Rachel Glennerster

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

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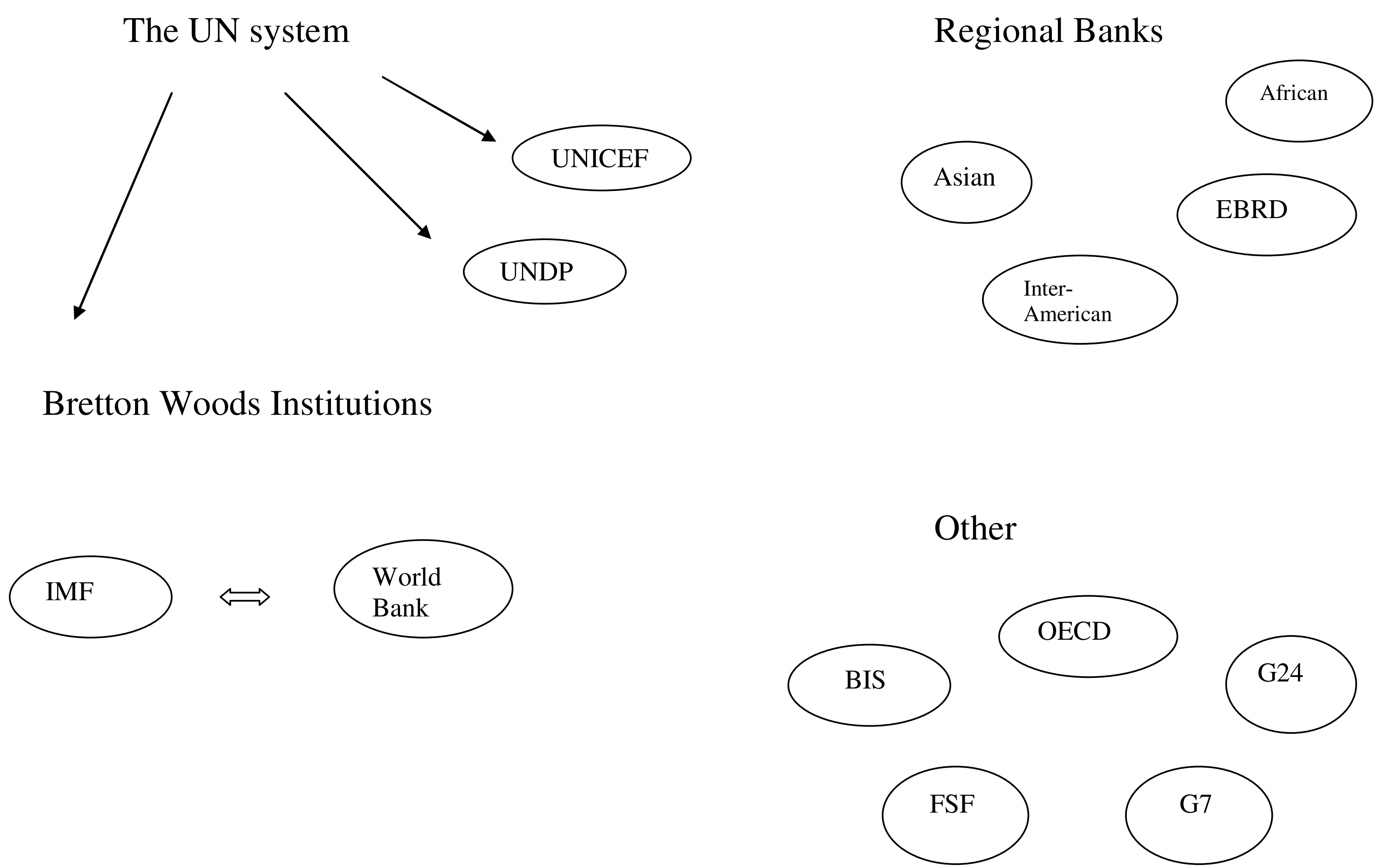
Outline of lecture

- 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



International Monetary Fund and World Bank Group
What is the same? What is different?

	IMF	World Bank
Established	1944/45	1944/45
Historical genesis	Great depression	Post WWII rebuilding
Membership	Governments	Governments
Voting	Size/importance economy	Size/importance economy
Discipline	Economics	Mainly economics
Focus	Macroeconomics Balance of payments Exchange rates Inflation Fiscal deficits Financial system	Microeconomics Health, education Public sector reform Infrastructure Regulatory systems Financial system
Tools	Technical advice Surveillance/coop Lending Setting a framework	Technical advice Lending Coordinating donors
Scale	2,490 employees $1.8bn lent FY2009 to 28 countries	10,000 professional staff $58.8bn FY2009 767 projects, 48 countries

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)

$$GDP = Cp + Cg + Ip + Ig + X - M$$

$$\underbrace{(S\text{-}I)p}_{\text{Private balance}} + \underbrace{(S\text{-}I)g}_{\text{Govt balance}} = \underbrace{X - M}_{\text{Trade balance}}$$

Balance of payments (budget constraint)

$$\underbrace{\text{Exports} - \text{imports}}_{\text{Trade account}} + \text{FI\&T} + \underbrace{\text{capital inflows} - \text{outflows}}_{\text{Capital account}} = \Delta\ \text{reserves}$$

Fiscal sector: (budget constraint)

Taxes – expenditure = govt balance = - financing

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

M predictable relationship)

MV=PY

IMF conditions

How does IMF and WB lending impact these constraints?

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

IMF money

$$(S\text{-}I)p + (S\text{-}I)g = X - M$$

Can be bigger

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

Can be bigger

Less bank borrowing means less inflation

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.

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