CHAPTER 18

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Chapter Outline

(A) The International Monetary Fund (IMF)

(B) International Liquidity and SDRs;

(C) International Bank for Reconstruction an

(D) International Development Association;

(E) International Finance Corporation;

(F) United Nations on Conference on Trade a

(G) The Multilateral Investment Guarantee A

(A) THE INTERNATIONAL M

IMF is a post-war international monetary institution.

IMF came into being to promote economic and financial co-operation among the member countries with a view to facilitate the expansion and balanced growth of world trade.

The International Monetary Fund (
break-down of the Gold Standard resul
world nations felt the need for internatio
affairs. The United States Treasury in
International Stabilisation Fund. The U
International Clearing Union. The USA's
and UK's proposal is known as *'Keynes*
1944 in the form of joint statement by ex
This became the basis for International M
Hampshire during July 1-22, 1944. An a
Fund by 44 nations in this conference.

Thus, the International Monetary Fun
cooperation among the member countries
of world trade with effect from March 1,
44 in 1947 to 187 as on 31st January, 20

♦ OBJECTIVES OF IMF

The objectives of the IMF are to:

- avoid the competitive devaluation an
- establish and maintain currency conv
- develop multilateral trade and payme

The objectives of the IMF as stated i

- To promote international monetary coo
machinery for consultation and collab
- To facilitate the expansion of b...

- IMF provides technical advice to its members regarding monetary and fiscal policies.
- IMF provides short-term financial assistance to its members to get rid of the balance of payments problems/crisis.
- IMF provides machinery for the orderly adjustment of exchange rates.
- It functions as a reservoir of currencies of member countries and enables the members to borrow the other currencies.
- It functions as a lending institution of foreign currencies.
- It provides a machinery for altering the par values of the currency of a member country, in order to improve long-term balance of payments position of member countries.
- It also provides a machinery for international consultancy.
- It conducts research studies and publishes the reports.
- It conducts short-term training courses on fiscal, monetary and balance of payments for employees of member countries through its Central Banking Services Department, the Fiscal Affairs Department, Bureau of Statistics and the IMF Institute.

ORGANISATIONAL STRUCTURE

The IMF is an autonomous organisation affiliated to the UNO. The organisational structure of the IMF consists of:

- Board of Governors
- Executive Board
- A Managing Director
- IMF secretariat helps managing director in carrying out the activities
- Interim Committee
- Development Committee.

Board of Governors: The Board of Governors is the decision-making organ of the Fund. The Board of Governors is the highest body. It exercises powers and takes decisions. The Board of Governors consists of one Governor and one Alternate Governor appointed by each member country. The member country appoints its Finance Minister or the Governor of its Central Bank as the Governor. The Governor has the right to vote. The Alternate Governor participates in the Board Meetings, but has voting right only in the absence of the Governor. All powers of the IMF are vested in the Board of Governors. The Board of Governors may delegate to the Executive Board all except certain reserved powers.

The Board of Governors meets once in a year and reviews previous year's activities of the Fund. It also takes policy decisions. Any five-member countries having 25 per cent of the total voting rights can convene a special meeting. However, power to make major decisions in the following areas is delegated to the Board of Directors:

- Access by the members to the Fund's resources.
- Charges and remuneration.
- Review of fund and consultations among its members.

The Executive Board: The Executive Board, at present has 21 members. Five major members of the Fund are appointed by the countries having the largest quotas, *viz.,* the USA, UK, Germany, France and Japan.

The Sixth Executive Director is appointed by the Kingdom of Saudi Arabia. The remaining 15 directors are elected by the remaining member countries.

Articles of Agreement confer vast powers on the Board and the Board of Governors also delegates the powers. These powers include: All Fund activities including regulatory, supervisory and financial. To bring the major changes, 85% of voting rights is essential. Thus, the Executive Board is an important organ of the IMF.

Managing Director: The Executive Directors elect the Managing Director, who is a politician or an important international official. The Managing Director is a non-voting chairman of the Board and the head of the Fund staff.

The Interim Committee: The interim committee, at present has 22 members. It was created in 1974. The objectives of this committee are:

- to advise the Board of Governors on supervising the management.
- to advise the Board of Governors on adaptation of the international monetary system with a view to avoid disturbance.

The Development Committee: This committee was also established in 1974 and has 22 members. Its objective is to:

- advise and report to Board of Governors on all aspects of the transfer of real resources to developing countries.

Figure 18.1 presents the organisational structure of IMF.

FIGURE 18.1 : Organisational Structure of IMF

Board of Governors ← • Interim Committee • Development Committee

↓

Executive Board of Directors

↓

Managing Director

↓

IMF Secretariat

♦ VOTING RIGHTS

A mention was made regarding the voting rights of the member countries and the requirements of 85% of voting rights to bring about changes. The voting rights are determined by the quotas. Each member country has 250 basic votes irrespective of its quota. In addition to the basic votes, member country has one voting right for every quota of SDRs 1,00,000. As such, we shall now discuss the quotas.

as determine
rights in

» **Quotas:** The capital of the IMF which is represented by the General Account is contributed by the quotas allocated to the member countries. The quota determines:

- size of the subscription of the member country to the IMF Capital/General Account.
- voting power (or voting rights) of the member country, and
- the drawing rights of the member country.

Quotas of the member countries are determined on the lines:

(i) 2 per cent of the national income of the member country.

(ii) 5 per cent of the gold and US dollar reserve of the member country.

(iii) 10 per cent of the average annual imports of the member country.

(iv) 10 per cent of the maximum variation in annual exports of the member country.

(v) the sum of *(i)*, *(ii)*, *(iii)* and *(iv)* increased by the percentage ratios of average annual exports of national income.

» **Payment Method:** At the time of the formation of the IMF, the members were required to pay 25% of its quota in the form of gold or 10% of its net official holdings of gold and whichever is less. *Table 18.1* presents quotas and voting rights of selected number countries.

It is observed from this table that 10 countries together have more than 50% of quota and voting rights of IMF in January 2011. These countries include USA, Japan, Germany, UK, France, China, Canada, Italy, Saudi Arabia and Netherlands.

TABLE 18.1 QUOTA AND VOTING RIGHTS OF SELECTED COUNTRIES (AS OF 31ST JANUARY 2011)

Country	*Quota (in millions of SDRs)*	*%*	*Votes Number*	*%*
Australia	3,236.4	1.49	32,614	1.47
Brazil	3,036.1	1.40	30,611	1.38
Canada	6,369.2	2.93	63,942	2.88
China	8,090.1	3.72	81,151	3.65
France	10,738.5	4.94	107,635	4.85
Germany	13,008.2	5.98	130,332	5.87
India	4,158.2	1.91	41,832	1.88
Italy	7,055.5	3.24	70,805	3.19
Japan	13,312.8	6.12	133,378	6.01
Netherlands	5,163.4	2.37	51,874	2.34
Papua New Guinea	131.6	0.06	1,566	0.07
Russian Federation	5,945.4	2.73	59,704	2.69
Saudi Arabia	6,985.5	3.21	70,105	3.16
Switzerland	3,458.5	1.59	34,835	1.57
UK	10,738.5	4.94	107,635	4.85
USA	37,149.3	17.09	371,743	16.74
Tuvalu	1.8	0.001	268	0.01
Vanatu	17.0	0.01	420	0.02
Total	**217,435.5**	**100.00**	**2,221,085**	**100.00**

Source: http://www.imf.org/external/np/sec/memdir/members.htm (21/01/2011).

This method was modified under the second amendment. This amendment came into force from April 1, 1978. Under this amendment, the member country has to pay 25 per cent of its quota in SDRs or hard currencies. The member can pay the remaining 75 per cent of its quota in its own currency which can be deposited in its central bank. The fund delinked the practices of subscribing to its capital in the form of gold from April 1978.

» **Revising the Quotas:** The fund reviews and revises the quotas once in five years in order to meet the growing demand for finance with a majority of 85 per cent of total voting rights. *Table 18.2* presents the revision of quota.

larger share of SDRs or of any other scheme operated by the Fund with the idea of increasing the world liquidity. It is unfortunate that the proposal of UNCTAD for the creation of 'Fund Units' did not find much support of the developed countries. The evolving international monetary system is aimed not only at maintaining an orderly condition in the fast-moving economies of the developed countries, but also giving a major forward thrust to the suffering economies of the less developed countries.

(C) THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (IBRD) OR THE WORLD BANK

As stated earlier, the International Monetary and Financial Conference was held at Bretton Woods, New Hampshire during July 1-22, 1944. The main purpose of this conference was finalisation of the Articles of Association of the International Monetary Fund and establishment of an institution for the reconstruction of the war shattered world economies. The conference has given birth to the twin international financial institutions, *viz.*, International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD). IBRD is popularly known as World Bank.

The global trade mechanism was severely affected due to the II World War. Further the war also affected the manufacturing facilities, infrastructural facilities and the like. Germany, France, UK, Japan and other countries were the worst victims of the war. Further, there was a fear of another World War due to the economic inequalities among the Western countries, Asian countries and the African countries. The Third World countries felt the need for development of agricultural and industrial sectors of their economies. At the same time the war shattered economies felt a strong need for reconstruction of their economies.

IBRD is popularly known as World Bank.

The participant countries at the Bretton Woods conference felt that only IMF cannot achieve these objectives. As such, the conference resolved to establish another institution for reconstruction of weak countries, *i.e.*, establishment of the World Bank on 5th December 1944.

IMF was established to provide short-term assistance to correct the balance of payments disequilibrium while the IBRD was established to provide long-term assistance for the reconstruction and development of the economies of the member countries.

IBRD is an inter-governmental institution, corporate in form. Its capital is entirely owned by its member-governments.

Functions

According to the *Article 1* of the Agreement, the functions of the World Bank are:

(i) To assist in the reconstruction and development of territories of its members by facilitating the investment of capital for productive purpose and the encouragement of the development of productive facilities and resources in developing countries.

IBRD was established to provide long-term assistance for the reconstruction and development of the economies of the member countries.

(ii) To promote private foreign investment by means of guarantees on participation in loans and other investment made by private investors, when capital is not available on reasonable terms, to supplement private investment by providing finance for productive purpose out of its own resources or from borrowed funds.

(iii) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in the balance of payments of member countries by encouraging international investment for the development of their productive resources, thereby assisting in raising productivity, the standard of living and conditions of workers in their territories.

(iv) To arrange the loans or guarantees by it in relation to international loans through other channels so that more useful and urgent small and large projects are dealt with first.

Loans

The prime objective of granting loans by the bank is for overall and integrated development of the member countries. The loans are meant for the reconstruction of the member countries. Bank has taken steps to make sure of the end-use of the loans.

The bank grants loans as follows:

Power Sector	30% of the total loans
Transport Sector	30% of the total loans
Agriculture, Forestry, Fishing, Industrial Sector, Technical Assistance, Population control, tourism, urbanisation, Drainage, etc.	40% of the total loans

Memberships

Any country can join as a member of the IBRD by signing in the Charter of the Bank as its subscriber. Bank can suspend any member, if the country concerned fails to discharge its responsibilities to the IBRD. The members of the IMF are also the members of the World Bank. The membership of the Bank as on January 3, 2011 was 187. The member country has to pay all the dues and also its share of losses, if it resigns.

♦ ORGANISATIONAL STRUCTURE

The IBRD is managed by a three-tier structure including Board of Governors, Executive Directors and President.

Board of Governors: The Board of Governors is vested with full authority and control over the Bank's activities. Each member country appoints normally its Finance Minister as a Governor and the Governor of its Central Bank as Alternate Governor for the Board of Governors of World Bank for a period of five years.

The Alternate Governor exercises his voting rights only in the absence of the Governor. The strength of the voting rights of the Governor depends upon the amount of the contribution of the country to the share capital of the Bank.

Out of the total voting rights the share of USA is 22.5% and UK's share is 9.11%. The Board of Governors normally meets once in a year. However, it meets quite often, if necessary.

IBRD is managed by a three-tier structure including Board of Governors, Executive Directors and President.

Executive Directors: A body of 21 Executive Directors supervises the entire operations of the Bank. Out of these 21 directors, five are appointed by the five largest shareholders of the World Bank, *viz.*, the USA, UK, Germany, France and Japan. The remaining 16 directors elected by the Governors of the remaining member countries. These 21 directors elect the President of the Bank, who presides over the monthly meetings of the Executive Directors.

The Scope of the decisions of the Executive Directors include:

- Policy-making within the framework of the Articles of Agreement.
- Loans and credit proposals.

The Executive Directors present to the Board of Governors:

- Audited annual accounts
- Administrative budget
- Annual report on the operation and policies of the Bank.

President: The president of the Bank normally does not have voting rights except in case of exercising equal rights. He is assisted by Senior Vice-Presidents and Directors of various departments in the day-to-day functioning of the bank. *Figure 18.2* presents the organisational structure of the World Bank.

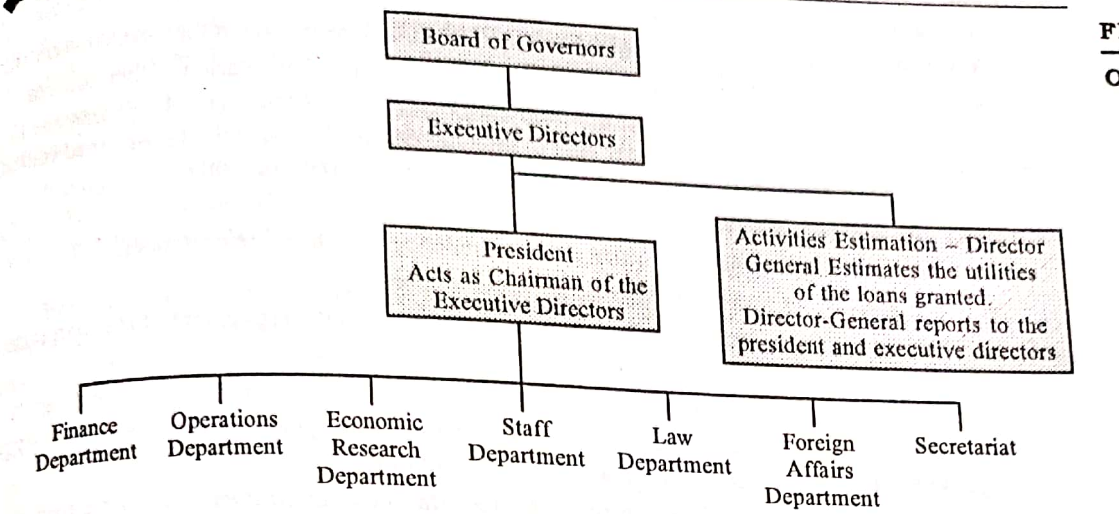

FIGURE 18.2 : Organisational Structure of the World Bank

Capital

The authorised capital of the Bank is US $ 10 billion divided into 100,000 shares of US $ 1,00,000 each. The subscribed capital is US $ 9.4 billion. The capital of the Bank was increased by US $ 9.3 billion in July 1992. This enhanced capital is subscribed by the republics of the former USSR. It is further increased to $ 24 billion and it is US $ 27 billion as on 31st January, 2008.

The member countries contribute their share capital to the Bank as follows:

- 2% of the share capital in the form of gold and US dollars. The IBRD utilises this amount freely for granting loans.
- 18% of the share capital in the form of the own currency. The Bank also uses this amount for granting loans.
- 80% of the share capital is payable at the request of the Bank. Bank does not use this amount for granting loans. But it can use this amount in discharging its responsibilities.

♦ FUNDING OBJECTIVES OF THE BANK

IBRD has the following funding objectives:

- To make sure of availability of funds in the market.
- To provide funds to the borrowers at the possible lowest cost through manipulating the currency mix and opting the time when the interest rate in the market is low.
- To control volatility in net income and overall charges of the loan.
- To provide an appropriate degree of maturity transformation between borrowings and lending.

The authorised capital of the Bank is US $ 27 billion divided into 1,00,000 shares of US $ 1,00,000 each.

Bank's Borrowings: One of the important activities of the Bank is borrowing.

In order to lend the funds, it borrows the money.

- It borrows in the international capital market both on medium-term and long-term basis.
- It also borrows on currency Swap Agreements.
- It borrows under the Discount net programme.

IBRD's borrowing instruments include Central Bank Facility and US dollar dominated facility. The World Bank borrows from the Central Banks of the member countries with the help of these instruments. Another instrument is Floating Rate Notes. IBRD borrows from the commercial banks and other financial institutions with the help of this instrument.

Bank's Lending Activities: Bank grants loans to the member countries as follows:

- Granting loans from its own funds.
- Granting loans from the funds borrowed by the Bank in the market of the member countries.
- Guaranteeing the loans raised by the member countries from various other sources.

The Bank imposed a condition that the total direct and indirect loans and the guarantees to a member country should not exceed 100 per cent of member country's unimpaired subscribed capital, reserves and surplus. Bank follows the following conditions in granting loans:

Conditions for granting loans:

- If the borrower is unable to raise a loan under reasonable circumstances.
- If the loan is for reconstruction and/or development.
- When the member country or its central bank guarantees the repayment of the loan raised by a company or a local government of a member country.
- If a competent committee recommends a loan in the form of a written project report.
- In addition to providing direct loans, indirect loans and guaranteeing the loans, IBRD provides the following facilities to its member countries.

Structural Adjustment Facility: In order to help the member countries suffering from the balance of payments disequilibrium, IBRD introduced the structural adjustment facility. These funds are used to finance the general imports, but not the imports of luxury goods and military goods.

Enhanced Structural Adjustment Facility: IBRD established the enhanced structural adjustment facility, in order to increase the availability of concessional resources to the low-income member countries.

Special Action Programme: IBRD started special action programme in order to improve its ability to assist member countries in the following lines:

- Provide lending for structural adjustment, policy changes, export-oriented production, full utilisation of existing capacity and maintenance of critical infrastructure.
- Provide finance for timely implementation of high priority projects.
- Provide advisory services. *(See Box 18.3)*.

BOX 18.3 : IBRD's ADVISORY SERVICES TO PAPUA NEW GUINEA

The World Bank prepares a Country Assistance Strategy (CAS) for active borrowers from the International Development Association (IDA) and the International Bank for Reconstruction and Development (IBRD). The CAS takes as its starting point the country's own vision for its development, as defined in a Poverty Reduction Strategy Paper or other country-owned process.

IBRD provided advisory services to Papua New Guinea in preparing reports for borrowing from World Bank, International Development Agency and International Finace Corporation in the areas like:

- Strategic directions for human development in Papua New Guinea
- support ongoing maintenance of highways and national roads
- IFC sponsors training for Papua New Guinean women in the seafood sector.
- Improved infrastructure brings economic and social growth
- Smallholder agriculture development project (loan & credit)
- A smallholder agriculture project

♦ TECHNICAL AND ADVISORY ASSISTANCE

IBRD provides technical and advisory assistance to its member countries in addition to financial assistance. Technical assistance includes:

- Assessing the economic resources of the members and set up priorities to be followed in developmental programmes.
- Sending survey missions to member countries to conduct intensive studies of national resources with a view to formulate policies for long-term development of the country.

Economic Development Institute: The Bank has established the Economic Development Institute in order to provide training to the senior officials of the less developed countries.

Having studied IMF and IBRD, now we study the affiliates of IBRD. The World Bank has three affiliates, *viz.*, International Development Association, International Finance Corporation and Multi-lateral Investment Guarantee Agency.

Poverty Reduction Strategy: IBRD aims to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and (non-lending) analytical and advisory services.

The World Bank prepares a Country Assistance Strategy (CAS) for active borrowers from the International Development Association (IDA) and the International Bank for Reconstruction and Development (IBRD). The CAS takes as its starting point the country's own vision for its development, as defined in a Poverty Reduction Strategy Paper or other country-owned process. Oriented toward results, the CAS is developed in consultation with country authorities, civil society organizations, development partners, and other stakeholders. The purpose of the CAS is to set out a selective programme of Bank Group support linked to the country's development strategy and based on the Bank Group's comparative advantage in the context of other donor activities. CAS is designed to promote collaboration and coordination among development partners in a country.

Financial Services

IBRD is a source of innovative and cost-effective financing and risk management. An extensive menu of flexible and complementary options allows countries to pick and choose financial terms and a mix of products to meet the needs of development programmes and portfolio risk management objectives. IBRD financial solutions come with the added benefits of world-class technical expertise and a dedicated team of specialists to structure a custom financial solution each time.

Knowledge Services: IBRD also provides various knowledge services that include:

- Poverty Assessments
- Social and Structural Reviews
- Public Expenditure Reviews
- Sector Reports
- Country Economic Memoranda
- Knowledge Sharing

(D) INTERNATIONAL DEVELOPMENT ASSOCIATION

International Development Association (IDA) was established in 1960 as an affiliate of the World Bank. IDA was established primarily to provide finance to less developed member countries on a 'soft' loan basis. Hence, IDA is called the soft loan window of the IBRD. The president of the IBRD is the head of the IDA.

Objectives

Objectives of the IDA are:

- To provide development finance on easy terms to the less developed member countries.
- To provide assistance for poverty alleviation in the poorest countries.
- To provide finance at concessional interest rates and macro-economic management services in order to promote economic development, raise productivity and living standards in less developed countries.

The macro-economic management services include: human resource development techniques, population control, development of health, education, nutrition, etc.

IDA was established in 1960 as an affiliate of the World Bank.

Membership

Membership of the IDA is open to all members of IDA. It had 187 members in January 2011. IDA has two types of members, *viz.*, Part I members and Part II members. Part I members are the developed countries. There are 24 countries in this category. They are called G-24 countries. Part II members are the developing countries.

Organisation

The organisation of the IBRD is also the organisation of IDA. The staff of IBRD from the president to the officers operate the IDA.

IDA was established primarily to provide finance to less developed member countries on a 'soft' loan basis.

Loans

IDA loans are known as IDA credits. Only member Governments can borrow from IDA. The member countries with per capita income of less than US $ 695 at 1990 prices are eligible to borrow from IDA. IDA grants loans to those projects which are not financed by IBRD. IDA observes the following criteria in approving the projects:

- *Poverty criterion:* Where the living standard is low due to high population and low productivity.
- *Performance criterion:* The projects should be financially and economically viable.

Conditions of Loans: Conditions of IDA loans include:

- Repayment period is 35-40 years.
- Grace period is 10 years.
- Interest rate varies between Zero to 0.5%. This is waived now.
- Administrative fee is 0.75% on the loan amount disbursed.

(E) INTERNATIONAL FINANCE CORPORATION

International Finance Corporation (IFC) was established in July 1956 in order to provide finance to private sector in developing countries. IFC is also an affiliate of the World Bank, but it has separate legal entity, funds and functions.

Membership

All the members of the World Bank are eligible to become the members of the IFC. It had 187 members as on 31st January, 2011.

Objectives

IFC helps for the growth of productive private enterprise particularly in the less developed countries. Thus, it contributes for the economic development of the less developed member countries. The objectives of the IFC as stated in *Article 1* of its Article of Agreement are as follows:

"The purpose of the corporation is to further economic development by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas, thus supplementing the activities of the International Bank for Reconstruction and Development. In carrying out this purpose, the corporation shall:

(i) In association with private investors, assist in financing the establishment, improvement and expansion of productive private enterprise which would contribute to the development of its member countries by making investments, without guarantee of repayment by the member Government concerned, in cases where sufficient private investment is not available on reasonable terms;

(ii) Seeking to bring together investment is not available on reasonable terms;

(iii) Seek to stimulate, and to help create conditions conductive to the flow of private capital, domestic and foreign, into productive investment in member countries.

IFC was established in July 1956 in order to provide finance to private sector in developing countries.

ASSISTANCE TO THE MEMBER COUNTRIES

IFC provides financial assistance to large, medium and small-scale private sector industries of the member countries.

IFC helps for the growth of productive private enterprise particularly in the less developed countries.

It provides loans to different industries, *viz.*, power, petrochemicals, mining, oil and natural gas exploration, telecommunication, financial services, tourism, and the like. It provides assistance to the private sector industry in developing countries in the following methods:

- **Direct Investment:** IFC invests directly, equity capital along with the private investors in companies in developing countries. Its investment should not be more than 50% of the total capital of company. The investment by the IFC for economic development with reasonable commercial return. The assistance of the IFC would be used for buying machinery and equipment, meeting foreign exchange requirements, local costs, working capital, etc.
- **Foreign and Local Capital:** IFC provides foreign capital and local capital to the private industry in the form of loans. It brings investors and industry closer by acting as underwriters and as sponsors of investment.
- **Technical Assistance:** IFC provides technical assistance of the private business enterprises in developing countries in order to make them more productive. It conducts project studies, undertakes financial studies, assists the companies in policy-making.
- **Capital Markets Development:** The IFC has a capital markets department. This department provides specialised resources for studying capital markets in developing countries. Its assistance includes:
  - Financial support and advice for the development of financial institutions.
  - Provides legal, financial and institutional framework to encourage foreign and local capital investment in developing countries.
  - Develops financial companies, leasing and venture capital companies, mutual funds, merchant bankers, etc.
- **Help to Small-scale Industries:** IFC helps small-scale industries in the following ways.
  - Offering advice for preparation of project reports provides technical assistance.

IFC created these facilities for developing countries. These include:

South Pacific project facility, Africa Project Development facility, Business Advisory service for Caribbean and Central America and Polish Business Advisory service, African Management service company, and Technical Advisory service.