INTERNATIONAL FINANCIAL INSTITUTIONS : ROLE OF IMF, WTO AND ROLE OF WORLD BANK

Unit - I **Lesson No. 3**

C.No. M.COM-FC 412 **SEM : Fourth**

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3.1 INTRODUCTION

At the Bretton Woods Conference in 1944 it was decided to establish a new monetary order that would expand international trade, promote international capiborne out of this Conference of the end of World War II. The World Bank was established to help the restoration of economies disrupted by War by facilitating the investment of capital for productive purposes and to promote the long-range balanced growth of international trade. On the other hand, the IMF is primarily a supervisory institution for coordinating the efforts of member countries to achieve greater cooperation in the formulation of economic policies. It helps to promote exchange stability and orderly exchange relations among its member countries. It is in this context that the present chapter reviews the purpose and working of some of the international financial institutions and the contributions made by them in promoting economic and social progress in developing countries by helping raise standards of living and productivity to the point of which development becomes self-sustaining.

3.2 OBJECTIVES

After studying this lesson, you will be able to:

• Describe the working and objectives of some of the international financial institutions;
• Explain the various dimensions of World Bank and IMF; and
• Know how the international financial institutions are regulated.
explain the nature and functions of the WTO;
• describe the basic principles that underlie WTO agreements ;
• list the major multilateral and plurilateral agreements of the WTO;
• elaborate on the exceptional circumstances under which a country is permitted to act contrary to the basic principles of the WTO; and
• describe the IP related issues in the Doha Development Agenda

3.3 INTERNATIONAL SOURCES OF FINANCE

One major source of financing is international non-profit agencies. There are several regional development banks such as the Asian Development Bank, the African Development Bank and Fund and the Caribbean Development Bank. The primary purpose of these agencies is to finance productive development projects or to promote economic development in a particular region. The Inter-American Development Bank, for example, has the principal purpose of accelerating the economic development of its Latin American member countries. In general, both public and private entities are eligible to borrow money from such agencies as long as private funds are not available at reasonable rates and terms. Although the interest rate can vary from agency to agency, these loan rates are very attractive and very much in demand.

Of all the international financial organisations, the most familiar is the World Bank, formally known as the International BankforReconstruction and Development (IBRD). The World

Bank has two affiliates that are legally and financially distinct entities, the International Development Association (IDA) and the International Finance Corporation (IFC). Exhibit 1 provides a comparison among IBRD, IDA and IFC in terms of their objectives, member countries, lending terms, lending qualifications as well as other details. All three organisations have the same central goals: to promote economic and FM-305 476 social progress in poor or developing countries by helping raise standards of living and productivity to the point at which development becomes self-sustaining.

Toward this common objective, the World Bank, IDA and IFC have three interrelated functions and these are to lend funds, to provide advice and to serve as a catalyst in order to stimulate investments by others. In the process, financial resources are channelled from developed countries to the developing world with the hope that developing countries, through this assistance, will progress to a level that will permit them, in turn, to contribute to the development process of other less fortunate countries. Japan is a prime example of a country that has come full circle. From being a borrower, Japan is now a major lender to these three organisations. South Korea is moving in a direction similar to that of Japan nearly a quarter of a century ago.

3.4 INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF) came into official existence on December 27, 1945, when 29 countries signed its Articles of Agreement (its Charter) agreed at a conference held in Bretton Woods, New Hampshire, USA, from July 1-22, 1944. The IMF commenced financial operations on March 1, 1947. Its current membership is 182 countries. Its Total Quotas are SDR 212 billion (almost US$300 billion), following a 45 per cent quota increase effective from January 22,1999.

• Staff: approximately 2,700 from 110 countries.

• Accounting Unit: Special Drawing Right (SDR). As of August 23, 1999, SDR I equalled US $1.370280.

IMF is a cooperative institution that 182 countries have voluntarily joined because they see the advantage of consulting with one another on this forum to maintain a stable system of buying and selling their currencies so that payments in foreign currency can take place between countries smoothly and without delay. Its policies and activities are guided by its Charter known as the Articles of Agreement.

IMF lends money to members having trouble meeting financial obligations to other members, but only on the condition that they undertake economic reforms to eliminate these difficulties for their own good and that of the entire membership. Contrary to widespread perception, the IMF has no effective authority over the domestic economic policies of its members. What authority the IMF does possess is confined to requiring the member to disclose information on its monetary and fiscal policies and to avoid, as far as possible, putting restrictions on exchange of domestic for foreign currency and on making payments to other members.

There are several major accomplishments to the credit of the International Monetary System. For example, it

• sustained a rapidly increasing volume of trade and investment;
• displayed flexibility in adapting to changes in international commerce;
• proved to be efficient (even when there were decreasing percentages of reserves to trade);
• proved to be hardy (it survived a number of pre-1971 crises, speculative and otherwise, and the down-and-up swings of several business cycles);
• allowed for a growing degree or international cooperation;
• established a capacity to accommodate reforms and improvements.

To an extent, the fund served as an international central bank to help countries during periods of temporary balance of payments difficulties by protecting their rates of exchange. Because of that, countries did not need to resort to exchange controls and other barriers to restrict world trade.

3.4.1 ORIGIN OF IMF

The need for an organisation like the IMF became evident during the great depression that ravaged the world economy in the 1930s. A widespread lack of confidence in paper money led to a spurt in the demand for gold and severe devaluation in the national currencies. The relation between money and the value of goods became confused as did the relation between the value of one national currency and another.

In the 1940s, Harry Dexter (US) and John Maynard Keynes (UK) put forward proposals for a system that would encourage the unrestricted conversion of one currency into another, establish a clear and unequivocal value for each currency and eliminate restrictions and practices such as competitive devaluations. The system required cooperation on a previously unattempted scale by all nations in establishing an. innovative monetary system and an international institution to monitor it. After much negotiations in the difficult war time conditions, the international community accepted the system and an organisation was formed to supervise it.

The IMF began operations in Washington DC in May 1946. It then had 39 members. The IMF's membership now is 190 after the **Principality of Andorra** virtually joined IMF on October 16, 2020.

3.4.2 MEMBERS AND ADMINISTRATION

On joining the IMF, each member country contributes a certain sum of money called a 'quota subscription', as a sort of credit union deposit. Quotas serve various purposes.

· They form a pool of money that the IMF can draw from to lend to members in times of financial difficulty.
· They form the basis of determining the Special Drawing Rights (SDR).
· They determine the voting power of the member.

3.4.3 STATUTORY PURPOSES

The main purposes of the International Monetary Fund are:

a. To promote international monetary cooperation through a permanent institution that provides the machinery for consultation and collaboration on international monetary problems.

b. To facilitate the expansion and balanced growth of international trade and to contribute, thereby, to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

c. To promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation.

d. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

e. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustment in their balance of payments without resorting to measures destructive to national or international prosperity.

f. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

3.4.4 FINANCIAL ASSISTANCE

The IMF lends money only to member countries with balance of payments problems. A member country with a payments problem can immediately withdraw from the IMF the 25 per cent of its quota. A member in greater difficulty may request for more money from the IMFand can borrow up to three times its quota provided the member country undertakes to initiate a series of reforms and uses the borrowed money effectively. The frequently used mechanisms by the IMF to lend money are:

a. Standby Arrangements

b. Extended Arrangements

c. Structural Adjustment Mechanism (With low interest rates)

Regular IMF facilities

a. Standby Arrangements (SBA) are designed to provide short-term balance of payments assistance for deficits of a temporary or cyclical nature, such arrangements are typically for 12 to 18 months. Drawings are phased on a quarterly basis, with their release made conditional on meeting performance criteria and the completion of periodic programme reviews. Repurchases are made $3^{1/4}$ to 5 years after each purchase.

b. **Extended Fund Facility (EFF)** is designed to support medium-term programmes that generally run for three years. The EFF aims at overcoming balance of payments difficulties stemming from macroeconomic and structural problems. Performance criteria are applied, similar to those in standby arrangements and repurchases are made in 4½ to 10 years.

Concessional IMF facility

a. **Enhanced Structural Adjustment Facility (ESAF)** was established in 1987 and enlarged and extended in 1994. Designed for low-income member countries with protracted balance of payments problems, ESAF drawings are loans and not purchases of other members' currencies. They are made in support of three year programmes and carry an annual interest rate of 0.5 per cent, with a 51h year grace period and a 10 year maturity. Quarterly benchmarks and semi-annual performance criteria apply; 80 low income countries are currently eligible to use the ESAF.

3.4.5 RESPONSIBILITIES OF THE INTERNATIONAL MONETARY FUND

i. Promoting international monetary cooperation
ii. Facilitating the expansion and balanced growth of international trade
iii. Promoting exchange stability
iv. Assisting in the establishment of a multilateral system of payments.
v. Making its resources available, under adequate safeguards to members experiencing balance of payments difficulties

The Fund seeks to promote economic stability and prevent crises; to help resolve crises when they do occur, and to promote growth and alleviate poverty. To meet these objectives, it employs three main functions, as discussed here.

3.4.6 ROLE OF THE INTERNATIONAL MONETARY FUND

(IMF) played a significant role in stabilizing the exchange rates thereby facilitating international payment adjustments. Economists across the world have commended its role in enforcing monetary discipline among its members.

a. **IMF brings stability in exchange rate:** The IMF has laid down a clear guidance of exchange rate policies. Its policies prevent the member countries from making competitive devaluation to boost up exports. As a result of all these, the system of exchange under the IMF is stable.

b. **IMF's role in development of international trade:** The IMF has been instrumental to the growth of international trade. It acts as the reservoir of the currencies of all the member countries. A borrowing country can borrow the currency of another country out of this reservoir. It extends loans in foreign exchange to the member countries for financing the current transactions. It also provides technical advice on monetary and fiscal matters. It conducts research studies and publishes them. This multilateral assistance helps members in solving their problems in trade, thereby promoting international trade.

c. IMF is strict on multiple exchange rates: The IMF does not permit the member countries to adopt multiple exchange rates leading to restrictive practices. The system of exchange rate combines the element of stability with flexibility. It maintains stability in exchange rates.

d. IMF's elaborate lending operations: The main operation of the fund is lending to member countries. It has introduced a variety of loan facilities to its members. Initially, the lending operations were confined only for solving the problems of deficit payments. But now they have been remarkably extended. Member countries can have regular facilities, concessional facilities and special facilities. Credit Tranches and extended fund facility are some of the regular facilities. Structural adjustment facility and enhanced structural adjustment facility are some concessional schemes offered to the member countries. The special facilities offered by the IMF fund include compensatory and contingency financing facility, systematic transformation facility and contingency credit line.

e. IMF's role in currency convertibility: With the charges introduced after 1973 in the international monetary system, a member can peg its currency to

- either a single major currency or
- a basket of currencies or
- allow it to float independently.

A currency is said to be floating when its is left free to find its own parity in the international market. The IMF is the catalyst in the convertibility of currencies. It endeavors to achieve full global convertibility of currencies in the next decade. All developing countries will achieve full convertibility.

f. IMF's role in Consultation and guidance: The IMF provides the necessary machinery for consultation and collaboration on international monetary problems. Monetary, fiscal and financial problems and also matters relating to exchange and trade affecting international payments are clearly studied. It deputes experts to member countries to deal with the balance of payments problems. It also conducts short term training courses on fiscal, monetary and balance of payments for personnel from member nations.

g. Boon to developing countries: The IMF is a boon to developing countries. Less developed countries get enormous assistance from IMF like

- Financial assistance to get rid of balance of payment deficits
- concessional financial assistance for promotion of exports
- suggestions for overcoming constraints in the development process
- Assistance in the formulation of development oriented monetary, fiscal, exchange and trade policies
- extension of central banking advisory services to less developed countries towards the improvement of functioning of their central banks
- institutional training for the personnel in member countries; and
- Special Drawing Rights (SDRs) to resolve the problem of international liquidity.

3.4.7 FUNCTIONS OF THE INTERNATIONAL MONETARY FUND

a. **Surveillance:** A core responsibility of the IMF is to encourage a dialogue among its member countries about the national and international consequences of their economic and financial policies, to promote external stability. This process of monitoring and consultation, normally referred to as 'surveillance', has evolved rapidly as the world economy has changed. IMF surveillance has also become increasingly open and transparent in recent years. The initiatives used to inform bilateral surveillance and aimed at promoting global economic stability are as follows:

· The IMF works to improve its ability to assess the member countries' vulner-abilities to crisis, identifying and promoting effective responses to risks to economic stability, including risks from payments imbalances, currency misalign-ment, and financial market disturbances.

· In collaboration with the World Bank, the IMF conducts in-depth assessments of countries' financial sectors under the Financial Sector Assessment Programme (FSAP). The Fund is further deepening financial and capital market surveillance, particularly in its analysis of emerging market members.

· The IMF has developed and actively promotes standards and codes of good practice in economic policy making. It is also involved in international efforts to combat money laundering and the financing of terrorism.

The importance of effective surveillance was underscored by the financial crises of the late 1990s. In response, the IMF has undertaken many initiatives to strengthen its capacity to detect vulnerabilities and risks at an early stage, to help member countries strengthen their policy frameworks and institutions, and to improve transparency and accountability.

b. **Technical Assistance:** The objective of IMF technical assistance is to contribute to the development of the productive resources of member countries by enhancing the effectiveness of economic policy and financial management. The IMF helps countries strengthen their capacity to design and implement sound economic policies. The IMF helps its member countries build their human and institutional capacity to design and implement effective macroeconomic and structural policies, put in place reforms that strengthen their financial sectors, and reduce vulnerability to crises. The IMF generally provides technical assistance free of charge to any requesting member country within the IMF resource constraints. About three-quarters of the Fund's technical assistance go to low- and lower-middle income countries, particularly in sub-Saharan Africa and Asia, and post-conflict countries. The IMF provides technical assistance in its areas of expertise: namely macroeco-nomic policy, tax policy and revenue administration, expenditure management, monetary policy, the exchange rate system, financial sector sustainability, and macro- economic and financial statistics.

Since the demand for technical assistance far exceeds supply, the IMF gives priority in providing assistance where it complements and enhances the IMF's other key forms of assistance, i.e., surveillance and lending.

c. **Lending:** Even the best economic policies cannot eradicate instability or avert crises. In the event that a member country does experience financing difficulties, the IMF can provide financial assistance to support policy programmes that will correct underlying macroeconomic problems, limit disruptions to the domestic and global economies, and help restore confidence, stability, and growth. IMF financing instruments can also support crisis prevention. The IMF is accountable to the governments of its member countries. At the apex of its organizational structure is its board of governors, which consists of one governor from each of the IMF's 190 member countries. All governors meet once a year at the IMF-World Bank Annual Meetings.

The IMF's resources are provided by its member countries, primarily through payment of quotas, which broadly reflect each country's economic size. The annual expenses of running the Fund are met mainly by the difference between interest receipts on outstanding loans and interest payments on quota 'deposits'.

3.5 INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT(IBRD) / WORLD BANK

The IBRD was set up in 1945 along with the IMF to aid in rebuilding the world economy. It was owned by the governments of 151 countries and its capital is subscribed by those governments; it provides funds to borrowers by borrowing funds in the world capital markets, from the proceeds of loan repayments as well as retained earnings. At its funding, the bank's major objective was to serve as an international financing facility to function in reconstruction and development. With Marshall Plan providing the impetus for European reconstruction, the Bank was able to turn its efforts towards the developing countries.

Generally, the IBRD lends money to a government for the purpose of developing that country's economic infrastructure such as roads and power generating facilities. Funds are directed towards developing countries at more advanced stages of economic and social growth. Also, funds are lent only to members of the IMF, usually when private capital is unavailable at reasonable terms. Loans generally have a grace period of five years and are repayable over a period of fifteen or fewer years. The projects receiving IBRD assistance usually require importing heavy industrial equipment and this provides an export market ror many US goods. Generally bank loans are made to cover only import needs in foreign convertible currencies and must be repaid in those currencies at long-term rates.

The government assisted in formulating and implementing an effective and comprehensive strategy for the development of new industrial free zones and the expansion of existing ones; reducing unemployment, increasing foreign-exchange earnings and strengthening backward linkages with the domestic economy; alleviating scarcity in term financing; and improving the capacity of institutions involved in financing, regulating and promoting free zones.

The World Bank lays special operational emphasis on environmental and women's issues. Given that the Bank's primary mission is to support the quality of life of people in developing member countries, it is easy to see why environmental and women's issues are receiving increasing attention. On the environmental side, it is the Bank's concern that its development funds are used by the recipient countries in an environmentally responsible way. Internal concerns, as well as pressure by external groups, are responsible for significant research and projects relating to the environment.

The women's issues category, specifically known as Women In Development (WID) is part of a larger emphasis on human resources. The importance of improving human capital and improving the welfare of families is perceived as a key aspect of development. The WID initiative was established in 1988 and it is oriented to increasing women's productivity and income. Bank lending for women's issues is most pronounced in education, population, health and nutrition and agriculture.

3.5.1 PURPOSE OF WORLD BANK

The World Bank group is a multinational financial institution established at the end of World War II (1944) to help provide long-term capital for the reconstruction and development of member countries. The group is important to multinational corporations because it provides much of the planning and financing for economic development projects involving billions of dollars for which private businesses can act as contractors and suppliers of goods and engineering related services.

The purpose for the setting up of the Bank are

a. To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and encouragement of the development or productive facilities and resources in less developed countries.

b. To promote private foreign investment by means of guarantees or participation in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.

c. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and condition of labour in their territories.

d. To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, can be dealt with first.

e. To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

The World Bank is the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). The IBRD has two affiliates, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The Bank, the IFC and the MIGA are sometimes referred to as the "World Bank Group".

3.5.2 FUNCTIONS OF THE WORLD BANK

The principal functions of the IBRD are set forth in Article I of the agreement as follows:

a. To assist in the reconstruction and development of the territories of its members by facilitating the investment of capital for productive purposes.

b. To promote private foreign investment by means of guarantee of participation in loans and other investments made by private investors and when private capital is not available on reasonable terms, to make loans for productive purposes out of its own resources or from funds borrowed by it.

c. To promote the long-term balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members.

d. To arrange loans made or guaranteed by it in relation to international loans through other channels so that more useful and urgent projects, large and small alike, will be dealt with first. It appears that the World Bank was created to promote and not to replace private foreign investment. The Bank considers its role to be a marginal one, to supplement and assist foreign investment in the member countries.

e. A little consideration will show that the objectives of the IMF and IBRD are complementary. Both aim at increasing the level of national income and standard of living of the member nations. Both serve as lending institutions, the IMF for short-term and the IBRD for long-term capital. Both aim at promoting the balanced growth of international trade.

3.5.3 ROLE OF THE WORLD BANK

The World Bank is internationally recognised and supported that provides technical & financial assistance to many developing countries in the world. It also aids their advancement, in an economy with a primary goal of reducing poverty. World Bank has the largest knowledge of developing countries. Also, they are the largest source of funding. The role of world bank is

a) To help the war-devasted countries by granting them loan for reconstruction.

b) To provide extensive experience & the financial resources of the bank to help the poor countries increase their economic growth, reducing poverty & a better standard of living.

c) To grant development loan to the under-developed countries

d) To provide loans to various governments for irrigation, agriculture, water supply, heath, educations etc.

e) To promote foreign investments to other organisations by guaranteeing the loans.

f)` To provide economic, monetary & technical advice to the member countries for any of their projects.

g) To encourage the development of industries in under-developed countries by introducing the various economic reforms.

3.5.4 FUNCTIONING OF THE WORLD BANK

The World Bank is the world's largest source of development assistance, providing nearly $30 billion in loans, annually, to its client countries. The Bank uses its financial resources, its highly trained staff and its extensive knowledge base to individually help each developing country onto a path of stable, sustainable and equitable growth. The main focus is on helping the poorest people and the poorest countries hut for all its clients, the Bank emphasises the need for: investing in people, particularly through basic health and education; protecting the environment; supporting and encouraging private business development; strengthening the ability of the governments to deliver quality services efficiently and transparently; promoting reforms to create a stable macroeconomic environment conducive to investment and long-term planning; focusing on social development, inclusion, governance and institution building as key elements of poverty reduction. The Bank is also helping countries to strengthen and sustain the fundamental conditions that help to attract and retain private investment. With Bank support- both lending and advice- governments are reforming their overall economies and strengthening banking systems. They are investing in human resources, infrastructure and environmental protection which enhance the attractiveness and productivity of private investment. Through World Bank guarantees, MICA's political risk insurance and in partnership with IFC's equity investments, investors are minimising their risks and finding the comfort to invest in developing countries and countries undergoing transition to market-based economies.

How World bank raises money?

The World Bank raises money for its development programmes by tapping the world's capital markets and in the case of the IDA, through contributions from wealthier member governments. IBRD, which accounts for about three-fourths of the Bank's annual lending, raises almost all its money in financial markets. One of the world's most prudent and conservatively managed financial institutions, the IBRD sells AAA-rated bonds and other debt securities to pension funds, insurance companies, corporations, other banks and individuals around the globe. IBRD charges interest from its borrowers at rates, which reflect its cost of borrowing. Loans must be repaid in 15 to 20 years; there is a three to five year grace period before repayment of principal begins. IDA helps to promote growth and reduce poverty in the same ways as does the IBRD but using interest free loans (which are known as IDA "credits"), technical assistance and policy advice. IDA credits account for about one-fourth of all Bank lendings. Borrowers pay a fee of less than 1 per cent of the loan to cover administrative costs. Repayment is required in 35 to 40 years with a 10 years grace period. Nearly 40 countries contribute to IDA's funding, which is replenished every three years. IDA's funding is managed in the same prudent, conservative and cautious way as is the IBRD's. Like the IBRD, there has never been default on an IDA credit.

Who runs the World Bank?

Like the Fund, the Bank's structure is organised on a three-tier basis; a Board of Governors, Executive Directors and a President. The Board of Governors is the supreme governing authority. It consists of one governor (usually the Finance Minister) and one alternate governor (usually the governor of a central bank), appointed for five years by each member.

The Board is required to meet once every year. It reserves to itself the power to decide important matters such as new admissions, changes in the bank's stock of capital, ways and means of distributing the net income, its ultimate liquidation, etc. For all technical purposes, however, the Board delegates its powers to the Executive Directors in the day-to-day administration.

At present, the Executive Directors are 19 in number, of which five are nominated by the five largest shareholders — the USA, the UK, Germany, France and India. The rest are elected by the other members.

The Executive Directors elect the President who becomes their Ex-officio Chairman holding office during their presence. He is the chief of the operating staff of the Bank and is subject to the direction of the Executive Directors on questions of policy and is responsible for the conduct of the ordinary business of the Bank and its organisation.

Lending Operations

Loans are granted to member countries only after the Bank is fully satisfied about the economic position of the borrowing country as well as the soundness of the specified projects for which assistance is sought. In granting loans, the Bank is prepared to take reasonable risks but insists that funds obtained from it should be used for purposes which are constructive and practical.

The Bank has powers of supervision and control to ensure that funds are used for the purposes for which the loan is granted. Normally, the Bank makes medium or long-term loans, the term being related to the estimated useful life of the equipment or plant being financed.