The World Bank and the IMF as international economic institutions

Prabirjit Sarkar

Historical perspective

International economic relationship dates back at least to 3000 B.C. At that time trade - both internal and external - was mostly in the form of barter: commodities were exchanged for commodities. In many cases, valuable metals and coins made of these metals used to play the role of national and world money. During the days of mercantilism, world trade and commerce flourished. In the process of exploring the sea route to Indian sub-continent, American continents were discovered to the European people. Then started the history of colonisation - colonies of settlements and colonies of exploitation were established in different parts of the globe. This colonisation gave a great boost to the process of industrialisation in Europe.

No international institution existed throughout the 18th and 19th centuries to cope with rapid expansion of world trade and commerce. Different countries had different monetary sytems. Although gold has been used as a means of payment since ancient times, an international system of gold standard started operation only in the last quarter of the 19th century. Following in the footsteps of Britain, many Western countries decided to go for gold. It lasted until 1914. Rapid industrial development in the West and flourishing trade and commerce during this period of gold standard created a nostalgia among some statesmen and academicians. So after the First World War, some attempts were made to reestablish the gold standard. But soon came the years of the Great Depression, the 1930s, which saw competitive devaluations, beggar-thy-neighbour policies in the face of large scale unemployment and sluggish growth. Then came the devastation of the Second World War.

While the Second World War continued, two academician-cum-civil servants, J.M. Keynes and H.D. White representing Britain and the USA (respectively) started exchanging notes with the objective of developing an international economic and monetary mechanism that would reconstruct and develop the world economy through global trade and cooperation. Finally the two countries along with 42 other members of the United and Associated Nations sat together at Bretton Woods (USA) during July 1944. This Bretton Woods Conference gave birth to the siamese twins, the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), popularly known as the World Bank.

The World Bank aims to promote long-term economic growth through increased investment in the infrastructure i.e. roads, docks, power stations etc. It also helped the reconstruction of the war destroyed economies. Later on, two other affiliates of the World Bank were established - the International Development Association (IDA) and the International Finance Corporation (IFC). The IFC was

established in 1956 to supplement the World Bank's activities by encouraging private enterprise and investment in the poor countries. The IFC acts as a multilateral investment bank which provides guarantees and aquires equity shares and grants loans. The IDA was established in 1960 to grant soft loans to very poor countries - most of its funds are used to provide loans to countries with per capita incomes below $400 per annum. The IDA's funds come mainly from rich countries' subscriptions and transfers from World Bank's profit. The IFC also gets funds from the World Bank. The World Bank gets funds from the subscription of member countries in proportion to their economic strength and it also raises funds through borrowing in the international capital market.

The basic objective of the IMF is to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy. Under the IMF Agreement each member country was required to observe certain rules of good conduct in the monetary field such as keeping the exchange rate alterations of their currencies to a maximum of 10%; a higher rate of alteration required IMF permission. Another obligation of the members was to provide the resources with which the Fund would operate. Each member country had to pay to the Fund a subscription partly in gold and partly in its own currency; the amount of subscription of each country was decided on the basis of its economic strength. The voting power of the members depends on their subscriptions. Thus the rich countries such as the USA and the UK and their allies dominate the IMF.

The IMF was established in 1945 and became operational in March 1947. It had an original membership of 44 which now has reached 150 countries. As membership of the World Bank is conditional upon IMF membership, it has also about 150 country share holders. Almost all the countries of the capitalist world and many socialist countries such as China, Hungary, Poland have joined the IMF-World Bank organisation. Thus IMF-World Bank developed as a true global institution.

Performance of the IMF and the World Bank: A critical evaluation

With this brief description of history, let me make a general evaluation of IMF-World Bank as an international economic institution. The world economic system that evolved out of the Bretton Woods Conference was a better development than the situation of the 1930s. The system worked for a quarter century, 1947-1971. The war- devasted economies of Europe and Japan recovered rapidly. However, the success of the new system was not due to its intrinsic value; it depended much on the US Marshall Plan (1948-52). In fact, the system depended too much on the USA. Breakdown of the world monetary system that emerged out of the Bretton Woods Conference resulted from the US decision to float the dollar. In many cases, IMF-World Bank behaved as a part of US department of foreign affairs.

Firstly, the post-war reconstruction process depended mostly on US Marshall Plan. During 1948-52, the USA under the Marshall Plan transferred about 3% of its GNP to its allies in Europe and Asia. World Bank aid to the development process of the poor countries could not match that. The Marshall Plan created high hopes among the development activists in the United Nations; it was hoped that a special fund, SUNFED, should be set up to administer large-scale soft aid more or less on Marshall Plan terms to poor countries. But the World Bank then opposed the idea of soft aid to poor countries and also the involvement of the UN (where the poor countries are the majority) in financial aid. The IDA never reached dimensions remotely comparable with the Marshall Plan (Singer, 1989, p.8). Recent years experienced a sharp decline of IDA fund as the USA followed by other rich countries made a 25% reduction in their contribution.

In fact since the late 1960s, official concessionary lending started to give way to transnational commercial bank (TNB) lending. Under the impact of the cheap money policy pursued by the OECD countries led by the USA, the TNBs accumulated huge lendable surplus much before the rise of OPEC and accumulation of petro-dollars in the TNBs. Perhaps under the pressure of the TNB lobby, OECD countries relaxed the barriers that previously hampered commercial lending to the poor countries. The involvement of the TNBs in the development process of the poor countries was welcomed by the rich countries as it relieved their burden of official development assistance. The World Bank welcomed this as supplementing their own meagre resources. Robert McNamara in his 1978 World Bank Presidential Address commented: "It is neither surprising nor undesirable that private lending accelerated".Thus under the moral support of the World Bank, the task of developmental lending to the poor countries was privatised; lending activities of the TNBs flourished in the poor countries. Accumulation of petro-dollars in the TNBs boosted it further. The TNBs with the urge to dispose of their huge lendable surplus advanced substantial amounts of loans for unproductive purposes. It was advanced to finance capital flight. According to some estimate, over the period 1974-82, capital flight from Mexico amounted to US $32.7 billion, that from Venezuela amounted to 10.8 billion and from Argentina to 15.3 billion and over the same period, the external dept of Mexico, Venezuela and Argentina reached $82.6 billion, $27 billion and $32.6 billion respectively (Bagchi, 1988, p.807). Much of this capital flight was financed by TNB loans and most of their dept was owed to TNBs.

Besides capital flight, TNB loans were advanced for importing consumption goods (including arms and ammunitions) from the big OECD countries. It is true that some of the TNB funds were formally invested in development projects but investmnet priorities and development policies were often perverse. For instance, projects undertaken in the name of building infrastructures went as far as building whole new cities from scratch such as Brasilia in Brazil and Abuja in Nigeria (Hosseinzadeh, 1988). For Brazil, their Ministry of Industry and Commerce estimated that the TNB loans were used for $50 billion worth of

incomplete projects "with zero degree of usefulness" (Time Magazine, 2 July 1984).

Thus it is clear that lending activities of the TNBs violated the basic norm of commercial banking - huge amounts of loans were advanced for unproductive purposes or for non-viable projects. This is the crucial factor behind the present debt crisis. The IMF-World Bank did nothing to prevent this crisis. Rather they supported the TNB activities in the poor countries as the TNBs were in need of potential borrowers of their accumulated lendable surplus. With the announcement of Mexican default in 1982, they came to the rescue of the TNBs. As Singer (1989b, p.4) commented, "... the IMF and World Bank (which stood on the sidelines while the debts accumulated or even applauded the 'efficient recycling' of surpluses) have now become agencies for debt collecting rather than suppliers of liquidity for deficit countries". We shall come to this point later.

Secondly, the global monetary system developed under IMF depended too much on US hegemony. Ignoring the suggestion of Keynes for an international currency such as bancor or unitar, a gold-convertible dollar was given the key currency role. So the supply of international money depended on US balance of payments deficits. In the initial years, the system worked well. The USA had uge gold reserves compared to the amount of dollars in circulation in the whole world. So there was no problem of confidence in taking dollars as gold-equivalents. Dollars were held universally as reserve assets. Under the Marshall Plan and also under US developmental and military aid in a cold war regime US dollar reserves accumulated outside the USA. This facilitated world trade and commerce. Thus the success of the system depended on the Big Brother role of the USA. It enjoyed the "seignorage" in issuing dollars. Some countries were not prepared to give the USA this opportunity which is normally enjoyed by a government within their territorial jurisdiction. So these countries (e.g. France) started to convert dollars into gold. Gold prices started to rise and the US government found it difficult to maintain the fixed price of gold in terms of dollar.

Besides, to keep up confidence in the dollar, the US trade and payment deficit should be kept to a lower level so that external holding of dollar lies well below US gold reserves. But US involvement in war and military exercises all over the globe could not contain the deficit within the safe limits. Even if it succeeded in doing that, that would keep up the confidence in dollar at the cost of restricting the supply of international money in a situation of expanding world trade and commerce. This is the dilemma of the IMF system. Finally under the constant speculative pressure on dollar, it was delinked from gold. Following the dollar, all major currencies started to float signalling the break down of fixed exchange regime of the IMF. Now we have the managed float system under IMF surveillance.

Thus the IMF is very much there although the IMF system of fixed exchange rates has broken down. Its presence is very much felt by the poor deficit countries. Countries facing balance of payment difficulties approach the IMF for help. For

balance of payments need the member countries can draw 25% of their subscription (called quota) in any currency of their choice. Use of the next three quarters of their subscriptions (which they paid in terms of their currencies) - called second, third and fourth credit tranches - invokes increasingly strict IMF conditionalities. Here comes the question of IMF ideology which we shall discuss soon. Besides these credit tranches, IMF offers a number of financing facilities. One is the Compensatory Financing Facility established in 1963 to help primary producers confronted by temporary export shortfalls for reasons beyond their control such as draught or flood destroying crops. Similar assistance is provided for exceptional import expenditure due to shortfall in domestic food production. Next comes the Buffer Stock Financing Facility established in 1969 to assist members participating in international buffer stock schemes approved by the IMF. International agreements exist on sugar, rubber etc. commodities in order to stabilise their prices.

In fact, the BSF Facility scheme was a delayed attempt to complete the Bretton Woods system. In addition to the World Bank and IMF, the Bretton Woods system was to have included an International Trade Organisation (ITO) with the basic function of stabilising and maintaining commodity prices. Keynes always considered this to be an indispensible third pillar of the Bretton Woods system but it never came into being (Singer, 1989a, p.6). In the UN Conference on Trade and Employment in Havana (1946-47), a charter was drafted to form an ITO that would consider issues of interest to poor countries such as international commodity agreements, economic development and restrictive business practices. But the Havana Charter was never ratified by the US congress; rather an interim agreement - General Agreement on Tariffs and Trade (Gatt), 1948, came into force. It contained very few provisions dealing with the problems of export price instability and growth of poor countries.

The fact that the Bretton Woods system remained incomplete contains the germ of the chronic debt disease of the poor countries, namely commodity price instability. In the absence of any mechanism of price stabilisation (in accordance with the general belief) primary commodity prices experienced greater cyclical fluctuations than manufactures throughout the post-Second World War period; the degree of cyclicality was observed to be greater for the poor countries than for the rich developed countries (Thirlwall and Bergevin, 1985, pp.809-810). Not only that, primary commodity prices experienced prolonged depressions and short-lived booms. Gains in the booms are more than wiped out in the depressions. This is one factor behind debt accumulation of the poor countries during the IMF-World Bank years after the Second World War.

Since 1974, the Extended Fund Facility (EFF) has been operating under the IMF to provide members with financial assistance to overcome structural balance of payments problems. Under this scheme, IMF is giving medium-term loans. In 1979, it started the Supplementary Financial Facility (SFF) by borrowing from the rich members at a market-related interest rate. This is to aid countries with severe balance of payments problems arising from oil price movements and external debt problems.

To sum up, the IMF-World Bank twins born at the Bretton Woods Conference of 1944 created a new world economic environment and generated high hopes for global development through trade and cooperation. The world economy recovered from the depth of Great Depression and the destruction of the Second World War. External trade expanded rapidly. Trade-war-dumping, competive devaluations and discriminatory protectionism of the pre-war period are not so widely observed. But the IMF-World Bank system could not live up to the expectations of the poor countries. Apparently, there is much thought given to tackle the problems of development and trade of the poor countries. But the conditions of assistance are often perverse.

In fact, the IMF and the World Bank are controlled by the rich countries and hence by the Western transnationals (TNCs) since the TNCs dominate their respective governments. Hence one common feature of IMF-World Bank conditionality is liberal entry of foreign capital and foreign goods to the poor countries with acute balance of payment problems. This liberalisation is intended to bring economic efficiency to the poor countries. But this liberalisation accentuates the balance of payment problems of the poor countries. The case studies of Lall and Streeten (1977) showed that TNCs had negative effects on the balance of payments of the poor host countries. Their operation leads to more imports of arbitrarily priced capital goods, raw materials and intermediate goods, remittances in the form of royalties, technical fees, profits and interests; the sum total of all these often exceed the value of exports of products produced by them plus the inflow of equity capital and loans generated through their influence. It may not be a mere coincidence that in the top two Highly Indepted Countries (HICs) such as Brazil and Mexico, the share of foreign-owned or affiliated enterprises in their manufacturing production is very high - around 40% - while for Japan and the USA, foreign controlled firms account for only 5 to 6 per cent of their manufacturing activity (Raffer, 1987, pp.217-218).

Besides liberalisation, another feature of IMF-World Bank conditionality is substantial real devaluation of national currencies of the countries seeking their assistance to tide over their balance of payments problems and/or debt servicing commitments. It is argued that this devaluation will help to improve their export competitiveness as IMF-World Bank theory holds that balance of payment deficits and indeptedness follow from overvalued currencies.

This type of IMF-World Bank conditionality suffers suffers from a "fallacy of composition" as it expects that what may be good for an individual deficit country must also be good for all the deficit countries as a whole. Within a structural adjustment agreement, each country is expected to increase its exports by real devaluation, wage cuts etc. No account is taken of the impact of such an export expansion by one country on the export proceeds of other countries. Yet at the same time, other countries are also advised to push their exports through broadly identical measures - outward orientation, substantial devaluation of their currencies etc. This is the problem with the country-by-country approach of IMF and World Bank, as Singer (1989b) pointed out clearly.

It is also to be noted that while the IMF-World Bank approach is too country-specific, it is at the same time not country-specific enough. The recommendations made to different countries show a surprising similarity to each other. It can be observed that measures recommended to various countries show a 70 to 80 % overlap of identity (ibid). Therefore, as Singer (1989b) commented, the IMF-World Bank policy packages are more inspired by ideology and pre-conceived theory than derived from concrete analysis of specific country situations.

The IMF-World Bank tackling of the present debt crisis of the poor countries suffers from this fallacy of composition. It has been observed that debt pressures on the poor countries led to "desperation exports" and a sharp decline in the export prices and terms of trade of the highly indepted countries (Sarkar, 1990). This is the transfer burden of debt, once discussed seriously by Keynes (1929) in the context of German reparation payments after the First World War. The IMF-World Bank policy prescriptions can often be blamed for such "desperation exports" and the mounting transfer burden of debt of the poor countries. This problem is particularly serious in the case of competing exporters of primary commodities facing inelastic demand so that large price cuts are necessary to achieve given increases in export volume. For example, if Chile devalues and expands its share of the copper market, this is bound to affect the share of Zambia and Zaire; if all of them try to do this simultaniously the results would be general immiserisation (Singer, 1989b). This is also true for coffee, tea, cocoa, rubber and other commodities exported by the poor countries.

Available evidence indicates that between 1980 and 1985, the volume of copper exports of the poor countries rose by 12 per cent and its price fell by 35 per cent. This is true not only for copper. The aggregate volume of 10 "core" commodities mainly exported by the poor countries such as sugar, coffee, cocoa, natural rubber etc., rose by 8 per cent while the unit value of exports fell by 28 per cent (Sakar, 1990). That means the poor countries which expanded export volumes of these commodities under IMF/World Bank structural adjustment programmes have faced the Fisherian Paradox: The more the deptors pay, the more they owe.

The most striking piece of evidence comes from the source of World Bank. In the controversial report "World Bank/UNDP: Africa's Adjustment and Growth in the 1980s", some data were presented to show that countries with "strong reform programmes" are doing better than countries without such programmes. But it could not hide the fact that the African countries which have adopted "strong adjustment programmes" and expanded their export volume by 5% per annum during 1985-87 faced a terms of trade loss at the rate of 5% per annum during the same period while other African countries which refused to oblige the IMF/World Bank (fully or partially) did not face any deterioration in their terms of trade (Sarkar, 1990). This confirms the view that outward orientation and export drives associated with debt pressures and IMF/World Bank type of adjustment programmes put downward pressures on export prices and terms of

trade making the debt burden to that extent heavier rather than lighter (Singer, 1989b).

Concluding comments

From all this it is clear that the world economic order created by the international economic institutions such as the IMF and World Bank - the siamese twins born at Bretton Woods - did not benefit the poor countries and there is no prospect for them to improve their living standards. Before the Bretton Woods era, they were colonies or semi-colonies and in the post-Bretton Woods world order they are facing a neo-colonialist regime. The activities of IMF and World Bank try to tie them more and more into the neo-colonial bondage. In the older order, they faced long-term deterioration in their terms of trade and in the post-war years they continue to face the same fate (Sarkar, 1986). In the mid-1970's, there was some hope for changing the Bretton Woods order in favour of a new order where the interest of the poor countries' development would be given more importance. But the development of the 1980s belied that hope. The neo-colonialist grip of the Bretton Woods order has become tighter. Lack of unity among the poor countries prevented the emergence of a South Bank. Rather OPEC- influenced higher oil price revenues of a section of the poor countries were kept in the Western TNBs which in turn recycled it to the needy poor countries at a cheap but flexible interest rate. Soon interest rates soared high and world recession started under the monetarist policies of the rich countries. IMF and World Bank waited for this situation and came with their fundamentalist policy packages. As discussed above, these are keeping the poor countries in a vicious circle of poverty and debt.

It is true that the economic order created at Bretton Woods is a definite improvement over the disorder which existed in the inter-war years. But this is mainly for the rich and powerful countries and to some poor countries tied to the apron-strings of the powerful countries. But it must be remembered that if all the poor countries try to tie themselves to the apron-strings of some powerful countries it is unlikely for all of them to get a caring mother. So it is in the interest of the poor countries that the old order of Bretton Woods should be changed. Only unity and cooperation among the poor countries can lead to a consensus for a new world economic order with new institutions free from the blant neo-colonialist ideology of the IMF and World Bank.

References

Bagchi, A.K., 1989, "The IMF View of International Economic Policy and the Relevance of Sraffa's Critique of Economic Theory", in Bharadwaj, K. et al. (eds.), "Essays on Piero Sraffa", London, Hyman.

Hosseinzadeh, E., 1988, "Global Debt: Causes and Cures", Review of Radical Political Economics, Vol. 20, No. 2 & 3.

Keynes, J.M., 1929, "German Transfer Problem", Economic Journal, Vol. 39.

Lall, S. and Streeten, P., 1977, "Foreign Investment, Transnationals and Developing Countries", London, Macmillan.

Raffer, K., 1987, "Unequal Exchange and Evolution of the World System", London, Macmillan.

Sarkar, Prabirjit, 1986,"The Singer-Prebisch Hypothesis: A Statistical Evaluation", Cambridge Journal of Economics, Vol. 10.

Sarkar, Prabirjit, 1990, "Debt Pressures and the Transfer Burden of LDCs", Economic and Political Weekly, June 16-23.

Singer, H., 1989a, "Lessons of Post-War Development Experience: 1945-1988", IDS Discussion Paper, No. 260, Sussex, England.

Singer, H., 1989b,"The Relationship between Debt Pressures, Adjustment Policies and Deterioration of Terms of Trade for Developing Countries", Working Paper No. 69, Institute of Social Studies, Hague, The Netherlands.

Thirlwall, A.P. and Bergevin, J., 1985, "Trends, Cycles and Asymmetries in the Terms of Trade of Primary Commodities and Less Developed Countries", World Development, Vol. 13, No. 7.