

# Good essay about international monetary fund, world bank and developing countries...

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## **Introduction**

International Monetary Fund and World Bank are two well-reputed financial institutions that try to ensure that the global economy is in healthy state and the economic disparity among people and nations are reduced as much as possible. The basic goals of these institutions are focused around developing nations. Developing nations across the world have many basic problems impeding their progress. Many people in those countries are ridden with problems like the lack of access to clean water, lack of sanitation facilities, no access to primary and secondary education, disparity among girl and boy child, lack of health facilities and lack of access to basic daily meal.

Developing countries know that they need to act upon those issues but in many cases they do not have the required funding to start the process. IMF and World Bank try to bridge the gap financially. IMF and World Bank work in collaboration with the government of developing countries to come up with financial assistance plans. The purpose behind the action is to provide adequate funds so that the government of the developing nations can spend the money in a manner to improve the overall economy of the developing countries and mitigate some of the problems plaguing those nations. This essay will discuss upon the role of IMF and World Bank in providing funding to developing countries and whether or not those aids fulfilled the purpose the funding was meant for in the past and if not, what are the probable causes of failure of the overall funding program and how it can be improved in future.

## **IMF and World Bank**

International Monetary Fund and World Bank were created in Bretton Woods, New Hampshire, United States of America in 1944. The basic goal at that time was to create a global financial infrastructure of cooperation and development which will lead to more prosperous and stable global economy. Till this date the goal for International Monetary Fund and World Bank remains same. However, with the passage of time the roles of International Monetary Fund and World Bank have evolved a lot.

International Monetary Fund mainly looks into the monetary policy part of the global economy. It provides all countries, if required, with monetary policy advice and financial technical assistance to help build a strong and sustainable economy. Apart from the above two services the main role of International Monetary Fund is also to provide short term loans to countries and help design balance of payments related problems (IMF 2013).

International Monetary Fund provides loans to developing and poor countries which may not get any loans on its own for economic growth. International Monetary Fund loans are generally short term and funded by developed countries as per the quota rule.

World Bank, on the other hand, promotes long term economic growth and poverty reduction. World Bank provides financial and technical support to help countries reform certain sectors of the economy. It also provides assistance to implement specific projects by providing technical expertise and financial aids (IMF 2013). For example, World Bank provides help in building health centers and schools, protecting the environment and fighting diseases. World Bank also provides funds for developmental construction

projects including road construction, electricity power plant construction and so on. World Bank only focuses on long term projects. The funding comes from the World Bank member country contributions and bond issuance.

## **Factsheet**

International Monetary fund has mainly two goals. The first goal is to achieve its external goal of helping countries reduce balance of payments and current account deficits. The second goal is help poor countries technically and financially to achieve its short term basic economic growth objectives like poverty eradication programs. World Bank, on the other hand, has singular goal of helping the developing countries financially and technically to achieve long term growth.

IMF and World Bank are helping the poor nations for almost 70 years now. Especially, African countries have got billions of dollars as financial aids from IMF and World Bank for growth and project funding. Those countries also have got assistance from IMF and World Bank in getting loans from private financial institutions for different growth initiatives. However, all those developing and poor countries need to repay those loans to either World Bank or IMF or to other private financial institutions. In 2010 alone almost \$184 billion was paid out by the developing countries as debt (Munevar and Toussaint 2013). One will get bamboozled if he compares it with the Millennium Development Goals (MDGs). Total expenditure for MDGs by IMF and World Bank for the 2010 across the globe was \$60 billion only, one third of the amount the developing countries are paying out as debt service to World Bank, IMF and associated financial members (Schneider 2010).

Between 1985 and 2010, the net public debt flows for the developing countries are a whopping \$530 billion (Munevar and Toussaint 2013). 70% of those are coming from African nations. In many sub Saharan countries the majority of the fiscal budget spend are allocated to repay the debt. In fact some of the sub Saharan countries had to cut down on the expenditure related to the basic growth programs like primary education, road construction and health access to repay the loans. Many developing countries are in a debt trap. They are so overburdened by the debt that they cannot spend enough for the economic growth of their countries. Even after 70 years of financial help, barring a few African nations almost all of the countries are still under severe poverty lacking access to many basic necessities for the citizens. This poses a big question about the objective and the methodology employed by IMF and World Bank in last 70 years.

### **Why did the model fail?**

There are several reasons given by several economists and financial analysts for the failure of the funding model of IMF and World Bank. The main problem as cited by many analysts is as below.

In its initial days IMF and World Bank followed the Polak Model of macroeconomic investment which was a simplistic model. Polak model assumed that if money was injected in an economy and its business was open for trade with other economies then in the long run economic growth would happen for that country. This basic philosophy was used by IMF and World Bank in its early days. IMF and World Bank provided short term loans as well as developmental loans to the developing countries assuming that

those economies would grow in time and would become financially stable. Once financially stable they would no longer require any financial aid and would be able to pay the debt without any problem (Edwards 1989). However, they never thought what if the model failed. There was no consideration of unexpected events and uncertainty in the basic model. However, there were many macroeconomic forces playing their part in the whole process as was expected by IMF and World Bank. Firstly, all those loans provided to developing nations, in many cases African nations, were funded by developed countries like US, UK, France, Germany and so on. United States was the major fund provider for many developing countries in last half of the last century. But after providing the loans IMF, World Bank and the country funding the loan imposed several conditions which are more commonly known as structural adjustment. For example, if IMF is providing a short term loan funded by US to a country in sub Saharan Africa then it wants the country to open up its public sector for privatization, trade liberalization and austerity measures. This may not be beneficial for the developing country. In fact if the funding is provided by US, US will try to get into some of the countries' public sector and make those areas privatized. Those private companies will definitely function in a more efficient way than the publicly held company. This may mean job cuts and shutting down of even more public companies. Added to that, the profit earned by those companies will not stay in the developing countries. In fact the private companies will realize the profit in US. The amount of money injected by IMF funding may be less than the overall money that will be taken out of the economy by the private companies as profit. Additionally,

because of privatization and less control over its operation, the governments of the developing countries may not improve their revenue in the short and medium term. This will mean that to repay the debt they need to employ austerity measures like lessening funding in areas like education, health and food programs. This will not improve the economic situation and create more poor population than before, reducing the revenue for the government further. Government will be more cash trapped and eventually fall into a debt crisis. For example, the coal mines in Zimbabwe were mainly funded by UK companies and all those financial institutions booked their profit outside Zimbabwe. Those private companies which were operating in Zimbabwe but booking their profit elsewhere were not bound by law to spend anything to uplift the local people. The financial institutions made billions of dollars as profit but the coal mines in Zimbabwe still remain as one of the most impoverished lot in the whole of Africa (Harvey 2013). The government of Zimbabwe does not have enough money to come up with initiatives for improving the life of people and private companies are not bound to do anything. The situation has not improved in last 30 years.

Furthermore, the basic financial model used by IMF and World Bank during 1950s to 1970s was very simplistic. The importance of governance was not factored in the financing model. Many a time the funding provided by IMF or World Bank never reached the intended recipients. The benefit ripped out of the investment was not shared equitably among the society. For example, World Bank provided a loan to Zambia for its hydro power project over Zambezi River. A major part of the loan was wasted because of local contractor problems and corruption. Only a part of the loan was used to build

the hydro dam. As a result the hydro power project was finished but a large number of people affected and displaced by the Dam project were not compensated. This way the project investment created a hydro power generator which was used to meet the electricity need and prosperity of the industries but on the other hand many people who were living a decent life before they were displaced out of their homes due to the Dam became poor. As a result of the above cases many big budget funding programs are now deemed as risky by IMF and World Bank.

### **How it can be improved?**

The whole debt crisis situation can be handled in multiple ways. First and foremost, we need to look at the short term issues that IMF and World Bank need to address. The developing countries which are in debt trap and hurting their economy due to the debt burden should be considered for debt reduction. IMF can talk to the funding countries and private parties who have arranged for the debt for the developing countries and come to some sort of solution to reduce the debt burden for those countries. It seems unfair on the part of fund providers but it is not an uncommon practice. For example, after the 2008 financial crisis, US government has reduced or completely written off debts of financial institutions worth \$1.2 trillion (Weisbrot 2013). The total amount of loans the US government holds to all developing countries in Africa put together is not even 5% of that figure. It will have not much impact of US economy at all but it will definitely impact the developing countries in a positive way and help them come back to the growth path. However, the above solution may not be sustainable and is only a short term



fix. In the long term IMF and World Bank need to come up with better structure. In fact the previous programs have gone so bad that even IMF and World Bank is now starting to interfere in the policy matters of the countries and even suggested that the developing countries should increase the tax for the rich people substantially to repay the debt and reduce balance of payments (France-Press 2013). IMF and World Bank are very important financial bodies and those bodies are required to function the way they are doing it now. The main thing requiring change is the change of framework by IMF and World Bank for funding based on the country in concern as macro-economics of countries vary vastly from each other. IMF programs have worked in lowering inflation in some cases. However, the programs failed in growth targets. IMF and World Bank should come up with a better conditionality and structural adjustment policy while providing loans. Pure structural adjustment policies only promote free market and often the profit pie is enjoyed by somebody else. IMF and World Bank funding should be purely growth and objective based. For example, World Bank should provide funding to a developing nation for "Poverty Reduction" program (Weisbrot 2013). The primary objective should be poverty reduction. In the past the basic assumption was that if World Bank invested in some developmental project, it would automatically improve the conditions of the poor in that country. This specific object oriented approach will at least ensure that the money is being spent on the right purpose and the profit is not shared by unintended stakeholders. Finally, the borrowing country should be made more involved in the whole process. Instead of IMF or World Bank creating a plan for poverty reduction for a developing country, the country itself should

draw the poverty reduction plan. This way the developing country will feel more ownership of the loan and also will come up with better fiscal policy. Finally, the involvement of banks and World Bank/IMF should be lessened. Currently the banks heavily influence the process of drawing the conditionality of the loan. The developing country has less say in that. However, if the involvement of the borrowing country is increased and the bank is moderated then there is a chance that a better and feasible loan and fiscal policy plan will evolve.

## **Conclusion**

IMF and World Bank were created in 1944 with the purpose of greater good for the world economy. The main targets for these two institutions are to create a congenial environment for growth globally and help provide basic access to all human races. The main programs, run by IMF and World Bank, provide funds to the developing countries for the reduction of balance of payments and help reduce poverty. In last 70 years, IMF and World Bank have provided billions of dollars of loan to poor countries. However, it is arguable how much those findings have helped. For example, majority of the IMF and World Bank funding were in Africa and still most of the African nations are in deep poverty lacking basic necessities like education, clean water and health facilities. The main problem stems from less understanding of the uncertainties of the macroeconomic model. In many cases the amount of money injected is less than the amount of money taken out of the system in the developing countries. The solution to this problem is not simple. In short term IMF and World Bank should try to write off some of the loans to

provide relief and bring back the developing countries to the normal growth path. Additionally, for the future IMF and World Bank should come up with a model where the borrowing nations are more involved in the whole process and banks should not force their conditionality criterion too much on those nations. This way the borrowing nations may come up with a policy and fiscal plan which will be more feasible and effective.

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