THE INTERNATIONAL ARCHITECTURE (INSTITUTIONS AND POLICY)

William Coleman
University of Tasmania, Hobart, Tasmania, Australia

Keywords: Balance of payments, bank solvency, capital markets, central bank, convertibility, corruption, currency peg, developing countries, economic crisis, environment, euro, European Central Bank, foreign currency, G8, international financial system, international institutions, International Monetary Fund, liberalization of capital, monetary unions, Paris Club, structural reforms, World Bank

Contents

1. Introduction
2. The Banks
2.1. The International Monetary Fund
2.1.1. The Fund 1946–1973
2.1.2. The Fund after 1973
2.1.3. Operations
2.1.4. Issues
2.2. The World Bank
2.2.1. Operations
2.2.2. Issues
2.3. The Bank for International Settlements
2.3.1. Operations
2.3.2. Issues
3. The Blocs
3.1. Euro/ECB: European Monetary Union
3.1.1. Operations
3.1.2. The Euro As a Rival for the U.S. Dollar
3.2. The Communauté Financière Africaine Area
4. The Clubs
4.1. The Paris Club
4.2. The Highly Indebted Poor Countries Debt Initiative
5. The Accords
5.1. The Group of Eight
5.1.1. Issues
Glossary
Bibliography
Biographical Sketch

UNESCO – EOLSS SAMPLE CHAPTERS

Summary

The twentieth century saw the birth of a number of important international institutions and procedures intended to improve the operation of international financial affairs: the International Monetary Fund, the World Bank, the Bank for International Settlements, the European Central Bank, the Paris Club, and the G8 Heads of Governments Summits.

Since the mid 1980s the usefulness of these institutions has become increasingly contentious. Interest has grown in redesigning the medley of institutions that make up the somewhat haphazard "architecture" of the world's financial system. This article examines the challenges faced by these institutions that underlie the current impetus for reform.

It is hard to imagine the international financial system without the International Monetary Fund. In the same vein, many poorer third-world countries would find it hard to imagine participation in the international financial system without a World Bank. Even the European Central Bank has rapidly become a massive fact of life. Yet, all of these institutions have recent, or extremely recent, origins. The IMF and the World Bank, in particular, were designed to cope with very different circumstances from today's. It remains to be seen whether the flexibility that these institutions have undeniably displayed can cope with the stresses of the changing economic landscape, or whether more fundamental change will be required.

1. Introduction

The array of international financial institutions set up in the twentieth century is heterogeneous in character. It includes organizations intended to alleviate balance of payments difficulties (the International Monetary Fund, or IMF); to facilitate the transfer of capital to the third world (the World Bank); to foster cooperation of central banks (the Bank for International Settlements, or BIS); to coordinate international policy making (the Group of Eight (G8) Heads of Government Summits); and to transfer monetary policy to supranational institutions (the European Central Bank, or ECB). How useful these institutions are is contentious and since the mid 1990s interest has grown in redesigning the medley of institutions that make up the world's somewhat haphazard financial "architecture". This article provides an overview of the origins, structure, and functions of the principal organizations and then discusses the challenges they face, which underlie the current impetus for reform.

2. The Banks

2.1. The International Monetary Fund

The IMF was established in 1946 (although it was proposed in 1944) with the purpose of securing the stability of the exchange rates of industrialized countries. By the beginning of the twenty-first century, the fund's activities had broadened markedly to include:

- supporting the structural reform of developing economies,
- helping "transition economies" transform themselves into market economies,
- advising on the establishment and reform of taxation systems,
- facilitating the service of commercial debt of the governments of developing countries, and
- granting debt relief to certain highly indebted poor countries.

UNESCO – EOLSS SAMPLE CHAPTERS

Behind all these activities lies a fundamental purpose: the resolution of balance of payments difficulties. The principal tool for achieving this is organizing lending from sovereign states without balance of payments difficulties to sovereign states with balance of payments difficulties. The IMF, therefore, is a “financial intermediary” between sovereign states. The IMF resists being designated as “first and foremost a lending institution.” It is true that the IMF is not divided between owners, borrowers, and lenders as familiar lending institutions are: the owners of the IMF (“members”) are those who borrow and lend to it. Further, the fund’s emphasis on providing advice to members, and securing information sharing amongst its members, plainly distinguishes it from ordinary lending institutions. Nevertheless, it is “in some ways like a credit union.”

The IMF is not an aid agency. It does not, in general, provide grants. It does not lend for long periods; seven years is the maximum loan period. It does not provide loans for specific projects, nor does it provide loans for developing countries without balance of payment difficulties. The touchstone of its lending is always assistance with the balance of payments.

The fund’s rules are in the Articles of Agreement signed by all fund members that invest ultimate authority in the Board of Governors, composed of the finance ministers of its 182 member states. Being so large, the board meets only once a year, and overall IMF policies are set by a 24-member Interim Committee (established in 1974), made up of finance ministers and central bank governors, that meets twice a year. The Board of Governors otherwise delegates its authority to a Board of Executive Directors. No loan or eventful decision is taken without the Board of Executive Directors’ approval. This board has 24 members. The United States, Japan, Germany, France, the United Kingdom, Russia, China, and Saudi Arabia each provide a director. The remaining 16 directors represent groupings of countries formed on a broadly geographic basis. The Baltic and Scandinavian states, for example, constitute a grouping with one director.

The decisions of the Board of Executive Directors are reached through an informal process of consensus that is assisted by a provision for voting in the absence of consensus. Directors are vested with a number of votes according to the size of the financial contribution that the country (or group of countries) each represents makes to the fund. The United States has 17.5% of the total votes. This weighting has been reduced over the years; in 1946 the U.S. had 30% of the votes. Nevertheless, since some critical decisions (such as the size of members’ financial contributions, and the sale of fund gold) require an 85% majority, the U.S. effectively retains a veto on those decisions. It is also worth noting that the combined votes of the U.S., Japan, Germany, France, and the U.K. amount to 40% of total votes.

The Board of Executive Directors appoints a managing director, who also acts as the chairman of the Board and by convention is not a United States citizen.

The IMF was born of planning for post-war reconstruction. It was born of a wish to avoid a recurrence of the financial breakdown of the 1930s thought to have contributed

UNESCO – EOLSS SAMPLE CHAPTERS

to the political catastrophe that engulfed the world at the close of that decade. More specifically, it was born of a concern to create an international financial system that:

- allowed the free use of foreign exchange (F.X.) for current transaction purposes, and
- provided stable exchange rates.

To achieve the second goal, two plans were brought to negotiations at Hotel Bretton Woods in New Hampshire in 1944: the Keynes Plan and the White Plan.

The Keynes Plan may be interpreted as an attempt to reestablish the pre-1914 gold standard in a renovated and rationalized form. The gold standard was the system whereby each central bank had declared itself willing to buy and sell its currency at a certain rate for gold. These currency/gold parities implicitly set bilateral rates for any given two currencies. Keynes essentially wanted to resurrect the gold standard but have an artificial gold replace real gold. Unlike real gold, this artificial gold would not be subject to the vagaries of geological knowledge or the irrational passions of speculators, and would be completely elastic to the wishes of government. It would therefore contribute to the government control of the economic environment that Keynesian economics sought.

In the Keynes Plan, each central bank would prescribe a value of its currency in terms of "bancor," which may be thought of as an artificial gold without tangible existence. Bancor would be held only by central banks. The plan would be implemented with the allocation to each central bank of a quantity of bancor equal to the average of its annual imports. This endowment bancor would settle trade accounts. So a Briton wishing to import from France would present sterling to the Bank of England, which would then use its bancor to buy francs from the Bank of France at the prescribed rate, and would then sell the purchased francs to the British importer. A further right to bancor (equal to annual imports) would be automatically available at a fixed interest if that country agreed to depreciate its currency. It was hoped that this replenishment in bancor would moderate the size of the necessary depreciation.

In the Keynes Plan there was no collective decision making body, since there were no decisions of any import to make. The scheme would run itself. The plan's secretariat would not retain full-time managers, and the secretariat would not be located in the United States. The Keynes Plan is best understood in light of the Keynesian concern to avoid sacrificing full employment for the sake of maintaining fixed exchange rates. It was an attempt to contrive a system of fixed rates that did away with the deflationary policies formerly entailed in a commitment to stable exchange rates. It essentially amounted to granting a large pool of credit to deficit countries that would give them room to pursue full employment policies and simultaneously maintain stable exchange rates.

Harry Dexter White, U.S. Secretary of Treasury, provided a scheme that in policy terms was both more conservative and more radical. It was more conservative in emphasizing exchange rate stability, rather than maintaining full employment. It was more radical in envisaging the creation of a significant decision making multilateral institution. White's plan was directly inspired by the experience of the 1930s. In the wake of the instability of the United States in the early 1930s, the U.K. and France had in the late 1930s agreed

UNESCO – EOLSS SAMPLE CHAPTERS

to joint action to keep exchange rates stable. White essentially envisaged an expansion of this scheme to cover every country. It would be called the Stabilization Fund.

The Stabilization Fund would consist of stock of a number of currencies and gold, each of which would have been contributed by member nations. The Stabilization Fund would operate like a commodity price stabilization scheme. Each currency would be given a target value. When a currency was above its target value, it would be sold. When a given currency was below its target value, it would be bought and accumulated. In theoretical terms, the Stabilization Fund could be compared to a revived gold standard, except that each member country had agreed beforehand to make available part of its gold and currency to any country having difficulty in maintaining its exchange rates. The Stabilization Fund of the White Plan would not operate automatically. There would be a full-time central decision making body, located in Washington.

2.1.1. The Fund 1946–1973

The outcome of the Bretton Woods negotiations was an international treaty to create the IMF. This organization was more Stabilization Fund than Keynes Plan. The IMF may be compared to a club. To be a member each country is required to pay a joining subscription, known as a "quota." As envisaged in 1946, the quota was to be composed of two elements:

- gold; and
- the country's own currency.

Gold was to be 25% of the total quota. On commencing operations in 1946, the fund therefore had a pool of national currencies amounting to US$8.8 billion. This was considerably smaller than the US$30 billion bancor that Keynes envisaged in his scheme. Members were to have duties and privileges. All countries (except the U.S.) were required to declare a "par value" for their currency in terms of U.S. dollars. Each country's central bank was required to buy domestic currency for U.S. dollars at the par rate. There were two qualifications to this commitment to a pegged rate. First, the required "convertibility" of domestic currency into dollars at a par rate applied only to current transactions: the central bank was not required to supply U.S. dollars for domestic currency if U.S. dollars were wanted for a capital account transaction. The notion of free capital movements was never part of the original IMF. The second qualification was that each central bank was allowed to change its par if it found itself in "fundamental disequilibrium."

The U.S. was required to declare a value of the U.S. dollar in terms of gold; this was US$35 per ounce. The Federal Reserve was obliged to buy the U.S. dollars of other central banks with gold at a rate of US$35 per ounce. Since the U.S. dollar was pegged to gold, and since all other currencies were pegged to the U.S. dollar, all currencies were directly or indirectly pegged to gold. Thus the Bretton Woods system was something like a gold standard. At the time, one of the IMF's designers said: "We decided to use gold but call it dollars." The scheme differed from the gold standard in one critical respect, however: private individuals were not permitted to hold gold as a financial asset. This had been made illegal by the United States in the 1930s, and other

UNESCO – EOLSS SAMPLE CHAPTERS

countries followed suit. As a quid pro quo for declaring a par value, each member was permitted to borrow (or "purchase") from the pool any currency. Thus if the pound was facing downward pressure the Bank of England might borrow U.S. dollars (or yen), and use that to buy pounds. In summary, in 1946 the designers of the IMF sought to have the financial resources of the world at the world's disposal to keep rates fixed.

This program of stability succeeded admirably for 25 years but the fault line was the special position of the United States. Aspects of that special position were enviable. Every member central bank was committed to buy U.S. dollars with its own currency upon presentation of U.S. dollars. This meant that the U.S. could effectively acquire francs (or sterling) by printing U.S. dollars and having its citizens present U.S. dollars to the Banque de France (Bank of England) for francs (sterling). By contrast, no country could reverse maneuver with the U.S. If Britain printed pounds, U.K. citizens could not turn them into U.S. dollars by presenting them at the Federal Reserve Bank. Little surprise, then, that European central banks in the 1960s began to accumulate U.S. dollars. The only limit on this process was the other aspect of the special position of the United States: the U.S. was required to buy U.S. dollars with gold. Europeans central banks could turn their dollars into gold and they did so. Following a sharp decline in U.S. gold reserves in the late 1960s, convertibility of U.S. dollars into gold was suspended in August 1971. An attempt to resuscitate the system in December 1971 (the Smithsonian Agreement) by instituting a new set of parities succeeded for less than two years. In March 1973 European currencies began to float against the U.S. dollar.

2.1.2. The Fund after 1973

The abandonment by the major developed economies of parities with the U.S. dollar in 1973 was formalized in January 1976 by the Second Amendment of the fund's Articles of Agreement. The amended articles committed members only to maintaining "a stable system of international rates" (not a "system of stable international rates"). As of 1999, no industrialized country pegs its exchange rate. In 1999, of 148 countries with distinct legal tender in the IMF, only 47 maintained classical pegs; and only one European country (Macedonia) did so. (A total of 73 were either floating or managing a float without a pre-announced path for the exchange rate; the remainder pegged horizontal bands, or had crawling pegs, or crawling bands. Crawling bands are where the upper and lower permitted values of the currency are revised gradually, while a crawling peg is where the permitted value of the currency is revised gradually.) It is likely that the crises of the late 1990s in East Asia, Russia, and Brazil will bring the policy of pegged exchange rate into further dispute. In addition, the significance of exchange rate pegs will diminish with the current trend to reduce the number of currencies: in 1999, 11 distinct currencies turned into one euro, and the possibility of dollarization beckons.

Loans to developing countries: From the late 1970s the focus of the fund switched sharply from the industrialized countries to developing countries. In 1977 loans to industrialized countries totaled US$6.9 billion and loans to developing countries US$6.4 billion. By 1997 loans to industrialized countries stood at zero, while loans to developing countries stood at US$52.6 billion. Although the IMF is not a development agency, the economic problems of developing countries loomed in the fund's consciousness. In keeping with this new consciousness, in 1982 the IMF began a new

UNESCO – EOLSS SAMPLE CHAPTERS

activity when the Mexican government began experiencing difficulty servicing its debts to first-world banks. This type of problem had never been within the remit of the fund, yet it appeared to have obvious implications for the integrity for the international financial system. The IMF offered traditional remedies for this new difficulty. It provided moderate amounts of loans to the governments in question. This was effective since the debt crisis turned out to be more of a liquidity crisis than a genuine insolvency crisis. As a quid pro quo, the IMF required from Mexico and other Latin American countries higher taxes and less government spending.

With the fall of the Berlin Wall in 1989, the IMF faced an array of new economic problems in Eastern European economies seeking a "transition" to a market economy. The IMF advised on modernization of taxation and financial systems. In the judgment of some observers, this experience clarified the IMF's new identity: it was now a device for structural reform in countries outside the rich, developed world. The IMF also pursued its traditional function of mediation. In 1993 a new "systematic transformation facility" was introduced to provide credit for these economies. The involvement of the IMF with Eastern Europe (as distinct from the former Soviet Union) was brief. By 1999 only Croatia and Bulgaria had outstanding obligations to the IMF. The IMF's engagement in the former Soviet Union was larger and lengthier. By the close of the 1990s Russia had been extended up to US$13 billion of extended adjustment facility (this was more than half of the IMF's total of US$24 billion in the extended arrangements).

Capital account crises of the 1990s: From the mid 1990s a series of sudden exchange rates crises dominated by loss of confidence led the IMF to make and arrange loans dwarfing its previous experience. The "packages" the IMF arranged in this period include US$18 billion to Mexico in 1995; US$35 billion to Indonesia, Korea, and Thailand in 1997; US$20 billion to Russia and US$41 billion for Brazil in 1998.

2.1.3. Operations

The operations of the IMF turn on the management of its assets and liabilities. Gold was the traditional focus of central banking, and the key to the IMF system as it was envisaged in 1946. But by the early 1970s the IMF objective of maintaining the world on a gold exchange standard disappeared and gold was removed from the IMF system and abandoned as the fund's unit of account. It was decided that 25% of each member country's quota need no longer be in gold; it could instead be in currencies "acceptable" to the fund. Gold is now an "inert" asset of the fund: it is not used in any IMF operations. Between 1976 and 1980, the IMF sold 1500 tonnes of gold, leaving it with 3000 tonnes. In the late 1990s de-emphasis of gold received renewed impetus. The IMF was given approval for the sale of several hundred of its remaining 3000 tonnes of gold.

Quotas: The original source of the fund's credit was the quotas of currency supplied by member states on joining the IMF. These quotas have been increased by a factor of 184 since the fund originally began, yet the IMF considered the increase of 45% in January 1999 "urgent." This is partly because of the huge expansion of trade and capital flows since the IMF began: whereas world exports amounted to US$53 billion in 1948, they totaled US$5546 billion in 1997. The "urgency" of quota increases is also partly because the quotas of only 30 of the 182 member countries "count," since only they supply convertible currencies with developed markets.

UNESCO – EOLSS SAMPLE CHAPTERS

The special drawing right: The First Amendment to the articles of the fund in 1970 had introduced the "special drawing right" (SDR) in order to expand the reserves of the system. Recall that each country's right to borrow is limited to a multiple of their quota (that is, their contribution in currency to the fund). In 1970 each country was given the right to borrow a certain extra amount; it could borrow a prescribed multiple quota *plus* its holdings of SDR. The SDR was a right to borrow foreign currency that did not require backing in terms of borrower's currency. Since the SDR was a right to borrow foreign currency it could be treated as a reserve asset. Unlike gold or the U.S. dollar, this asset was controllable by international agreement. It was hoped that it would be expanded to meet the needs of the growing world economy. There was the hope that SDR may become the principal reserve asset of the international financial system. This hope of creating an artificial reserve asset is reminiscent of Keynes' bancor.

The agreements to borrow: An additional source of finance for fund credit is provided by industrialized countries. This began with the general agreement to borrow (GAB) in 1962, when 11 countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the U.K., and the U.S.) agreed to lend up to a certain pre-specified limit to the IMF. Until 1983 the use of GAB funds was restricted to Group of Ten (G10) members **(see *Section 2.3. The Bank for International Settlements*)**. However, it was not until 1998 that GAB funds were first used for a non-member country (Russia). In 1998, the new agreement to borrow was launched, drawing additional funds from 13 more countries, including Saudi Arabia. These two coexisting agreements mean that an amount up to a credit line of 34 billion SDR is available to the fund.

Borrowing facilities: The maximum amount of borrowing from the fund ("purchases" in IMF terminology) permitted to each country depends on (i) the size of each country's quota, and (ii) each country's eligibility for certain "facilities." The basic facility is the "credit tranche." (The stand-by facility is an assurance that a country with such a facility will be allowed to use its credit tranche.) From 1974 the extended fund facility (EFF) allowed purchases of amounts up to 300% of quota in total (or 100% in a given year). The compensatory and contingency financing facility (CCFF) introduced in 1988 and the supplemental reserve facility (SRF) introduced in 1997 permitted further purchases. The enhanced structural adjustment facility (ESAF) is a concessional IMF facility intended for poorer developing country members undertaking economic reform programs. ESAF loans carry an interest rate of 0.5% a year and are payable over 10 years with a five-year grace period. The maximum access is 250% of quota, and may be higher in exceptional circumstances. The utilization of 250% does not prejudice the entitlement to draw up to 300% by the EFF. This total amount of credit granted by the IMF is not large in relative terms; it is about US$90 billion; or about US$22.5 per person outside the industrial group of countries (see Table 1). Compare this to the more than US$1000 billion in external bank credit alone given to countries outside the industrialized group.

	Total	**Stand-by and EFF and CCFF**	**ESAF**
Industrial countries	0	0	0

Africa	6.7	2.2	3.9
Asia	23.0	21.6	1.4
Europe	19.2	17.9	0.5
Middle East	0.6	0.5	0.1
Western Hemisphere	15.0	11.9	0.4
World	64.8	58.5	6.3

Source: IMF, *International Financial Statistics* (Washington, D.C.: Produced by Joint IMF World Bank CD-ROM Project, 1999).

Table 1. Outstanding obligations to the IMF, February 28, 1999, SDR (billions)

Conditionality: The right to borrow is conditional on the country undertaking policy measures recommended by the IMF. In the early years of the fund, Britain (a debtor country) wanted borrowing to be more of a right than a privilege. The U.S. preferred borrowing to occur only under certain conditions. A solution was to make borrowing up to 25% of quota "unconditional," the remainder being conditional on the country undertaking certain policy adjustments. These conditions are outlined in Letters of Intent that borrowing countries sign. These Letters of Intent were confidential until the East Asian financial crisis of 1997/98. The effectiveness of conditionality was increased somewhat with the Third Amendment to the articles in 1990, which allowed the fund to suspend the voting rights and other privileges of countries that do not keep their undertakings.

Surveillance and consultations: Article 4 of the fund's Articles of Agreement deems that "the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies." One tool of surveillance is known as "Article IV consultations." From 1978 the IMF has undertaken "consultations" with all member countries. Typically occurring annually, they consist of a two-week mission of several IMF members to the country in question to discuss economic policy with senior officials.

UNESCO – EOLSS SAMPLE CHAPTERS

2.1.4. Issues

The fund's role in structural reform and market liberalization: The IMF has long required borrowing countries to implement an adjustment package. But in the East Asian crisis of 1997/98 the IMF insisted on an unprecedented depth of structural reform from borrowing members; the establishment of independent central banks; the admission of foreign banks; privatizations; bank closures; de-monopolization; tariff cuts and the abolition of subsidies.

Criticism of inappropriate stress on structural reforms: Critics have argued that the stress on structural reforms (i.e. market liberalization) is inappropriate. In their minds:

- the goal of the IMF is to relieve balance of payments difficulties, not to bring the blessings of the free market to the world. Critics would see Michel Camdessus'

statement in November 1997 that the East Asian exchange rate crisis was a "blessing in disguise" as evidence of distortion in the fund's priorities. Instead of structural reform being welcomed as a means to secure exchange rate stability, an exchange rate crisis was being welcomed as a means of securing structural reform.

- structural reform will not help achieve the goal of exchange rate stability. The origin of the crisis in Thailand, these critics contend, was an overheating economy, not market distortions. The crisis in Korea, they contend, was more a matter of a self-justifying panic than bad fundamentals. These critics, in other words, simply deny the IMF's contention that structural problems were at the heart of the East Asian crisis of 1997/98.
- structural reform actually hinders exchange rate stability. This is because the requirement of structural reform provides the wrong tests for foreign investors to judge the borrowing country's financial policy. Whether cloves are sold in a free market or a monopoly is irrelevant to achieving exchange stability in Indonesia. However, if the IMF requires the de-monopolization of this industry, and Indonesia fails to comply, Indonesia is seen by foreign investors as having failed to meet the IMF program. Since the IMF is the guardian of financial integrity, the country is seen to be lacking it and an exchange rate crisis may result.

An important battle in this controversy over liberalization is the liberalization of capital movements. The IMF at its foundation had no interest in liberalizing capital movements. However, during the 1990s the fund favored eliminating controls on capital movements. In September 1997 the Interim Committee announced that it favored an amendment in the articles of the fund to promote the "orderly liberalization of capital movements." The Interim Committee charged the Board of Executive Directors to accord a "high priority" to preparing a draft of such an amendment. This is remarkable proof of the fund's commitment to free capital flows, since many observers were blaming the East Asian crisis, in full swing in late 1997, on overly free capital movements.

The fund and the moral hazard problem: The IMF has been criticized for fostering "moral hazard." Moral hazard refers to the possibility that the knowledge that assistance will be provided in the case of misfortune may change actions so that the misfortune is more likely to happen. (In respect to fire insurance, for example, the householder may act less cautiously, and so make a fire more probable.) The knowledge that the IMF will assist in the case of balance of payments difficulties may induce member countries to so act that the probability of balance of payments difficulties is increased. As a case in point, these critics fault IMF assistance to Mexico that has encouraged more erratic conduct of Mexican monetary policy. In the same vein, such critics believe that, by nurturing moral hazard, the large bail-out of Mexico in 1995 created the Asia crisis: in the words of one such critic "the reason we have Asia is that we bailed out Mexico. We signaled to creditors around the world that you could lend to Asia and the IMF would bail you out if you got in trouble." It has been pointed out in reply that, generally, the optimal amount of moral hazard is not zero. Accompanying the optimal amount of insurance, for example, will be a certain amount of moral hazard. Thus the identification of an element of moral hazard in the programs of the IMF is not sufficient objection to the IMF's programs.

UNESCO – EOLSS SAMPLE CHAPTERS

The fund's sensitivity to social dimensions of economic crisis: The fund's frequent prescription to borrowing states to reduce public spending has led to its being criticized for ignoring humanitarian and social considerations. The fund was criticized, for example, for leaving Nicaragua bound by agreements to cut public spending in the wake of Hurricane Mitch in November 1998 (which left 10 000 dead and two million homeless in Nicaragua and Honduras). The IMF's response is that it encourages the reduction in public spending through reduced military spending, and has made certain social measures part of IMF-supported adjustment programs: poverty surveys; public housing; the establishment of minimum pensions; extension of coverage and duration of unemployment benefits; the reorientation of social expenditures towards the most vulnerable. Further, it reports that a fund study found that social spending of members borrowing from the fund grows 1.5 faster than that of non-borrowing members. Certainly, the IMF has sometimes followed imperatives other than economic ones: for example, following Pakistan's detonation of a nuclear device in May 1998, the IMF suspended loans to that country.

Regionalism versus multilateralism: Some critics contend that concerted action by neighboring states is more effective in stabilizing exchange rates than the multilateralism of the IMF. The use of regional bodies to complement multilateral bodies is familiar in the political sphere—the European Union (E.U.), the Association of South East Asian Nations (ASEAN), and the Organization of African Unity (OAU)—and has an analogy in the regional development banks sitting alongside the World Bank (e.g. the Asian Development Bank). In this vein, an Asian IMF has been proposed and other regional IMFs could be envisaged. Any such regional IMF, however, would obviously have to have the creditor countries to fund debtor countries.

As a subject of controversy, the IMF has elicited contradictory proposals, both to enlarge and to reduce its domain. The former U.S. Secretary of Treasury George Schultz and the eminent monetary historian Anna Schwartz have both proposed its abolition while at the other extreme George Soros has proposed that the IMF grow into an international central bank. The IMF Deputy Director Stanley Fischer has explored at length the possibility of creating an international lender of last resort (i.e. an international organization committed to provide, without restriction, credit at a penalty rate, to any loan based on good collateral).

The IMF began as a device to help fix F.X. rates; it has evolved into an agency to facilitate the international solution of international financial problems. Why does the IMF exist? Its warrant appears to lie in the assumption that economic disorder will lead to political disorder. This assumption is buttressed by the weaker presumption that, even if economic problems do not cause political troubles, remedying economic difficulties can help remedy political problems (the IMF's conduct in Russia exemplifies this assumption). These assumptions may often be true, but it is also possible that political disorders underlie economic disorders (and with monetary affairs this seems especially plausible). In this case, the attempt to cure economic problems with economic solutions will cure neither the economic problems nor the political ones.

UNESCO – EOLSS SAMPLE CHAPTERS

2.2. The World Bank

The World Bank's Articles of Agreement states that the bank's purpose is "the development of productive facilities and resources in less developed countries." The principal tools in this endeavor are (i) the organization of long-term lending from first-world lenders to state-owned and private enterprises in the third world, and (ii) the provision of expert advice by the World Bank to less developed countries.

The World Bank is composed of the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation (IFC). The IBRD is owned by its 180-plus member states. Each member has a holding of the bank's 1.452 million shares. The shareholdings of each member state are in accord with the size of the economy; 17% of shares are held by the United States, leaving it with power to veto any changes in the IBRD's capital base or articles of amendments (which require 85% majority); 47% of shares are controlled by the Group of Seven (G7).

The powers of the IBRD are invested in a Board of Governors, each member country appointing a governor. The board meets once per year and delegates the conduct of the general operations of the IBRD to a Board of Executive Directors. The USA, Japan, Germany, the U.K., France, Russia, China, and Saudi Arabia each appoint one director. The remainder are chosen by groups of countries. The board appoints a president who chairs the board and has a casting vote. The president is by convention an American citizen.

The IDA has its own Articles of Agreement but shares staff, headquarters, and president with the IBRD. The IFC is affiliated with the IBRD but describes itself as "legally and financially independent, with its own Articles of Agreement, shareholders, financial structure, management and staff."

The World Bank's origins lay in the devastation caused by World War II. (In Article 1, "war damage" is given far greater prominence than development.) This devastation was accompanied by the almost total cessation of international private capital movements. In the early post-war world almost every country, including significant (or formerly significant) international creditors such as Switzerland, the U.K., Belgium, France, and Scandinavia, had restrictions on private capital outflow. The movement of capital across borders appeared to require a multilateral government organization. The United States would inevitably be the dominating force (in the early years of the bank the United Stares was the only source of useable capital: 90% of the paid up capital of the bank was in national currencies that were unconvertible). This organization would therefore be located in the United States, in Washington, in keeping with enduring hostility to Wall Street in the wake of the 1930s.

The IBRD began operations in June 1946. In its early years the bank's loans were restricted to first-world countries: the largest loan (in real terms) the bank has ever made was a loan to France in 1947. It made its first third-world loan in 1948. Throughout the first decades, the bank's lending emphasis was on "growth": electrification, dams, power stations, bridges, and highways. Since the IBRD lent only to state-owned

UNESCO – EOLSS SAMPLE CHAPTERS

institutions, the IFC was founded in 1956 to arrange finance for private entities charging market rates. Its investments were often in power, water, and telecommunications. The IFC invests only when an investment makes “a special contribution that complements the role of market operators.” With the political emergence of the third world in the 1950s came an imperative to establish an institution more directly concerned with the poorest countries. This resulted in the creation in 1960 of the IDA, which was charged with providing concessional finance for development projects.

During Robert MacNamara’s presidency (1968–1981), the World Bank group experienced rapid expansion. During his presidency, annual lending grew by a factor of 12; staff went up by factor of five, and the People’s Republic of China was admitted. In the 1980s, the bank became involved in the debt crisis of Latin America. The bank arranged loans to some of these states to help them fulfill their obligations to foreign banks. During the 1980s there was also a distinct switch from the bank’s traditional commitment to growth to making the eradication of poverty the number one goal. In more recent years there has been a proliferation of World Bank concerns: promoting gender equality, addressing the needs of the disabled, protecting indigenous peoples land rights, and “paying attention” to child labor.

-
-
-

TO ACCESS ALL THE **27 PAGES** OF THIS CHAPTER,
Visit: http://www.eolss.net/Eolss-sampleAllChapter.aspx

UNESCO – EOLSS SAMPLE CHAPTERS

Bibliography

Kapur D., Lewis, J.P., and Webb, R., eds. (1997). *The World Bank: Its First Half Century*. Vol. 2, *Perspectives*. Washington, D.C.: Brookings Institution Press. [This book provides a useful survey of the role and development of the World Bank.]

Medhora R. (1992). The West African Monetary Union: institutional arrangements and the link with France. *Canadian Journal of Development Studies* **13**, 151–179. [This article provides a useful summary of the West African Monetary Union.]

Yeager L.B. (1965). *International Monetary Relations—Theory, History and Policy*. New York: Harper and Row. [This book provides a useful survey of the history of the institutions that make up the international architecture.]

Biographical Sketch

William Coleman graduated from the University of Sydney in 1981 with first class honors in a Bachelor of Economics. He was for several years a Research Officer at the Reserve Bank of Australia. In 1989 he was awarded a Ph.D. at the London School of Economics for his dissertation *Prices and Interest Rates in the United Kingdom, 1870–1982: Tests of Some Simple Walrasian Models*. Since 1991 he has been a member of the School of Economics at the University of Tasmania, where he lectures on financial economics, macroeconomic theory, and economic methodology. He has co-authored a textbook, *Money and Finance in the Australian Economy* (1994), and published on the gold standard, bimetallism, central bank independence, business cycles, and the Fisher Effect. He has also published in the history of

economics and is the author of *Rationalism and Anti-Rationalism in the Origins of Economics* (1995). He won the U.S. History of Economics Society Prize for the Best Article on the History of Economics in 1996 and is currently working on an intellectual biography of four founders of Australian economics: L.F. Giblin, D.B. Copland, James Brigden, and Roland Wilson. He is chief executive officer of the History of Economic Thought Society of Australia and is the co-author of *Exasperating Calculators: The Rage over Economic Rationalism and the Campaign against Australian Economists* (2000), a book that received widespread publicity in the broadsheet press of Australia.

UNESCO – EOLSS
SAMPLE CHAPTERS

©*Encyclopedia of Life Support Systems* (EOLSS)