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Citation for published version:
Mano, V 2022, 'The Vulnerability of a Small, Open Economy in A Situation of Global Fiscal Crisis: The Impact of the Greek Debt Crisis on the Foreign Direct Investments to Macedonia', *Journal of International Business Research and Marketing*, vol. 7, no. 3, pp. 14-22. https://doi.org/10.18775/jibrm.1849-8558.2015.73.3002

Digital Object Identifier (DOI):
10.18775/jibrm.1849-8558.2015.73.3002

Link:
Link to publication record in Heriot-Watt Research Portal

Document Version:
Publisher's PDF, also known as Version of record

Published In:
Journal of International Business Research and Marketing

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Download date: 23. Apr. 2025

ResearchLEAP

Journal of International Business Research and Marketing

Volume 7, Issue 3, 2022

journal homepage: www.researchleap.com

The Vulnerability of a Small, Open Economy in A Situation of Global Fiscal Crisis: The Impact of the Greek Debt Crisis on the Foreign Direct Investments to Macedonia

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DOI: *10.18775/jibrm.1849-8558.2015.73.3002*
URL: *https://doi.org/10.18775/jibrm.1849-8558.2015.73.3002*

Keywords:
FDI, Financial Liberalization, Greece, IMF, Macedonia

ABSTRACT

The objective of my research is to critique the International Monetary Fund (IMF) stance on foreign investment and the benefits for small, open economies of allowing the free movement of capital. In my research as a whole I will explore the extent to which this stance impacted upon and influenced the economic policies of Macedonia. This will involve providing a contextualized, critical account of the policy of the IMF focusing on a comparison of its policies during the early 2000s through policy documents, political discourse and enacted policies in Macedonia. The conditionality associated with these policies, such as the enforcement of austerity measures (including cutting public spending and reducing debt) and the privatization of public institutions has provoked strong reactions in countries which receive such loans (Goldstein et al., 2003; Feldstein, 1998). Moreover, the main aim of the policies and the lack of in-depth analysis on the levels of development of the economies involved has had devastating outcomes in the past (such as with the East Asian currency crisis [1997/8], Latin American – Argentinian crisis [2001], Ex-Soviet Union crisis [1998], Eurozone crisis [2007/8]) (Lal, 1987; Goldstein et al., 2003; Joyce, 2003). My focus in this research is on exploring how the process of Financial Liberalization (FL) of the Macedonian economy affected capital flows in the form of foreign direct investments (FDI) in the private sector and how the recent Greek crisis of 2008 has impacted on this. According to Barnett and Monastiriotis, the neighboring countries (Albania, Bulgaria, Macedonia and Serbia) in which Greece is either the first or the second largest direct investor, are 'most vulnerable to negative spillover through reduced FDI flows' as Greek-owned FDI accounts for 7-9% of the GDP of those countries (2010: 47). In the case of Macedonia, the reality of FL was tested by the collapse of the Greek economy. The first part of my research will critically evaluate simplified models used in previous research to explain the influence of crisis on FDI in small economies like Macedonia. I will argue that investigating the impact of FL is much more complex and cannot be explained by linear regression. Instead, by undertaking an in-depth documentary analysis of official reports and documents, I will seek to investigate how the official view of the benefits of FL impacted on the Macedonian economy, thus implicitly testing the accepted IMF position.

1. Introduction

At the end of the Second World War the victorious nations designed a new settlement to ensure a stable framework for political economy on a global basis as the Bretton Woods Conference, 1944 (Waltz, 1979). This settlement was instantiated in three international organisations: the International Bank for Reconstruction and Development (IBRD), the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT), which initially played a role in governing the international economy (Baldwin, 1993; Cox, 1987; Gowan, 1999; Shaw, 2000; Wallerstein, 1974; Waltz, 1979).

The main goal of these three institutions was controlling access to various types of resources, to provide assistance to the countries recovering from the war and to provide norms for global economic stability (Selznick, 1949; Pfeffer and Salancik, 1977; Oliver, 1991; DiMaggio and

Powell, 1983; Useem, 1993).The logic of the IMF was to transfer large amounts of money through loans in order to endeavour crisis management, and induce financial liberalisation (FL) by conditioning governments and controlling the flow of financial resources and deficits (Soc, 2009). Over the succeeding decades the organisation was relatively successful at ensuring stability in the economies who had attended the conference, but the IMF prescription was less effective in the case of the countries that did not have a seat at the table, particularly to those known as the 'developing world'.

Towards the end of the 1980s traditional economists developed what is known as the Washington Consensus, a combination of

policies wherein governments prohibited the increase of budget deficits, and loose monetary policy increased inflation, in order to resolve the main issues of the Latin Americna financial crisis (Stiglitz, 2002). These policies were characterised as a more 'radical approach to economic development and stabilization' (Stiglitz, 2002: 17). Williamson indicates ten generalisations which are dispersed by academics as norms by which countries which are in the middle of the development process can obtain economic growth. This paper will focus on the process of financial liberalisation implemented by the IMF in Macedonia.

The IMF held an influential role throughout the 1980s and 90s by assisting the countries- clients around the world in need of loans, but this then weakened significantly and the period leading up to the 2008 global financial crisis failed to highlight any need for IMF assistance (Chorev and Babb, 2009; Kapur and Webb, 2006; Ketkar and Ratha, 2009). However, the occurrence of the 2008 crisis returned the institution to a pedestal of importance, initially because of the IMF's monopolistic position, its background in the development in the periphery of the European Union, the need for financial help and control and finally, the EU's preference of collaborating with the IMF to provide rescue plans with unbounded conditionality (Chorev and Babb, 2009; Grabel, 2011, p. 808; Lutz and Kranke: 2010).

Section Two of this paper provides a contextualized, critical account of the policy of the IMF, focusing on a comparison of its policies during the early 1990s and the financial liberalization of various markets. Moreover, the main aim of the policies and the lack of in-depth analysis of the levels of development of various economies have had devastating outcomes in the past. By considering a number of examples, I intend to highlight that the conditionality associated with these policies has provoked strong reactions in the countries receiving IMF loans (Goldstein et al., 2003; Feldstein, 1998; Joyce, 2003; Lal, 1987;).

2. Financial Liberalisation and the IMF

The idea of financial globalization and global integration was developed through the process of cross country capital flows and the liberalisation and deregulation of domestic financial sectors and capital accounts; through these processes markets and the financial world in general were driven to transform their structures (Das, 2006, p. 1). As Stiglitz argues, whilst the industrialised markets liberalised their markets slowly (the FL process started after the second world war and was completed in the 1970), the process of FL was forced on developing markets and they were expected to instantly deregulate their markets, resulting in the lack of a safety net to cushion the blow from the recent economic (banking) crisis of 2008 (2002, p. 65). Therefore, the vulnerability that developing countries are faced with whilst undertaking the process of FL must not be disregarded; the overvalued local currency and the extended domestic borrowing might result in a currency crisis which would decrease the markets credibility towards foreign investors, and lead to capital outflow due to speculation and contagion (Prasad et al., 2003, p. 5).

FL is a process through which banks and other financial institutions gain more freedom, thus resources are been allocated according to the market fluctuations (Wang et al., 2008, p. 315). According to some academics, financial integration can generate further development of both domestic markets and foreign financial institutions (De Gregorio and Guidotti, 1995; Guiso et al., 2004; Prasad et al., 2003, p. 6; Rajan and Zingales, 1998). Masten et al. (2008: 298;) argue that the more financial instruments that are available in an economy, the lesser the transaction and information costs and thus the financial development of an economy leads to economic growth by assisting in a better trade of financial agents, which increases the investment and generates economic growth (Guiso et al., 2004; Rajan and Zingales, 1998). Moreover, FL might have a positive effect on growth in a number of ways; by improving the allocation of capital, by developing national financial markets (the higher competition of IFI (International Financial Institutions) decreases the cost of intermediation and this in turn increases the request for funds and expands the size of the domestic market), and by improving the institutional structure of the market (fewer issues with asymmetry in the flow of information, better regulation policy and stability) (Bekaert et al., 2001; Giannetti and Ongena, 2007; Klein and Olivei, 2005; Masten et al., 2008, p. 299). However, the literature suggests that the level of materialisation of the positive effects on growth is dependent 'on the market imperfections and distortions, with weak financial institutions and legal system playing a role' thus FL has a positive influence on growth for developed economies, but for poor developing economies financial integration is damaging (Boyd and Smith, 1992; Edwards, 2001). The macroeconomic policies, along with a stable institutional framework, are some of the important factors that play a significant role on the level of growth achieved through FL by engaging 'less volatile and growth-enhancing capital flows', but the crucial factor for the underdevelopment of markets 'is the initial design of liberalisation and reform policies' along with institutional development that stimulates the growth rates and macroeconomic performance (Acemoglu et al., 2002; Masten et al., 2008, p. 300; Prasad et al., 2003; Roland, 2000). For the purpose of my research I intend to focus on the FL of economies represented by the 'removal of government interference in financial markets' and the liberalised foreign capital inflow (Stiglitz, 2002, p. 60). However, before moving to a detailed analysis of the crises worldwide (East Asian crisis, Latin American Crisis and Russian crisis), in this paper I critically analyse the main duties of the IMF, and the effects of the policies implemented.

The two main duties of the IMF are firstly, to identify and advise on the economic reforms that should be undertaken by a specific government in order to maximize the output for the initial period and secondly, at the same time control how the reforms are implemented by the government (Marchesi and Sabani, 2005). In other words, based on the idea that markets are not perfect (generating high levels of unemployment and stagnation) and that 'collective action at the global level for economic stability' (as well as politic stability) is required, the main intention of the IMF was to prevent a global crisis by influencing underachieving countries (through rising expenditures, decreasing taxes and interest rates) to increase their usage of their natural resources, increase demand and stimulate economic growth (Stiglitz, 2002, p. 13). However, the IMF found it difficult to objectively achieve one of its main duties - analysing and investigating in depth - what was the macroeconomic situation, how the country was performing economically, and whether it was maintaining a good level of budget deficits or was it over borrowing. It has been argued that the IMF places its main focus on inflation levels, without taking into regard the economy's levels of growth and employment - low inflation does not necessarily indicate that the economy is stable, for it might have high unemployment and no growth (Peet, 2009; Stiglitz, 2002). The structural policies implemented by the IMF have as a main target the realisation the idea of market economy by decreasing government influence; these policies include various financial reforms, trade liberalisation, capital markets and exchange rate liberalisation, as well as privatisation of public organisations, labour-market reforms, pricing reforms and many more (Goldstein et al., 2003, p. 367; Joyce, 2003). As Stiglitz argues, the IMF never established the cause-effect relationship or the 'means with ends' connection between the policies or reforms implemented and the aims to be achieved; being one of the reasons why there is no thorough analysis before implementing policies (2002, p. 27).

'The policy conditionality is flawed' is another concern that many academics cite; the numerous performance conditions, measure of policy, and benchmark and program reviews have generated uncertainties in borrowers' behaviour and in the completion of structural programs (Frankel, 2000; Woods, 2001). The conditionality of IMF loans is seen by Stiglitz as imposing on a country terms that it must satisfy in order to receive the financial assistance, but which on the other hand might not guarantee repayment or might even generate negative political results (the policies might weaken the economy in the short run, but demonstrate benefits in the long run) (2002, p. 45). Stiglitz argues that it is the authoritarian position of the IMF that indicates that loan-recipient countries are colonies, not in a position to state their opinions on the matter; this relationship often results in tension and a sense of dictatorship as alternative policies suggested by the 'client country' are not permitted for discussion (2002, p. 43; Joyce, 2003).

Another crucial point that Volcker and Gyohten highlight is the different approach of the IMF's structural programmes towards the country's level of development: developing countries tend to undertake larger structural reforms than industrially developed countries, highlighting the obvious difference in economic and political power amongst nations (1992). The IMF's approach of 'one-size-fits-all' cannot be applied in significantly different economies or even when economies are going through a transition and where the market has not been present before.

A fourth criticism of the IMF's operating process is the way it strays from its policies and processes (macroeconomic and exchange rate policie) into a bundle of structural policies which result in IMF inconsistency and loss of reputation. The IMF lacks expertise and professionalism to generate sound policies in diverse areas such as trade policy, privatisation or poverty education, as many of these reforms fall outside the scope of the financial sector and instead should be duties of the World Bank (Goldstein et al., 2003, p. 368). Barro and Lee (2003) have come to the conclusion that the recent operations of the IMF are based on specific interests rather than objective professionalism; the size of the loan is larger and repeated when the country that is receiving it has a larger portion of influence in the IMF, or has political and economic linkages with the US and other shareholders. Additionally, Radelet and Sachs (1998) suggest another concern: private investors react to illiquidity by losing confidence in the market and decreasing capital flows, the main tool in resolving liquidity issues, thus deep structural reforms in servicing illiquidity will only result in frightening investors.

However, tasks that the IMF undertook to complete were not successful - the FL of markets was implemented too quickly in some developing countries, and even in transitional countries there proved no positive effect on economic growth. The implementation of rapid trade liberalization made developing economies more vulnerable, leading to devastating economic and social results (Stiglitz, 2002, p. 18). Feldstein argues that developing countries in need of financial assistance hesitate to turn to the IMF straight away, as they perceive those borrowings as costly and over-conditional; these countries either turn to the IMF much later or decide to borrow from regional crisis lenders, resulting with even more difficulties in resolving crisis issues (1998, p. 24, Bergsten, 2000, p. 25). The IMF, in previous cases where economies were faced with crisis, implemented its well-known scheme of policies and reforms which focused on pro-cyclical adjustments, privatisation and FL of markets such as in the East Asian crisis in 1996, but Gerbel argues that ten years later the IMF policies are still

characterised by inconsistency (2011, p. 806; Singh, 1999; Wade, 2007). In the section ahead I intend to focus on the history of the three main crises and provide a more detailed summary of the factors and outcomes of IMF's involvement in these major crises.

2.1 The History of Crises

There are a number of studies that focus on specific IMF events, disclosure of programs, agreements amongst countries in debt, IMF agreements and the countries' progress of collaboration with the IMF (Hayo and Kutan, 2005). This section differs to previous studies and by focusing on a particular event (the FL of markets) that envisions the overall impact of IMF actions on investor behaviour.

2.1.1 East Asian Crisis

In the 1980s the Thai economy was growing strongly, but by 1996 exports started decreasing, the rapid growth of the Thai economy which had resulted in a property market boom was stagnating, leading to distress in regards for the stability of 'non-bank financial institutions' and, as short-term foreign loans were issued, it was obvious that the Thai currency would be affected (McIntyre, 2001, p. 96; Stiglitz, 2002, p. 105). Government officials of Asian countries (including the Thai government) realised that the IMF policy of rapid FL of their markets was a destructive policy that would lead to a high inflow of money, and make the economy vulnerable to any outflow of capital (Feldstein, 1998; McIntyre, 2001, p. 96). Being unable to react to these effects of the FL (due to IMF's position towards a country not responding to IMF policies and leading to capital outflow) resulted in a crisis in the Thai economy, which spread to Indonesia, South Korea and Hong Kong (Feldstein, 1998; Stiglitz, 2002, p. 93).

Although a lot of research has been done both during and after the crisis, there is a difference in how the crisis and the factors that led to its occurrence were analysed and perceived. A number of academics have supported the fundamentalist approach which supports the idea that the crisis occurred as a result of distress in the economy, stagnation of growth, and stock and real estate bubbles (Corsetti, Pesenti, and Roubini, 1998; Kaminsky, 1998; and Krugman, 1979). On the other hand, a group of researchers argued that the collapse of the peg led to a self-fulfilling crisis (Eichengreen and Wyplosz, 1993; Obstfeld, 1996). However, most of the critics of the IMF argued that the crisis occurred because of tricky and problematic financial flows, the quick liberalisation of the market, the lack of government intervention especially on the vulnerability of domestic companies towards external debt, and the excessive foreign investment. All of these issues resulted in the IMF's bailout program which demonstrated a misdiagnosis and led to larger control and influence over the domestic economic operations of the country in crisis (Goldstein et al., 2003, p. 366; Gore, 2000, p. 799). It has been argued that the factors that led to the occurrence of the Asian crisis were not only macroeconomic flaws, but more of a 'moral hazard' that emerged from the national institutional mismanagement (including the deficiencies rooted in the IMF) that influenced weak investments and generated loss of confidence and speculative attacks in the market (Chang, 2000; Kaminsky and Schmukler, 1999; Kindleberg, 1978; McKinnon and Pill, 1998).

With the previous argument, it is of great importance to lay out the main prescriptions that the IMF imposed on the East Asian economies and more specifically on the Thai economy, and whether they were successful or not. It has been argued that IMF policies which were implemented to achieve financial deregulation of the market removed many of the measures (controls on foreign borrowings in the private sector, coordination of borrowings and investments, weak bank supervision) established in the individual economies which provided 'stability conditions of the Asian high debt model' (Wade and Veneroso; 1998). The financial restructuring, recapitalizing of financial institutions and privatization was one of the prescriptions that the IMF imposed in order to make the Asian financial systems operate like western ones, but IMF did not succeed in making the systems operate like the western ones (Wade and Veneroso, 1998). Another point that Feldstein highlights is the fact that the IMF had imposed very detailed and microeconomic conditions on the Asian economies - but it is unacceptable for a financial institution to impose and intervene in the domestic economic policy and structure of the economy (1998; Radelet and Sachs, 2000). According to Wade and Veneroso (1998), the IMF approach produced enormous social costs whilst trying to westernise the Asian economies and reduce their high debt system; the institution was criticised for its failure to consider the economic and social costs of its actions. According to Krugman (1998), the presence of moral hazards and the 'dismantling of public guarantees on investment' decreases the level of investment and at the final stage, financial speculation emerges which pressures the economic system into an inefficient equilibrium as was the case in the Asian economies. The slowdown of the stock market and real estate market, which were fed through foreign direct investments, generated speculative actions which on the other hand led to losses and distress in the financial and cooperative sectors. These hazards generated speculations about the Asian market and led to reversals of financial capital, deflation of currency and investor panic (Corsetti et al., 1999).

2.1.2 Russian Crisis

The beginning of the 1990s in the Soviet Union was characterized by 15 countries using the same currency with their own central bank creating credit, the cost of inflation was

spread throughout the USSR and each government obtained their own seigniorage from the credit creation (Rosefielde, 2005). Even though, the USSR collapsed in 1991, in the period up to 1998 the Russian currency indicated stability and attracted foreign capital in flow (mostly short term) and the Russian privatization process both on small and large scale was graded 3 (out of 4), indicating that it was rather successful. However, according to Boettke this was 'an illusion' (1999; Martinez-Vazquez et al., 2001). During the period of restructuring the Russian economy, investments decreased due to a number of barriers such as inappropriate amounts of lending, a feeble economy based on non-payments among companies, weak bankruptcy procedures and socio-political and economic conditions (Martinez-Vazquez et al., 2001). At the end of 1998 the Russian economy, as well as western countries' expectations that the programs of stabilization would lead to a success, caved in (Gould-Davies and Woods, 1999). Amongst the various external institutions which provided strategic economic assistance driving the country through a stable transition to a market economy, the IMF played a central role (Gould-Davies and Woods, 1999; Sachs, 1994; Wedel, 1998).

The reforms implemented by the IMF were categorized into two generations, the first involved macroeconomic stabilization, privatization, monetary policy and control of inflation rates, trade and price liberalization, and removal of protection in the economy (Gould-Davies and Woods, 1999). Some of the criticisms in regards to the initial reforms were focused on the IMF decision to retain the common currency system in Russia which led to higher inflation rates, inability of currency stabilization, outflow of funds and distortion of the policy making (Gould-Davies and Woods, 1999; Wedel, 1998). Furthermore, the IMF did not succeed to forecast the collapse in output (Gould-Davies and Woods, 1999). Another criticism was that the IMF's engagement in providing support was rather lethargic; by the time the institution began to provide assistance, the domestic political environment had abraded (Gould-Davies and Woods, 1999; Sachs, 1994). There were numerous debates about whether Russia should implement a rapid 'shock therapy' of liberalisation of the market, which might have disadvantages in terms of economic failures/ increased political corruption, but without creating a majority of investors focusing on capitalism, people might have returned to communism (Stiglitz, 2002, p. 141). Prices that had been controlled were suddenly allowed to find their own level, leading to hyperinflation and exacerbating the inevitable problems that the process of transition brings. Monetary policy was implemented to decrease inflation by increasing interest rates, but the prices of natural resources were not liberalised, leading to a rapid rise in the black market on fuel, and people made profits off the wrongly implemented government policies (Stiglitz, 2002, p. 142).

The second generation of reforms Gould-Davies and Woods argue included the production of growth, oversight of the financial sector, transparency of fiscal policy, flexible labour markets, transparency in the judicial system, improved quality of governmental expenditure and a positive role of the state in the economy (1999). These reforms did not manage to generate substantial changes as there were continued problems relating to the close relationship between government and influential companies and tax evasion (Gould-Davies and Woods, 1999). The IMF advised Russia to borrow in foreign currency in order to save money (the rouble interest rate was higher than the dollar interest rate), but this difference in interest rates indicated that the rouble could devalue and make repayment of foreign creditors much more difficult for the government (Stiglitz, 2002, p. 147; Sachs, 1994). The inability to reform the economy and its fiscal policy remained a long term obstacle which led to intense corruption, tax evasion, mafia growth and illegal capital outflows (Gould-Davies and Woods, 1999). Another issue that was not taken under consideration by the IMF was that the social aspect of transition economies was not taken into account when applying the Washington Consensus policies. The eroded 'social capital' in Russia was easily observed, where corruption and stealing were a trend, not a case of misconduct. The IMF focus on inflation set aside other more substantial issues such as poverty, inequality and social capital, which are significant for forming an environment attractive for new investments (2002, p. 162). Furthermore, Sachs argues that the process of reforms relied on 'fly-in missions rather than on-the-ground assistance in Moscow'. The institution's relationship with the country's policy officials should have been more intense and the number of IMF representatives and the frequency of meetings should have been increased (1994).

According to Gould-Davies and Woods, the institution did not succeed at two main positions, in the specific and immediate goal to stabilize the Russian economy and it also failed to provide straight forward monetary advice or to 'disband the rubble zone' (1999; Sachs, 1994). Russia stopped payments and devalued its local currency resulting in financial crisis with interest rates soaring in the former Soviet Union countries (Stiglitz, 2002, p. 149; Feldstein, 1998).

2.1.3 Latin American Crisis

In the 1970s Latin America was subjected to a number of crises, hyperinflation and other economic distresses, but all of these turbulences had minor effects on the international environment (Hutchison and Noy, 2003; Kaminsky et al., 2003; Mishkin and Savastano, 2000). During the 80s, the Latin American countries initiated serious reforms to restructure their economies - they shifted away from protectionist regimes and governmental controls and began implementing market-oriented policies (Edwards et al., 1999).

In the 90s Argentina was one of the Latin American economies that was faced with high inflation rates. Advised by the IMF, the local currency was fixed to the US dollar which restricted monetary policy manoeuvres, leading to reducing inflation rates (Nechio, 2010, p. 2). However, the side effects of this monetary independence, such as the lack of labour and fiscal reforms, along with the occurrence of the Russian and Brazilian crises, generated significant outflows and increased prices which resulted in a raise of the financial debt, decreasing the competitiveness of the Argentinean market and driving it into depression (Nechio, 2010, p. 2). Thus, the lack of monetary policy that the Argentinian economy gained through fixing the local currency to the dollar, increased the confidence in the market temporarily, but in the long run limited the manoeuvres to face depression; because of the already increased debt fiscal policy, the Argentinian economy was not in a position to maintain the level of its local currency (Nechio, 2010, p. 3; Scott Cato, 2006). The crisis that occurred in Argentina can also be linked in a way to the recent crisis in Greece: both countries' monetary policies had a positive effect on the economy, generating confidence in the market and resulting in decreased inflation rates and lower interest rates, but at the same time, this monetary autonomy produced various problems in both economies (Nechio, 2010, p. 2). The Argentinian currency was vulnerable to outside speculations; these speculations produced increased capital outflows leading to negative foreign reserves (Nechio, 2010). The Argentinian bank system was left vulnerable to exchange rate risk and the costs from exchanging pesos to dollar resulted in currency discrepancies (Nechio, 2010). Keeping in mind that most of the assets were kept in local currency and liabilities were denominated in dollars, and due to the fact that 20% of their assets were made up of government bonds, the Argentinian banking system was exposed to higher sovereign default risk; this resulted in 90% of sovereign debt being held in foreign currency (Nechio, 2010, p. 3). As Nechio argues, Argentina was in a more vulnerable position compared to Greece as the previously created Argentinian currency board was jeopardized by speculations and later was neglected, which demonstrated inconsistency in how the crisis was resolved.

According to a number of academics the fact that the IMF programs have not been successful in Latin American countries can be explained by four main factors: external shocks combined with poor institutions, poor macroeconomic management, and the lack of policy credibility and nature of the stabilization programs. These led to the poor performance of the stabilization programs (Fernández-Arias and Montiel, 2001; Hutchison and Noy, 2003; Joyce, 2001; Rigobon, 2002). More specifically, Fernández-Arias and Montiel (2001) consider the instability of inflation rates (due to trade shocks and sudden movements of international capital) and volatile macroeconomic policy to be crucial in the instability and stagnation of the Latin American region and economy. Rigobon suggests that the main reason for the unsuccessful implementation of the IMF stabilization programs is the inconsistency of implementing the policies in the Latin American countries, and the decision to abandon the programs because of the atypical nature of the policies implemented in a situation of high inflation rates (2002). On the other hand, Joyce reports that the lack of penalties when a program has not been completed, or the low costs of re-entering in a new program generates abandonment and repeating IMF programs as was the case in the Latin American countries (2001).

Therefore, the crisis in Latin America emerged as a 'result of separate and unrelated inadequate policies in individual countries, the IMF recommended virtually the same policy package to all of Latin America: devaluation, [and] reduction of fiscal deficits' (Pastor, 1987b; Pastor, 1989). As pointed out in previous cases, the main failure of the IMF and the policies implemented was the persistence that devaluation of inflation rates would attract capital inflow, and not considering that capital controls might generate scepticism amongst investors and lead away the capital flow (Taylor, 1986). As Pastor argues, the set of adjustments that the IMF had proposed to resolve the financial distress of the economies did not apply considering the circumstances. Even though there are a number of unsuccessful examples, traditional economists continue to consider liberalization and global monetarism as beneficial and will return capital in the markets, though this has not yet occurred (1989).

3. Macedonian Economic History

The slow recovering economic situation in the transitional countries of the Balkan has faced obstacles in regards to policies implemented halfway, delay in developing market-oriented institutions, political inconsistency of the interest of the country and the implemented reforms were seen as imposed by foreign factors, not as a necessary reform for further development of the economy (Minassian, 2002, p. 45). As many other transition economies, Macedonia also demonstrated increase in unemployment and monetary inconsistency during the initial phase of its reform period in the beginning of the 90s, this effect was generated by the collapse of Yugoslavia and its economic system, shrinkage of the market and decrease in the demand, led to decrease in productivity of manufacturing companies and losses (Barker, 2010; IMF, 1998: 6). Therefore, companies began borrowing credit from banks which surpassed the banks' available funds, in order to stabilise these effects, the Macedonian Central Bank implemented a monetary policy and by becoming lender-of-first resort (Perotti, 1994; IMF, 1998). This increased the budget deficit, led to unfavourable real interest rates, hyperinflation and depreciation of the local currency; after these effects the government implemented 'credit ceilings', the supply of money was limited, the borrowing

rate was increased above the inflation rate and the local currency was pegged with the German Deutsch-mark (IMF, 1998, p. 6; Perotti 1994). Moreover, the inflation pressure was strengthened by the increase of the financial institutions that functioned in the banking sector, mostly because of the government's low minimum equity capital requirements and the negative real interest rates for lending (IMF, 1998, p. 7). As the large part of the loans of the more dominant banks were non-performing, the government undertook recapitalisation of the non-performing loans and replaced them with government bonds, the intention was to impose limitation on the banking sector's lending operations and increase in the requirements for the minimum equity capital for the entry of new banks in order for monetary stability to be achieved in the economy (Brixi et al., 1999, p. 20). However, this practice has been argued to be not so efficient, as financial institutions in the banking sector exist to provide long term funding and loans; the main problem was the low confidence of the private sector as well the households in the Macedonian banking sector, which is demonstrated by the short term deposits that can be withdrawn immediately due to instability of the Macedonian banking system (the hyperinflation, the collapse of the pyramid savings institution TAT and the deposits lost in the banks of Yugoslavia) (Stiglitz 1992, p. 40). The method which led to stabilisation of the inflation rates was followed by the appropriate method for stabilisation of the foreign exchange rates, which generated stability as macroeconomic indicators are very irritated by the exchange rates volatility (Brada and Kutan, 1999, p. 19; Minassian, 2002, p. 47). Thus Macedonia implemented a softer approach in stabilising the foreign exchange rate and after pegging its currency with the Deutsch-mark and devaluation of it against the USD, increased exports (Brada and Kutan, 1999, p. 19; Minassian, 2002, p. 47).

However, I would like to argue at this point that economic growth and stability are not as easily achievable especially in transitional economies. A linear and positive relation among monetary stability and economic growth in transition economies was detected through the research that Fisher et al. undertook on the levels of inflation and growth amongst 26 transitional economies (1998). Another research undertaken by Gelb and Gray which focused on analysing particular indicators of countries to determine the highest correlation among them with growth, indicate the same findings, macroeconomic stability is the main factor that lead to growth of transition economies (1991). Both Winkler and Roland discuss that the causes of the stabilisation policies are often dependent of the economic performing of the transitional country, thus low growth can be a result of the corporate governance or the inadequate privatisation processes (2000, 2000). Moreover, Winkler through his research demonstrates that Macedonia has not achieved economic growth because of the underdevelopment of its corporate governance; on the other hand, Roland's research indicates that not only corporate governance correlates with economic efficiency of the transition states but corporate governance is linked to the privatisation reforms implemented in the Macedonian economy (2000; 2000). Another research undertaken by Rizov comes to the findings that for transition economies to achieve economic growth a crucial role plays the access to resources and capital which limits the emergence of new enterprises; the limitations cause market imperfections and low levels of confidence amongst FDI , which are essential for achieving economic growth (2011). However, Altomonte and Guagliano argue that the reason why the Mediterranean part of Europe, to which Macedonia falls geographically, does not have a high level of FDI is the fact that this region is vulnerable to social distress and conflict which does not spread certainty and makes investors speculative of what outcome will their investment have; thus solving any unresolved political, ethnic or religious issues is one of the obstacles for this region's progress (2003).

Having the previously stated and being aware of the fact that the small but significant growth and increase in the industry production that Macedonia indicated in 2007 has led to some stabilisation of real wages, some increase in exports and decrease in unemployment rates, the country has not yet achieved macroeconomic stability (IMF, 2008; Barker, 2009). Therefore, the objective of my research is to critique the IMF stance with regard to foreign investment and the benefits for small, open economies of allowing the free movement of capital. I will explore the specific extent to which this stance impacted upon and influenced the policies of Macedonia. This will involve providing a contextualised, critical account of the IMF’s policy prescriptions during the early 2000s and comparing these with policy documents, political discourse and enacted policies in Macedonia. In the case of Macedonia, the reality of FL was tested by the collapse of the Greek economy. I will analyse this relationship from a critical rationalist view in order to argue that the occurrence of the crisis was not a simple example of ‘cause and effect', but a more complex situation. I intend to tackle the research through the idea that the non-linear interactions amongst heterogeneous agents, as well as feedback loops defined as a ‘circular arrangement of causally connected elements’, bring economies into a state of disequilibrium (Arthur, 2013; Byrne, 1998; Capra, 1997; Lux and Westerhoff, 2009). My intention is to explore how certain variables (particularly the level of FDI) by causing a small effect on other variables (such as interest rates and growth), generate effects on the initial variables (the level of FDI). More specifically, these feedback loops will assist my argument that even small changes (positive feedback loops) can bring about more change that affects the first element of the cycle (Capra, 1997; Walby, 2007). If these interrelations are as complex as some theorists propose (Capra, 1997; Walby, 2007), the existing economic models are inadequate and misleading. My hypothesis is that

the theory of FL being propagated by the IMF from the 1980s has had a negative impact on Macedonia. To address/answer/evaluate this hypothesis I will answer three specific research questions:
1. To what extent has the IMF liberalisation agenda been influential in determining Macedonia's policy towards foreign investment?
2. What has been the historical relationship between Greece and Macedonia in terms of FDI?
3. How did this relationship affect the consequences of the Greek crisis on the Macedonian economy?

4. Conclusion

Although critiques of the IMF began to emerge following the 2008 financial crisis (Stiglitz, 2010; Peet, 2009), few have focused specifically on the failure of the model of FL and virtually none have thoroughly analysed this specifically within the context of the vulnerable and interconnected economies of the Balkans (Barnet and Monastiriotis, 2010; Dimireva, 2010). My research fits into a tradition of literature that explores the body of knowledge on financial contagion globally (for example, the East Asian currency crisis [1997/8], Latin American – Argentinian crisis [2001], formerSoviet Union crisis [1998], crises in Ireland and Portugal [2007/8]), and will specifically provide an insight into how IFI have been involved with and contributed to the destabilisation and vulnerability of the present economic situation in Macedonia (Goldstein, et al., 2003; Feldstein, 1998; Peet, 2009; Stiglitz, 2002). This makes it a useful case-study of how small, open economies, which are to some extent still struggling with the process of transition, are affected by crisis and contagion affecting their economic neighbors.

My thesis will also make a theoretical contribution, by applying complexity theory in order to bring a fresh perspective to the economic study of the FL of small economies, with the specific consideration of Macedonia. By considering Macedonia a complex economic system I intend to argue that non-linear interactions of agents cause random and unpredictable effects on the macro-economic stability and growth of the country (Arthur, 2013; Frieden, 2007; Mowles, Stacey and Griffin, 2008).

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