Evolution of the International Economy

12.1. Introduction

In July, 1944, forty four nations of the world assembled at a Conference at Bretton Woods, New Hampshire (USA) to evolve the media and modes of payments which will be acceptable to most of the countries of the world and to establish some institutions through which international obligations can be settled. With this basic objective the Conference resolved to establish two institutions, namely, International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD or World Bank). The IMF has been established mainly to promote economic and financial co-operation among member states in order to facilitate the expansion and balanced growth of world trade. The World Bank (IBRD) has been established for reconstruction and development of the member states. Again, in 1947, twenty three countries of the world came to an agreement in Geneva on multilateral trade. The agreement is known as General Agreement on Tariffs and Trade or, in short, GATT. Its objective is to expand multilateral trade. In 1994, GATT had 114 members. In that year, GATT itself merged into a new organisation named World Trade Organisation or WTO. Its main objective is to develop an integrated, viable and durable multilateral trading system among its member states. In October, 2003, the number of member-nations of WTO stood at 146. Again, in March 1964, the United Nations Conference on Trade and Development (UNCTAD) was established to deal with problems of world trade and development, with special attention to the needs of developing countries. With the emergence of such international institutions like IMF, World Bank, UNCTAD and, above all, the WTO, a new international economy has emerged. A new era characterised by liberalisation and globalisation has begun, particularly from the decade of 1990s. New challenges and new problems have been emerging after the evolution of this new international economy. In this chapter, we shall consider the objectives, functions and performance of some of these international institutions having deep impact on the world economy. Some of such important institutions are IMF, World Bank, WTO, UNCTAD, European Union (EU), etc.

12.2. International Monetary Fund (IMF)

In Bretton Woods Conference in July, 1944, it was decided by 44 nations that two international financial institutions would be established to solve the problems of international liquidity. These institutions would try to solve the multilateral trade problems among nations and to increase the co-operation among them. One institution was the International Monetary Fund (IMF) or simply the Fund and the other was the International Bank for Reconstruction and Development (IBRD) or the World Bank as it is popularly known. The IMF started its activities in 1945 with 44 member states. In July 1996, the number of its members was 181.

The IMF has a fund based on quotas allocated to its members. When a country joins the IMF, it is assigned a quota. This quota has 3 implications : (i) It determines the amount of subscription to be made by the member country. Higher the quota, higher is the subscription. Of this quota, 25% is to be paid in gold or any usable currency and the residual 75% in the currency of the member state. (ii) Higher the quota of the member country, higher will be its power to get loans from the IMF. (iii) Higher the quota of the member country, higher will be the value of its vote. The highest quota in the IMF is of the U. S. A. Naturally, the U. S. A. is the most powerful and influential member country in the IMF.

12.2.1. Organisation and Structure of the IMF

The Second Amendment of 1978 made important changes in the organisation and structure of the IMF. It has a three-tier structure. The main structure of the IMF consists of a Board of Governors, Executive Board and a Managing Director. The Board of Governors and the Executive Board are decision-making organs of the IMF. Their decisions are binding on the IMF and its members. The Board of Governors is constituted by taking one representative from each member state. The members of the Board of Governors meet once in a year. As a matter of practice, most of decision-making powers of the Board of Governors have been delegated to the Board of Executive Directors or the Executive Board. Hence, the Executive Board regulate all activities of the IMF. It is the most powerful organ of the Fund. The Executive Board has 22 members. Among them, six members or Executive Directors are appointed by six member countries having the largest quotas. These members are permanent members. The rest 16 members are elected at intervals of two years by the remaining member states. A Managing Director is elected from among the Executive Directors. He is the chief executive of the IMF. He is the non-voting chairman of the Executive Board. The head office of the IMF is situated in Washington.

12.2.2. Objectives of the IMF

The IMF was established with the following objectives :

(1) To promote international monetary co-operation ;

(2) To facilitate the expansion and balanced growth of international trade and thereby to maintain high employment ;

(3) To promote exchange stability and to avoid competitive exchange depreciation ;

(4) To establish multilateral exchange system and to eliminate foreign exchange restrictions ;

(5) To help the member countries to correct maladjustment in their balance of payments ;

(6) To expand capital movement in underdeveloped countries ; and

(7) To develop confidence among the member countries by rescuing them at the hour of crisis by giving monetary help.

12.2.3. Functions of the IMF

The IMF performs various functions keeping in view its objectives. We briefly mention them (i) The IMF tries to promote international monetary co-operation. (2) It provides monetary help to the member countries to remove maladjustment in their balance of payments. (3) The IMF tries to promote exchange stability. It directs its member countries to avoid competitive exchange rate depreciation. (4) The Fund aims at reducing tariffs and other trade restrictions by member countries. It is the function of the IMF to have a surveillance of the policies being adopted by the member states. (5) The Fund provides technical advice to its member countries on monetary and fiscal policies. It also conducts short training courses on fiscal, monetary and balance of payments policies for personnel from member states. (6) The IMF provides technical experts to member nations suffering from balance of payments difficulties. (7) The Fund conducts many research studies and publishes their results.

Among these functions, the most important function of the IMF is its financial help to member nations. The Fund has a variety of facilities for lending its resources. The notable among them is the special drawing rights. From economic standpoint, it is the most important aspect of the Fund. Each country's drawing right is determined by its quota. It has 5 parts. The first part is called Gold Tranche because it corresponds to the country's subscription in gold. The next 4 are called First, Second, Third and Fourth Credit Tranches. Any member country can automatically borrow from its Gold Tranche without much difficulty. Thereafter, drawing on the Fund depends on the approval of the Fund. The condition of approval becomes more and more stringent as a member country goes beyond its First Credit Tranche. Usually a country must repay the Fund within 3 – 5 years. There is an increasing rate of interest on drawings that go beyond the Gold Tranche.

12.2.4. An Evaluation of the Performance of the IMF

The IMF started its operation in December, 1947. Since then, the IMF has been helping its member countries for making adjustments in their balance of payments. Both the developed and the developing countries have been benefitted from the Fund. However, there are some **limitations of the activities of the IMF.** We summarize them one by one.

(1) The resource of the Fund is limited in relation to its need. With this limited resources, it is not possible to meet the need of all the member states, particularly of the less-developed countries. The Fund has failed to solve the balance of payments problem of the developing countries.

(2) Due to inequality in the distribution of quota, very few developed nations (specially USA) dominate over the policies of the IMF.

(3) Very often, the IMF interferes with the internal activities of a country in the pretext of the conditions of the loan taken by the country.

(4) The IMF has not been completely successful to eliminate different trade restrictions imposed by different member states.

(5) The Fund's attitude is very conservative. It imposes stringent conditions for lending to member countries and charges high rate of interest.

(6) To remove the fundamental disequilibrium in the balance of payments of the primary producing countries, the prices of their primary products should be stabilised first. But nothing concrete was done by the Fund in this respect.

(7) The initial aim of the IMF was to maintain stability in exchange rate. But the IMF failed to attain this goal. Hence, it was decided later that the member states may follow either fixed or flexible exchange rate. At present, most of the member states have opted for flexible exchange rates.

Besides loans, India has received certain other benefits from the IMF. By virtue of being a member of the IMF, India is also a member of the World Bank. From the World Bank, India has been receiving financial aid for various development projects. Further, the IMF provides advisory help to India on monetary, fiscal and balance of payments policies. It has also been providing short-term training courses to Indian personnel on such policies.

12.3. International Bank for Reconstruction and Development (IBRD) or World Bank

The Bretton Woods Conference held in July, 1944 resolved to establish two international financial institutions to solve the problems of international liquidity. One institution was the International Monetary Fund (IMF) and the other was the International Bank for Reconstruction and Development (IBRD). The second institution is also known as World Bank. The main function of the IMF is to give short term loans to its member countries to tide over their balance of payments difficulties. On the other hand, the main function of the World Bank is to give long term loan to its member countries for the reconstruction and development of their economies.

The IBRD or the World Bank is a sister institution of the IMF. The Bank started its functioning in June, 1945. A member of the IMF automatically becomes the member of the World Bank. If any country resigns its membership of the IMF, it can no longer remain a member of the Bank. The initial authorised capital of the Bank was 10,000 million dollars. Of this, the amount of paid-up capital was 9,400 million dollars. However, the capital of the World Bank has been increased from time to time in later periods. As a result, its resources and thereby its lending capacity has greatly increased from its initial position. To be a member of the World Bank, each member country has to pay a subscription quota. This subscription has three parts :

(i) 2% of the subscription quota to be paid in gold or US dollar.

(ii) 18% in own currency of the member country. The Bank can lend it to any member country.

(iii) The remaining 80% is not to be paid directly by the member country. It is deposited with the central bank of the member state as a separate account. The World Bank can mobilise this as and when necessary.

12.3.1. Organisation and Structure of the World Bank

Like IMF, the World Bank has a three-tier structure with a President, Board of Executive Directors and Board of Governors. The highest policy-making body of the Bank is the Board of Governors. Every member country appoints one Governor and an Alternate Governor for a period of 5 years. The voting power of each Governor is related to the financial contribution of its government. The Board of Governors is the supreme body. Below it, there is a Board of Executive Directors consisting of 21 members. Of them, 6 are appointed by 6 largest shareholders of the Bank. These 6 member states are the U. S. A., U. K., Germany, France, Japan and India. The remaining 15 are elected by the remaining members. The Executive Directors are elected for a period of two years. The voting power of each Executive Director is proportional to the value of subscription of his country to the Bank. The Executive Directors elect the

President of the Bank. The President presides over the meetings of the Board of Executive Directors. The Executive Directors meet once in a month. The President of the World Bank is the chief executive of the Bank. He supervises the day-to-day functioning of the Bank.

Besides, the World Bank has two committees. One is the Advisory Committee and the other is the Loan Committee. The Advisory Committee is appointed by the Executive Directors. It consists of seven members. They are experts in different fields. The Loan Committee considers the feasibility of any proposal of loan to any member country by the Bank.

12.3.2. Objectives of the World Bank

The Articles of Agreement of the World Bank mention the objectives of the Bank. The Bank was established with the following objectives :

(1) To help in the reconstruction and development of member countries.

(2) To encourage the development of productive resources in developing countries by supplying them investment capital.

(3) To promote private foreign investment in member countries.

(4) To promote long term balanced growth of international trade and to maintain long term equilibrium in the balance of payments.

(5) To help in raising productivity, standard of living and conditions of labour in the member countries.

(6) To encourage long term foreign investment.

(7) To help in constructing economic infrastructures, such as, railway, road, electricity, etc. in the member countries.

In fine, while the objective of the IMF is to remove short term disequilibrium in the balance of payments of the member countries, the objective of the World Bank is to provide long term loans to the member countries for their reconstruction and development.

12.3.3. Borrowing and Lending Activities of the Bank

The Bank's main function is to provide loans to its member countries. To do that, the Bank has to develop a capital fund. The Bank's capital is subscribed by its member nations. The Bank also takes medium and long-term loans in the international capital markets. The Bank also borrows from member governments, government agencies and central banks. Further, the Bank offers issues to investors in the international money markets. The Bank finances its lending operations from these resources.

The Bank lends to member countries in any of the following ways : (i) by making or participating in loans out of its own funds, (ii) by making or participating in direct loans out of funds raised in the market of a member or otherwise borrowed by the Bank, (iii) by guaranteeing in whole or in part laons made by private investors.

The Bank follows certain **principles to grant loans.**

(1) The Bank generally gives loans only for specific projects.

(2) The proceeds of the loan should be invested in those undertakings which have prospects to strengthen the economy of the borrowing country.

(3) The Bank would finance only the foreign exchange cost of importing goods and services needed for the project in question.

(4) The Bank does not generally impose any condition regarding the mode of utilisation of loan in a particular project.

The Bank performs the following **important functions :**

(1) The Bank gives loan to the member countries or the provincial government of the member countries directly for reconstruction and development.

(2) If any member country gives loan to another member country, the Bank can provide the needed guarantee for that loan.

(3) The Bank gives loans to the private enterprises of its member countries.

(4) If any foreign organisation gives loan to the member country, the Bank can provide guarantee for that loan.

(5) The Bank provides technical assistance with the loan.

(6) The Bank provides training to the senior officials of the member developing countries. It is also engaged in inter-organisational co-operation. In recent years, the World Bank has made certain modifications in its lending procedures. For example, instead of scrutinising individual projects of a borrowing country, the Bank gives loans to the development banks of the borrowing countries. These banks again give loans to the individual projects.

Earlier, the Bank could not provide equity or risk capital, and without government guarantee, no lending was possible. To fill up this institutional gap, the Bank has set up International Finance Corporation (IFC). Again, for the development of agriculture, roads and communication, and education in underdeveloped countries, the Bank has set up International Development Association (IDA). Loan from IDA is free of interest. Only a nominal service charge is levied.

12.3.4. A Critical Evaluation of the World Bank

The World Bank has been quite successful in attaining its primary goal of reconstruction and development of member countries. It has helped in the post-war reconstruction of Europe. It has been helping both the developed and the developing countries in their process of economic development. Since 1970, the Bank has been giving more loans to developing countries for investment in their infrastructure. Further, the Bank has been trying to raise the productivity and standard of living in the poor countries. However, there are some limitations in the activities of the Bank. We may briefly mention them as follows :

(1) It has been pointed out that capital and other resources of the Bank are not adequate in relation to the need. It has failed to meet the financial needs of the developing countries fully.

(2) It has been alleged that in its day-to-day functioning, the Bank discriminates against the developing countries of Asia and Africa.

(3) The Bank has been accused of charging high interest and commission even from the underdeveloped countries.

(4) The Bank insists on the presence of repaying capacity before granting loan to a member country. Such a condition is very harsh to a developing country. In fact, repaying capacity of an underdeveloped economy will increase only after the completion of the project by utilising the loan.

(5) The Bank gives loan to the underdeveloped countries for specific or urgent projects. It does not grant loan for the general development of the country.

(6) The bank gives more importance to private sector than other sectors.

(7) Sometimes the Bank has granted loans on other than economic considerations.

In spite of these criticisms, it must be admitted that the World Bank has rendered useful service specially to underdeveloped countries through International Development Association (IDA). The IDA loan is granted for a term of 30 to 50 years and it is free of interest. Only a nominal service charge is levied. The conditions of repayment are also very much liberal. Thus, the World Bank has been playing a useful role in the reconstruction and development of underdeveloped countries. Its role will be more effective if the following conditions are fulfilled : (i) more resources at the disposal of the Bank, (ii) more flexible lending policy and (iii) directing more funds towards the poor countries where the shortage of capital is acute.

12.3.5. India and the World Bank

India is one of the founder members of the World Bank. The Bank has been helping India in its planned economic development. Since the inception of the Bank, it has been assisting India in the following ways :

(i) The Bank has granted loans to India for her development projects. (ii) It has conducted field surveys of different economic plans of India. (iii) The Bank has given expert advice and opinion in various economic matters. (iv) It has sent mission groups and study teams to India for monitoring and consultations on its aided projects in India. There is also a Cheif of Mission of the Bank at New Delhi for this purpose. (v) The Bank has trained Indian personnel at its Economic Development Institute (EDI).

India has been the largest recipient of loan from the World Bank since August, 1949. The industries or sectors which have been benefitted are ports, oil exploration, gas, aircrafts, coal, iron, aluminium, fertilisers and railway. The Bank has also given technical assistance to different projects of India. Further, at the instance of the World Bank, India was getting loans for her development plans from the Aid India Consortium of twelve developed countries. It has been replaced by India Development Forum since 1995. India now gets financial assistance from this institution also.

Thus, India, as a member of the World Bank, has received much help from the Bank. The Bank loan has been utilised in the development of agriculture, industry, energy and transport. However, the availability of loan from the IDA has recently reduced. Hence, India will have to borrow more from the Bank in future. The terms of Bank loans are more stringent than those of the IDA loans. The terms of IDA loans are very liberal. Such loans are free of interest ; only a service charge is levied. Hence, the reduction of IDA loan and increase in the loan from the World Bank will lead to a heavy financial burden on India.

12.3.6. International Development Association (IDA)

The International Development Association (IDA) is an affiliate of the World Bank. The President of the World bank is also the head of the IDA. It was established in September, 1960. It is a "soft loan window" of the World Bank. Neither the World Bank nor the International Finance Corporation (IFC) could solve the basic problem of underdeveloped countries of the scarcity of cheap and long term credit. As a result, these countries suffer a great difficulty in the balance of payments, particularly in the early years of their development. To stability, a rising standard of living and closer relations among member countries. By 1961, the Community had removed all quotas on industrial goods. It established a full customs union in 1968.

The European Coal and Steel Community (ECSC) was established in 1952. Its aim was to create a common European market in coal, iron ore, scrap and steel. The Community gradually harmonised external tariff among member countries and adopted a common external tariff among its members in 1958. In 1967, the ECSC was merged with the EEC and EURATOM to create the common institutions of the European Community (EC), or what is now called European Union (EU).

The main objectives of the European Union are as follows :

(i) To promote economic and social progress and a high level of employment and to achieve balanced and sustainable development.

(ii) To introduce European citizenship. This does not replace national citizenship but complements it and confers a number of civil and political rights on European citizens.

(iii) To develop an area of freedom, security and justice and, more particularly, the freedom of movement of persons.

(iv) To maintain a set of uniform EU laws.

The European Union has emerged as single frontierfree market in the European countries. National barriers within the EU have been eliminated. Capital, labour and goods and services can move freely inside the member countries of the Union. Restrictions on imports imposed by member countries have been removed. They have been replaced by a Union Tariff System. As a result, access to the EU will be greater for all countries. The single market has become fully operational from January 1, 1995.

The European Union has achieved some of its major objectives. It has ensured free movement of capital, labour and goods and services among member countries. It has also established common policies in the field of agriculture and commerce. It has successfully created a European currency unit called EURO. EURO is the name of the new currency of 12 member states of the European Union. These twelve countries are Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland. Of the 15 members of the EU, 3 member countries have not yet participated in this programme of uniform currency system. These 3 countries are Denmark, Sweden and the United Kingdom. The EURO currency system has been operative since January 1, 2002. As a result of these measures, a vast common market has been created and trade has expanded considerably in the member countries. However, the EU has been successful in achieving a complete economic and political union. The Union has failed to evolve a common transport policy. There has been lack of harmonisation on fiscal and monetary measures among the member countries. In spite of these limitations, it must be admitted that the EU has amply helped its member countries to expand their trade and investment and thereby to raise their standard of living.

12.6. World Trade Organisation (WTO)

In 1947, 23 countries of the world came to an agreement in Geneva on multilateral trade. This agreement which came into effect on January 1, 1948 is known as General Agreement on Tariffs and Trade (GATT). These countries sought to expand multilateral trade among themselves. India is one of the founder-members of GATT. Later many other countries signed this agreement and in 1994, the number of the members of GATT stood at 124. There were provisions of discussion among the member countries in the GATT agreement. These discussions are called rounds. The eighth round of GATT was held in 1986 at Punta del Este in Uruguay. Hence, it is referred to as 'Uruguay round'. This round continued for eight years. The Dunkel draft was prepared in this discussion. The member countries approved the draft on April 15, 1994. As per recommendations of the Dunkel draft, a new organisation is formed. Its name is World Trade Organisation or WTO. The agreement regarding the establishment of the WTO has come into force since January 1, 1995. India is one of the founder-members of the WTO. There were 77 member countries of the WTO on January 1, 1995. It had increased to 127 by December, 1996. During the Fifth Ministerial Conference at Cancun in Mexico (September 10 — 14, 2003), the number of member countries of the WTO stood at 148.

12.6.1. Difference between WTO and GATT

The WTO is the successor to the GATT. It is not an extension of the GATT. It completely replaces GATT and has a very different character. The **first** major difference between the GATT and the WTO is that the GATT was no organisation. It was only an agreement. But the WTO has been established as an organisation. **Secondly,** the GATT had no legal status. But the WTO has a legal status. It has been established by an international agreement ratified by the governments and legislatures of member countries. **Thirdly,** in GATT, there were separate agreements on separate issues. These were not binding on all members. Any member could stay out of any agreement. But the WTO agreements are binding on all members. **Fourthly,** the GATT rules were applicable only to trade in goods. They did not include services. But the WTO agreements cover not only trade in goods but also trade in services. They include trade related intellectual property rights (TRIPs) and trade related investment measures (TRIMs).

12.6.2. Structure of the WTO

Organisationally, the highest authority of the WTO is the Conference of the ministers of member countries. This Conference is to be held at least once in two years. Besides, there is a General Council for the functioning of the Organisation. This Council consists of the representatives from the member countries. There are three separate councils under this General Council : Council for trade in goods, Council for trade in services and Council for trade related aspects of intellectual property rights. Further, the General Council convenes the meetings of the committee for the settlement of disputes among the member nations and the committee for the review of trade related policies.

12.6.3. Objectives of the WTO

The WTO has the following objectives :

1. To raise the standard of living in member countries by ensuring full employment and by expanding production and trade in goods and services ;
2. To develop an integrated, viable and durable multilateral trading system ;

3. To promote sustainable development in member countries by the optimal use of resources ;

4. To help the developing countries to get a share in the growth of international trade ;

5. To reduce tariffs and other trade barriers among member countries and to eliminate discriminatory treatment in international trade relations and

6. To ensure linkages between trade policies, environmental policies and sustainable development.

12.6.4. Functions of the WTO

According to clause 3 of WTO agreement, the **WTO has five principal functions :**

(1) This organisation will try to execute the conditions contained in the WTO agreement and to promote multilateral trade agreement.

(2) This organisation will function as a forum of discussion among member countries.

(3) If any dispute or controversy arises among member countries, the WTO will try to settle that dispute. This organisation will apply the approved rules meant for the settlement of any dispute.

(4) This organisation will examine different trade policies as per procedures laid down in the agreement.

(5) To bring harmony in the world economic policy, this organisation will co-operate with the World Bank, the International Monetary Fund and their associated institutions.

12.6.5. Main Resolutions Adopted in the Uruguay Round

In order to know the effect of the establishment of WTO on less developed economies, we have to know the main resolutions adopted in the Uruguay round. Agreement was reached on the following points in the discussion of the Uruguay round. The members of the WTO agreed to abide by the following policies :

1. The member countries will not impose any quantitative restriction or quota on the export and import of agricultural products. If necessity arises, they will impose tariff instead of quota. They will try to decrease the rate of tariff.

2. Import quota on textiles and fibre products imposed by developed nations will be waived within ten years. Thus, the trade in textiles and fibre products will be liberalised.

3. The member countries will reduce tariff on manufacturing goods.

4. The member countries will not impose any restriction on foreign investment and they will not discriminate between indigenous and foreign investments.

5. The member countries will amend their patent and copyright laws. They will introduce product patent instead of process patent in food, medicine, chemical goods, etc.

6. Bank, insurance, tourism, labour and such other services are now included in the GATT. The member countries will adopt a liberalised policy in the export and import of such services.

12.6.6. Advantages of Underdeveloped Economies

As a result of the establishment of the WTO and the introduction of a new international trade system, underdeveloped economies are expected to enjoy some benefits. They are mentioned below :