

## INTERNATIONAL FINANCIAL SYSTEM

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<https://doi.org/10.5281/zenodo.10968211>

### ARTICLE INFO

Qabul qilindi: 10-aprel 2024 yil

Ma'qullandi: 11-aprel 2024 yil

Nashr qilindi: 13-aprel 2024 yil

### KEY WORDS

*economy, financial system, credit, world funds, international business, foreign exchange market.*

### ABSTRACT

*This article discusses the role and characteristics of the international financial system in the world economy. The international financial system is a set of relations that are directly related to the movement of global funds and serve the financial and economic interstate relations and international business (foreign trade, lending, subsidies, tourism, exchange of scientific and technological developments, etc.).*

**Introduction:** The international financial system includes a set of relationships that are directly related to the movement of world funds and serve to serve financial and economic interstate relations and international business (foreign trade, lending, subsidizing, tourism, exchange of scientific and technical developments, etc.). The prerequisites for ensuring the stability of the global financial system and its effective development are created through the development of production, business, the formation of a balanced interstate currency market, the global division of labor resources, and the creation of a unified global economic system. A stable system of international financial relations is impossible without the creation of reliable financial institutions, since such a system in the global view is a form of regulation of monetary relations.

The international financial system (IFS) constitutes the full range of interest-and return-bearing assets, bank and nonbank financial institutions, financial markets that trade and determine the prices of these assets, and the nonmarket activities. (e.g., private equity transactions, private equity/hedge fund joint ventures leverage buyouts weather bank financed or not, etc.) through which the exchange of financial assets can take place. The IFS lies at the heart of the global credit creation and allocation process. To be sure, the IFS depends on the effective functioning and prudent management of the IMS and the ready availability of currencies to support the payment system.<sup>1</sup>

Finance of modern society is the basis of the international financial system. Cash resources are a basic element for business and the world's economic mechanisms of our time. The international monetary and financial system includes economic relations that have been

<sup>1</sup> International Monetary System vs. International Financial System — and the Significance for Policy Makers by Gail D. Fosler

established in the social environment, as well as financial funds formed on the basis of national income and the redistribution of the social product.

Money, currency and the financial system are historical categories that were formed in the process of development of state functions, business and commodity-money relations. The origin of the word "finance" is due to the Latin term, which can be translated as cash payments. It was in this meaning that it was used, starting from the 13th century, in the largest shopping centers of that time: Genoa, Florence, Venice. In the future, the world system of international financial and economic relations and world business began to use this term to describe monetary relationships, as well as tools that form the resources of countries necessary to achieve their political and economic goals.

Thus, at present, the concept of finance is used both for public funds and for business. The embodiment of the material essence of state finances are central and local budgets, funds of state enterprises and state funds. The basic principles on which financial systems are based are expressed as follows:

- The presence of a monetary form of relationship;
- The presence of signs of distribution and the absence of an equivalent natural exchange;
- Availability of a system for distributing the total product and national income through specialized funds.

What is the international financial system? The modern international financial system is a well-established organized form of world monetary relations, which is supported by existing agreements between different countries. The structure of the international financial system consists of several components:

1. World monetary goods, which serves as an expression of world monetary relations. The second variant of deposit money was used by the countries of the "Common Market" (European Community). The total system of payment instruments is international liquidity. It includes gold, international money and stocks of currencies that have the property of convertibility.
2. Exchange rate - the price of exchange of monetary units of one state, expressed in the money of another state. There are two types of exchange rates: - Solid or fixed exchange rate (the basis of a firm exchange rate is the gold equivalent of national monetary units or monetary parity); - Floating or flexible exchange rate (determined by comparing purchasing power, expressed in the price of the consumer basket, while the floating exchange rate is not related to monetary parity).
3. National currency markets. The first example of such a market was the gold market. Its sale was carried out at the official price. The concept of the official price in this case includes the cost, which is fixed by international agreements.

To maintain the agreed level of the price of gold, the Central Banks used such an instrument as intervention that is, putting up for sale state reserves of gold with growing demand. Between 1838 and 1934, a triple ounce cost \$20.67. After that, the price was increased to \$35, and, starting in 1968, rose to \$38. A similar system lasted until the end of the summer of 1971, and the price of gold at that time was \$42.22.

4. International monetary and financial organizations. The modern system of international financial organizations is regulated by the International Monetary Fund, which is designed to promote interstate cooperation and the unification of business forces for the effective resolution of world financial problems. As an institution of the international financial system,

the International Monetary Fund controls monetary commodity of world importance serves as a measure of the wealth exported from the state. The first such equivalent was gold. Subsequently, in various settlements between companies from different countries and the states themselves, bank bills, deposit checks and other forms of credit money began to be used. In the 70s, composite money of international (SDR) and regional significance (ECU) began to be used as such an instrument currency reserves, provides conditions for compliance with currency exchange rates, counteracts currency restrictions, and provides loans to national economies experiencing temporary problems in maintaining the balance of payments. An important role is also played by such subjects of the international financial system as the World Bank Group, the Basel Bank for International Settlements, the European Investment Bank and other organizations that provide foreign currency lending.

**Table 1**

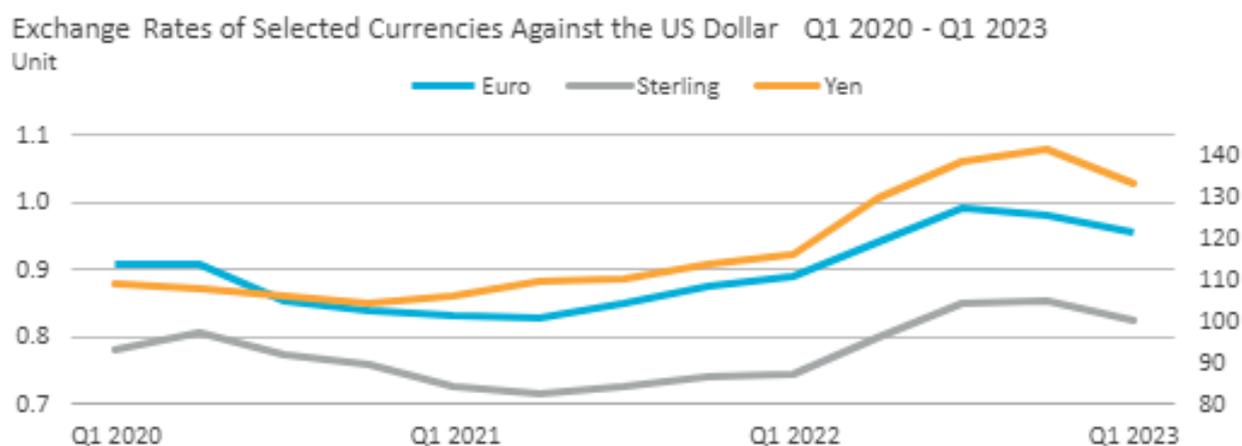
**World output growth, 1991–2024 (Annual percentage change)<sup>2</sup>**

Continents group	2019	2020	2021	2022	2023	2024f.
World	2.5	-3.2	6.1	3	2.4	2.5
Africa	2.6	-2.4	4.5	3.1	2.7	3
America	1.7	-3.8	6	2.5	2	1.8
Asia (excl. Cyprus)	3.7	-0.9	6.5	3.6	3.9	3.9
Europe (incl. Cyprus)	1.8	-6	5.8	2.9	0.6	1.2
Oceania	2.1	-1.8	5.1	3.5	1.8	1.5
Developed countries	1.8	-4.2	5.4	2.4	1.4	1.5
Developing countries	3.6	-1.6	7.1	3.9	3.9	4

The development of the international financial system began with the formation of the Bretton Woods system. This happened in 1944. The idea to unify various national currencies and bring them into line with the monetary units of the advanced states, which at that time were the United States and Great Britain, became the basis for the creation of the first monetary system of world importance. The implementation of such an idea was supposed to create the basis for the formation of a monetary union. According to the Bretton Woods agreement, gold and "reserve currencies" were recognized as the main equivalents for international payments, which were the US dollar and the British pound sterling. All states that joined the agreement received the right to freely exchange currency from their own reserve funds for gold or vice versa. The official international price of gold was set in US dollars, and it was this currency that guided the formation of prices in international trade. The English pound, although it received, the same as the dollar, the status of a reserve currency, but performed such functions only partially. This currency was used mainly in the colonies and dominions of Great Britain. The size of the British gold reserve was not so significant that the world price of gold could be reflected in pounds, so the indirect exchange rate of the pound to the dollar was used to display the parity. Initially, the exchange rate was \$4 per pound sterling. In 1948, there was a

<sup>2</sup> Trade and Development Report 2023 - Chapter I unctad.org

devaluation as a result of which the pound fell to \$2.8 and in 1967 to \$2.4. The states that joined the Bretton Woods system had to reflect the parity of their currencies by fixing their exchange rate to the dollar, based on purchasing power parity. The reflection of the parity of currencies against the dollar could be indirect using the pound sterling. The deviation of the established exchange rate from the gold parity could be no more than 1%. When creating unfavorable situations, the National Central Banks had to maintain the established size of the exchange rate through foreign exchange interventions. In addition, the agreement provided for the possibility of adjusting the exchange rate using such instruments as devaluation and revaluation.



Source: Euromonitor International



**Picture 1.** Exchange rate of selected currencies against the US dollar<sup>3</sup>

At the same time, the function of state financial bodies is not only control, but also direct participation in the work of the financial market through the issuance of securities of national importance. The list of the most active participants in international financial relations, in addition to banks, includes non-banking financial and credit organizations, companies with different forms of ownership and private entrepreneurs. The maintenance and provision of international financial relations, as well as the performance of intermediary functions, are carried out by minor participants in international financial relations – stock exchanges, information agencies, analytical publications, statistical and rating organizations, universities, companies providing consulting services, and so on.

How the institution of the international financial system works. The main element in the system of international finance after the adoption of the Bretton Woods agreement is the IMF, which is a supranational currency credit institution. The main purpose of the International Monetary Fund is to organize international currency relations, overcome state currency restrictions and form a system of international payments. The International Fund, as a specialized representative of the UN, monitors the accuracy of compliance by the member states of the IMF charter and provides financial assistance aimed at overcoming the balance of payments deficit in countries where adverse economic processes are observed.

<sup>3</sup> US Dollar Exchange Rate Shifts: Drivers, Impacts and Outlook for 2023 - Euromonitor.com

Although the International Monetary Fund is accountable to the UN ECOSOC, it is independent in terms of staffing, financial policy, and membership of member states. The formation of IMF resources takes place on the basis of savings and authorized capital, which is formed by mandatory contributions from member states. At the same time, the size of the entrance quota is determined on the basis of an analysis of the country's share in the international trade turnover. Depending on the size of the quota, the state receives a certain number of votes in solving international credit and currency issues, and can also count on receiving a specific amount of credit resources. The Charter of the International Monetary Fund states that the state must allocate  $\frac{1}{4}$  of its contribution in gold and the remaining  $\frac{3}{4}$  in foreign currency (in the formation of the Jamaican international financial system, foreign currency and SDRs are used instead of gold).

When joining the International Monetary Fund, each state receives the right to 250 votes. In addition, for every \$400,000 of loan funds provided, the country receives another vote, which is taken away from the state of the debtor on the loan. A certain decision comes into force if it was supported by 60 percent of the participants, which account for at least 85 of all available votes. Now the United States (19.3%), England (6.7%), Germany (5.5%), France (4.8%), Japan (4.6%) have the most votes. Each member of the International Monetary Fund can borrow in the amount of their gold share (automatically) and 4 credit shares (each of such shares is usually  $\frac{1}{4}$  part). If the state acts as a creditor, then the required currency as a loan is also provided automatically for the entire amount of loans provided through the International Fund. The purpose of obtaining such loans in foreign currency can only be to cover the national payment deficit, and not to replenish their own foreign exchange reserves. Such loans form the "reserve position of the state in the IMF" and can be attributed to a special share of international liquidity. A credit transaction through the International Monetary Fund differs from the traditional understanding of loans, since it has the form of exchanging government currency for the required currency. This operation is called the IMF tranche. As a consequence, the repayment of a loan in such a situation is a redemption of the national currency and can only be carried out using the monetary units of the IMF creditor. The International Monetary Fund is most liberal in the allocation of foreign currency loans within the 1st credit share (from  $\frac{1}{4}$  to  $\frac{1}{2}$  share), since it is believed that in this case the state can independently overcome the existing payment deficit problems. The provision of loans from the second to the fourth shares (from 50% to 125% of the quota) is characterized by the growing complexity of the procedure. The International Monetary Fund provides such loans only if there is a guarantee that they will be directed to the directions necessary for the IMF. The position of the Fund excludes the use of loans to support development programs. The allocation of the tranche is associated with the adopted state stabilization programs aimed at improving the balance of payments of the state of the recipient of the loan. Individual requirements may include:

- Devaluation of the state currency;
- Freezing salaries;
- Cancellation of government subsidies;
- Increasing tax rates;
- Reducing the size of public lending;
- Facilitating the admission of foreign businesses to the domestic market.

The total amount of the loan is divided into several parts. The allocation of the next part is made after certain requirements of the International Monetary Fund are met. Typically, the Fund's loans are granted for a period of three to five years.

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