal with challenges emanating from globalisation events. The way in which these institutions carried out their roles and managed crises also gave rise to several criticisms.

This chapter is organised as follows: the first section explores the mandates and roles of the IMF and the World Bank. The second section highlights the criticisms of these institutions, while the last section summarises the chapter.

## 3.2 The objectives and functions, and related changes over time, of the IMF and the World Bank

### 3.2.1 The IMF

The IMF is an international institution consisting of 188 member countries as of 2015. The IMF oversees the international monetary system, to ensure that it works efficiently. The primary objectives of the IMF are to promote the exchange rate stability, expansion and the balanced growth of international trade (IMF, 2015a:4).

#### 3.2.1.1 The functions of the IMF

The functions of the IMF are, namely (IMF, 2015a:4):

i. To provide advice to its member countries regarding the adoption of macroeconomic policies, as the basis of alleviating poverty and stimulating economic growth.

ii. To provide temporary funding to its member countries encountering balance of payments difficulties.

iii. To provide technical assistance and training for countries to be able to build the expertise and institutions necessary to implement sound economic policies.

### 3.2.1.2 Origin, growth and contemporary role of the IMF

The desire by the participants at the Bretton Woods Conference of 1944 to establish a stable exchange rate regime, can be understood against a brief history of the international monetary system from circa 1870. The historical and changing role of the IMF is presented in a format not yet available in a single research report. This is done through the use of various sources that have appeared in the literature between the 1980s and 2017.

In the 1870s, the international monetary system was based on the Classical Gold Standard. The United States officially adopted the Gold Standard in 1879. This led to all major developed countries and most developing countries to adopt the Gold Standard, although in different years (Mollick, 2016:89-92).

The Gold Standard law obligated countries' central banks to preserve the value of the national currency with regards to a fixed weight of gold, by buying and selling gold at a fixed price based on demand (Newby, 2012:1498).

The exchange rates were relatively stable amongst countries of the world that adhered to the Gold Standard and policy makers praised the operations of the system (Morys, 2013:205). It was not until the start of the First World War that major countries suspended their commitment to gold convertibility. This resulted in the collapse of the system and floating exchange rate arrangements (Dibooglu, 1998:227).

After the First World War, governments and central bankers were in quest of an international monetary system that would bring about exchange rate stability. They desired the prosperity that prevailed during the Gold Standard. In April 1925, Britain returned to the Gold Standard and by the end of the same year several countries became committed to the gold system. The interwar Gold Standard came to be known as the 'Gold Exchange Standard', because it operated as an exchange system based on key currencies. It functioned well until Britain started experiencing continuous balance of payments deficits and suffered from large gold outflows. The Bank of England was under pressure to consistently engage in strict monetary policy activities to maintain gold convertibility. The adjustment mechanisms of the system were also unable to rectify such deficits and its stability was under threat (Wandschneider, 2008:152-156).

The Gold Exchange Standard started to collapse when, in September 1931, Britain abandoned it and devalued the pound. This led to other countries, which had made the convertibility of their currencies reliant on the British pound, abandon the Gold Exchange Standard (Selgin, 2013:14).

Following the collapse of the Gold Exchange Standard (1925-1931), the members at the Bretton Woods Conference in 1944 saw a need for a new set of cooperative monetary arrangements. This was because several countries engaged in competitive currency devaluations and adopted restrictive economic policies on trade and capital flows (Dominguez, 1993:357-360).

The IMF with the small membership base of twenty eight countries in 1945 (Reinhart & Trebesch, 2015:5), was created to maintain the fixed but adjustable exchange rate system (Meltzer, 2007:177). The US Dollar was fixed to gold at $35 per ounce, while the currencies of other IMF members were fixed to the Dollar at dissimilar rates (Weiss, 2010:108).

The IMF played a marginal financing role during approximately the first decade (1945-1955) of its operation[5] (Bordo & James, 2000:15). According to Truman (2017:8), the "Total IMF disbursements from its fiscal year 1948 to fiscal year 1956 were only $1,236 million. Repayments were $958 million, and IMF credit outstanding on April 30, 1956, the end of the Fund's fiscal year, was only $72 million". The United States largely fulfilled the financing role through the Marshall Plan Programme. The programme transferred approximately $13 billion to Europe during 1948 to 1951 (De Long & Eichengreen, 1991:2).

By the late 1950s, the IMF led to the achievement of full currency convertibility[6] by numerous countries. The Bretton Woods fixed exchange rate system worked as predicted from 1959-1968 under full currency convertibility (Garber, 1993:461). This era of full currency convertibility is regarded to be a period of prosperity, which was associated with sustained economic growth and liberalisation of international trade. The IMF further seemed to be carrying out its mandate smoothly (Bird, 2007:686).

[5] The IMF started operating in 1945.
[6] The ease that one currency can be converted to another currency and can be used for settlements of international financial transactions.

The delegates at the Bretton Woods Conference that created the IMF, had envisaged the operation of the fixed exchange rate system in presence of limited global capital flows (Eichengreen, 1993b:623). In the late 1960s, global capital flows expanded, which led to the unsustainability of the Bretton Woods system (Obstfeld & Taylor, 2003:125). The expansion of capital flows presented another challenge of spill-over effects that the IMF didn’t have to deal with during its early years (Rajan, 2008:113-114).

During the 1960s, the UK, which was the issuer of the world's second most valuable reserve currency, also experienced a persistent balance of payments deficit (Bordo & James, 2000:16). The Bretton Woods system became under severe strain, as the US encountered balance of payments deficit and a decline in gold reserves. Inevitably, the system collapsed during the early 1970s (Fukumoto, 2011:852-853).

After the collapse of the Bretton Woods system, the developed countries adopted floating exchange rates, although many countries still decided to keep their exchange rates fixed mainly to the US Dollar (Meltzer, 2007:178).

The IMF’s role changed after several developed countries adopted floating exchange arrangements, as it was originally created to manage the fixed exchange rate system. In addition, the countries with floating exchange rates, which were mainly the developed countries, no longer had to be concerned with having enough reserves and to borrow from the IMF in times of financial need (Khatkhate, 2008:33). This was because of the expansion of capital markets that provided such funds (Bordo & James, 2000:16). For example, the last IMF programmes to the developed countries before the Great Recession, were in Italy and the UK in 1977 (Yoon, 2005:183).

The current account deficits were also no longer a problem for the developed countries in the 1970s, as in 1970 the G-7[7] countries recorded very small current account surpluses of less than $3 billion (Boughton, 2000a:282).

[7] The United States, Canada, France, Germany, Italy, Japan, and the United Kingdom.

Beginning in the 1980s, the IMF's membership expanded to include the developing countries, as of 30 April 1980 the IMF's members had risen to one hundred and forty (IMF, 1980:83). From this period, the IMF increased its involvement in the developing countries. By way of example, during the 1980s-debt crisis and 1990s crises, the IMF lent to the developing countries that were most affected by these crises. This was because the banking and debt crises tended to have a longer lasting impact on countries compared to the previous currency crises that the IMF had to deal with. The IMF became more dedicated to long-term assistance, rather than its original mission of temporary assistance (Reinhart & Trebesch, 2015:3).

After the fall of the Soviet Union in the early 1990s, the IMF started to champion the cause of financial liberalisation. It shifted focus to promoting the free international flow of capital, as it embraced the removal of existing controls, and restrictions on exchange and financial operations. Due to the contagion effect of an economic crisis, the IMF has since the 1990s also increased its involvement in the management of capital account liberalisation (Yoon, 2005:184-185).

In summary, the IMF's role changed after the collapse of the Bretton Woods system in the early 1970s. The IMF's involvement in the global economy has swung between the developed and developing countries. During the Bretton Woods system, the IMF focused on the developed world and from approximately the 1980s on the developing world.

### 3.2.2 The World Bank

The World Bank is an international institution comprising of 188 member countries as of 2015. Its main objective is directed at reducing poverty and promoting sustainable development. The World Bank Group has five institutions playing different roles, namely the World Bank in the form of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA)[8]. The International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID) form part of the World Bank group (World Bank, 2015:7-9).

[8] The IBRD and the IDA share similar staff and headquarters.

#### 3.2.2.1 The functions of the World Bank Group

The functions of the World Bank Group, are namely (World Bank, 2015:7):

i. International Bank for Reconstruction and Development

- To lend to governments of middle-income and creditworthy low-income countries.

ii. International Development Association

- To provide interest-free loans, or credits and grants to governments of the developing countries.

iii. International Finance Corporation

- To provide loans, equity and advisory services to stimulate private sector investment in the developing countries.

iv. Multilateral Investment Guarantee Agency

- To provide political risk insurance and credit enhancement to investors and lenders to facilitate foreign direct investment in the emerging market economies.

v. International Centre for Settlement of Investment Disputes

- To provide international facilities for conciliation and arbitration of investment disputes.

#### 3.2.2.2 Origin, growth and contemporary role of the World Bank

Similar to the IMF, the evolving role of the World Bank since its creation is outlined in the manner that has not been a focal point of several independent research reports.

After the Second World War, private capital flows were limited (Rajan, 2008:110). The private capital markets were still underdeveloped and most governments other than the US could not provide capital (Owen, 1994:98). For example, the global stock of international investments measured by the value of assets in 1945 was 5% of world GDP (Ravallion, 2016:78).

The World Bank with the initial membership of twenty eight countries on 27 December 1945 (World Bank, 2001a), was established to play a major role in providing funds to the liquidity constrained global economy and reconstruction after the Second World War (Gilbert *et al*. 1999:601; Weaver & Park, 2007:461). The architects of the World Bank believed that it would provide temporary financing for countries to grow enough until they were able to borrow commercially (Clemens & Kremer, 2016:53).

The World Bank played a marginal role during the early years of its operation. It provided small amounts of capital in the form of loans to the European countries to rebuild infrastructure that was destroyed during the war (Goldman, 2007:13). The US government provided the bulk of post-war reconstruction capital to Europe through the Marshall Plan (Broad, 2006:390; Woods, 2006b:43; Sharma, 2013:668). Challenges facing developing countries, such as poverty did not form part of the World Bank’s agenda in those early years (Peet, 2009:127).

To be able to work towards the objective of this research, it is necessary to give a brief review of the establishment of the institutions within the World Bank Group listed above in section 3.2.2.1.

Since the creation of the World Bank, its Articles of Agreement prevented it from providing loans to the private sector without any government guarantees (Owen, 1994:99). There were concerns from member country governments that the private sector was not being effectively assisted by multilateral lending institutions in their current form. To address these concerns, the IFC was established in the mid-1950s, which is often referred to as the private sector arm of the World Bank Group (Mundy & Menashy, 2014:17).

In the beginning of the 1960s, the World Bank Group expanded again to create the IDA (Sanford, 1997:297), as a response to the struggle that some of the World Bank’s borrowers, especially the developing countries in Africa and Asia experienced in repaying their loans (Owen, 1994:98). The IDA provides grants and interest-free loans on concessional terms to the developing countries with per capita income below $1 215 per year. Domestic currencies are converted to the US Dollar at market exchange rates (Clemens & Kremer, 2016:54-55).

During the mid-1960s another World Bank Group institution known as the ICSID was created. The establishment of the ICSID was necessitated by the need to encourage international investment to the developing countries, especially in the form of FDI. This was because of the benefits FDI brings such as employment, infrastructure, technology and skills transfer. The ICSID's role is additionally to resolve any disputes related to FDI that may arise (Bashmill, 2016:2-4).

The 1980s period not only witnessed the creation of another new World Bank Group institution, but also a shift in the World Bank's role. MIGA was established in 1988 to provide insurance against political risks (Eichengreen *et al*. 1993a:594). During the 1980s, the World Bank became involved in assisting the developing countries regarding lending and policy advice following the 1980s-debt crisis. The World Bank expanded its activities beyond project lending to include adjustment loans (Sanford, 1988:261-262; Jayarajah & Branson, 1995:108; De Janvry & Dethier, 2012:11). This was because many developing countries participated in the global economy which exposed them to the international economic shocks. The developing countries became more dependent on trade and finance as the basis for their economic prosperity (Kahler, 2016:2).

In the 1990s, the World Bank focused on social policies in steering economic growth as the means to reduce poverty (Vetterlein, 2007:513). To get access to the World Bank's funds in the 1990s required countries to follow privatisation policies as a precondition (Goldman, 2007:17). This conditionality complemented the Washington Consensus of the 1980s. The Washington Consensus was explained to be an appropriate policy for debtor countries to overcome their debt problems. It was focussed on the 'neoliberalism policies' such as trade and inward FDI liberalisation, privatisation and deregulation (Williamson, 2004:1-3).

The introduction of the Washington Consensus was a significant shift within the World Bank, as Keynesianism dominated the ideas in the World Bank during its initial years. This is because one of the architects of the World Bank included John Maynard Keynes, who is the founder of the Keynesian school of thought. At that time, the World Bank's thinking did not support trade liberalisation and export-orientation (Broad, 2006:390-391). Keynesianism was in favour of government intervention in a world where there are market imperfections (Steil, 2013:1).

During the late 1990s, East Asia experienced a financial crisis (1997-98), which was associated with plummeting stock markets and depreciating Asian currencies (Valvi *et al*. 2012:5-6). Following the Asian crisis, there were proposals regarding the regulation of financial transactions. It was not until April 1998 when the World Bank's president, Wolfensohn, declared an end to the Washington Consensus. Subsequently, a new agenda for the World Bank focused on the promotion of social issues, such as basic education and primary healthcare (Pereira, 2016:827).

In summary, the World Bank's role shifted since it was first established. Similar to the IMF, during its first few decades, the World Bank focused on the developed countries such as Europe and later following the 1980s debt crisis, it shifted attention to the problems of the developing countries.

## 3.3 The criticisms of the IMF and the World Bank

There are numerous criticisms of the IMF and the World Bank, which relate to them fulfilling their roles and how they dealt with the past global financial crises. The study focuses on the criticisms of the two institutions which appeared in the literature leading up to the Great Recession.

This section is divided into two parts. It starts by focusing on the criticisms that apply to the two institutions and lastly on the criticisms which deviate from the joint approach and apply to only one institution.

The points of criticisms that can be considered jointly are, firstly, the criticisms on the performance of these institutions in achieving their mandates. Secondly, the criticisms based on their policy advice in resolving crises and conditions attached to their lending. Lastly, the criticisms of these two institutions pertaining to their declining lending role.

The first main critique of these two institutions has been their ineffectiveness in achieving their mandates, especially since the 1970s.

Critics argue that the IMF does not have the expertise to deal with developmental issues and should focus on problems of global financial stability, which it has failed to address in the past (Stiglitz & Tsuda, 2007:84). This is because after the collapse of the fixed exchange rate system in the early 1970s, the IMF was engaged in developmental issues. This made it similar to the World Bank as it shifted its focus to poverty reduction and promoting growth (Milner, 2005:836).

In the case of the World Bank, since McNamara left the Presidential office of the World Bank in 1981, there has been a discussion on whether it has focused more on structural adjustment policies at the expense of poverty reduction (Sanford, 1989:151). During McNamara's term, he supported a broader notion of development which emphasised the issue of poverty reduction (Woods, 2006b:45).

Meltzer adds that the World Bank is ineffective in performing the role of poverty reduction, as this has led to the IMF to be involved in poverty reduction, through its Poverty Reduction and Growth Facility (PRGF) lending (Meltzer, 2007:179). Askari, however, expounds that for the World Bank and the IMF to be successful in implementing their changing roles since their origin, they must work together (Askari, 2004:59).

The second criticism of these institutions is on their conditional lending and policy prescriptions to some of the past crises.

The IMF has been accused of exacerbating a crisis by advising countries to adopt strict economic policies in exchange for its financial support (Krueger, 1998:1989; Weithöner, 2006:1258). It has also been blamed for not putting too much attention on the poverty effects of its stabilisation policies (Woods, 2006a:374).

Studies researching the 1990s financial crises such as Asian financial crisis of 1997-98, explain how the IMF requires countries to implement economic policy changes that may harm growth in exchange for financial support (Radelet & Sachs, 1998:12; Corsetti *et al*. 1999:356-359).

The World Bank has faced a similar critique to the IMF regarding the impact of its policy lending during past crises. In the past, the World Bank's loans and credits have primarily been for specific projects, but the World Bank's role has since around the 1980s expanded to include adjustment loans. Critics argue that the World Bank does not have sufficient experience of adjustment loans (Bajpai, 1990:791).

A study by Easterly showed that there is little evidence on the positive effects of the adjustment lending programmes. The adjustment lending could have an adverse impact on the poor in the short-term, but assist them in the long-term by increasing growth (Easterly, 2003:378). The short-term adjustment suffering by the poor can mean up to thirty years, which is quite significant if one were to scrutinise it (Abbasi, 1999:1004). Sanford explains that the poor would even be hurt more in the long-term, by stagnation and misallocation of resources. This may take place when a country has unsound economic policies (Sanford, 1988:269).

The third criticism which opponents of the IMF and the World Bank raise is that there is a declining demand for their financial assistance.

The diminishing lending role of the IMF is owed to the decline in the demand for its resources, as capital inflows to individual countries have increased considerably (Hormats, 1998:37; Goldman, 2007:20). Critics argue that the role of the IMF was limited even before the collapse of the Bretton Woods system in the early 1970s, as the IMF was mainly supposed to deal with the global economic relationships between the developed countries (Eichengreen *et al.* 1993a:593).

Several countries have started building international reserves and reforming their economic policies to prevent a crisis from taking place. Such initiatives show that countries are making efforts to avoid the IMF's assistance as a lender of last resort (Kapur & Webb, 2007:581). In this regard, Meltzer has supported the reduction of the IMF in size, because of its limited mandate (Meltzer, 2007:178-180).

Regarding the World Bank, there has been a perspective that its lending role is also weakening. This is because of wider access to international capital markets by those countries that would normally have approached the World Bank for assistance (Krueger, 1998:1992; Weaver & Park, 2007:462). However, Owen maintains that the rationale for the World Bank has been that it would take a long time before private capital markets could finance the programmes that the World Bank currently sponsors (Owen, 1994:106).

There are two specific points of criticisms which apply to the one institution and not to the other.

First, in the context of the IMF, the focal point has been on its crisis prevention efforts. The crisis prevention efforts of the IMF have been its weakness, particularly during the 1990s (Ostry & Zettelmeyer, 2005:5). This can be based on the IMF's failure to detect the possibility of a crisis occurring, by using its surveillance tools effectively (Malliaris, 2002:78).

Second, the World Bank's critics have positioned their attention on its complex mandate as an institution (Gilbert *et al*. 1999:599). This critique is centred on the World Bank's projects that involve a considerable number of goals, which are extended over several countries globally (Mallaby, 2005:75).

In summary, these institutions have undeniably performed their roles in the face of criticisms and weaknesses. The criticisms mentioned against these institutions have not been to abolish them, as they have related to reforming these institutions or reducing them in size. This seems to suggest that these institutions still have a role to play in the global economy.

## 3.4 Summary

Section 3.2 revealed that the IMF and the World Bank were created in the 1940's to manage the global economy. Each institution had a specific mandate. On the one hand, the historical role of the IMF was to reconstruct the international monetary system after the Second World War. On the other hand, the World Bank was aimed at post-war reconstruction of Europe and to provide funding to countries after the war. It was not until the 1970s and 1980s that the roles of the two institutions were reformed, as the growth in private capital flows changed the global economic landscape.

The IMF's role changed following the collapse of the Bretton Woods system in the early 1970s, as it was originally setup to manage it. During this period the developed countries withdrew from the IMF with regards to requesting financial assistance. The IMF became more involved with the developing countries since the 1980s crisis. In the 1990s, the IMF's role extended to the promotion of free movement of capital.

The World Bank's role started evolving since the 1980s, following the debt crisis. It started lending to the developing countries affected by the crisis. In the 1990s, the World Bank shifted its focus to social policies that promote growth. It also expanded its role to include programmes on education and healthcare.

Section 3.3 provided evidence of the criticisms which have been similar and those that have deviated from the two institutions. The IMF and the World Bank's analogous criticisms related to their incapability to achieve their mandates. The inadequate policy prescriptions and effects of their policy lending have been highlighted as their critique. The growing irrelevance of both these institutions in providing finance is regarded to be a result of the expansion of private capital markets.

The specific criticism of each of the two institutions has been that the IMF is ineffective in preventing crises. The World Bank has been accused of its goal congestion, as it has evolved to include more institutions with complex goals.

The next chapter focuses on the global impact of the Great Recession and the Euro sovereign crisis.

# 4. Chapter Four: A review of the causes, spread and impact of the Great Recession and the Euro sovereign crisis

## 4.1 Introduction

To analyse the strengths and weaknesses of the IMF and the World Bank in responding to the Great Recession and the Euro sovereign crisis in the next chapter, it is necessary to provide a background on the beginnings of these crises. This will highlight the effect of these crisis events in the global economy and the role these two institutions had to play in mitigating the adverse effects of the crises. This chapter addresses the third secondary objective of this research report.

The chapter firstly provides a synopsis of the causes and spread of the Great Recession and the Euro sovereign crisis. Secondly, an analysis of the impact of these two crises globally is presented. Lastly, it provides the summary of the chapter.

## 4.2 The causes and spread of the Great Recession and the Euro sovereign crisis

### 4.2.1 The Great Recession

The OECD[9] countries enjoyed a period of decreasing volatility in the macroeconomic variables such as output and inflation during the 1980s (Giannone *et al*. 2008:5). From the mid-1980s, it was also a period of economic stability in the US, as reflected by a substantial decline in economic volatility in the US compared to what it experienced during the 1970s (Bullard & Singh, 2012:375).

The US economy continued to grow at a steady pace up until the mid-2000s. This economic growth was fuelled by the continuous expansion of credit and low levels of interest rates, which powered consumer expenditure (Peicuti, 2014:57).

[9] Organization for Economic Cooperation and Development.

The period of declining economic fluctuations and macroeconomic stability in the US is known as the Great Moderation (Pancrazi, 2015:208). The Great Moderation period lasted until about 2007 (Bezemer & Grydaki, 2014:169). By late 2007, the US started encountering a contraction in wealth, an increase in risk spreads, as well as the weakening in the operation of the credit market. This was the beginning of what many did not predict to become a US financial crisis. The crisis started in the US housing market associated with declining housing prices, which led less creditworthy borrowers to default on their loans. This was brought about by sub-prime mortgage lending from financial institutions and the housing bubble[10] (Reinhart & Rogoff, 2008:340).

Authors such as Eichler add that the cause of the US financial crisis is because the US banking sector was not well regulated at the time leading up to the crisis (Eichler, 2012:1215). Critics refer to the repeal of the Glass-Steagall Act of 1933 in 1991 to have relaxed the US banking sector regulation. The Act regulated the US banking sector by restricting the private sector banks from functioning as both commercial and investment banks (Lloyd's, 2010:17-20).

In a globalised world, there is a risk of a crisis experienced by one country to affect other countries. This takes place when countries of the world are financially and trade linked (Schmukler *et al*. 2003:25; Copelovitch, 2010:1). Shahrokhi explains how the US financial crisis spread to other countries globally. "The U.S. housing bubble, which peaked in 2007, caused the values of securities tied to U.S. real estate pricing to plummet, damaging financial institutions worldwide. Economies worldwide slowed as credit tightened and international trade declined. Governments and central banks responded with unprecedented fiscal stimulus, monetary policy expansion and institutional bailouts" (Shahrokhi, 2011:194).

[10] The housing bubble was the increase in the housing prices followed by a sharp decline.

African countries such as South Africa were not severely affected by the US financial crisis through the financial sector. The South African financial institutions were protected against the foreign assets risks spreads that were seen in several countries around the world. This was because the South African financial institutions are well-regulated, as they adhere to the Basel set of standards. The implementation of Basel II in 2008 has been vital in improving the management and prevention of a risk caused by a crisis in other countries[11] (SA National Treasury, 2011:13-14).

The Basel standards come from an international institution named the Bank for International Settlements (BIS) which has its origins in 1930. The original role of the BIS was to endorse central bank cooperation and to ensure that there was a smooth flow of international financial settlements globally (Auboin, 1955:1-2). Unlike the focus of the IMF, which is investigated in this study mostly on countries' governments and central banks, the BIS has a financial stability mandate mainly focused on international private sector banks (Lloyd's, 2010:17).

The BIS started focusing more on international private sector banks since the late 1980s. For example, beginning in 1988, the BIS introduced capital standards for international banks, Basel I. These standards aimed to ensure standardisation of the banking regulation and supervision globally (Ozgercin, 2012:98). In 2004, the BIS further released updated international banking standards, Basel II. These standards that were due to be implemented starting from the end of 2006, were designed for the purposes of improving credit risk management. Basel III was released in December 2010 and was to be implemented in phases starting from 1 January 2013. The introduction of Basel III had come with international bank capital requirements levels, which were higher than those set out in the previous Basel standards. The Basel III standards were following the lessons learnt from the US sub-prime financial crisis (BIS, 2014).

[11] The success with which the South African financial system was shielded from the global recession, was later further strengthened by the adoption of the Twin Peaks model. The Twin Peaks model meant the creation of two regulators, namely a prudential and market conduct regulator. The prudential regulator is based at the South African Reserve Bank (SARB) and the Financial Services Board (FSB) is a market conduct regulator (FSB, 2014:13). This is following the promulgation of the Financial Sector Regulation Bill on 21 August 2017 that is now referred to as the Financial Sector Regulation (FSR) Act, 9 of 2017 (SA National Treasury, 2017).

Quite a few US private sector banks failed during the recession even in the availability of the international banking standards from the BIS. For example, the US financial crisis intensified following the insolvency of the investment bank, Lehman Brothers, in September 2008 and other financial institutions[12]in the US (Xafa, 2010:475; Gnath *et al*. 2012:5). Other financial institutions globally that had securities such as stocks and bonds linked to the US real estate prices, collapsed following the housing bubble as previously mentioned (Shahrokhi, 2011:194).

It was only from late 2007 during the beginnings of the US financial crisis that the US federal banking agencies started to implement the Basel II final regulation to banks. The regulation was only fully implemented from 1 April 2008. The Basel II standards were also applied to mostly the larger US private sector banks which have operations internationally by federal banking agencies. Other US banks were only required to meet the Basel I standards and could upgrade to Basel II standards by choice. The requirement for the application of Basel standards by banks in the US is different to other regions such as Europe. For example, the European Union (EU) had authorised the implementation of the Basel II standards to all EU banks in 2005, of which a formal agreement was reached by 2006. This was done even though the BIS Basel standards are aimed at private sector banks with an international footprint (European Parliament, 2011:8-10).

The US sub-prime financial crisis later came to be known as the Great Recession because the crisis had spread worldwide. It is regarded as the worst financial crisis since the Great Depression of the late 1920s and early 1930s (Steil, 2013:1).

The impact of the financial crisis on the global economies on indicators such as merchandise trade, FDI and GDP will be discussed later in the chapter.

### 4.2.2 The Euro sovereign crisis

Baldwin and Gros (2015:2) stated that during the early stages of the Euro Zone (EZ), the “Big capital flows from EZ core nations like Germany, France and the Netherlands to EZ periphery nations like Ireland, Portugal, Spain and Greece were taken as evidence that the euro was fostering real convergence between a slow-growing core and more dynamic periphery economies”.

[12] For example, Bear Sterns and AIG.

During the beginning of 2009, the EU celebrated a successful decade since the establishment of the Euro common market (Bris *et al*. 2014:554). The celebrations were short-lived, as the newly elected Greek government announced during late 2009 that the Greek fiscal deficit was more significant than previously estimated. Greece had also exceeded the Stability and Growth Pact regulations for the Euro Zone countries (Copelovitch *et al*. 2016:814).

The Stability and Growth Pact regulations stipulate that a country's fiscal deficit may not exceed 3% of GDP (Moisescu-Duican & Giurescu, 2016:196). In 2009, the EU estimated that the Greek general fiscal deficit was 13.6% of GDP (EU, 2010:6).

The Greek fiscal balance problems resulted in an unexpected weakening in investor confidence (Gómez-Puig & Sosvilla-Rivero, 2016:133) and decline in capital inflows (Unger, 2017:435). By 2011 and 2012, several EZ countries had repeatedly exceeded boundaries set on the EZ fiscal deficits. These countries included France, Greece, Germany, Ireland, Italy, Portugal and Spain (Selvaraj, 2015:7; Jäger & Grigoriadis, 2017:23). The fiscal deficit problems in EZ came to be known as the Euro sovereign crisis.

This study has also observed a different point of view on the first signs of the Euro sovereign crisis. The early signs of the Euro Zone crisis are stated to have appeared in Ireland as early as September 2008. This is explained against the background of the insolvency of major US investment banks such as Bear Sterns and Lehman Brothers. The bailout of Bear Sterns in March 2008 indicated to the market that governments globally were to assist insolvent domestic banks financially. Beginning in September 2008, when Lehman Brothers became insolvent, Ireland started to experience banking and fiscal deficit problems (IEO, 2016:9). This is because of financial globalisation where financial institutions globally, including the Euro Zone, had been exposed to the toxic US financial assets during the housing bubble (Shahrokhi, 2011:194). Governments' fiscal deficits increased, as the bank rescue programmes required large sums of money (Eichler, 2012:1215).

The Euro crisis spread to several countries that were mostly interconnected to the Euro Zone through international trade. The UK and the US, which are significant traders of the Euro Zone countries, were also affected by the crisis. During mid-2011, the UK exports to the EU had declined by about 5% as a result of the crisis. The US exports to the EU countries like Greece, Italy and Spain had also fallen since 2010 (Selvaraj, 2015:10-13).

The impact of the Euro sovereign crisis on the global economy will be assessed in more detail below.

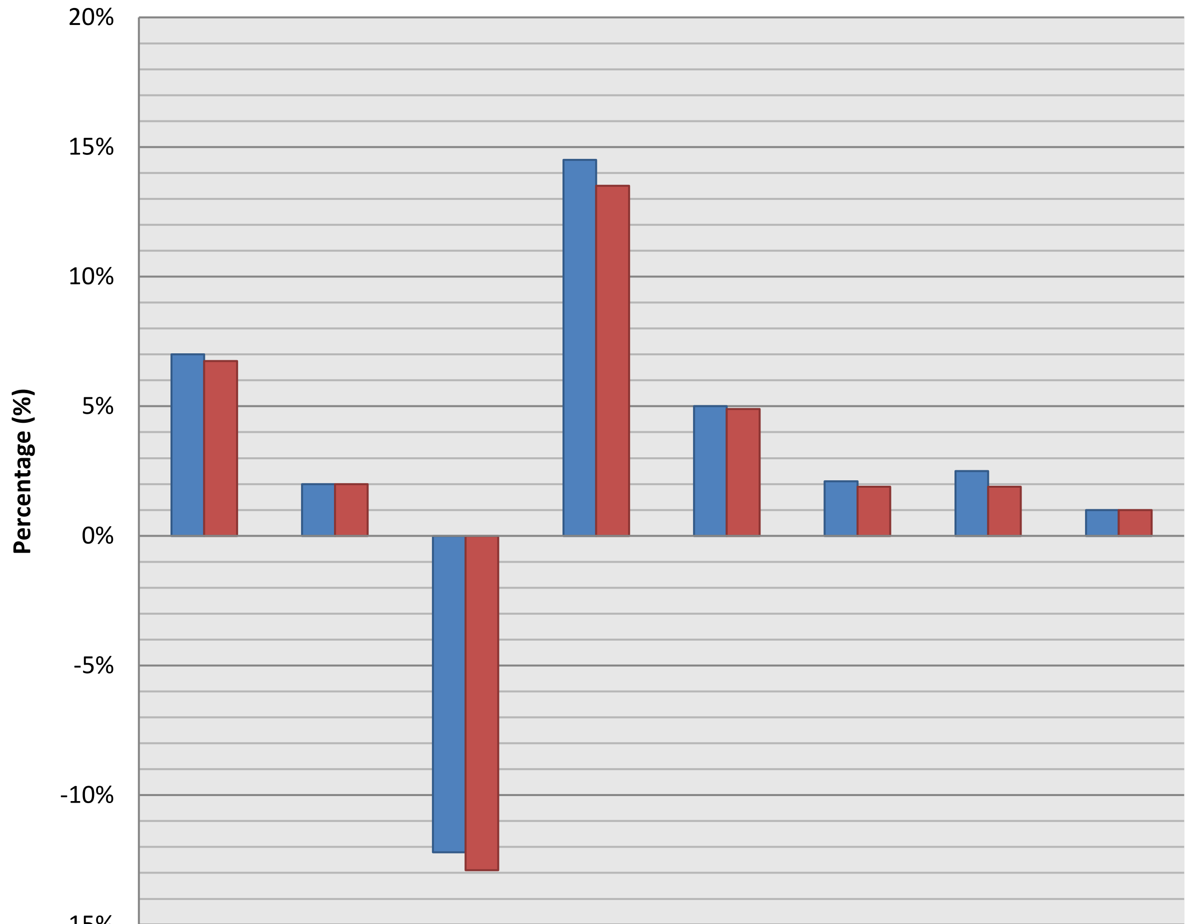
## 4.3 The impact of the Great Recession and the Euro sovereign crisis on the global macro-economy

This section now concentrates on the effects of the Great Recession and the Euro sovereign crisis on three global macroeconomic indicators, namely world merchandise trade, world FDI and world GDP.

### 4.3.1 World merchandise trade

The trend of world merchandise trade is analysed by the use of two figures. First, Figure 4.1 shows the annual percentage change of the world merchandise trade (exports and imports) during the pre-crisis period of 2006-07 and beyond until 2014 in real terms. Second, Figure 4.2 illustrates the annual percentage change of the world merchandise exports by region during the pre-crisis period of 2006-07 and beyond until 2014 in real terms. The year 2007 is included in the pre-crisis period throughout this research report because the US financial crisis started in late 2007.

**Figure 4.1 World merchandise trade 2006-2014 (annual % change in real terms)[13]**




| | Pre-crisis average (2006-07) | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| Exports | 7% | 2% | -12,2% | 14,5% | 5% | 2,1% | 2,5% | 1% |
| Imports | 6,75% | 2% | -12,9% | 13,5% | 4,9% | 1,9% | 1,9% | 1% |

Source: Author's interpretation based on WTO World Trade Reports (WTO, 2008:4; WTO, 2009:6; WTO, 2010:24; WTO, 2011:22; WTO, 2012:20; WTO, 2013:24; WTO, 2014:23; WTO, 2015:24).

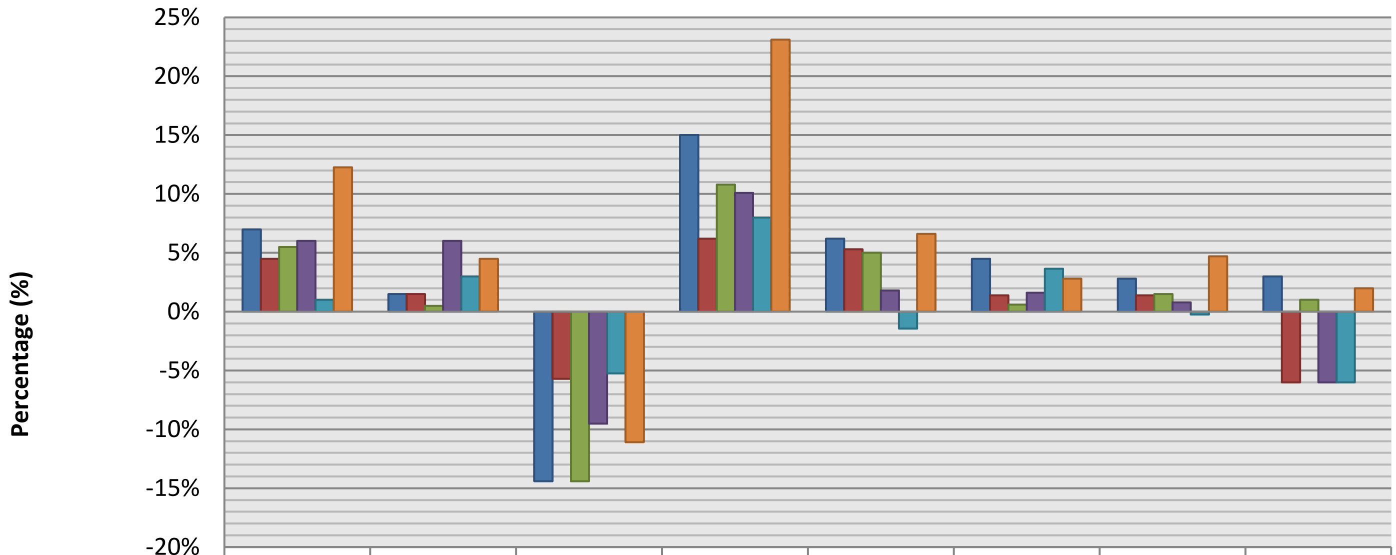
According to Figure 4.1, in 2008 world merchandise exports and imports grew at a slower rate of 2% compared to the average pre-crisis period of 2006-07. During the pre-crisis period of 2006-07, the growth of world merchandise exports and imports, respectively, was at an average of 7% and 6.75%. The world trade situation worsened in 2009, as the growth of world merchandise exports and imports reached negative levels of 12.2% and 12.9% respectively.

[13] The pre-crisis average is calculated based on data obtained from the 2008 WTO World Trade Report.

In 2010, the global economy was recovering from the recession, as the growth in world merchandise trade (exports and imports) figures reached positive levels as illustrated in Figure 4.1. Despite the recovery in 2010, world merchandise exports and imports rose at a sluggish rate again in 2011, which was during the early stages of the Euro sovereign crisis. For example, the growth of world merchandise exports fell from 14.5% in 2010 to 5% in 2011, while the growth of world merchandise imports also decreased from 13.5% in 2010 to 4.9% in 2011.

During the years 2012-14, the growth of world merchandise exports and imports averaged 1.9% and 1.6% respectively.

**Figure 4.2 World merchandise exports by region 2006-2014 (annual % change in real terms)[14] [15]**




| | Pre-crisis average (2006-07) | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| North America | 7% | 1,5% | -14,4% | 15% | 6,2% | 4,5% | 2,8% | 3% |
| South and Central America | 4,5% | 1,5% | -5,7% | 6,2% | 5,3% | 1,4% | 1,4% | -6% |
| Europe | 5,5% | 0,5% | -14,4% | 10,8% | 5% | 0,6% | 1,5% | 1% |
| Commonwealth of Independent States (CIS) | 6% | 6% | -9,5% | 10,1% | 1,8% | 1,6% | 0,8% | -6% |
| Africa and Middle East | 1% | 3% | -5,25% | 8% | -1,45% | 3,65% | -0,25% | -6% |
| Asia | 12,25% | 4,5% | -11,1% | 23,1% | 6,6% | 2,8% | 4,7% | 2% |

Source: Author's interpretation based on WTO World Trade Reports (WTO, 2008:4; WTO, 2009:6; WTO, 2010:24; WTO, 2011:22; WTO, 2012:20; WTO, 2013:24; WTO, 2014:23; WTO, 2015:24).

[14] It should be noted that the Africa and Middle East percentage changes in Figure 4.2 are measured by averages, as in some of the WTO World Trade Reports their data is disaggregated.
[15] The pre-crisis average is calculated based on data obtained from the 2008 WTO World Trade Report.

Figure 4.2 demonstrates the annual percentage changes in world merchandise exports by region. In the 2009 period, during the recession, regions such as Europe, Asia and North America experienced negative annual percentage changes in merchandise exports of over 10%. For example, the annual growth in merchandise exports for Europe, Asia and North America were -14.4%, -11.1% and -14.4% respectively. Other regions such as South and Central America, the CIS, Africa and the Middle East also achieved negative yearly growth in world merchandise exports of 5.7%, 9.5% and 5.25%, respectively, during 2009.

In addition to the declines in the growth of merchandise exports in 2009 according to Figure 4.2, the emerging and developing countries were affected by the recession through the declining workers' remittances (Dullien *et al*. 2010:1).

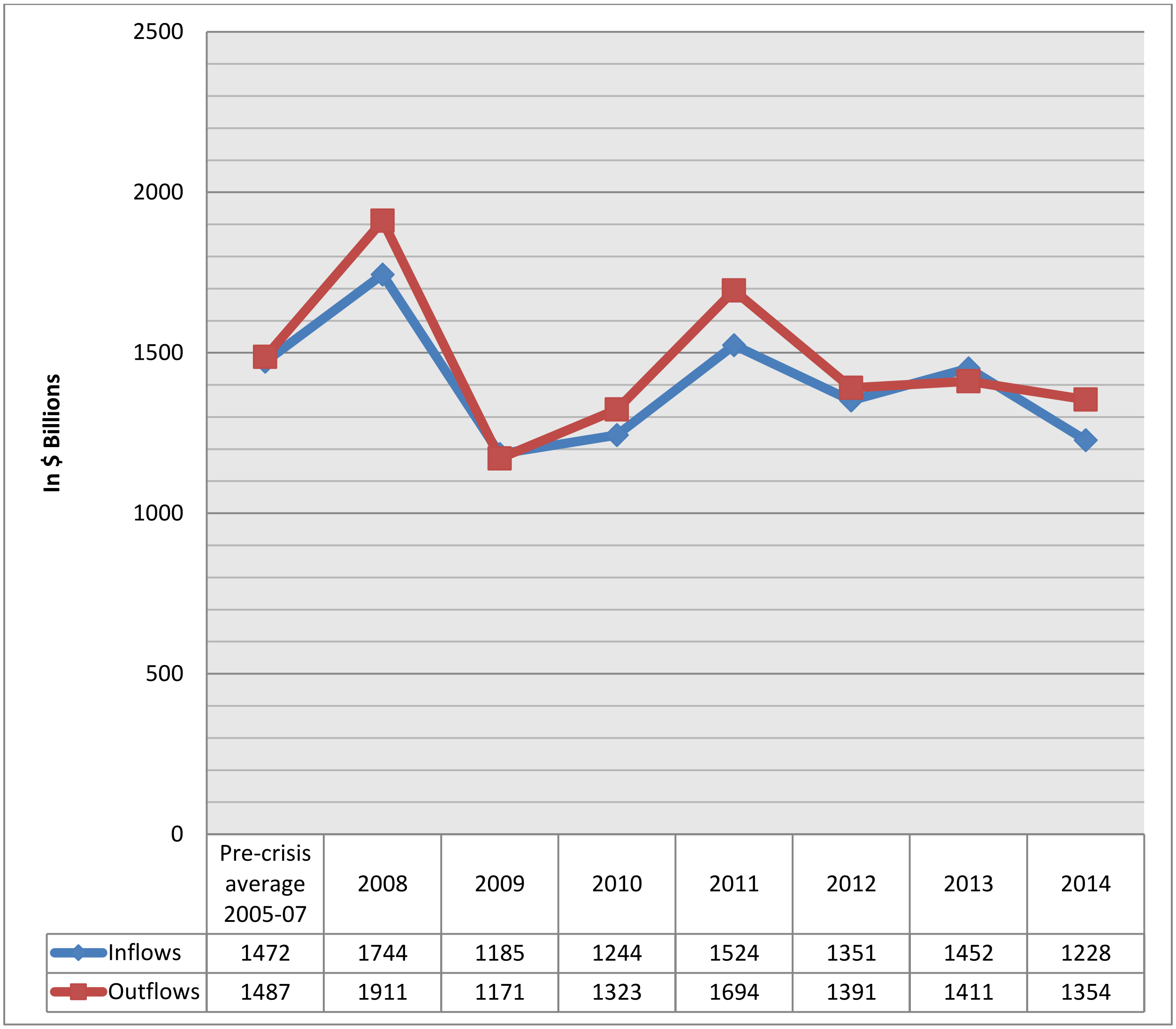
In 2011, as the Euro Zone countries experienced a sovereign crisis, five regions[16] of the world experienced a slower positive growth of merchandise exports compared to 2010. It is only Africa and the Middle East combined that recorded a negative growth of merchandise exports of 1.45% as per Figure 4.2

### 4.3.2 World FDI

The trend of FDI is analysed by the use of Figure 4.3. It shows the world FDI inflows and outflows at nominal prices in ($ billions) during the pre-crisis period of 2005-07 and beyond until 2014.

[16] Europe, Asia and North America, South and Central America and the CIS.

**Figure 4.3 World FDI flows at nominal prices 2005-2014 (in billion $)[17]**




| | Pre-crisis average 2005-07 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| Inflows | 1472 | 1744 | 1185 | 1244 | 1524 | 1351 | 1452 | 1228 |
| Outflows | 1487 | 1911 | 1171 | 1323 | 1694 | 1391 | 1411 | 1354 |

Source: Author's interpretation based on various UNCTAD World Investment Reports (UNCTAD, 2011:24; UNCTAD, 2012:24; UNCTAD, 2013:xvi; UNCTAD, 2014:xviii; UNCTAD, 2015:18).

According to Figure 4.3, world FDI flows have fluctuated from the pre-crisis period to the year 2014. During 2008, there was an increase in world FDI inflows to $1 744 billion from the average pre-crisis (2005-07) level of $1 472 billion. This was also the case for the world FDI outflows as they increased from $1 487 billion to $1 911 billion during the same period. It was not until 2009 as the recession engulfed the global economy that world FDI inflows and outflows plunged to $1 185 billion and $1 171 billion respectively.

[17] It should be noted that the data for 2005-2010 was obtained from the 2011 UNCTAD's World Investment Report.

Domit and Shakir attribute the decline in world investment as a share of GDP during 2009 to the fall in demand for and trade of manufactured goods and machinery. This is mainly because manufactured goods and machinery represent a significant portion of investment expenditure (Domit & Shakir, 2010:187).

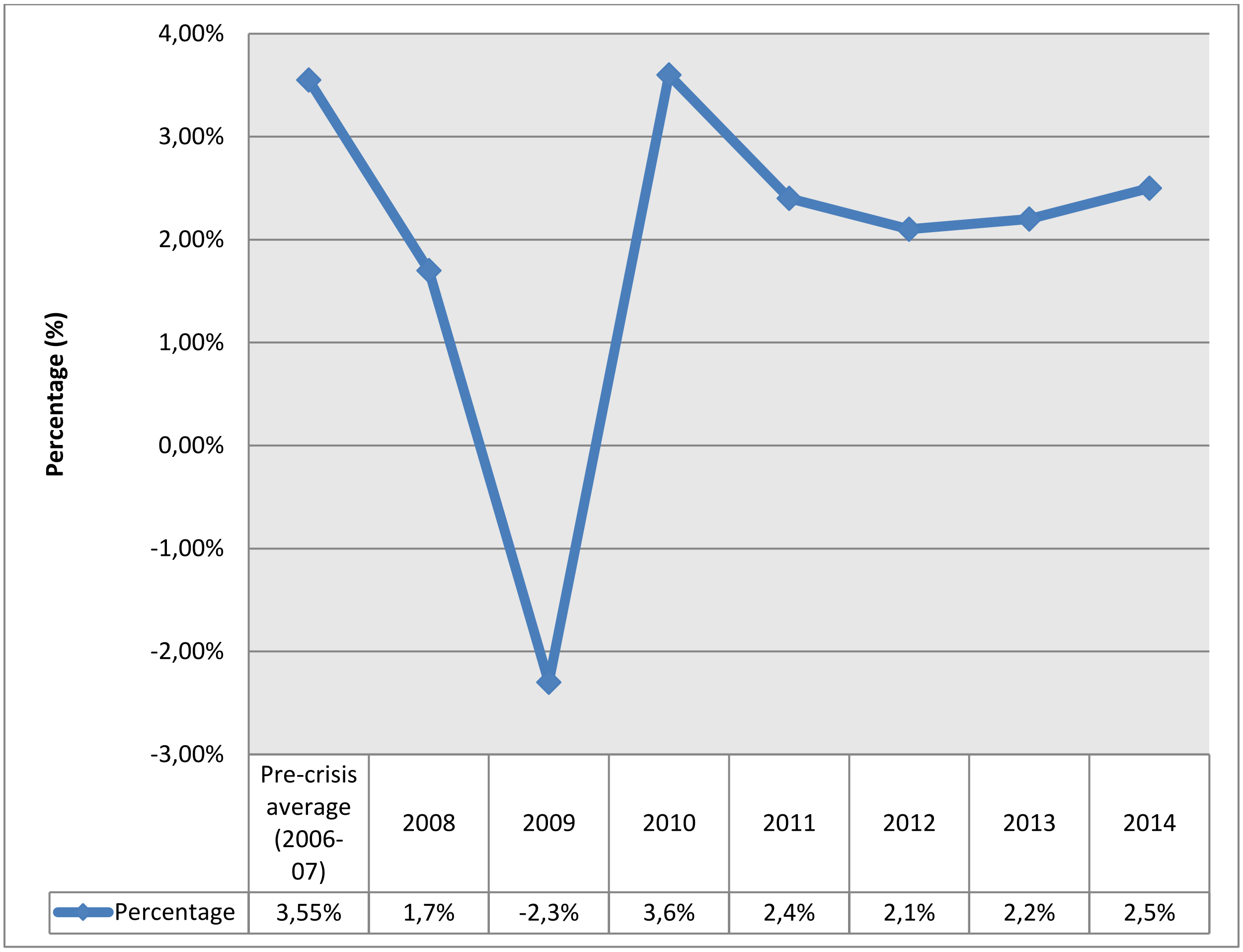
Figure 4.3 also illustrates that world FDI flows reached their lowest levels in 2009 when compared to the performance of the pre-crisis period of 2005-07 and beyond until 2014. During 2010 and 2011, world FDI flows continued to rise as most countries were recovering from the recession.

In 2012, during the Euro sovereign crisis period, world FDI flows decreased when compared to the previous year as revealed by Figure 4.3. World FDI inflows plunged to $ 1 351 billion in 2012 from $1 524 billion in 2011. World FDI outflows also dropped to $1 391 billion in 2012 from $1 694 billion in 2011. These levels were still below the pre-crisis average and 2008 levels.

### 4.3.3 World GDP

This section illustrates the impact that the Great Recession and Euro Crisis had on world GDP through two figures. First, Figure 4.4 shows the annual percentage changes of world GDP during 2006 until 2014 in real terms. Second, Figure 4.5 indicates the annual percentage changes of world GDP by region from 2006 to 2014 in real terms.

**Figure 4.4 World GDP 2006-2014 (annual % change in real terms)** [18] [19]



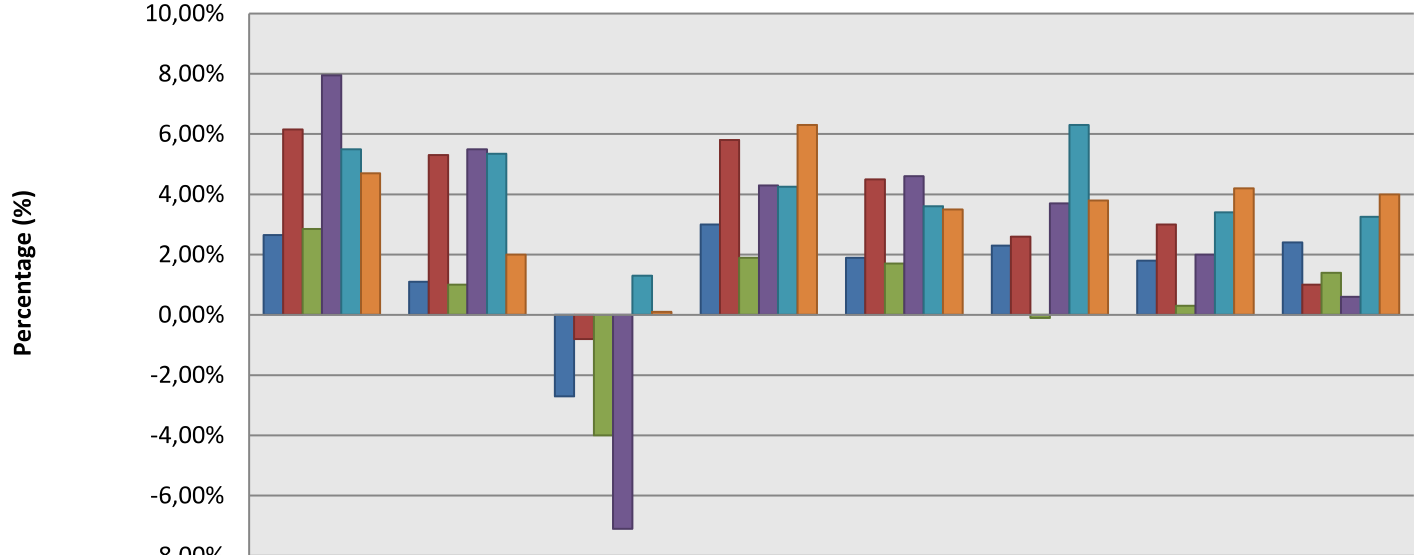

Source: Author's interpretation based on WTO World Trade Reports (WTO, 2008:4; WTO, 2009:6; WTO, 2010:24; WTO, 2011:22; WTO, 2012:20; WTO, 2013:24; WTO, 2014:23; WTO, 2015:21).

Figure 4.4 demonstrates that in 2008 the growth of world GDP was lower than the pre-crisis period of 2006-07. During the pre-crisis period, the average growth rate of world GDP was 3.55%, while in 2008 it is 1.7%. During the recession in 2009, the world GDP growth reached a negative level of 2.3%.

In 2011, during the Euro sovereign crisis period, it is evident from Figure 4.4 that there was a decrease in the world GDP growth from 2010. This was also the case in 2012 as the world GDP grew at a sluggish rate of 2.1% when matched to 2.4% in 2011.

[18] It should be noted that the Africa and Middle East percentage changes in Figure 4.4 are measured by averages, as in some of the WTO World Trade Reports their data is disaggregated.
[19] The pre-crisis average is calculated based on data obtained from the 2008 WTO World Trade Report.

**Figure 4.5 World GDP by region 2006-2014 (annual % change in real terms)** [20] [21]




| | Pre-crisis average (2006-07) | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| North America | 2,65% | 1,1% | -2,7% | 3% | 1,9% | 2,3% | 1,8% | 2,4% |
| South and Central America | 6,15% | 5,3% | -0,8% | 5,8% | 4,5% | 2,6% | 3% | 1% |
| Europe | 2,85% | 1% | -4% | 1,9% | 1,7% | -0,1% | 0,3% | 1,4% |
| Commonwealth of Independent States (CIS) | 7,95% | 5,5% | -7,1% | 4,3% | 4,6% | 3,7% | 2% | 0,6% |
| Africa and Middle East | 5,5% | 5,35% | 1,3% | 4,25% | 3,6% | 6,3% | 3,4% | 3,25% |
| Asia | 4,7% | 2% | 0,1% | 6,3% | 3,5% | 3,8% | 4,2% | 4% |

Source: Author's interpretation based on WTO World Trade Reports (WTO, 2008:4; WTO, 2009:6; WTO, 2010:24; WTO, 2011:22; WTO, 2012:20; WTO, 2013:24; WTO, 2014:23; WTO, 2015:21).

[20] It should be noted that the Africa and Middle East percentage changes in Figure 4.5 are measured by averages, as in some of the WTO World Trade Reports their data is disaggregated.
[21] The pre-crisis average is calculated based on data obtained from the 2008 WTO World Trade Report.

Figure 4.5 displays that during the two crisis events investigated in this study, regions of the world were affected differently. In 2008, as the US financial crisis intensified, Europe, North America and Asia, respectively, recorded the lowest annual GDP growth of 1%, 1.1% and 2%. Other regions such as South and Central America, the CIS, as well as Africa and the Middle East achieved annual GDP growth of above 5%. In 2009, as the financial crisis became a global recession, four regions, namely the CIS, Europe, North America, and South and Central America were most affected as their yearly GDP growth reached negative levels. Africa and the Middle East, as well as Asia still maintained positive annual GDP growth rate of 1.3% and 0.1%, respectively, in 2009.

During 2011, the annual GDP growth rate of all the regions, except for the CIS, had declined from 2010. In 2012, it was only the European region which had achieved a negative annual GDP growth rate of 0.1%. This might have been triggered by several Euro Zone countries which were encountering a sovereign crisis.

## 4.4 Summary

This chapter has provided a brief background on the causes, spread and impact of the Great Recession and the Euro sovereign crisis on the global economy.

Section 4.2 explained the causes of the two crises. The Great Recession started with the US financial crisis. The US financial crisis was caused by the subprime mortgage lending by the US financial institutions and the housing bubble, which resulted in the default of the less creditworthy borrowers. The US financial crisis is also argued to have been precipitated by the insufficiently regulated banking sector.

The crisis mostly spread to countries globally whose financial institutions were exposed to foreign assets.

The Euro Zone crisis started with Greece experiencing a significant fiscal deficit in 2009. The fiscal deficit problems led to a decline in the investor confidence and capital inflows declined. In 2011 and 2012, several Euro Zone countries experienced a sovereign crisis, as they had repeatedly experienced fiscal deficits.

This study, in addition, indicated a view that the first sign of the Euro crisis might have been in Ireland during late 2008. This is when Ireland experienced banking and fiscal problems because of the exposure to the US financial crisis.

The Euro crisis spread to countries that were particularly trade linked to the Euro Zone such as the UK and the US.

Section 4.3 revealed evidence on the influence of the Great Recession and the Euro sovereign crisis on the three global macroeconomic indicators, namely world merchandise trade, world FDI and world GDP.

The growth of world merchandise trade (exports and imports) reached negative levels during the recession in 2009 when compared to 2008. This might have been due to the decline in the global demand for goods and services because of the global recessionary environment. The world merchandise trade growth also dropped in 2011 after recovering in 2010. During 2011, one of the most significant trading groups, the Euro Zone, experienced a sovereign crisis which had a negative impact on world trade.

The merchandise exports of regions such as Europe, Asia and North America were most affected during the recession. The growth rate of the merchandise exports of these regions reached negative levels of over 10% in 2009. In 2011, during the Euro crisis period, the growth of merchandise exports for all the regions decreased from 2010.

Evidence was also presented that the world FDI flows (inflows and outflows) declined in 2009 during the recession. It is revealed that in 2009, the world FDI flows reached their lowest levels when compared to the pre-crisis period of 2005-07 and beyond until 2014. The world FDI flows also decreased in 2012, during the Euro sovereign crisis period, when compared to 2011.

The world GDP growth declined in 2008 and 2009 from the previous year as the global economy experienced a global recession. During 2008 regions such as Europe, North America and Asia were most affected by the recession, as they recorded the lowest annual GDP growth when compared to other regions. In 2012, it was only the European region that had achieved a negative yearly GDP growth rate. This might have been that several Euro Zone countries were still facing a sovereign crisis in 2012.

Overall, this chapter has shown the spread of the US financial crisis and the Euro sovereign crisis globally. Countries of the world were already trade and financially globalised preceding the two crises studied because of the benefits that globalisation brings. Globalisation worked as a mechanism that ensured that the crises speedily spread worldwide, as the negative spill-over effects of a crisis are rapid whenever there is some form of trade or financial integration.

The next chapter investigates how the IMF and the World Bank dealt with the challenges produced by the Great Recession and the Euro sovereign crisis. It will also examine whose mandate was best suited for which aspect of the recession and the sovereign crisis respectively.

# 5. Chapter Five: Evaluation of the role of the IMF and the World Bank in responding to the Great Recession and the Euro sovereign crisis

## 5.1 Introduction

As we have seen from the earlier chapters, the historical role of these institutions provides the background in observing differences in their response to challenges before the Great Recession and the period under review. The literature on their criticisms permits an investigation into whether those points of criticisms are still relevant.

This chapter seeks to accomplish the fourth and fifth secondary objectives defined in the first chapter. The organisation of the chapter is into two parts. The first section focuses on the strengths and weaknesses of the IMF and the World Bank. The last section provides a summary of the chapter.

## 5.2 The strengths and weaknesses of the IMF and the World Bank

This section analyses the strengths and weaknesses of these institutions to steer globalisation to the benefit of all countries and the interventionist role during times of a crisis.

### 5.2.1 The International Monetary Fund

#### 5.2.1.1 The IMF Strengths

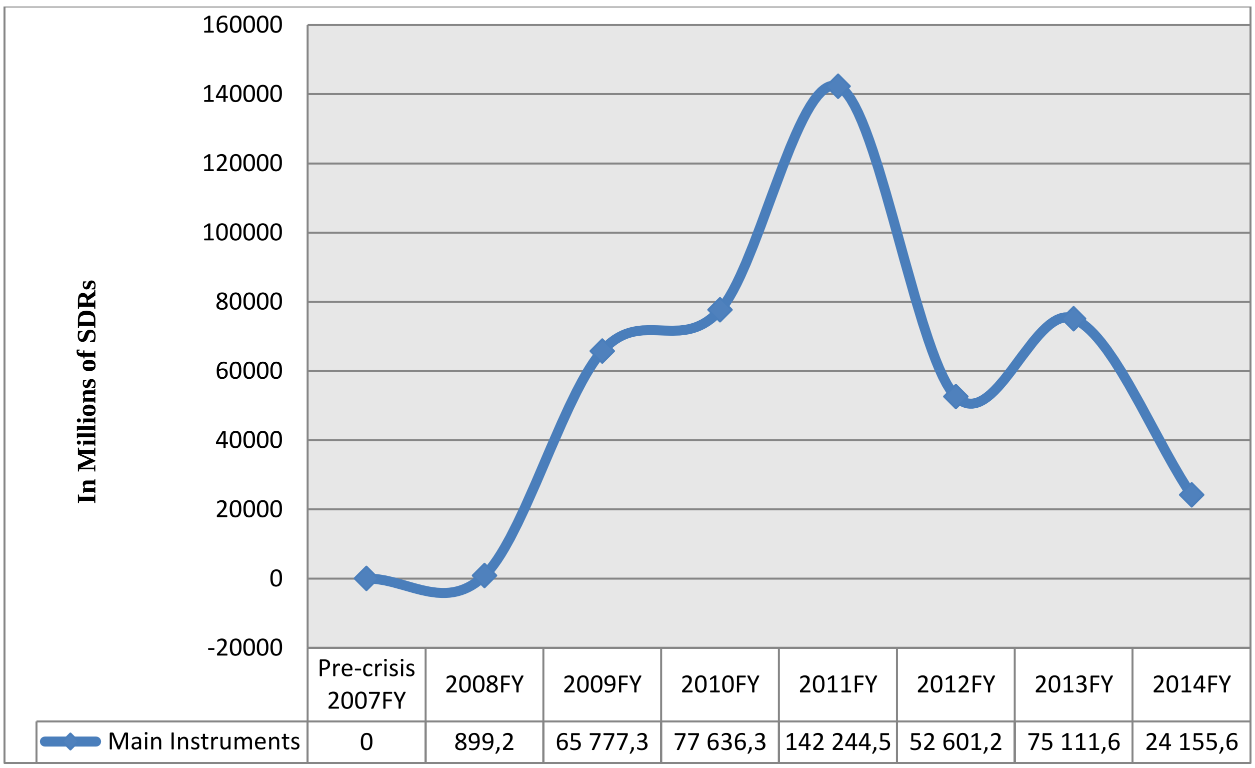
**I. IMF's crisis lending**

One of the functions of the IMF is to provide temporary financial support to member countries in turbulent times (IMF, 2015a:4). By carrying out its lender of last resort function efficiently, the IMF can play a role in minimising the effects of a crisis.

a. The trend in the IMF's lending

To examine the IMF's lending during the two crises events under review, it is necessary to observe the trends in the IMF assistance. Figure 5.1 and Figure 5.2 are developed from data obtained from various IMF Annual Reports, to show the tendency of the IMF's lending commitments during 2007-2014. Figure 5.1 focuses on the IMF's non-concessional lending commitments (lending at market interest rates), while Figure 5.2 concentrates on the IMF's concessional lending commitments (lending below market interest rates) both measured in millions of Special Drawing Rights[22] (SDRs). The year 2007 is included in the pre-crisis period because the US crisis that became a recession started in late 2007, as previously mentioned.

**Figure 5.1 IMF's approved main/non-concessional lending arrangements 2007-2014 (in millions of SDRs)** [23] [24] [25]




Source: Author's interpretation based on IMF Annual Reports (IMF, 2008b:43; IMF, 2009e:32; IMF, 2010a:25; IMF, 2011:23; IMF, 2012c:24; IMF, 2013a:40; IMF, 2014:34).

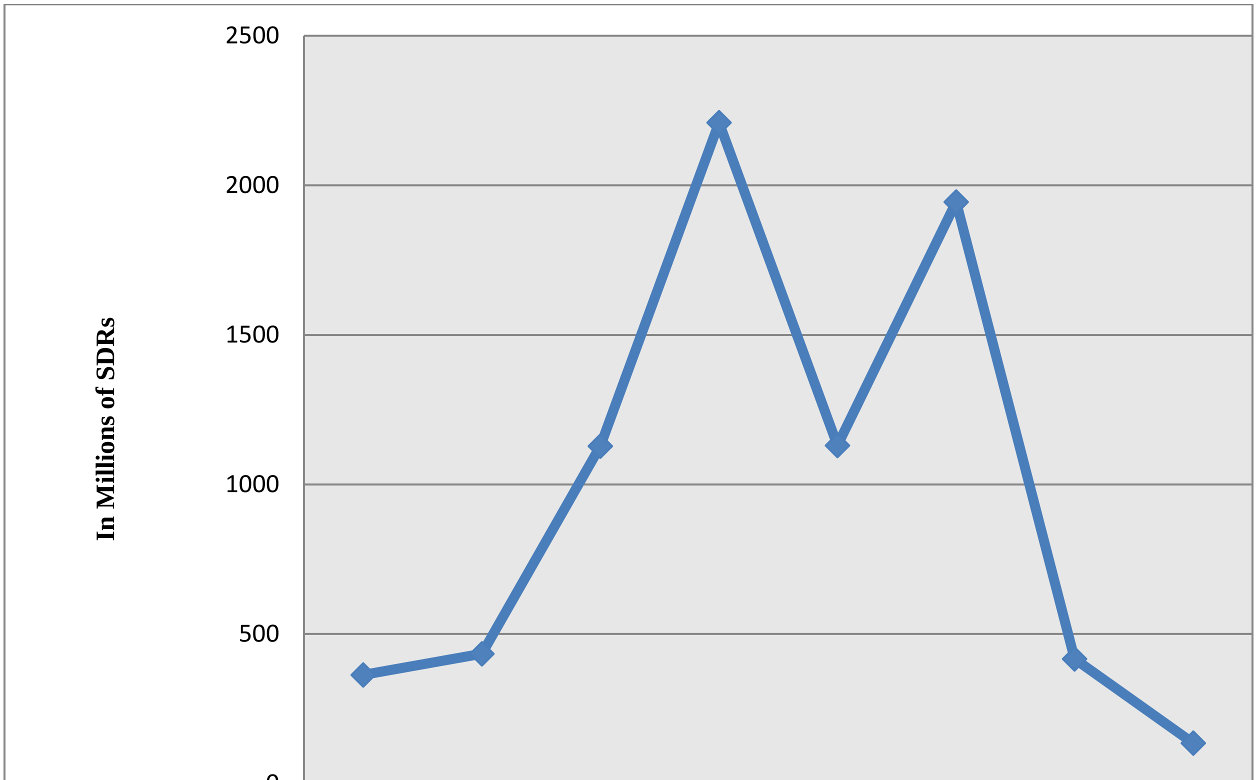
[22] Interest-bearing reserve asset created to supplement members' reserve assets. SDR holdings can also be exchanged with other members for freely usable currency.
[23] Due to the unavailability of data, the 2007FY is denoted by "0".
[24] The numbers reflected in this figure include the augmentations/reductions of the amounts previously approved.
[25] The financial year of the IMF is from May to April.

Observing the trend of the IMF's non-concessional lending commitments as per Figure 5.1 between 2007 and 2014, it is apparent that there was a steep increase from 2008 to 2009 and then again from 2010 to 2011.

The increase was from 899.2 (in millions of SDR) in 2008 to 65 777.3 (in millions of SDR) during 2009 in the midst of the recession. Figure 5.1 further illustrates that during 2011 when the crisis engulfed the Euro Zone, the IMF's lending arrangements rose. During the 2011 period, the lending arrangements of the IMF augmented to 142 244.5 (in millions of SDR) from 77 636.3 (in millions of SDR) in 2010, which was an increase of approximately 83%. The IMF's lending arrangements decreased significantly during 2012 and then fluctuated until 2014.

The Independent Evaluation Office (IEO) of the IMF estimated that the IMF's non-concessional lending, which is the form of lending to mostly the developed countries, rose from almost nil to approximately $400 billion during the 2008-2013 period (IEO, 2014:4). This indicates that the IMF started assisting the developed countries again. The developed countries withdrew from the IMF with regards to requesting financial assistance beginning in the 1970s as reported on earlier in the third chapter.

**Figure 5.2 IMF's approved PRGT/concessional lending arrangements 2007-2014 (in millions of SDRs)** [26] [27]




| | Pre-crisis 2007FY | 2008FY | 2009FY | 2010FY | 2011FY | 2012FY | 2013FY | 2014FY |
|---|---|---|---|---|---|---|---|---|
| PRGT Instruments | 363 | 433,8 | 1 128,0 | 2 209,4 | 1 130,3 | 1 944,9 | 417,1 | 135,1 |

Source: Author's interpretation based on IMF Annual Reports (IMF, 2007a:38; IMF, 2008b:43; IMF, 2009e:35; IMF, 2010a:26; IMF, 2011:24; IMF, 2012c:26; IMF, 2013a:41; IMF, 2014:34).

According to Figure 5.2, the trend of the IMF's concessional lending[28] commitments also increased from 2007 until 2010. For example, there was an increase from 363 (in millions of SDR) during 2007 to 2 209.4 (in millions of SDR) in 2010. In 2012, during the Euro sovereign crisis period, the IMF's concessional lending commitments also increased to 1 944.9 (in millions of SDR) from 1 130.3 (in millions of SDR) in 2011.

This displays that the IMF was willing to also assist the developing countries, as the IMF's concessional lending is the form of lending to the developing countries.

[26] The numbers reflected in this figure include the augmentations/reductions of the amounts previously approved.
[27] The financial year of the IMF is from May to April.
[28] Lending below-market interest rates.

b. IMF's previous crisis lending trends

There is evidence that the IMF's lending increased during the past crises. During the 1980s debt crisis, the IMF increased its lending to prevent an economic collapse of the affected countries (Güven, 2012:873). Orastean's research also revealed that the IMF's lending increased during the Mexican crisis in 1994-1995, the Asian crisis in 1997-1998, the Russian crisis in 1998, the Brazilian crisis in 1998-1999 and the Argentinian crisis in 1999-2002 (Orastean, 2014:414).

c. IMF's lending criticism

Critics of the IMF as discussed in the third chapter stated that the demand for the IMF's financial assistance is declining. This study finds that the IMF's financing was in demand during the crisis periods studied. For example, there was an increase in both the concessional and non-concessional lending arrangements that the IMF had with several countries during the crisis periods, as shown in Figure 5.1 and Figure 5.2.

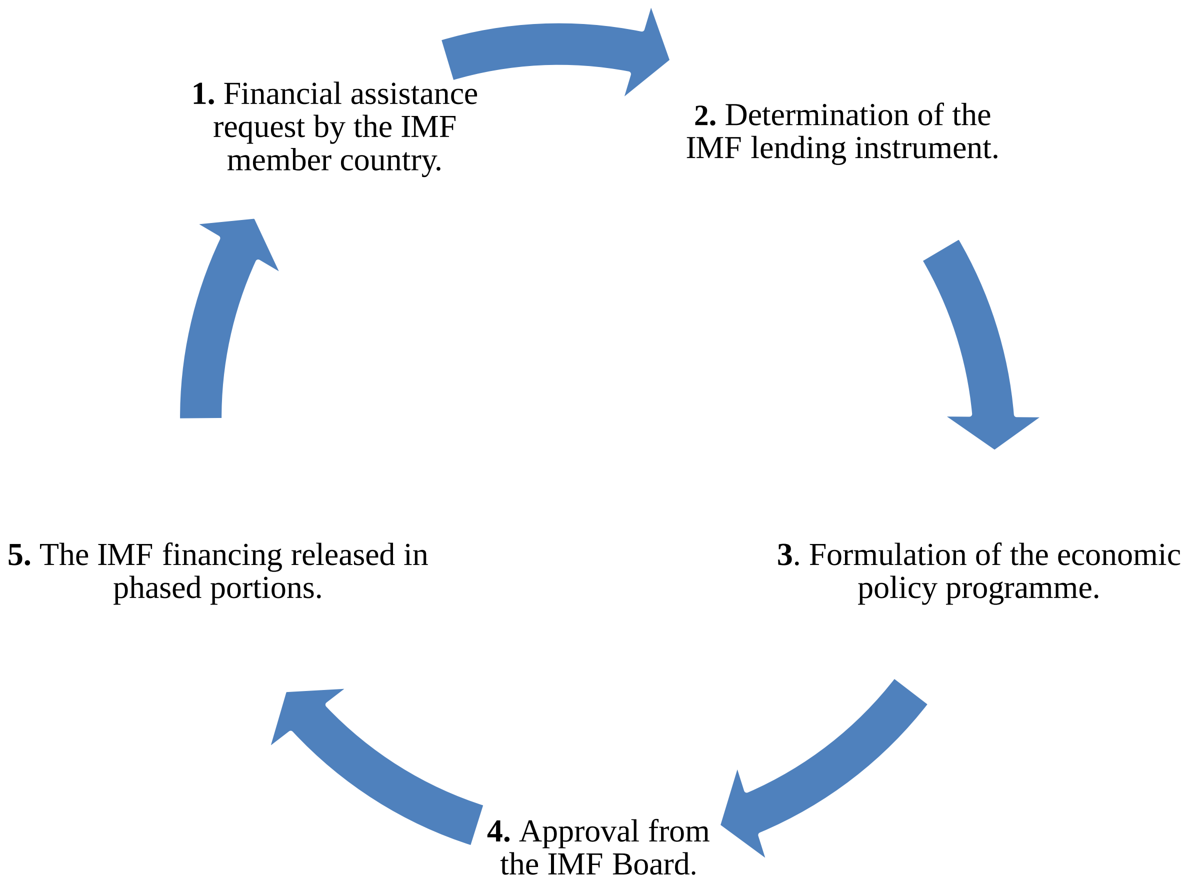
The IMF's involvement with the developed countries faded after the collapse of the Bretton Woods system as explained in the third chapter. The rise in the non-concessional lending commitments during the period studied indicates that the IMF assisted the developed countries. The IMF's non-concessional lending is mostly for the developed countries.

In summary, the IMF's lending commitments increased to assist the countries in dire need of financing. The timing of the rise of the IMF's lending commitments was when the Great Recession engulfed the global economy. The increase in the IMF lending commitments was also the case in 2011 when numerous Euro Zone countries experienced a sovereign crisis that the IMF's non-concessional lending arrangements increased.

## II. The IMF's crisis management

To analyse the speed in which the IMF intervenes in an economic crisis, it is necessary to review its time frames for approving funding. There is a process that needs to be followed to get such financial assistance from the IMF. Figure 5.3 below has been designed to show the steps to be followed when a country approaches the IMF for financing.

**Figure 5.3 Process of obtaining the IMF financing**




Source: Author's interpretation based on (IMF, 2016j:1).

Figure 5.3 shows that first, a country approaches the IMF. The second step is for the IMF to determine an appropriate lending instrument based on the needs of a member in financial distress. Each IMF's lending instrument has different rules and conditions that apply. The third step is, in consultation with the borrowing member, the IMF would formulate an economic policy programme as part of conditionality to lending. The economic policy programme is presented to the IMF Board in the form of a 'Letter of Intent' by the borrowing member. The fourth step would then involve obtaining approval from the IMF's Board on the matter. The fifth step is once the approval from the IMF Board has been granted, the funding can be released in portions concurrently to the implementation of the economic policy programme by the borrowing member.

a. IMF’s crisis intervention time frames

In the 2009 financial year, which was a time during the recession, seven out[29] of the fourteen IMF non-concessional lending arrangements[30] were approved as part of the IMF’s emergency financing mechanism procedures. These lending arrangements were under the IMF’s Stand-By Arrangement (SBA). (IMF, 2009e:32). This indicates that the IMF has been prepared to provide urgent financing to minimise the potential costs of an economic crisis.

Table 5.1 displays the IMF’s crisis intervention time frames during the Euro sovereign crisis. This table shows the onset of the crisis, the date of the financial request. The amount and date of approval is also indicated in the table.

**Table 5.1 IMF's time frames in crisis intervention during the Euro sovereign crisis**

| Crisis | Onset of the crisis | Financial support request | Financial support approval |
|---|---|---|---|
| Euro sovereign crisis | December 2009 | 23 April 2010 | Greece-<br>-SDR 26.4 billion (approximately €30 billion) approved on 9 May 2010 (SBA).<br>- SDR 23.785 billion approved on 15 March 2012 (4 year Extended Fund Facility (EFF))[31]. |
| | | November 2010[32] | Ireland- SDR 19.466 billion (approximately €22.5 billion) approved on 16 December 2010 (3 year EFF). |
| | | 7 April 2011 | Portugal- SDR 23.742 billion (Approximately €26 billion) approved on 20 May 2011 (3 year EFF). |
| | | 29 April 2013 | Cyprus- SDR.891 million approved on 15 May 2013 (3 year EFF). |

Source: Author’s interpretation based on various data (EU, 2011:4; Gibson *et al*. 2012:498; IMF, 2013b:49; IEO, 2016:1-12).

[29] Armenia, Georgia, Hungary, Iceland, Latvia, Pakistan and Ukraine.
[30] Lending at market related interest rates.
[31] The EFF arrangement was a second arrangement that replaced the SBA arrangement. The SBA is focused on short-term balance of payments (BoP) problems. The EFF concentrates on medium to long-term BoP problems which was exactly what Greece was experiencing.
[32] There is no specific date in the literature on when Ireland requested for the IMF assistance.

According to Table 5.1, the Euro crisis started in late December 2009 in Greece as previously stated. The IMF had lending arrangements with several Euro Zone countries, namely Greece, Ireland, Portugal and Cyprus.

The Euro sovereign crisis witnessed collaboration between the IMF, the European Commission and the European Central Bank known as the Troika. This partnership was primarily formed to provide emergency assistance to those countries affected by the crisis (Visvizi, 2014:335; Featherstone, 2015:295-310).

The objective of this analysis is to conduct a comparative analysis of the IMF's crisis time frames during the Euro crisis and past crises below.

b. IMF's previous crisis intervention time frames

Table 5.2 shows the IMF's response time frame for financial support for crises preceding the Great Recession. It should be stated at the outset that there was typically no criteria used in selecting the Mexican and Asian crises, other than just conducting a comparative analysis of the IMF's crisis intervention time frames with the period studied (2007-2014).

**Table 5.2 IMF's time frames in crisis intervention during the Mexican and Asian crises**

| Crisis | Onset of the crisis | Financial support request | Financial support approval |
|---|---|---|---|
| Mexican crisis | 20 December 1994 | 6 January 1995 | Up to SDR 12,070.2 million (approximately $17.8 billion) on 1 February 1995 (18-month SBA). |
| Asian crisis | 2 July 1997 | 14 August 1997 | Thailand- Up to SDR 2.9 billion approved on 20 August 1997 (SBA). |
| | | 31 October 1997 | Indonesia- Up to SDR 7.3 billion approved on 5 November 1997 (SBA). |
| | | 3 December 1997 | Korea- Up to SDR 15.5 billion approved on 4 December 1997 (SBA). |

Source: Author's interpretation based on various data (IMF, 1995; IMF, 1997a; IMF, 1997b; IMF, 1997c; IMF, 1998:23-32; IMF, 2012b:463-477).

For purposes of this analysis, the start dates for the Mexican and Asian crises were selected as the days when the respective currencies were devalued as per Table 5.2. The Mexican crisis of 1994-95 started on 20 December 1994 with the devaluation of the Peso (IMF, 2012b:464-477). The Asian crisis of 1997-98 arose on 2 July 1997 following the devaluation of the Thai Bhat (IMF, 1998:27). The Mexican and Asian crises were currency crises.

The political and economic events which took place before the devaluation of the Mexican and Asian currencies formed the background to the onset of these crises respectively. In the case of the Mexican crisis, political economists may argue that the crisis started with the political instability which was the period leading up to the devaluation of the Peso. The political instability involved the assassination of a prominent presidential candidate known as Luis Donaldo Colosio during March 1994 (Gonzalez, 2015:58). This political instability led to the investors' uncertainty regarding the ability of the Mexican government to conduct domestic policy, thus, capital outflow occurred (Mathur *et al*. 1998:39-40).

Other analysts refer to the first signs of the Asian crisis in 1996 when foreign investors started to lose confidence in the Thai and Korean stock markets. As late as March 1997, Malaysian equity markets also began to decline considerably (Radelet & Sachs, 1998:17).

This study finds that the times it took for the IMF to approve financial support in the earlier crises to the time it took for approvals during the Euro crisis to be reasonable in a crisis situation. During the Mexican crisis it took the IMF approximately twenty six days (6 Jan-1 Feb 1995). During the Euro sovereign crisis it took the IMF about sixteen days (23 Apr 2010-9 May 2010) to approve Greece's request for financial assistance. However, during the Asian crisis, the IMF took a lesser time to approve funding for Thailand and Indonesia. The approval for support to Thailand and Indonesia was about six days (14-20 Aug 1997) and five days (31 Oct- 5 Nov 1997) respectively.

During the Euro sovereign crisis which started in December 2009 in Greece, it was not until on 23 April 2010 that Greece became the first Euro crisis country to approach the IMF for assistance formally as per Table 5.1. It took the Greek authorities about three months before they applied for the IMF financing, which is long when compared to the Mexican and Asian crises as per Table 5.2. This raises a question of whether countries avoid seeking the IMF's assistance in the immediate period after a crisis and consider alternative sources of funding.

In summary, the IMF has been efficient in approving financial assistance requests from countries encountering an economic crisis, as this was true during both the Mexican and Asian crises and the Euro sovereign crisis.

#### 5.2.1.2 The IMF's Weaknesses

##### I. IMF's lending instruments

This section provides an overview of the IMF's lending instruments. This is done to examine the role of these instruments for the period of the study.

The IMF has used Stand-By Arrangements since June 1952 as one of its main lending instruments. Through this lending instrument, the IMF member countries receive financial support for any balance of payments needs. This support can include financing for a member country's import bill or foreign debt (Elekdağ, 2008:626-627).

Table 5.3 displays the IMF's lending instruments. This table consists of the name and year in which a particular lending instrument was adopted, the qualification criteria, conditions attached to the financing, as well as the repayment periods.

**Table 5.3 IMF's lending instruments**

| **Year Adopted** | **Instrument** | **Eligibility** | **Conditionality** | **Repayment Period** |
|---|---|---|---|---|
| 1952 | 1. Stand-By Arrangement (SBA) | • Financing made available to:<br>○ All IMF member countries with external financing needs. | • Economic policies to address issues that led to a country seeking the IMF assistance. | • $3\frac{1}{4}$ - 5 years. |
| 1974 | 2. Extended Fund Facility (EFF) | • Financing made available to:<br>○ All IMF member countries with severe Balance of Payments (BoP) problems. | • Policies to address the structural and economic difficulties. | • $4\frac{1}{2}$ & 10-year period. |
| 2008 | 3. Exogenous Shocks Facility-High Access Component (ESF-HAC) and Exogenous Shocks Facility-Rapid Access Component (ESF-RAC) | • Financing made available to:<br>○ Poverty Reduction and Growth Trust (PRGT)-eligible countries (low-income countries). | • Economic programme concentrates on the adjustment of the main shock. | • $5\frac{1}{2}$ & 10-year period. |
| 2009 | 4. Flexible Credit Line (FCL) | • Financing made available to countries with:<br>○ Sound policies and history of good economic performance. | • No conditionality attached to funding. | • $3\frac{1}{4}$ - 5 years. |
| 2010 | 5. Extended Credit Facility (ECF) | • Financing (medium-term support) made available to:<br>○ PRGT-eligible countries (low-income countries) with extended BoP problems. | • Countries agree to economic policies to aid them in achieving a stable macroeconomic position in the medium-term. | • $5\frac{1}{2}$ years grace period and 10 years till final maturity. |

| | | | | |
|---|---|---|---|---|
| 2010 | 6. Standby Credit Facility (SCF) | • Financing made available to:<br>○ PRGT-eligible countries (low-income countries).<br>○ Countries with stable macroeconomic conditions. | • Members agree to adopt policies that will attain stable macroeconomic conditions in the short run.<br>• A country's resolution of financing and adjustment needs to be attained in a 2 year period. | • 4 years grace Period & 8 years till final maturity. |
| 2010 | 7. Rapid Credit Facility (RCF) | • Urgent funding made available to:<br>○ PRGT-eligible countries (low-income countries). | • Policies adopted under RCF should address the BoP needs in line with the poverty alleviation and growth goals of a country.<br>• No ex post-funding programme conditionality applicable. | • $5\frac{1}{2}$ years grace period and 10 years till final maturity. |
| 2011 | 8. Precautionary and Liquidity Line (PLL) | • Financing made available to member countries with:<br>○ Sound policies and who remain committed to such policies.<br>○ History of good economic performance.<br>○ With some economic weaknesses, as this results not to qualify under the FCL. | • Biannual assessment against a set of economic indicators such as GDP, public debt, monetary & fiscal policy position and financial sector stability. | • $3\frac{1}{4}$ - 5 years. |
| 2011 | 9. Rapid Financing Instrument (RFI) | • Urgent financing available to all member countries. | • No requirement for a full-developed economic programme. | • $3\frac{1}{4}$ - 5 years. |

Source: Author's interpretation based on various data (IMF, 2010:22; Reichmann & de Resende, 2014:1-34; IMF, 2015b:3-32; IMF, 2016a:1-2; IMF, 2016b:1-2; IMF, 2016c:1-2; IMF, 2016d:1-2; IMF, 2016e:1-2; IMF, 2016f:1; IMF, 2016g:1-2; IMF, 2016h:1-2; IMF, 2016i:1).

Table 5.3 reflects two instruments used by members, but which have their origins prior to the Great Recession, namely the SBA of 1952 and the EFF of 1974. The emphasis of this analysis is mainly on the role of the IMF's lending instruments which have their origins during 2007-2014.

On 24 March 2009, the IMF press release indicated that the IMF Board approved an overhaul of the IMF's lending framework (IMF, 2009a). The SBA was upgraded in 2009. The upgrade included doubling of the borrowing amounts by members and access to the IMF's large sum of funds upfront. This was done in response to the global recession (IMF, 2016e:1).

- Concessional lending instruments

Although the IMF's Board approved an overhaul of its lending framework in 2009, the IMF's initiative for reforming its lending framework started a year earlier. It began with the Exogenous Shocks Facility-High Access Component (ESF-HAC) and Exogenous Shocks Facility-Rapid Access Component (ESF-RAC) in 2008, which succeeded the IMF's Exogenous Shocks Facility (ESF) of 2006. The ESF-HAC and ESF-RAC are under the IMF's Poverty Reduction and Growth Trust (PRGT) aimed at assisting low-income countries in times of economic shock. The PRGT conditions are specific to the adjustment of the main shock.

Table 5.3 also shows that the IMF has managed to adopt other concessional lending instruments focused on low-income countries, such as the Extended Credit Facility (ECF)[33], the Rapid Credit Facility (RCF) and the Standby Credit Facility (SCF) during 2010. The financing provided under the ECF and SCF has conditions that members need to apply, while under the RCF there is no ex-post funding conditionality applicable.

[33] The Extended Credit Facility was previously known as Poverty Reduction and Growth Facility of 1999.

- Non-concessional lending instruments

Table 5.3 further demonstrates that there was an introduction of the Flexible Credit Line (FCL)[34] and the Precautionary and Liquidity Line (PLL)[35] during 2009 and 2011 respectively. The financing under the FCL and PLL is associated with stringent qualification criteria. By way of example, to qualify for the IMF's assistance, member countries need to possess very sound economic policies and a good track record of economic performance. In comparison to the other IMF lending instruments as per Table 5.3, the FCL has no on-going conditions attached to the financial assistance provided. This is because countries that qualify under the FCL would already have sound economic policies. The conditions attached to the PLL relate to the biannual assessments of economic indicators such as the GDP, monetary and fiscal performances.

It should also be emphasised that with the existence of only the FCL and the PLL, the IMF would fail to fulfil its role as the lender of last resort, as a limited number of the IMF's members with sound policies would qualify under the FCL and the PLL (Xafa, 2010:486).

The Rapid Financing Instrument (RFI)[36] is financing available to all member countries as per Table 5.3. The conditionality under the RFI is lenient, as there is no need for a fully-developed IMF economic programme. This leniency is because policy implementation capabilities of countries may be limited because of the instabilities that countries may face during an unexpected crisis. The RFI is similar to the concessional RCF, because of its aim of providing urgent financing during a crisis. The difference between the two instruments is that the assistance under the RFI has similar financing terms as the IMF's SBA, the FCL and the PLL (IMF, 2016i).

[34] The FCL replaced the Short-Term Liquidity Facility (SLF) of 2008.
[35] The PLL broadened the scope of Precautionary Credit Line (PCL) of 2010.
[36] The RFI replaced the earlier IMF Emergency Assistance programmes, namely; the Emergency Natural Disaster Assistance (ENDA) of 1962 and the Emergency Post-Conflict Assistance (EPCA) of 1995.

a. Impact of the IMF's new lending instruments[37]

To assess the IMF's performance in managing crises for the period studied, it is worth observing the role of its new lending instruments. Although the IMF was strategic to introduce new lending instruments, another set of questions arises. Firstly, have countries availed themselves to utilise these newly introduced instruments? This is a fair question given the impact of the Great Recession and the Euro sovereign crisis on the global economy because probably the IMF itself would have thought that its customer base was going to increase. Secondly, whether these lending instruments are successful in restoring business confidence in those countries that use them?

For the first question, on 17 April 2009 which was during the recession, the IMF approved its first one-year arrangement under the FCL for Mexico of SDR[38] 31.5 billion which was approximately $47 billion. This arrangement with Mexico was the largest financial arrangement at that time since the IMF's creation (IMF, 2009b). It was subsequently followed by the IMF's FCL arrangements with Poland and Colombia on 6 May and 11 May respectively during the same year. Poland obtained a one-year approval of SDR 13.69 billion which was approximately $20.58 billion (IMF, 2009c), while Colombia received a one-year authorisation of SDR 6.966 billion which was approximately $10.5 billion (IMF, 2009d).

Since the inception of the FCL in 2009 until 2014, it was only Colombia, Mexico and Poland that had applied for the FCL and they did not draw funds from it. These countries treated their arrangements as a precaution. Treating their arrangements as a precaution meant that these countries did not intend to draw finances (IMF, 2016a).

In the case of the PLL, until mid-2014 only Morocco utilised this lending instrument (Reichmann & de Resende, 2014:21). For example, on 3 August 2012, the IMF approved a total of SDR 4,117.4 million approximately $6.21 billion (IMF, 2012a). The PCL, which is the PLL's predecessor, had found only one user[39] in early 2011 since its existence (Reichmann & de Resende, 2014:21).

The evidence above indicates that not many countries have been keen to utilise the FCL and PCL now the PLL.

[37] The new lending instruments are those that have their origins during 2007-2014.
[38] Special Drawing Right.
[39] Macedonia.

The IMF's concessional lending instruments such as the Exogenous Shocks Facility (ESF) also received few users in the 2009 and 2010 financial year, which was during the recession. During the 2009 financial year, three new ESF arrangements were approved by the IMF for Malawi, Kyrgyz Republic and Senegal of 52.1, 66.6 and 48.5 in millions of SDR respectively (IMF, 2009e:35). The IMF had four new arrangements under the ESF during the 2010 fiscal year. It approved 218.8 in millions of SDR for Tanzania on 29 May 2009. The IMF later authorised funding for Mozambique, Ethiopia and Maldives of 113.6, 153.8 and 8.2 in millions of SDR, respectively (IMF, 2010a:26).

A significant number of non-concessional lending arrangements that the IMF approved during the 2009 and 2010 financial years, which encompass the Great Recession, were under the old SBA[40]. During the 2009 fiscal year, fourteen[41] out of the fifteen approved arrangements were under the SBA with only the Mexicans receiving an FCL arrangement (IMF, 2009e:32). In the 2010 financial year, out of the fourteen newly approved arrangements, nine[42] were under the SBA, while two[43] were under the EFF (IMF, 2010a:25).

The Euro Zone countries that requested the IMF's assistance, namely Greece, Ireland, Portugal and Cyprus had their arrangements under the existing IMF instruments known as the SBA and the EFF during 2010-2013, even though the new instruments were available at that time (IEO, 2016:1). This shows that countries experiencing an economic crisis may desire to have their arrangements under the existing rather than the new instruments because of more lenient qualification criteria.

For the second question, evidence on the success of an IMF lending arrangement in restoring business confidence for countries that utilise the IMF's lending instruments, indicates that these instruments do improve business confidence even if countries do not draw from them.

Mexico which had an FCL arrangement with the IMF in 2009 was severely affected by the recession. In 2009, it is stated that the IMF estimated the value of the Mexican Peso to have depreciated by 25% against the US Dollar (Villarreal, 2010:2).

[40] All the IMF member countries qualify under the SBA.
[41] Armenia, Belarus, Costa Rica, El Salvador, Georgia, Guatemala, Hungary, Iceland, Latvia, Mongolia, Pakistan, Serbia, Seychelles, and Ukraine.
[42] Angola, Bosnia and Herzegovina, Dominican Republic, El Salvador, Iraq, Jamaica, Maldives, Romania, and Sri Lanka.
[43] Moldova and Seychelles.

The Mexican per-capita GDP declined by about 10% between the second quarter of 2008 to the second quarter of 2009. Similar to other developing countries, the Mexican economy was affected by the recession through significant economic volatility and deterioration in the stock markets through declining asset prices. Mexico also experienced a slowdown in international trade with the US, as the US is one of its largest trading countries (Sanchez, 2010:1-2). The Mexican and the US economic relationship became increasingly significant with the creation of the regional trade agreement in 1994 known as NAFTA[44] (Weisbrot & Ray, 2012:3).

With the concerns of a Mexican economic downturn, the IMF stated that the FCL arrangement assisted in restoring business confidence in Mexico, even though Mexico treated its FCL arrangement as a precaution (IMF, 2010b:7). This is supported by the research undertaken by the central bank of Mexico. The Mexican economic indicators such as real GDP growth improved. For example, from a 6.1% contraction in the real GDP growth rate in 2009, during 2010, Mexico witnessed a real GDP growth rate of 5.5% (Banco de México, 2011:2). The value of Mexican Peso also appreciated against the US Dollar by about 6% in the first quarter of 2010. This was brought about by the rise in the capital inflows to Mexico (Banco de México, 2010:20).

b. IMF's responses to previous crises

Evaluating whether the IMF was proactively engaged in designing lending instruments meant for a crisis or whether it started to be only reactionary to the Great Recession and the Euro sovereign crisis, this study finds no differences.

The IMF's flexibility in dealing with a crisis was seen during the earlier post-war crises, such as the Suez crisis of 1956, where it provided special large packages of financing to one of the combatants' countries, the UK (Maddison, 1964:176). Given the IMF's limited resources at that time, its support to the UK was unusual because its Articles of Agreement prohibited it from financing a significant and continual outflow of capital, which was precisely what the UK was encountering in 1956 (Boughton, 2001:427).

[44] North American Free Trade Agreement.

During the 1980s-debt crisis, the IMF developed new lending instruments. It established the Structural Adjustment Facility (SAF)[45] in 1986 as a response to the developing countries' incapability to service their debts on market terms (Boughton, 2000b). The Asian crisis of 1997-98 also led to the formation of a new lending instrument, known as the Supplemental Reserve Facility (SRF) (IMF, 1998:1).

In summary, the strict qualification criteria under some of the new IMF's lending instruments may explain why few countries have used these instruments and thus, the success of these instruments remains untested. For example, several Euro crisis countries had used the IMF's EFF and SBA. Table 5.3 also provided evidence that under the SBA and the EFF all the member countries can qualify, while under the FCL and PLL, it is only those few countries with sound economic policies that can be eligible for the IMF's financial assistance.

## II. IMF's crisis prevention

The primary mandate of the IMF mentioned in the third chapter is to oversee the international monetary system (IMF, 2015a:4). This mandate can be achieved when the IMF prevents crises from taking place through using its surveillance tools effectively.

There are several tools that the IMF uses to assess the economic and financial stability of its members. These tools include the Global Financial Stability Report (GFSR), the World Economic Outlook (WEO) and the Article IV Consultations. On the one hand, the GFSR and the WEO are prepared twice a year on a more global level and the data published on the IMF's website is on the global economic and financial market developments. On the other hand, the Article IV Consultations are usually conducted once a year at a country level, whereby the IMF staff informally visits each member and collects economic data[46]. The IMF staff would then prepare a report on the findings of their visit to the IMF Board. After the Board's review of the staff report and consultation with the country concerned, the country Article IV report is made available on the IMF's website (IMF, 2007a:19).

[45] The SAF was upgraded and known as the Enhanced Structural Adjustment Facility (ESAF) in 1987.

[46] The IMF staff also meets with government and central bank representatives to discuss the developments of economic policies of a country since their previous visit. In some instances, the IMF staff would meet with trade unions and academics.

As the basis of analysing the IMF's surveillance framework, this study focuses on the IMF's Article IV Consultation Reports. Article IV Consultations can be important because they assess and identify possible risks in individual countries.

a. IMF's crisis prevention efforts

- US financial crisis (later the Great Recession)

A study by Eichengreen and Woods revealed that before the US financial crisis the IMF had never evaluated the US financial sector. The IMF did the first review on the US during 2009-2010 (Eichengreen & Woods, 2015:33).

The Independent Evaluation Office (IEO) of the IMF also assessed the IMF's surveillance performance during 2004-07, which was the period leading up to the Great Recession. The IEO Report revealed that "The IMF's ability to correctly identify the mounting risks was hindered by a high degree of groupthink, intellectual capture, a general mind-set that a major financial crisis in large advanced economies was unlikely, and incomplete analytical approaches. Weak internal governance, including unclear lines of responsibility and accountability, lack of incentives to work across units and raise contrarian views, a review process that did not "connect the dots" or ensure follow-up, and an insular culture also played a big role, while political constraints may have also had some impact" (IEO, 2011:17).

- Euro sovereign crisis

This section concentrates on selected Euro Zone countries, namely Greece, Ireland and Portugal. It reviews the IMF Article IV Consultation Reports with the objective to reveal the IMF's capability in assessing economic risks in countries prior to a crisis.

- Greece

The Euro sovereign crisis originated in Greece in 2009, as previously mentioned. The 2006 IMF Article IV Consultation Report for Greece indicated that, although the Greek authorities had reduced their fiscal deficit during 2005, further deficit reductions were necessary. The Greek fiscal expenditure such as on public sector wages, defence and social grants was relatively higher than in other countries. During this consultation, the Greek authorities had set targets to progressively reduce their fiscal deficit and achieve a budget balance or surplus by 2012 (IMF, 2007b:9-10).

In the 2007 Greece Article IV Consultation Report, the IMF staff projections for the Greek general fiscal deficit as a percentage of GDP for the years 2009 and 2010 was 0.9% and 0.3% respectively (IMF, 2008c:14). This estimate was inaccurate as, starting in late October 2009, the Greek newly elected government was talking about a fiscal deficit of roughly 12.8% of GDP for that year (IEO, 2016:9). In the end, the EU estimated the exact general fiscal deficit to have been approximately 13.6% of GDP in 2009 (EU, 2010:6).

It may be that the IMF's lower estimates of the Greek fiscal balance in the 2006 consultation report, was inspired by the commitment of the Greek authorities to continuously reduce their deficit as the basis of achieving a stable fiscal position by 2012 (IMF, 2007b:9-10).

- Portugal

In the 2007 Portuguese Article IV Consultation Report, the IMF praised the newly elected Portuguese government which came to power in 2005 for an impressive fiscal policy. The fiscal policy was concentrated on fiscal consolidation[47]. For example, in 2006, the Portuguese actual fiscal deficit was 3.9% of GDP, when compared to 6.1% in 2005 (IMF, 2007d:4-12).

The IMF staff estimated the fiscal deficit of Portugal in 2009 to be 2.2% of GDP, which was still within the Euro Zone 3% limit for fiscal deficits (IMF, 2008d:29). This estimate by the IMF staff proved to be inaccurate as during 2009 the Portuguese fiscal deficit was 8.7% of GDP (Selvaraj, 2015:6).

[47] Fiscal consolidation refers to economic policies or activities implemented by a relevant government to reduce its deficit or foreign debt.

- Ireland

The IMF staff projections of the Irish general fiscal balance for 2007, 2008 and 2009 were respectively 0.8%, 0.4% and 0.2% of GDP in the 2007 Ireland Article IV Consultation Report. The IMF staff emphasised the possible weakening of the Irish fiscal balance in 2008 to be as a result of the sluggish growth in the Irish government revenue. The IMF staff also cautioned that the Irish fiscal balance would deteriorate significantly in the presence of an international economic shock. This was because of the large deterioration of the Irish fiscal balance experienced during 2000 to 2002[48]. It was in this context that the Irish authorities had agreed with the IMF to pursue a prudent fiscal policy. This was targeted at achieving a balanced fiscal position through the reduction in the growth of government expenditure (IMF, 2007c:12).

The IMF staff predictions of the Irish fiscal balance for 2009 also appeared to be incorrect. For example, Ireland's fiscal deficit for 2009 was 11.4% of GDP (Selvaraj, 2015:6), compared to a fiscal balance of 0.2% projected by the IMF staff.

It can be argued that the IMF did caution the Irish authorities of a possible deterioration of the fiscal balance if an international economic shock were to arise as discussed previously. The US financial crisis of 2007 that became a recession was an international economic shock.

b. IMF's surveillance criticism

One of the weaknesses of the IMF cited in the third chapter is regarding its crisis prevention, in that it has failed to prevent crises particularly in the 1990s. There is evidence that this criticism is relevant as the IMF was unable to avoid two major crises such as the US financial crisis that was later the Great Recession and the Euro sovereign crisis.

In summary, regarding the US financial crisis, the IMF never assessed the soundness of the US financial sector, which raises an important question of whether the IMF's efforts in preventing crises are biased and only focused on some of its members. Further, the inaccurate predictions of the IMF staff on the Greek, Portuguese and Irish fiscal balance leading up to the Euro sovereign crisis have been one of the IMF's weaknesses.

[48] The Irish fiscal balance deteriorated by approximately 5 percentage points of GDP during 2000 to 2002.

### 5.2.2 The World Bank

#### 5.2.2.1 The World Bank's Strength

**I. World Bank's crisis lending**

As it can be recalled from the third chapter, the function of the World Bank[49] is to lend to countries. The World Bank's lending can complement that of the IMF during an economic crisis.

a. The types of the World Bank's lending instruments

The World Bank's lending instruments for much of its history have been in the form of two basic types, namely investment loans and adjustment loans[50]. The investment loans from the International Finance Corporation (IFC) have a long-term emphasis of approximately 5 to 10 years to finance goods and services as part of the World Bank Group's social and economic development projects. The types of the World Bank's investment loans include Specific Investment Loan, Sector Investment and Maintenance Loan, Adaptable Program Loan, Learning and Innovation Loan, Technical Assistance Loan, Financial Intermediary Loan and Emergency Recovery Loan. The adjustment loans which come from the World Bank have a short-term emphasis of approximately 1 to 3 years and they perform a role of emergency financing needed for policy and institutional reforms. There are various types of the World Bank's adjustment loans, namely Structural Adjustment Loan, Sector Adjustment Loan, Programmatic Structural Adjustment Loan and Special Structural Adjustment Loan (World Bank, 2001b:1-3).

b. The trend in the World Bank lending

Similar to the IMF, to perform an analysis of the World Bank's lending, it is necessary to observe the patterns in the World Bank's assistance during the two crisis periods. Figure 5.4 demonstrates the World Bank's development policy lending commitments between the pre-crisis period of 2005-07 and beyond until 2014. The year 2007 is in the pre-crisis period because the US financial crisis started during late 2007.

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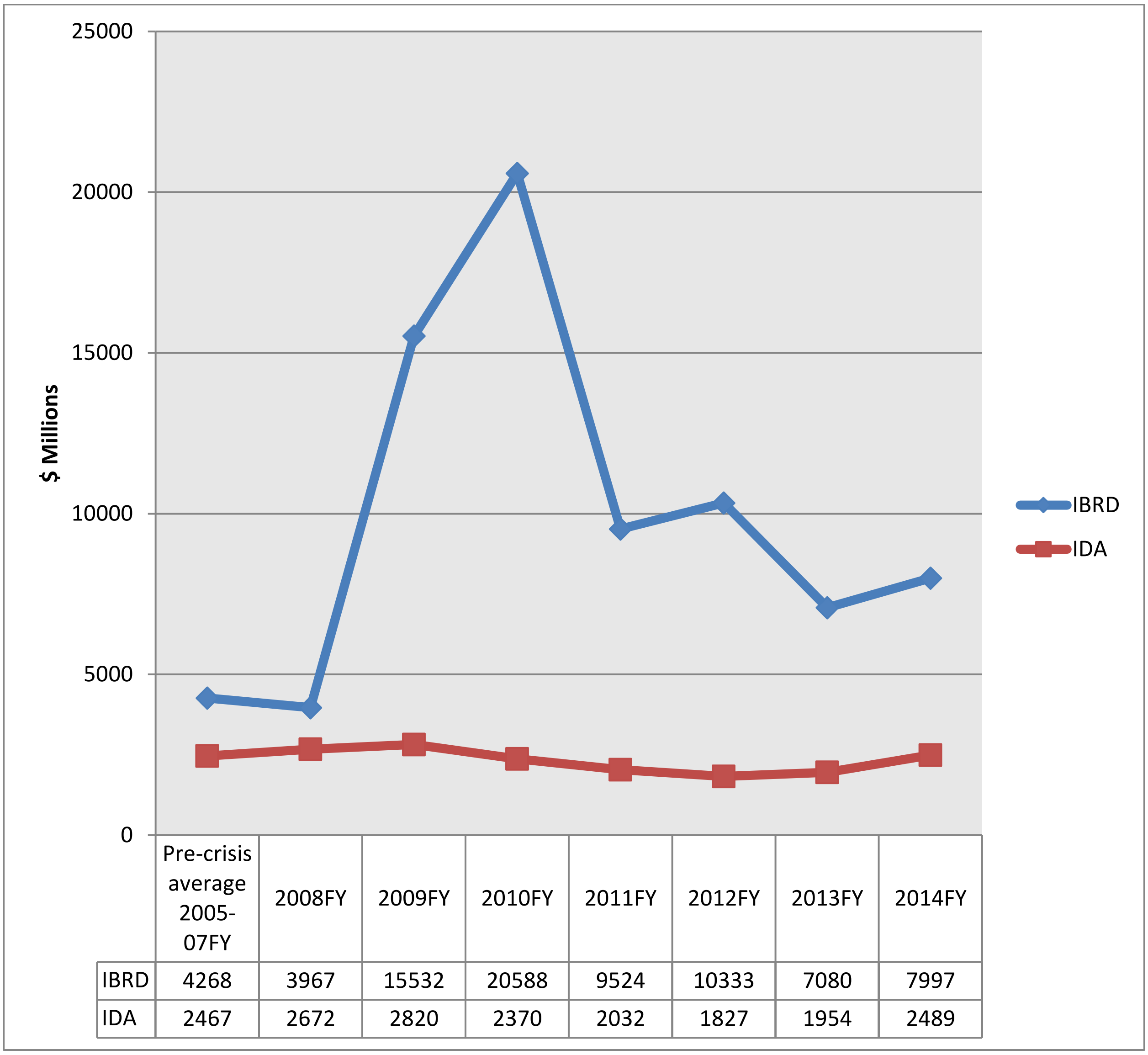
[49] The World Bank is in the form of the IBRD and the IDA as previously mentioned. The other institutions such as the IFC, MIGA and the ICSID form part of the World Bank Group.

[50] The adjustment lending is now known as development policy lending.

**Figure 5.4 World Bank's development policy lending commitments 2005-2014 (in million $)**[51] [52]




| | Pre-crisis average 2005-07FY | 2008FY | 2009FY | 2010FY | 2011FY | 2012FY | 2013FY | 2014FY |
|---|---|---|---|---|---|---|---|---|
| IBRD | 4268 | 3967 | 15532 | 20588 | 9524 | 10333 | 7080 | 7997 |
| IDA | 2467 | 2672 | 2820 | 2370 | 2032 | 1827 | 1954 | 2489 |

Source: Author's interpretation based on various World Bank Annual Reports (World Bank, 2007; World Bank, 2008; World Bank, 2010:8; World Bank, 2011:5; World Bank, 2015:58).

According to Figure 5.4, it is apparent that the trend of the IBRD development policy lending commitments fluctuated from the pre-crisis period (2005-2007) until 2014. For example, from a pre-crisis average of $4 268 million, the amount of lending commitments declined slightly to $3 967 million in 2008. In 2009 as the US financial crisis turned into a recession, the IBRD commitments more than tripled to reach $15 532 million.

[51] The pre-crisis average data for the IBRD and the IDA was obtained from the 2007 World Bank Annual Report.

[52] The financial year of the World Bank is from July to June.

During 2010, this number further increased to reach $20 588 million before fluctuating in the subsequent years to achieve an average of about $8 734 million (2011-2014). Although there was a fluctuation of the IBRD lending commitments during 2011-2014, this was still above the pre-crisis levels of 2005 to 2007.

There is an indication that the IDA's lending commitments also increased in 2009 during the Great Recession. For example, in 2009 the IDA's commitments stood at $2 820 million, which was approximately an increase of 10% from an average of $2 570 million in the preceding four years (2005-2008), as per the calculations based on Figure 5.4.

There was, in addition, an increase in the development policy lending commitments as a percentage of the total IBRD lending commitments during 2009. For example, during the pre-crisis period (2005-2007) the percentage of development policy lending commitments was approximately 32% of the total IBRD lending commitments ($4 268 million as a share of $13 525 million measured by averages) (World Bank, 2007). By 2009, the development policy lending commitments formed approximately 47% of the total IBRD lending commitments ($15 532 million as a share of $32 911 million) (World Bank, 2010:8).

The evidence on the lending role of the World Bank is supported by a study conducted by Bazbauers, which shows that the World Bank assisted several East Asian countries[53] during the Great Recession (Bazbauers, 2014:142-146).

Since the 2007 US financial crisis intensified with the insolvency of major US financial institutions in 2008, the International Finance Corporation (IFC) played a role particularly in the banking sector. This is based on the fact that the function of the IFC as previously mentioned is to provide loans, equity and advisory services to the private sector. The IFC initiated new crisis response initiatives in both investment and advisory services to increase the development impact (World Bank, 2009:2).

[53] Indonesia, Thailand, the Philippines and Vietnam.

A higher proportion, which is 33 of the 50 financial sector projects sampled during the Great Recession, was projects in response to the recession. Between the 2009 fiscal year and the third quarter of 2011, an estimated 63% ($16.9 billion of $26.9 billion) of the IFC investments were in the financial sector. The IFC started regional initiatives particularly in Easter Europe (IEG, 2012:78-79) and its investment lending was also seen in Sub-Saharan Africa during the recession (IEG, 2009b:v).

c. World Bank's previous crisis lending trends

Comparing the World Bank's lending trends in the past to the crisis events under review, it is found that in the past, the World Bank's lending increased during a period of a crisis. The 1980s-debt crisis brought about an increase in the World Bank's adjustment loan commitments to $6.5 billion in 1989 from a modest $0.5 billion in 1980 (Jayarajah & Branson, 1995:108).

d. World Bank's former responses to a crisis

This study finds no differences in how the World Bank responded to previous crises compared to the Great Recession and the Euro sovereign crisis. In response to the past crises such as the 1980s-debt crisis, the World Bank started the issue of Structural Adjustment Loans (SALs) (Sharma, 2013:669). Further, through its Special Action programme between the period 1984 and 1985, the World Bank worked towards preventing an economic collapse by urgently injecting $4.5 billion in aid into forty-four countries (Sanford, 1988:261).

During the Asian crisis in the late 1990s, the World Bank introduced the Special Structural Adjustment Loans (SSALs) for countries affected by the crisis (De Janvry & Dethier, 2012:12).

During the Great Recession, the World Bank responded with a Global Food Crisis Response Program (GFRP) to curb the adverse consequences resulting from high food prices on the world's poor (IEG, 2009b:7; World Bank, 2013). The World Bank's response with the GFRP is based on the fact that when the recession arrived, a substantial number of the developing countries were still wounded both socially and economically by the global food crisis which occurred before the recession. Such a response from the World Bank was quite prudent given its institutional focus on development (UN, 2011).

In 2012, another new World Bank lending instrument, Program-for-Results (P4R), was created. There is, however, no evidence that the establishment of the P4R lending instrument was in response to the Great Recession and the Euro sovereign crisis (Cormier, 2016:209-220). The P4R was introduced to shift the World Bank's lending to be more results driven (IEG, 2015:1).

e. World Bank's lending criticisms

First, one of the criticisms of the World Bank mentioned in Chapter Three is on its declining lending role. This decline in lending is because countries' have greater access to private capital markets than when the World Bank was first established. It is found that the World Bank and its institutions played a vital lending role during the Great Recession, as their lending commitments and credits increased. This increased lending during the crises provides evidence that the World Bank still has a lending role to play in the globalised world, regardless of the existence of the private capital markets.

Ravallion explains that the private capital flows cannot reach all the developing countries, as some developing countries have weak financial markets (Ravallion, 2016:80).

Second, the World Bank was criticised for its complex mandate and goal congestion. This study finds that the World Bank had a diversified role in managing the Great Recession, as its institutions played various roles. The World Bank lent to governments in developing countries such as the Asian countries. The IFC initiated crisis response projects meant for the private sector during the recession in regions such as Eastern Europe and Sub-Saharan Africa.

In summary, the World Bank's response, particularly to the Great Recession, has been its strength, as it has augmented its lending capacity. The evidence is also presented above to testify that the World Bank's affiliate, the IFC, got involved with projects aimed at responding to the recession.

## 5.3 Summary

The IMF and the World Bank played an essential role in responding to the harmful effects of the Great Recession and the Euro sovereign crisis. Section 5.2 indicated that the two institutions increased the lending commitments during the two crises. The IMF also approved the financial assistance requests from countries within reasonable time frames, to minimise the effects of the crises by restoring business confidence.

Section 5.2 also showed that the success of the IMF's new lending instruments that have their origins in 2007-2014 remain untested so far. Quite a few countries have used these instruments. The crisis prevention ability of the IMF is questionable. The IMF has not been able to provide warning signs of a possibility of an economic crisis, even in the presence of its surveillance tools.

Overall, this chapter revealed that the World Bank Group's lending was suited to the recession and the Euro crisis. The World Bank is an international institution focused on lending to countries. The IMF was also suited to respond to the two crises through its lending and development of several lending instruments. One of the functions of the IMF is to provide temporary financing during times of a crisis.

The next chapter concludes on the research question and objectives of the study mentioned in the first chapter. It will also outline the lessons learnt from the response of these institutions to the international economic crises studied, as well as areas for future research.

# 6. Chapter Six: Conclusion and Future research

## 6.1 Conclusion

### 6.1.1 Conclusion on the research question and objectives

The method of research was entirely a literature study to identify the strengths and weaknesses of the two international institutions in responding to international economic crises. The research methodology adopted was to systemise the published literature around the role of global governance institutions during the two economic crises, which has not yet been the emphasis of several research projects.

The primary objective of this study was to determine the role played by these institutions during the Great Recession and the Euro sovereign crisis in a globalised world. To achieve this objective, it was necessary to reveal the facts with regards to the secondary objectives.

The secondary objectives were, first, to explain the different ways in which the globalisation concept is defined and to briefly describe its origins. Second, it was to discuss the historical and changing roles, as well as the criticisms of the two institutions. Third, it was to provide a summary of the causes, spread and impact of the Great Recession and the Euro sovereign crisis in the global economy. Fourth, it was to examine the responses of the IMF and the World Bank to the Great Recession and the Euro sovereign crisis. Fifth, it was to reveal the strengths and weaknesses of the two institutions as displayed by their responses to the two international economic crises considered.

Chapter Two fulfilled the first secondary objective on the definitions of globalisation and its historical roots. It showed that globalisation has different interpretations as authors refer to the economic and non-economic definitions of globalisation. Authors who defined globalisation in respect of economic activities referred to factors such as FDI, international trade, and internationalisation of production and markets to be one of the features of globalisation. Some researchers who defined globalisation to include non-economic activities mentioned cultural, political and environmental aspects attached to globalisation.

The process of globalisation is also not a new phenomenon as it traces back several years ago. For example, evidence of people travelling across national borders as early as the fourteenth century was presented. The globalisation events other than migration took place later, such as trade liberalisation in the 1780s, technological improvements in the nineteenth century and 1990s that accelerated the process of globalisation and the growth of FDI in the 1980s.

The second secondary objective on the historical roles and criticisms of these institutions was met in Chapter Three. The lesson taken from that chapter is that the crises and globalisation events that took place after the Second World War had an impact on the original roles of the IMF and the World Bank. This led to a shift in their original roles over time, as they adapted their roles to suit the changing global economic environment. They have also performed their roles in the face of several criticisms, of which some of these criticisms are no longer relevant.

Chapter Four addressed the third secondary objective. The chapter indicated that the US financial crisis (later the Great Recession) was triggered by the sub-prime lending by financial institutions, as well as lack of banking regulation. The crisis spread globally more especially to financial institutions of countries that were financially globalised to the US. African countries such as South Africa were not affected by the crisis through the financial sector, as South African financial institutions are well regulated.

The South African financial system is strengthened by the adoption of the Twin Peaks model through the implementation of the Financial Sector Regulation Act in 2017. The Twin Peaks model and the Financial Sector Regulation Act, however, fall outside the scope of this research project.

The Euro crisis was caused by fiscal deficits that were experienced repeatedly by the Euro Zone countries. The crisis spread to countries that were particularly trade linked to the Euro Zone.

Chapter four also provided evidence on the adverse effects of the two crises events on the global macroeconomic indicators such as merchandise trade, FDI and GDP.

The fourth and fifth secondary objectives are achieved in Chapter Five. The evidence is presented in section 5.2 that these institutions played a significant role, mainly through their lending in response to the Great Recession and the Euro sovereign crisis. Their role during these two crises demonstrated their strengths and weaknesses.

The IMF strengths have been its crisis lending and time frames in intervening during a crisis after a country has filed a financial assistance request. For example, the IMF's lending commitments increased during the Great Recession and the Euro sovereign crisis, which demonstrates that the increase may have been in response to these crises. The IMF had also approved financial assistance requests by its members within reasonable time frames.

It is observed that the IMF's weakness has been the limited impact of its new lending instruments. This is based on the fact that few countries have shown interest in using the IMF's new lending instruments during 2007-2014. The majority of its members mostly used its old lending instruments such as the SBA. The IMF crisis prediction and prevention efforts have also been its weakness. The IMF has failed to prevent two major crises that took place during the period reviewed, namely the US financial crisis that later became the Great Recession and the Euro sovereign crisis.

Since the World Bank is a development institution, the only way that it was going to play a role in a globalised world was to lend in times of financial distress. This study has similar to the IMF, revealed that its lending had been its strength. This is based on the World Bank's lending, which increased significantly during the Great Recession to assist countries to cope with the recession.

On the issue whether these two institutions promote the interests of the developed countries at the expense of the developing ones as mentioned in Chapter One, this claim is found to be inaccurate. The IMF and the World Bank provided their assistance to both the developed and developing countries during the crisis periods studied. The IMF also established lending instruments to suit both the developed and developing countries, as it introduced both concessional and non-concessional lending tools.

Overall, the strengths of these institutions outweigh their weaknesses. However, the weaknesses of the IMF, especially its crisis prediction and prevention show that it should revisit its role to identify its failures and learn from them.

### 6.1.2 Conclusion on the lessons of the response of these institutions to the Great Recession and Euro sovereign crisis

This study did not find any substantial differences in how the two institutions dealt with past crises and the two crisis events studied. Regarding the rise of the IMF and the World Bank's lending commitments during the crisis periods reviewed, it was indicated that even during the previous crises periods, such as in the 1980s and 1990s, the IMF and the World Bank lending trends increased.

On the subject of the IMF and the World Bank's flexibility in responding to a crisis, it was revealed that these institutions have been proactively engaged in making efforts particular to a crisis.

In the case of the IMF, the overhaul of its lending framework led to the introduction of new lending tools. During the 1980s-debt crisis and the 1990s Asian crisis, the IMF also developed new instruments in response to these crises. The World Bank, since it is a development institution, initiated a Global Food Crisis Response Program in response to the Great Recession. Even during the previous crises such as the 1980s-debt crisis, there was an introduction of adjustment lending programmes, while in response to the 1990s Asian crisis the Special Structural Adjustment Loans were created.

The IMF's surveillance before the Great Recession and the period after found somewhat similar results as discussed in section 5.2.1.2. It was discovered that before the Euro sovereign crisis, the IMF's staff projections of several Euro Zone countries' fiscal balance were inaccurate. This is not different to the period preceding the US financial crisis that later became the Great Recession. For example, the Independent Evaluation Office of the IMF had also exposed the incomplete analytical approaches by the IMF as one of the causes for its incapability in identifying potential risks of a crisis occurring.

On the issue of whether some of the criticisms that have been named against these institutions in performing their respective roles in the globalised world are still relevant, several observations have been made.

Concerning the IMF, some criticisms are relevant, while others are irrelevant. This study found the criticism that the IMF's lending role has diminished not to be accurate. There was a rise in the IMF concessional lending commitments for the developing countries, as well as its non-concessional lending commitments for the developed countries.

The critique of the IMF's inability to identify and prevent crises through its surveillance function appeared to be relevant. It was also shown that even in the presence of the IMF's surveillance tools, the IMF has failed to prevent the Euro sovereign crisis and the US financial crisis which later became the Great Recession. In the case of the US financial crisis, the IMF might have been biased in its efforts for evaluating the economic and financial stability of the US, as it only began assessing the US financial sector after a crisis had occurred. Leading up to the Euro sovereign crisis, the inaccurate IMF staff projections of some of the Euro Zone countries' fiscal balance were observed.

Shifting the focus to the World Bank, the criticisms are on its diminishing lending role and complex mandate. These criticisms are found not to be relevant. The World Bank played a role during the Great Recession as it lent to several East Asian countries that were affected by the recession. There was also evidence of an increase in the World Bank's lending commitments more especially in the form of the IBRD during the recession and Euro sovereign crisis periods.

It was also found that the World Bank and the institutions that form part of the World Bank Group such as the IFC played diversified roles. For example, the World Bank focused on lending to governments in developing countries in East Asia, while the IFC concentrated on projects aimed at the private sector during the recession. This shows that the World Bank Group institutions have complementary roles, as shown by their response to the Great Recession.

The IMF and the World Bank are now better equipped to deal with global economic crises, as they learned from previous crises. These institutions have also shown that they are prepared to reform their lending roles. For example, the IMF has introduced several lending instruments over time aimed at specific purposes.

## 6.2 Future research

This study was not aimed at analysing any particular policy proposal that originated from these two institutions. Instead, it investigated their response to the Great Recession and Euro sovereign crisis. It is envisaged that specific policy proposals directed at specific situations and possibly confined to particular countries, could be the topic of several independent research projects on each of the two institutions.

The study also did not analyse the effects of the IMF and World Bank programmes on countries that received funding from these two institutions. Forthcoming studies can investigate the role of the IMF and World Bank's supported programmes during the recession and Euro crisis.

The research project was, in addition, limited to the role of the IMF and the World Bank. Future research can examine the role of other international groupings such as the G20, regional development banks and international institutions with a financial stability mandate such as the BIS[54] in responding to the Great Recession and the Euro sovereign crisis.

[54] Bank for International Settlements.

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