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Empirical Study on Bretton Woods Twins – World Bank and IMF

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Abstract – In 1944, the Bretton Woods Agreement established a new international monetary system. The creation of the International Monetary Fund (IMF) and the World Bank were two of its most enduring legacies. The World Bank and the IMF, often called the Bretton Woods Institutions, are twin intergovernmental pillars supporting the structure of the world's economic and financial order. Both have taken on expanding roles, and there have been renewed calls for additional expansion of their responsibilities, particularly in the continuing absence of a single global monetary agreement. The two institutions may seem to have confusing or overlapping functions. However, while some similarities exist (see the following figure), they are two distinct organizations with different roles. While both the World Bank and International Monetary Fund, are two separate entities, often not clear the role of each of them is therefore that this paper seeks to consolidate diverse information reviewed from both entities with the purpose of being able to understand the functioning and scope of each of these important institutions that have had successes and setbacks and ultimately have an active role in global finance and economy, despite the many detractors who are at levels world. There is an anecdote, which is worth mentioning. "John Maynard Keynes, recognized at the inaugural meeting of the International Monetary Fund was confused by the names he thought the Fund should be called a bank, and the World Bank should be called a bottom. Confusion has reigned ever since. The Bank and the IMF are two intergovernmental pillars supporting the structure of economic and financial world". The fundamental difference between the two is understood as the Bank institution primarily for the development, while the IMF is a cooperative institution that seeks to maintain an orderly system of payments and receipts between nations. The manner followed to choose the head of each organization has a different procedure, but the important thing is that in the next few years, several countries such as Brazil, India have more participation that is active.

Keywords: Bretton Woods Twins, World Bank, IMF.

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SIZE AND STRUCTURE

The IMF is small (about 2,300 staff members) and, unlike the World Bank, has no affiliates or subsidiaries. Most of its staff members work at headquarters in Washington, D.C., although three small offices are maintained in Paris, Geneva, and at the United Nations in New York. Its professional staff members are for the most part economists and financial experts. The structure of the Bank is somewhat more complex. The World Bank itself comprises two major organizations: the International Bank for Reconstruction, Development, and the International Development Association (IDA). Moreover, associated with, but legally and financially separate from the World Bank are the International Finance Corporation, which mobilizes funding for private enterprises in developing countries, the International Centre for Settlement of Investment Disputes, and the Multilateral Guarantee Agency. With over 7,000 staff members, the World Bank Group is about three times as large as the IMF, and maintains about 40 offices throughout the world, although 95 percent of their staff works at its Washington, D.C., headquarters. The Bank employs a staff with an astonishing range of expertise: economists, engineers, urban planners, agronomists, statisticians, lawyers, portfolio managers, loan officers, project appraisers, as well as experts in telecommunications, water supply and sewerage, transportation, education, energy, rural development, population and health care, and other disciplines.

SOURCE OF FUNDING

The World Bank is an investment bank, intermediating between investors and recipients, borrowing from the one and lending to the other. Its owners are the governments of its 180 member nations with equity shares in the Bank, which were valued at about $176 billion in June 1995. The IBRD obtains most of the funds it lends to finance development by market borrowing through the issue of bonds (which carry an AAA rating because repayment is guaranteed by member governments) to individuals and private institutions in more than 100 countries. Its concessional loan associate, IDA, is largely financed by grants from donor nations. The Bank is a major borrower in the world's capital markets and the largest non-resident borrower in virtually all countries where its issues are sold. It also borrows money by selling bonds and notes directly to governments, their agencies, and central banks. The proceeds of these bond sales are lent in turn to developing countries at affordable rates of interest to help finance projects and policy reform programs that give promise of success. Despite Lord Keynes's profession of confusion, the IMF is not a bank and does not intermediate between investors and recipients. Nevertheless, it has at its disposal significant resources, presently valued at over $215 billion. These resources come from quota subscriptions, or membership fees, paid in by the IMF's 182 member countries. Each member contributes to this pool of resources a certain amount of money proportionate to its economic size and strength (richer countries pay more, poorer less). While the Bank borrows and lends, the IMF is more like a credit union whose members have access to a common pool of resources (the sum total of their individual contributions) to assist them in times of need. Although under special and highly restrictive circumstances the IMF borrows from official entities (but not from private markets), it relies principally on its quota subscriptions to finance its operations. The adequacy of these resources is reviewed every five years.

RECIPIENT OF FUNDING

Neither wealthy countries nor private individuals borrow from the World Bank, which lends only to creditworthy governments of developing nations. The poorer the country, the more favourable the conditions under which it can borrow from the Bank. Developing countries whose per capita gross national product (GNP) exceeds $1,305 may borrow from the IBRD. (Per capita GNP, a less formidable term than it sounds, is a measure of wealth, obtained by dividing the value of goods and services produced in a country during one year by the number of people in that country.) These loans carry an interest rate slightly above the market rate at which the Bank itself borrows and must generally be repaid within 12-15 years. The IDA, on the other hand, lends only to governments of very poor developing nations whose per capita GNP is below $1,305, and in practice IDA loans go to countries with annual per capita incomes below $865. IDA loans are interest free and have a maturity of 35 or 40 years. In contrast, all member nations, both wealthy and poor, have the right to financial assistance from the IMF. Maintaining an orderly and stable international monetary system requires all participants in that system to fulfil their financial obligations to other participants. Membership in the IMF gives to each country that experiences a shortage of foreign exchange--preventing it from fulfilling these obligations--temporary access to the IMF's pool of currencies to resolve this difficulty, usually referred to as a balance of payments problem. These problems are no respecter of economic size or level of per capita GNP, with the result that over the years almost all members of the IMF, from the smallest developing country to the largest industrial country, have at one time or other had recourse to the IMF and received from it financial assistance to tide them over difficult periods. Money received from the IMF must normally be repaid within three to five years and in no case later than ten years. Interest rates are slightly below market rates, but are not so concessional as those assigned to the World Bank's IDA loans. With IMF resources, countries have been able to buy time to rectify economic policies and to restore growth without having to resort to actions damaging to other members' economies.

WORLD BANK OPERATIONS

The IBRD is the largest public development institution in the world, lending around US$ 25 billion a year to developing countries. The main purposes of the Bank, as outlined in Article One of its Articles of Agreement, are: “to assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes” and “to promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment thereby assisting in raising the productivity, the standard of living and conditions of labour in their territories”.

The Bank aims to achieve these goals through the provision of long-term loans to governments for the financing of development projects and economic reform. Voting power on the Bank’s board is based on the members’ capital subscriptions, which means the members with the greatest financial contributions have the greatest say in the Bank’s decision-making process. The US government holds 20 per cent of the vote and is represented by a single Executive Director. The 47 sub-Saharan African countries, in contrast, have two Executive Directors and hold only seven per cent of votes between them.

Each member of the Bank contributes two per cent of its subscription in gold or US dollars and 18 per cent in its national currency. Members pay in 20 per cent of the capital while the remaining 80 per cent is kept "callable" (to be paid in the event of a default). This guarantee allows the Bank to raise money for its lending purposes on international capital markets by the sale of its bonds.

Interest rates on World Bank loans are revised every six months and typically, the Bank charges borrowers a rate of interest 0.5 per cent above its own cost of borrowing on the international market, the proceeds going towards paying the Bank's operating costs and to add to reserves.

Loans were originally supposed to be given only to "specific projects"—usually infrastructural projects, such as the construction of highways, dams, and telecommunications facilities, and social welfare projects, such as those in the health and education sector.

In 1980, the Bank introduced adjustment lending under its structural adjustment programme (SAP) to provide financing to countries experiencing balance of payments problems while stabilisation measures took effect. These loans are provided to countries for social, structural and sectoral reforms, for example for the development of national financial and judicial institutions. The World Bank attaches conditions to its loans with the stated aims of ensuring the country's economy is structured towards loan repayment.

FUNCTIONS OF THE WORLD BANK

- It helps the war-devasted countries by granting those loans for reconstruction.
- Thus, they provide extensive experience and the financial resources of the bank help the poor countries increase their economic growth, reducing poverty and a better standard of living.
- In addition, it helps the underdeveloped countries by granting development loans.
- Therefore, it also provides loans to various governments for irrigation, agriculture, water supply, health, education, etc.
- It promotes foreign investments to other organizations by guaranteeing the loans.
- In addition, World Bank provides economic, monetary, and technical advice to the member countries for any of their projects.
- Thus, it encourages the development of of-industries in underdeveloped countries by introducing the various economic reforms.

IMF OPERATIONS

The IMF was conceived primarily as a supervisory institution to promote international monetary cooperation and facilitate the growth of international trade. This is to be achieved through maintaining monetary exchange stability and assisting member countries who are experiencing balance of payments problems.

Upon membership of the IMF, member countries deposit a sum of money known as a 'quota subscription'. This sum will determine how much money the country can draw from the Fund in times of crisis. Quotas also determine the voting rights of each member country, which means, like the World Bank, decision-making power in the IMF rests with the countries with the highest contribution.

The IMF lends money to member countries faced with balance of payments problems, ie when a country fails to earn sufficient foreign currency—through exports or provision of services—to pay for its imports. In return for financial assistance from the IMF, borrower countries must implement a set of economic reforms aimed at overcoming their balance of payments problems. Loans are disbursed in instalments and payment is tied to the countries' compliance with the structural adjustment policies._

IMF FUNCTIONS

- **Fixation of Par Value of Currencies in terms of Gold or Dollar:**

Every member country has to declare the par value of her currency in terms of US Dollars or in gold. The main objective of IMF is to maintain stability in exchange rates of the member countries.

- **Alternation of Limit within Par Value:**

There is over rigidity in the par values of the currencies of different countries. If Fund finds that there is fundamental disequilibrium in the balance of payments of a country, it can change the par values of its currency, A country is allowed to alter its basic par value within well defined limits i.e. up to 10 per cent after making her intention known to the Fund.

- **Loans of Foreign Currency:**

The Fund realises that a stable exchange is very essential for the proper growth and expansion of the free world trade. Therefore, it take-s steps to check the fluctuations in the par values by eliminating the disequilibrium in the balance of payment of the member countries.

- **Drawing Rights:**

A member country during hardships of the balance of payments can buy the required foreign currency from the Fund by offering more of its own currency over and above its original subscription. The Fund provides both maximum and normal limits of financial assistance for a short period. A member country can request for any currency under the credit line of 25 per cent of its quota in one year. This is known as gold tranche or reserve tranche drawing. However, the full amount drawn under these drawings should not exceed by 200 per cent of the Fund's holdings of a country's currency quota. The member countries do not borrow more than 150 per cent of quota, because any further borrowing in subject to increasing interference by the Fund.

- **Liquidity of Fund's Resources:**

If the borrowing countries are buying the currency of other countries, the Fund may accommodate such currencies as are not demanded. In fact, the Fund will not be able to act as a reserve Fund. Thus, it becomes necessary that the Fund should keep its resources in a liquid form so that the borrowing country may repurchase of domestic currency.

- **Position of Gold in Fund's Scheme:**

Under the Fund's scheme, status was given to gold, as every member country has to deposit in gold the Fund up to 25 percent of its quota or 10 per cent of its gold holdings. Under the agreement of the Fund, the par values of currencies of members are expressed in terms of gold, SDR and the US Dollars. In Fund's scheme, gold had been retained as a basis of determination of the par values of member's currencies.

- **Facilities during Emergency:**

Although IMF is opposed to, any rather controls on either foreign exchange or foreign trade. Still member-countries have been given the right to resort to these controls during emergency in the hope that they will lift it as early as the situation warranted.

CONCLUSION

We consider important to start the conclusions mentioned that there is ample evidence that G7 countries, and in particular the United States, make some kind of pressure on governments to vote in line with them in the General Assembly. As outlined above, G7 countries can to some extent control IMF and World Bank decisions, and can thereby use the international organizations to influence recipient countries' behaviour in ways compatible with their interests. The differences between them are clear in terms of definition but in the emerging economies sometimes, it is necessary to understand each function in order to maintain strong relationship with them. The World Bank provides loans to developing countries for capital programs. The World Bank's official goal is the reduction of poverty. The IMF works to improve the economies of its member countries The guidelines mentioned by the WB and IMF where taken by the Basel III, but it is necessary to clarify the real impact in emerging economies. How manage information and the quality of it is an aspect that in the future the academics and practitioners have to analyze and study in the relation with WB and IMF recommendations. The aspects related to Governance and how manage and identify stakeholders will become an important aspects that the IMF and WB have to study and evaluate not only in their members but also in the companies that have operations in their countries.

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