Rachel Glennerster

D-Lab: The Role of the International Financial Institutions in Development

October 26, 2009
Outline of lecture

• Overview of the international financial organizations
• What is similar and different between WB and IMF?
• Historic genesis of WB and IMF
• Macro framework: conditions of IMF lending
• How the IMF and World Bank fit into that framework
The International Financial Organizations

The UN system

- UNICEF
- UNDP

Bretton Woods Institutions

- IMF
- World Bank

Regional Banks

- African
- Asian
- Inter-American
- EBRD

Other

- BIS
- OECD
- G24
- FSF
- G7
## International Monetary Fund and World Bank Group
### What is the same? What is different?

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<th>IMF</th>
<th>World Bank</th>
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<td><strong>Established</strong></td>
<td>1944/45</td>
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<td><strong>Historical genesis</strong></td>
<td>Great depression</td>
<td>Post WWII rebuilding</td>
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<td><strong>Membership</strong></td>
<td>Governments</td>
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<td><strong>Voting</strong></td>
<td>Size/importance economy</td>
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<tr>
<td><strong>Discipline</strong></td>
<td>Economics</td>
<td>Mainly economics</td>
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<td><strong>Focus</strong></td>
<td>Macroeconomics</td>
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<td>Balance of payments</td>
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<td>Exchange rates</td>
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<td><strong>Tools</strong></td>
<td>Technical advice</td>
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<td>Surveillance/coop</td>
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<td>Lending</td>
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<td></td>
<td>Setting a framework</td>
<td>Coordinating donors</td>
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<tr>
<td><strong>Scale</strong></td>
<td>2,490 employees</td>
<td>10,000 professional staff</td>
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<td></td>
<td>$1.8bn lent FY2009 to 28 countries</td>
<td>$58.8bn FY2009 $767 projects, 48 countries</td>
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Governance of the IMF and World Bank

Board of Governors
(Ministers of Finance, Governors of CB/Ministers of Development)
(IMFC/Development Committee – 24 Governors)

Executive Directors
(24 full time representatives of governments)

Managing Director (IMF) /President (WB)

Deputy Managing Directors (IMF)/Vice Presidents (WB)

Area departments

Functional departments
Constituencies and voting shares of IMF Executive Directors  
(NB very similar for the World Bank)

**Single countries EDs:**
- US (17%)
- Japan (6%)
- Germany (6%)
- France (5%)
- UK (5%)
- Saudi Arabia (3%)
- China (3%)
- Russia (3%)

**Multi country EDs:**
- Belgium, Austria, Czech Rep, Turkey (central Europe) 5%
- Netherlands, Ukraine, Romania (other Balkans) 5%
- Mexico, Venezuela, Spain, (other central America) 4%
- Italy, Greece, Portugal, Malta, San Marino, Timor-Leste 4%
- Canada, Ireland, Jamaica, (other Caribbean) 4%
- Finland, Iceland, Denmark, Norway, Sweden (Baltics) 4%
- Korea, Australia, New Zealand, (Pacific Islands) 3%
- Egypt, Lebanon, Kuwait, Libya, (other Arab states) 3%
- Malaysia, Indonesia, Thailand, (other SE Asia) 3%
- Tanzania, Kenya, South Africa, (Anglophone Africa) 3%
- Switzerland, Poland, Serbia, (Central Asia) 3%
- Iran, Morocco, Pakistan, Algeria, Ghana, Tunisia 2%
- Brazil, Colombia, (other Latin America) 2%
- India, Sri Lanka, Bangladesh, Bhutan 2%
- Argentina, Peru, Chile, Uruguay, Bolivia, Paraguay 2%
- Equatorial Guinea, Rwanda, Congo (Francophone Africa) 1%
Historical genesis

**IMF:**
Great depression
Countries took individual actions to protect themselves
Increase in trade barriers
Collapse of international trade, everyone worse off
Rise of Hitler
Determination to avoid mistakes of the past

**World Bank:**
Post WWII, massive investment needs in Europe
Europe had no money and difficult to borrow
Bank willing to take the long-term view on the investment
The world would benefit from European prosperity
(avoiding the mistakes of post WWI history and rise of Hitler)
IMF Objectives

Article 1: 

i) promote cooperation

ii) increase trade, and therefore employment and income

iii) stable exchange rates (initially mainly fixed exchange rates)
    avoid competitive devaluation

iv) reduce restrictions on payments for trade

v) provide loans to help cover shortfalls in Balance of Payments
   to help correct BoP without hurting national or international interests

vi) therefore reduce the impact of BoP/foreign exchange crises
Macroeconomics 101: a series of definitions and budget constraints

Real sector (definition)

\[ GDP = C_p + C_g + I_p + I_g + X - M \]

\[(S-I)p + (S-I)g = X - M\]

Private balance  Govt balance  Trade balance

Balance of payments (budget constraint)

Exports – imports + FI&T + capital inflows – outflows = \( \Delta \) reserves

Trade account  Capital account

Fiscal sector: (budget constraint)

Taxes – expenditure = govt balance = - financing

Financing = CB financing + bank financing + privatization + new bonds + external

\[ MV = PY \]  (predictable relationship)

IMF conditions
How does IMF and WB lending impact these constraints?

Exports – imports + FI&T + capital inflows – outflows = Δ reserves

\[(S-I)p + (S-I)g = X - M\]

Can be bigger

Fiscal deficit = borrowing from banks + new bonds + donor money

Can be bigger

Less bank borrowing means less inflation

IMF money

World bank money
How does IMF and World Bank lending fit into this picture?

IMF lending

The deal: we will work with you to figure out the constraints. If you fit within them we will give you some additional money to ease the constraints (allow a bigger fiscal deficit or more imports or both).

Short-term lending: failure of export crop would require sharp cut in imports could do long term damage. Short term loan allows you to keep importing and avoid the damage.

Long-term lending: gives breathing space to improve policies that lead to long term grow.
World Bank Lending

**The deal:** there are investments countries can make with up front costs and long-run payoffs. We will lend you the money and give technical advice on the investments and you can pay us back out of the long-term benefits.

**Project lending**—building roads costs money but it helps generate higher output

**Program lending**—cutting tariffs reduces government revenue (and jobs) up front but helps stimulate growth. Loan will cover lost revenue and help pay for support to those made unemployed.