The Birth and Pecularities of the Bretton Woods Institutions and the Main Features of the International Financial System They Brought About

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Abstract

In July 1944, a New England resort hotel in Bretton Woods witnessed the birth of the International Monetary Fund and the International Bank for Reconstruction and Development mainly as a result of a bilateral agreement between the United States and United Kingdom. The primary functions foreseen for both institutions had their roots in the political and economical developments that had been experienced by the founder countries. The Fund's responsibility was to restrain the disorder that surfaced in the monetary system with the abandonment of the gold standard while the Bank was expected to assist in the reconstruction of the war-torn Europe. However, after 65 years, the mandates of both institutions not only broadened but also converged raising questions about their relative roles and their necessities for the new world order. This paper aims to examine the structure, formation and inter-relations of IMF and World Bank while exploring the financial, monetary and political environment that required the substitution of the International Gold Standard with the Bretton Woods system, a system brought about by the formation of these institutions.

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In the first part, the main motives behind the formation of a single international monetary system built on two inter-governmental institutions is discussed while a historical assessment and a brief description of the features of the International Gold Standard along with its characteristics are presented within.

The second part is about the structure and the recent overlapping of the tasks of IMF-World Bank and focuses on their mandates as well as their inter-relations. Their new lending policies and the introduction of new lending instruments are also discussed albeit not to a great extent.

I. The Foundation of Bretton Woods Institutions

A- Introduction

Everything started in a quiet, peaceful New England resort hotel. United Nations Monetary and Financial Conference had met there to agree on the Articles of Agreement[1] of the International Bank for Reconstruction and Development. The date July 1944 would not only be remembered as the birthdate of the IMF (The Fund) and World Bank (The Bank), but also mark the emergence of the endless debate over those Bretton Woods Institutions.

The prevention of the disruption of foreign exchanges, avoidance of the collapse of the monetary system and the composition of a sound currency basis for the balanced growth of international trade could be considered as the main motives behind the release of the Fund whereas the primary functions that had been foreseen for the Bank were the contribution to the reconstruction of Europe in the post-World War II era and the guaranteeing of loans made by private banks for the projects in poorer, developing countries.[2] However after 65 years, the Bretton Woods twins; rather than having specific functions and goals, moved

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1 Referred as the Articles in this paper.

2 Spero, J.E.: The Politics of International Economic Relations, p. 35 (1985)

to become permanent institutions for consultation and cooperation on international monetary, finance and economic problems.[3]

Both the IMF and the World Bank are moving to be macro economically interfering inter-governmental institutions. The past experiences these institutions had with their programs and projects, combined with the ever-changing economic environment, can be the justification for their changing nature.[4] However, the fact that their influences over deficit developed countries are diminishing[5] seems to raise doubts over the future of their new approach, as it is unlikely to predict that the Bretton Woods Institutions will be able to take the necessary steps to achieve their main goals, which are: foster global macro economic conditions conducive to the growth of all nations and stimulate development in the

[3] Generalizing the utmost aspirations behind the formation of the Bretton Woods Institutions as to provide state interference with local economic crises in order to render an international financial stabiity would not be far from truth. See Yüksel, Cüneyt.: Legal Issues of Global Governance, Economic Development and Democracy: Towards a Legal Theory of Restructuring the International Economic Institutions, *Annales de la Faculté de Droit d'Istanbul* Vol. 37 No. 54, p. 187-205 (2005).

[4] The failure of some recent IMF programs taught important lessons not only to IMF itself but also to its twin, the World Bank. The Bank acknowledged that structural adjustment and development finance could not be realized without stable economic environment. As a result, its concern with macroeconomics has intensified, particularly with the surfacing of very serious inflation problems in the developing countries in the 1980s. However, still it was IMF under the spotlight since notwithstanding its formation as an international monetary institution, IMF turned out to be an international finance institution having a broader mandate.

[5] No industrial country borrowed from the IMF since the beginning of 1980s. The last instance of a major industrial country making use of IMF resources was in 1976 when eight industrial countries drew a total of 2.6 billion SDRs (Vaidya, K. A.: Globalization Vol. I-II, p. 637, 2005). This fact may soon be altered taking into account the recent declarations from both the current Greek administration and the EU policy makers following the dire financial consequences of the recent Global Financial Crisis on Greece. (http://hosted.ap.org/dynamic/stories/E/EU_EUROPE_FEARING_THE_IMF?SITE=TNMEM&SECTION=HOME&TEMPLATE=DEFAULT Last visited on March 19 2010). The current situation is a cross-roads for the future of Eurozone as well as the new role IMF is stepping up to assume by helping some EU economies, starting with Greece. As of now; at least three of Eurozone's sixteen nations (namely Italy, The Netherlands and Finland) seem to be open to calling in IMF to Greece's rescue if necessary. *See* www.ft.com/cms/s/0/bc84626a-31fd-11df-a8d1-00144feabdc0.html Last visited March 22 2010.

Third World, even with the opposition from the developed countries. One of the biggest issues that the Bretton Woods Institutions will face to tackle is their obligation to please the creditors – which are the developed countries with extra surplus-[6] as well as the rest, which are the borrowers. Nevertheless, it is not surprising that the Bretton Woods Institutions broadened their playing field since the time they were formed. IMF now has 186 countries as members[7] compared with the 39 members it had back in May 1946 when the Fund started its operations. With having nearly all the countries as its members[8], IMF is, without a doubt, one of the most influential inter-governmental institutions in world economy while the World Bank, with its 185 members, is a very strong figure for the developing and less developed countries concerning the task it is undertaking (channeling financial resources from the richer countries to the poorer countries to help raise productivity and standards of living in the developing world but taking it all back with interest and debt repayment!).

B- The Birth of the Bretton Woods Twins

The basis of the Bretton Woods system was formed starting with the discussions held in Washington and London that were aiming to draft a set of rules in international monetary issues to be implemented after the World War II which was still being fought at that time. The Bretton Woods Institutions were established before the cessation of the warfare making them part of a greater undertaking to help the progress of international cooperation in the post war world. During those discussions two main

[6] In the light of the recent developments surrounding EU and some of her members namely Greece; the head of IMF Strauss-Kahn, with a very recent statement, asked countries like Germany and China, which have large current account surpluses, to curb their reliance on exports and start to focus on domestic consumption. A call which not surprisingly was ill-received by German officials. *See* www.spiegel.de/international/europe/0,1518,684185,00.html Last visited on March 22 2010.

[7] The latest member of IMF is the Republic of Kosova (IMF Press Release, No: 09/240, 2009).

[8] All countries that are members of the United Nations are also represented in the IMF. The only exceptions are Taiwan (expelled in 1980), Cuba (left voluntarily in 1964), Nauru, Liechtenstein, Monaco, North Korea, Andorra and Tuvalo.

plans were submitted from both United States and United Kingdom. Harry Dexter White, a member of the staff of the US Treasury (who later would become the US Executive Director of the Fund), composed the US plan (named the White Plan) whereas John Maynard Keynes (later Baron Keynes of Tilton) Honorary Advisor to the British Treasury, was the father of the British plan (named the Keynes Plan). Their proposals were drafted in 1941 and 1942, negotiated in 1943 and adopted at the International Monetary and Financial Conference of the United and Associated Nations in Bretton Woods, New Hampshire in July 1944. Delegates from 44 nations in addition to representatives of international organizations were present at the conference.[9] The preparation of the International Monetary Fund was the prior issue of the conference whereas the World Bank was in a kind of subordinate status.[10]

Not surprisingly White's plan was influenced by the bitter experiences of the 'Great Depression' in the USA. The stock market crash in 1929 that followed the prosperity of the 'roaring twenties' made USA enter a catastrophic economic period.[11] Between 1929 and 1932 industrial production decreased by 47 percent and the national income by 52 percent.[12] By March 1933 there were at least 14 million unemployed.[13] The White Plan had mainly focused on the establishment of international institutions that would be subject to the control of the member countries. In other words, the core of the White Plan was the establish-

[9] There were a total of 730 delegates at the United Nations Monetary and Financial Conference.

[10] Lastra, R.M: The International Monetary Fund in Historical Perspective, *Journal of International Economic Law*, p. 508 (2000); Mason, E.S. & Asher, R.E.: The World Bank Since Bretton Woods, pp. 21-22 (1973).

[11] It is interesting to see history repeating itself. Just like in 1930s: the mushrooming of deregulated financial markets and the consequent prosperity era ended with the collapse of unfettered financial market in 2008 marking this instance as the greatest contagious financial market crisis since the 'Wall Street Crash of 1929'.

[12] National Bureau of Economic Research, Recent Changes in Production, Bulletin 41, pp. 2-3 (1943).

[13] Horsefiled, J.K.: The International Monetary Fund 1945-1969, Volume I: Chronicle 5 (1969).

ment of a institution[14] that would ensure the stability of currencies and prevent the repetition of competitive devaluations and of the restrictions on payments as well as the setting up a bank for reconstruction and development.

On the other hand, Keynes's proposal included formation of an international clearing union and the creation of a large amount of credit to be distributed among all trading countries. The main idea of Keynes plan, which, in a way, reflected his belief in lack of liquidity being the key problem of the international system, was to avoid the balance of payments imbalances using a code of conduct governing the overdrafts on the union accumulated by debtors and the positive balances acquired by creditors.[15] This plan was entitled as 'Proposals for an International Currency (or Clearing) Union'.[16] Unlike the White Plan, the Keynes Plan primarily focused on the work of International Monetary Fund, which was referred to as the International Clearing (or Currency) Union, discarding the establishment of a bank for reconstruction and development. The Keynes Plan had faced resistance from the US negotiators claiming that it had inflationary tendencies and did not leave enough discretion to member country governments in implementing their balance of payment policies.[17] Thus at the end of the day; the White plan, after many discussions, gave birth to the International Monetary Fund and the International Bank for Reconstruction and Development with the agreements of the delegates of 44 countries.

The Soviet Union was the only country that did not become a signatory although it was represented in the Bretton Woods conference.[18] The same country would then go to charge the Bretton Woods Institutions at

14 A stabilization fund in his own words.

15 D'Arista, Jane: The Evolving International Monetary System, *Cambridge Journal of Economics* Vol. 33 No.4, p. 639 (2009).

16 The title of the final British draft did not involve the world 'currency'.

17 The *New York Times* regarded Keynes as an antagonist of stable exchange rates and as a champion of devaluation and credit expansion. (*New York Times,* A 'New' World Currency?, March 30 1943, p. 20)

18 See Hexner, Ervin: The Soviet Union and the International Monetary Fund, *The American Journal of International Law*, Vol. 40 No. 3, pp. 637-640 (1946).

a meeting of the General Assembly of the United Nations in 1947 to be 'branches of Wall Street' and the Bank to be subordinated to political purposes which make it the instrument of one great power.[19] This statement of the representative of the Soviet Union[20] at the meeting of the General Assembly of the United Nations was one of the first, but definitely not the last, criticisms of the Bretton Woods Institutions.[21]

1- The Need For A New International Financial System

The Bretton Woods Institutions were not founded in all of a sudden; the idea of having permanent institutions supervising international economy had started to be shaped years before the conference held in Bretton Woods, but the instability in any field caused by the threat of the probable confrontations between countries did not diminish for a half a century, disabling any kind of permanency.

The two world wars in which all the big powers participated, rendered great changes for both economical and political equilibriums. With

[19] Mason & Asher, p. 29 fn. 46 (1973). See also Knorr, Klaus: The Bretton Woods Institutions in Transition, *International Organization*, Vol 2, pp. 35-36 (1948). For the criticisms on the political determinants of IMF decision making see Truman, E.M.: Reforming the IMF for the 21st Century p. 80 (2006); Barro, R.J. & Lee, J.W.: IMF Programs: Who is Chosen and What Are The Effects?, *Journal of Monetary Economics* Vol. 52 No. 7, pp. 1245-1269 (2005); Bird, Graham & Rowlands, Dane: IMF Lending : How It is Affected by Economic, Political and Institutional Factors?, *Journal of Policy Reforms* Vol 4 No. 6, pp. 243-270 (2001).

[20] The fact that Russia, the main succesor of the ex-Soviet Union, is one of the best customers of IMF programs needs to be pointed out here. For example in 1998; the impact of the Asian financial crisis and a slump in oil prices forced Russia to turn to IMF to maintain her exchange rates. The fear of a collapse of Russian economy and its implications on world market alarmed the IMF resulting with the approval of a $22.6 billion emergency loan to Russia. (*New York Times*, Rescuing Russia: A Special Report; The Bailout of the Kremlin: How U.S pressed the IMF, July 17 1998, p.1)

[21] For a brief treatment of such criticisms see Yuksel, pp. 189-192. See also: Stiglitz, Joseph: Globalization and its Discontents (2002), Hertz, Noreena: The Debt Threat (2004). For a critical inquiry into the IMF and World Bank prescription see, Biersteker, T.J.: Reducing the Role of State in the Economy: A Conceptual Exploration of IMF and World Bank Prescriptions, *International Studies Quartely* Vol. 34 No. 4 (1990).

the World War I, came the collapse of the 700-year existing Ottoman Empire[22] and the end of monarchy in both Germany and Russia. The rise of National Socialism in Germany, Communism in Russia and Fascism in Italy formed a hybrid political map that would preserve its shape only till the end of the World War II with the termination of National Socialism and Fascism. However, Communism would stand its ground and make sure that its presence would be felt on every field.

In addition to those regime alterations, the economical weaknesses of the new nations that become independent after the World War forced changes in not only to the political but also the economical status quo. New countries were formed, new players come into stage and the inevitability of a fresh stable economic system was justified wih the social and political consequences of the world wars. What was needed, it was felt, was a form of international currency which would support national currencies, reduce uncertainty and bring stability, but which would not be of an automatic nature. All those aforementioned factors played a major part in achieving the Bretton Woods Conference. However, considering the Bretton Woods Conference as a starting point in bringing the first organized international monetary and financial system to life would not be correct, as the conference did not render a whole new system, in a way, replaced the previous one.[23]

22 A fact interesting enough to mention here is that the collapse of the Ottoman Empire was caused mainly by her external debt to the European countries (especially France) making the first example of a country caught in a debt trap. See Pamuk, Şevket: The Monetary History of Ottoman Empire, pp. 212-225 (2000).

23 It is also needs to be stressed that the idea of international economic co-operation that came up with the Bretton Woods Conference had to wait nearly half a decade to come into existence as a whole. The Bretton Woods system designed in 1940s foresaw the foundation of three international organizations: The International Monetary Fund (IMF) for the purposes of international monetary co-operation; the International Bank for Reconstruction and Development (IBRD) for the purposes of international development assistance-investment; and an International Trade Organization (ITO) for the purposes of international trade co-operation. However, while the IMF and the IBRD came into existence in the 1940s, the fate of ITO –which should have played the role of the necessary third leg of the Bretton Woods system- was quite different. Although the General Agreement on Tariffs and Trade (GATT) was signed in 1947, in not less than 48 years, the Bretton Woods system would recover its third leg- a permanent international trade

2- The International Gold Standard (British Pound Standard)

Indeed; the first clear example of an organized international monetary and financial system was the "International Gold Standard"[24], a system based upon the British Pound. The International Gold Standard were different from the system of IMF in the way that the 'universality' of the Gold Standard resulted from its adoption by many countries as their domestic monetary system.[25] In other words; the British Pound Standard, unlike the Bretton Woods System, was not meant to be an international monetary and financial system, however it turned out to be influential enough to attract the interests of most of the other countries. The fact that the British Pound became an international currency was mainly related to the character of British economy and its dominant status in the world.

The progress of Britain in the field of foreign exchange –starting from the 19th century- backed by the confidence in the stabilized character of the Pound, prepared the ground for its assumption of the role of an international currency.[26] In addition, Britain held a monopoly as the manufacturer for the world[27] and was the first country to adopt a *de facto* gold standard system for both domestic and international transactions[28], whereas most other trading nations were either on a bimetallic standard (such as USA and France), which involved the employment of both silver and gold coins as standard money, or on a silver standard as were the

organization- in the form of the World Trade Organization (WTO) in 1995. (Jackson, J.H.: The World Trade Organization: Constitution and Jurisprudence, Chp. 2, 1998)

24 For a detailed treatment of the 'International Gold Standard' see, Eichengreen, B.J.& Flandreau, M.: The Gold Standard in Theory and History (1997); Bordo, Micheal: A Retrospective on the Classical Gold Standard 1821-1931 (1984); Bordo, Micheal: Monetary Regimes in Transition (1993).

25 Horie, Shiego: The International Monetary Fund, p. 1 (1964)

26 Between 1860 and 1914 about 60% of the world trade was invoiced and settled in Sterling. (Williams, David.: The Evaluation of the Sterling System, p. 268, 1968)

27 Britain was also the leading trading nation in the world during that era. More than 30% of the exports of the rest of the world went to Britain in 1860 and a 20% in 1890. (Imlah, A.H.: Economic Elements in the Pax Britannica, 1958.)

28 In 1816 with the introduction of the golden sovereign as an unrestricted legal tender.

majority of other European countries during most of the 19th century. Furthermore, the Pound was freely convertible into a specific weight of gold allowing its usage without restrictions for foreign payments, while other countries had only a pseudo form of the gold standard, always subject to some restrictions.[29] Another unique feature in Pound's favor was the facilitation of international finance by Britain making London the center of exchange settlement as well as helping her to be established as the center of international finance.[30] As a result, the adjustment of credit through gold, which is the original and essential function of a gold standard system, came to be achieved on the basis of centralization in London. Thus the rationalization of world economy through gold was brought into being.[31]

The rise of Pound as an international currency had its respond in the global economic community. Especially during the 1870s, the movements towards gold accelerated causing silver lose its importance as an international standard. The first significant signs of this sudden change were the transition of Germany from silver to a gold standard in 1871 and the outcome of an international monetary congress held in Paris in 1867, which was in favor of the adaptation of a universal gold standard.[32]

The fall in the price of silver and hence its downfall as an international monetary standard was also brought about by the discovery of large deposits of the metal in Nevada and elsewhere which greatly contributed to a rapid increase in the world output of silver.[33] This excess of silver in the world market, which was aggravated by the suspension of the

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[29] Horie, p. 2.

[30] The Gold Standard had functioned in a nearly flawless fashion during the 19th century, a trait largely owing to the unrivalled experience and knowledge of the London banks and acceptance houses as well as the financial supremacy of the city of London. (Arndt, H.W.: The Economic Lessons of the Nineteen-Thirties, pp. 284-285, 1944)

[31] Horie, pp. 2-4.

[32] Gallarotti, G.M.: The Anatomy of an International Monetary Regime:The Classical Gold Standard 1880-1914, p. 165 (1995).

[33] Kenwood, A.G & Lougheed, A.L.: The Growth of International Economy, 1820-1960, p. 121 (1971).

minting of silver coins in the United States in 1873[34], caused the price of silver in terms of gold to drop below 16 to 1. Consequently, countries on a silver or bimetallic standard faced the possibility of substantial monetary inflation therefore the demonetization of silver became general after mid-seventies.[35]

3- The Fall of the Gold Standard

The movement to gold was completed by the end of 19th century.[36] It is difficult to be precise about the total duration of the gold standard as an international monetary system. To date its beginning (most would argue 1880)[37] is more difficult than to date its end as it is obvious that the outbreak of the World War I, in a way, marked its death since the post-war restoration of the system was short-lived contrary to the expectations. During and after the war convertibility into gold was universally suspended for a time, but there was a strong inclination everywhere to return to the system. However, with the prevailing wave of economic nationalism consequent to the war, the main focus shifted to employment and national income as the primary objects of economic stabilization, whereas the level of commodity prices was given a secondary consideration leading to policies of giving priority to domestic stabilization with a regulated currency instead of one controlled by gold.[38] Prior to this, inflationary policies during the war had exercised wide and profound impacts on the economies of all countries. Britain and many other countries increased the gold reserves of their central banks significantly by adapting a policy of centralizing gold. However, inflation during the war gave rise to a great increase in the amount of paper money in circulation and it became impossible to meet the demands for conversion at home.

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[34] In 1878 wih the Bland-Allison Act, US instituted a policy of limited silver coinage thus further marginalizing silver.

[35] Scammel, W.M: The Working of Gold Standard (1956)

[36] The elimination of silver as a central monetary metal was achieved aprroximately in 1874. (Gallarotti, p.165-166).

[37] See Ford, A.G.: The Gold Standard, 1880-1914: Britain and Argentina, p. 18 (1962).

[38] Horie, p. 17.

Therefore, their gold reserves were used only for the maintenance of external convertibility.

Additionally, the political and economical consequences of the World War had its effects in the world wide gold reserves. The surfacing of international imbalances of payments in wartime and the mushrooming of economically weak countries, which gained dependence only after the war, brought about an international misdistribution of gold. Also the rising production costs resulted in a decline in the output of gold, so that a shortage of gold was keenly felt by all.[39]

Under conditions mentioned above, it was expected that an attempt at the return of a gold standard system should be directed toward an economy in the use of gold rather than toward a gold coin standard system, which had been in existence in former days. Both at International Financial Conference held at Brussels in 1920 and at Genoa Conference, this feeling had been revealed leading to conclusion of an international convention on the basis of a gold exchange standard (a gold exchange system with gold exchange reserves).[40]

4- Great Depression

Britain returned to gold standard in 1925 at the pre-war parity, but not without its modifications. Under the new system called "Gold Bullion Standard System", gold reserves were regarded as necessary, solely for external purposes and it was therefore only from an international viewpoint that it could be called a gold standard system. The gold exchange

[39] The worldwide production of gold fell by one-third during the period from 1915-1922. (Fetter, F.A.: Modern Economic Problems, Vol. II, Part 2, 1922).

[40] Eichengreen, J.B.: Golden Fetters: The Gold Standard and the Great Depression 1919-1939, pp. 153-180 (1996). Following the Brussels and Genoa conferences several European countries opted for a return to the gold standard, Sweden becoming the first to do so in 1923. Germany followed in 1924 and France returned to the gold standard in 1928. It was expected that the gold standard woud provide price and exchange rate stability and promote the conditions conducive to the much needed development of international trade and finance. (De Macedo, J.B. & Eichengreen, B.J. & Reis, Jaime: Currency Convertibilty: The Gold Standard and Beyond, p. 182 1996.)

standard systems of other countries had been in the same character, but in a more pronounced degree. Britain could only live 6 years with the new gold bullion standard. It was due primarily to its long tradition of political economy that drove Britain to hasten to restore its gold standard system. However the imprudence of Britain to return to a gold standard at the old parity after the war without adequate preparation was the fundamental cause of the collapse of the system.[41]

After Britain left gold in 1931, the international panic centered on the United States, and nearly $2 billion in gold left the country in the fiscal year ending June 1932.[42] To stop the bleed, the American monetary authorities responded by implementing a fierce deflationary policy, which contributed to the rise of unemployment and causing a deeper depression. Therefore, the abandonment of the gold standard by the United States was a deliberate act of policy targeting to relieve the dreadful financial and economic conditions existing in the country rather than being driven by any external balance of payments difficulties as such.[43] Finally, on April 1933 the United States suspended gold payments in the belief that if the price of gold were raised commodity prices would automatically rise in direct proportion, thus encouraging business expansion.[44]

The abandonment of gold by United States was the virtual end of the gold standard. However, it is important to indicate that the great depression of 1930s was not the outcome of the abandonment of the gold standard, as it had its origin in the United States back in mid-1929.[45] Therefore, it is natural to date the first phase of the world depression from the American stock market crash, since the consequent collapse of the American economy not only deepened the economic difficulties of the countries (such as Argentina, Germany, Canada, Australia) already

41 Horie, p. 17.

42 Triffin, Robert: Our International Monetary System: Yesterday, Today and Tomorrow (1968)

43 Kenwood & Lougheed, p. 208.

44 ibid.

45 In fact it is not wrong to assume that the Great Depression was the last straw in the abandonment of the Gold Standard. (Naveen, Kumar & Somashekar, N.T.: Money Banking International Trade and Public Finance, p. 35 (2003).

suffering from depression but also caused a rapid economic decline in most parts of the world. The intensifying speculation in US stock market brought about a rise in interest rates.[46] Consequently, the expectations of earning speculative profits kept American funds at home and attracted large funds from abroad. The repatriation of French capital that followed the *de jure* stabilization of the Franc in 1928 did not better this difficult international lending situation.[47] On the other hand; the British money market, undergoing its own problems, lacked the resources to fill the gap created by the withdrawal of France and the United States from foreign lending. The result was a general tightening of credit everywhere, and especially a lack of finance for agricultural debtor countries whose balance of payments positions were worsening facing the threat of falling primary product prices.[48]

The worldwide depression of 1930s and the collapse of the gold standard were responsible for the spread of exchange controls and trade regulations, which severely restricted the exchange of goods between countries preventing any return to a steady capital outflow from creditor to debtor countries during the 1930s. Exchange control, which was a result of the shortage of foreign currency, held back the repatriation of capital, while trade regulations eliminated a large portion of the multilateral trade resulting in the inevitable decline of the volume of lending. The development of regional currency blocs[49] did not help the situation

[46] The Federal Reserve raised interest rates in 1928 to fight stock market speculation. (Meltzer, A.H. & Greenspan, Alan: A History of the Federal Reserve: 1913-1951, p. 234, 2003)

[47] France, with her return to the Gold Standard, built up her gold reserves in the expense of other countries thus forcing them to raise their interest rates and cut down their money supplies.

[48] Kenwood & Lougheed, pp. 203-204.

[49] The main blocs were the dollar area headed by U.S (with the introduction of the Hawley-Smooth Tariff Act in 1930, a typical exemplification of protectionism)) and joined by most of the Latin American countries; the sterling area centered on Britain and to a lesser degree consisted the British Commonwealth countries; the yen area of Japan; the gold bloc in Western Europe (France, Italy, Belgium, Netherlands and their colonies) and the exchange control area of central and south-east Europe (under the Schacht agreements) which was kind of dominated by Germany. (Frankel, J.A. & Stein, Ernesto & Wei, Shang-Jin: Regional Trading Blocs in the World Economic System, p. 127, 1997).

either with the direction of the loans became even more circumscribed.[50] The loans and investments were confined to members of the corresponding currency blocs based mainly on the geographical proximity or close economic ties between the members of these blocs.

The devices such as bilateral trading agreements promoted trade flows between countries but still, the benefits derived from this increase in the volume of international trade were offset by the loss of welfare as a result of the trade being conducted through bilateral rather than multilateral channels. The regional economic blocs gave rise to distortions of trading patterns because of the economic discrimination practiced against countries outside the bloc as well as contributing to loss of welfare stemming from the practice of operating preferential trading agreements. The outcome of all these developments was a considerable hindering in the growth of international trade during the interwar years.[51]

5- The Rise of the United States

The major change in the world economy after the two world wars was the rise of the United States as the greatest creditor nation. Consequently, the long tradition of isolationism of the United States, which was a little help to the world economy, became outdated and unsound. As time goes by, the United States came to gain the confidence that it could rise to the international competition and moreover, became aware of its duty and ability to take a leading role in the world economy. In this complete change of course; the United States faced two main obstacles: one being the direct control of trade and the other the instability of exchange rates. The aim of exchange control and discrimination through bilateralism was to economize on hard currencies, and this adversely affected the countries with such currencies.[52] It was not surprising that the prime victim was the US Dollar, which was a hard currency. More particularly the biggest concern of the United States and the greatest threat

[50] Kenwood & Lougheed, p. 221.

[51] ibid.

[52] Horie, p. 37.

she was facing was the sterling area currency bloc. After a long period of practicing economic isolationism embedded in the foreign policy of non-interference, the United States now upheld multilateralism against bilateralism as the main principle. The promotion of multilateral transactions was necessary for the US to persuade other nations to abolish their restrictive and discriminatory measures.

On the other hand, Britain, which for a long time was the preeminent country in the global finance owing to the nature of her economy, required an increase in world trade and in international co-operation as the indispensable foundation of her prosperity. Britain, therefore, had no reason to be against the promotion of multilateral transactions on a free and non-discriminatory basis, but the fact remained that Britain had lost very substantial external assets and gold reserves in the two world wars. Accordingly, the reconstruction of her domestic economy and achievement of full employment on national scale without taking into account her external relations were the most urgent problems for Britain at that time.[53]

As a result, the United States and Britain began to give consideration to those problems which were related to the post-war economy under the common necessity of international co-operation, though from different angles and for different reasons.[54] The compromise between the two schools of thoughts would render the Bretton Woods Agreement.[55] Both countries had acknowledged the fact that the strength and the stability of their economy would be their greatest weapon in the 20th century and the promotion of a united financial and monetary environment was their only means to achieve this, so with the collapse of the International Gold Standard, it was evident that they had to come up with a more dated and long lasting monetary system applicable to the whole globe.[56]

[53] ibid., pp. 38-39.

[54] See, Opie, Redvers: Aglo-American Economic Relations in War-Time, *Oxford Economic Papers* Vol. 9 No.2, pp. 115-151 (1957).

[55] Boughton, J.M.: A New Bretton Woods?, *Finance and Development*, Vol. 46 No. 1 (2009).

[56] Burk, Kathleen: Money and Power: America and Europe in the 20th Century, *History Today,* Vol. 43 (1993)

6- The Bretton Woods 'Exchange' System

The Bretton Woods Conference was dominated by US and Britain[57], the former at the time accounting for half of the world's manufacturing capacity as well as holding the most of the world's gold while the latter being the leading member of the *allies* of World War II. Consequently, as mentioned in the previous chapter, two main plans were submitted by Harry Dexter White, the US delegate and John Maynard Keynes, the Britain representative. The design of the system composed following the Bretton Woods Conference reflected the US plan much more than the British one.[58]

The system, the architects of the Bretton Woods Conference foresaw, was to retain the exchange rate stability experienced with the classical gold standard while at the same time would permit full employment policies by the utilization of floating rates. They also set up an adjustable peg system of fixed parities that would only change during a 'fundamental disequilibrium' to overcome the probable shortcomings of this combination.[59] Thus, as an 'ideal' international financial system, the Bretton Woods System was brought into reality.[60] Under this system, the central banks of member countries undertook the task to maintain fixed exchange rates between their currencies and the dollar by intervening in foreign markets. The value of the currencies was maintained via central banks by either selling the respective currency in exchange of dollar

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[57] The loose trans-governmental 'alliance' between the US and Britain on the post-war monetary order displayed during the Bretton Woods Conference had in fact its root in the fruitless Anglo-American wartime negotiations led by the State Departments of both countries. (Bordo, Micheal & Eichengreen, Barry: A Retrospective on the Bretton Woods System, pp. 157- 161, 1993)

[58] The main difference betwen the White Plan and the Keynes Plan was the insistence of White on monetary discipline and his further stress on multilateralism in international finance compared to Keynes. For a more detailed account on the differences between the White and Keynes plans see Boughton, J. M.: Why White not Keynes? Inventing the Postwar International Monetary System, IMF Working Paper No. 52 (2002)

[59] Bordo & Eichengreen, pp. 5-6.

[60] Although 32 countries declared par values on 1948, the system did not start to operate as intended until the Western European industrial countries made their currencies convertible on 27 December 1958. (ibid, p. 4)

should the currency climb in value or by buying the currency once its value descend.[61]

However; although the institutions established to manage the fixed exchange rates are still powerful forces in world economy, this system of fixed exchange rate was relatively short-lived. The system was dissolved between 1968 and 1973[62] with the then U.S. President Richard Nixon's announcement of the "temporary" suspension of the dollar's convertibility into gold in August 1971.[63] With attempts to revive the fixed exchange rates failing, the major currencies began to float against each other by March 1973.

Since the collapse of the Bretton Woods system[64], IMF members have been free to choose any form of exchange arrangement they wish with the exception of pegging their currency to gold.[65] The member countries have a variety of alternatives to choose between such as; allowing the currency to float freely, pegging it to another currency or a basket of currencies, adopting the currency of another country, participating in a currency bloc, or forming part of a monetary union.[66] However, whatever

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61 In other words; while other currencies were convertible to US dollar, the US dollar was convertible to gold. The dollar was the reserve currency and other countries could convert their dollar-holdings into gold.

62 Some would date its termination with the end of the gold pool and the start of the two-tier system in 1968. (Bordo & Eichengreen, p. 4.)

63 The inflation in United States, mainly due to the Vietnam War, and the experincing of the first trade deficit of the 21th century undermined the value of the dollar. This was the main reason for President Nixon to abandon the fixed value of dollar.

64 Commonly the Bretton Woods system is understood to refer to the international monetary regime that reigned from the end of the World War II until the early 1970s. This view narrows the outcome of the Bretton Woods conference to the setting up a pegged exchange system by creating an international basis for exchanging one currency for another in terms of gold while failing to take into account the creation of IMF and World Bank at the same conference. Although the exchange system tailored in Bretton Woods is no longer functional, the institutions formed at the conference, that are the present embodiment of the spirit of the Bretton Woods conference, are still of great significance and assumed the role of international monetary policy making.

65 IMF Articles of Agreement (Articles of IMF) Art. IV sec. 2 (b)

66 www.imf.org/external/about/histend.htm Last visited on May 30 2009.

de jure exchange arrangements chosen by the member countries may be; the *de facto* classification by IMF may differentiate considerably.[67]

Under the Bretton Woods 'Exchange' System there was some sort of control over the money supplies, since the US dollar was convertible into gold and the other currencies into dollars. On the other hand; the subsequent monetary system, after the 'closing of gold window' by US in 1971, is backed by nothing but the faith and credit of individual governments which means there are no longer any restraints on the amount of money that could be created. The end of the Bretton Woods 'Exchange' System also paved the way for a financial globalization wave all across the globe set off by the deregulation of the currency markets as well as the banking & investment sector.

II- The Structure of Bretton Woods Institutions

A- Introduction

As mentioned above IMF and World Bank were formed to be the pillars of the new financial system. However; nearly three decades after the collapse of the exchange system, these institutions continue to be of importance in the global finance. In 2009, governments trapped in balance of payments problems or in need of improving their country's basic infrastructure do not seem to have a wide range of options if they decide to seek funds in the global environment. Either the Fund (IMF) or the Bank (World Bank Group) is likely to be the last stop in a country's search for funding. Each of these institutions have their own lending policies, own lending facilities and own conditional[68] requirements. The issue of

[67] The classification system of IMF ranks exchange rate arrangements on the basis of the degree of flexibility and the existence of formal or informal committments to an exchange rate path. (International Monetary Fund, Annual Report on Exchange Arrangements and Exchange Restrictions, p. 13, 2008.)

[68] Conditionality is perhaps the most controversial aspect of the IMF and World Bank policies. Often grouped under the label Structural Adjustment or Development Policy (as it is now referred to) they may involve requirements to enhance aid-effectiveness such as anti-corruption measures as well as controversial ones such as rigid fiscal austerity poli-

merging the functions of the two institutions has become more and more topical in the last decades but those attempts did not change the fact that both the Fund and the Bank still serve as institutions having different primary objectives and different policies to achieve them. Yet it is also true that while the Fund preserves its independence of the Bank during the convergence endeavours, the Bank does not hold its autonomy to its twin's extent handling in the main role of the Fund.

B- World Bank

The Bank is an inter-governmental institution, established under Articles of Agreement (Articles) formulated at the International Monetary and Financial Conference, held in Bretton Woods. It had by then acquired two affiliates, the International Finance Corporation (IFC) and the International Development Association (IDA).[69] The assembly, which termed itself the World Bank Group, also had as an autonomous and non-financing institution, the International Centre for Settlement of Investment Disputes (ICSID).

The stockholders of the Bank are the member governments. The terms and conditions of membership are subject to the discretion of the Bank[70] while it is important to emphasize that one of the main conditions for the membership status is a kind of dual membership provision, which stipulate the applicant country to be a member of IMF as well.[71]As

cies or the privatization of key public services. Mostly due to the criticisms voiced over these requirements both IMF and the World Bank are taking steps in softening these measures. On conditionality see; Denters, E.M.G.: Law and Policy of IMF Conditionality (1996); Vreeland, J.R.: The IMF and Economic Development (2003); Hajnal, P.I. & Kirton, J.J.: Sustainability, Civil Society and International Governance, pp. 231-236 (2006). See also; Polak, J.J.: The Changing Nature of IMF Conditionality, *Princeton Essays on International Finance* No. 184 (1991).

69 Multilateral Investment Guarantee Agency (MIGA) was founded in 1988 as a part of the World Bank Group in order to promote foreign direct investment into developing countries.

70 IBRD Articles of Agreement (IBRD Articles), Article II. sec. 1(b)

71 IBRD Articles, Art. II. sec. 1(a). Only members of the IBRD are allowed to join the other institutions under the World Bank Group.

mentioned above, each member subscribes to shares of the Bank's capital stock.[72] The stock held is especially important in terms of voting power as each member has 250 votes plus one additional vote for each share of stock held.[73]

The main emphasis in the purpose of the Bank is on investment and development, and therefore on particular projects. Over 90% of the development credits and loans made by the Bank (the International Bank for Reconstruction and Development and its affiliate: the International Development Association) have been for specific projects such as crop production programs, hydroelectric power dams, roads, schools and fertilizer plants.[74] The number of projects, and the amounts loaned have grown noticeably over recent years. In the 1950s, the Bank was making fewer than twenty loans a year, mostly in Latin America and Europe, totaling about $400 million. In the fiscal year ending in June 1981, 246 loans, totaling $12.3 billion, were approved for 90 countries.[75] Earlier in 2009, in response to the global financial crisis, the Bank spent a record $58.8 billion[76] (20.7 billion dollars to infrastructure financing) targeting mainly middle income countries struggling amid the global crisis.[77]

72 IBRD Articles, Art. II. sec. 3(a), (b). According to the articles the minimum number of the shares to be subscribed by members other than the founding members is to be determined by the Bank which shall reserve a sufficent portion of the its capital stock for subscripton of such members. The Bank also preserves the right to prescribe rules laying down the conditions under which members may subscribe shares of the authorized capital stock of the Bank in addition to their minimum subscription. The authorized capital stock of the Bank which was divided to 100,000 shares with a par value of $100,000 each, corresponding to a sum of $10 billion in terms of US dollars of the weight and fineness in effect on July 1 1944, had been increased to 1,420,500 shares as of April 1986.

73 IBRD Articles, Art.V, sec. 3(a).

74 Baum, W.C.: The Project Cycle, Finance and Development (1982). Over the past two decades investment operations have accounted for 80% of the Bank's portfolio while over the fiscal years 2007 and 2008 the policy operations of the IDA and IBRD have accounted for less than 30% of the Bank's financial commitments. (www.worldbank.org/WBSITE/EXTERNAL/PROJECTS/0,,html Last visited on June 19 2009)

75 ibid.

76 A 54% increase over the previous fiscal year.

77 World Bank Press Release No. 2010/002/EXC July 1 2009.

Today, the International Bank for Reconstruction and Development (IBRD) and the International Development Agency (IDA) are together forming a World Bank that had become an international organization consisting of more than 180 countries. IBRD provides loans and development assistance to middle-income countries as well as creditworthy lower-income countries. IDA provides low-interest loans and other services to the poorest countries. IBRD and IDA loans are made to member countries; IBRD also makes loans to borrowers in a member country with the country's guarantee. Provide

The other members of the World Bank Group[78] are: The International Finance Corporation (IFC), which finances private sector ventures in developing countries in partnership with private investors therefore serve a different set of clients in the form of private sector and private investor representatives compared to the Banks' (which are governments and government agencies); the Multilateral Investment Guarantee Agency (MIGA), which promotes direct foreign investment in developing countries by providing guarantees against non-commercial risk[79] to foreign investors as well as offering a number of other services (such as technical assistance) as part of its primary goal to encourage foreign direct investment, and the International Centre for the Settlement of Investment Disputes (ICSID), which provides facilities for the settlement of investment disputes between foreign investors and their host countries.[80]

[78] The term 'World Bank' generally refers only to the IBRD and the IDA whereas the 'World Bank Group' refers to all institutions under the umbrella of World Bank. (www.worldbank.org Last visited on May 13 2009) We did not differentiate these two concepts in our study and did not refrain from using both terms interchangeably.

[79] The coverage includes non-commercial risks such as: Expropriation, transfer restriction, war and civil disturbance, and breach of contract for cases where there is a contract rendered between the investor and the host country government. (www.miga.org/guarantees/index_sv.cfm Last visited on June 22)

[80] ICSID provides facilities for the conciliation and arbitration of investment disputes between contracting states and nationals of other contracting states. (Convention on the Settlement of Investment Disputes Between States and Nationals of Other States , Sec. 1 Art. 1 (2).) ICSID have full international legal personality and capacity including to contract, to acquire and dispose of movable and immovable property and to institute legal proceedings. (Convention, Sec. VI Art. 18) The jurisdiction of ICSD extends to

The Bank carries out its development task through lending operations that are consistent with the lending policies and practices based on the Articles. According to the Articles: 1- Loans are made either to member governments or to governmental or private entities or enterprises in the territories of members. A loan, which is not made directly to the member in whose territories the project to be financed is located, must be guaranteed by that government as to principal interest and other charges.[81] 2- The Bank is not to compete with private lending institutions therefore does not lend for projects, or to countries, whose financial needs can be met on reasonable terms in the market.[82] 3- In making loans the Bank does not only satisfy itself as to the quality of the project and the borrower's ability to carry it out but must also be satisfied as to the borrower's (or guarantor's) creditworthiness.[83] 4- The use of loan proceeds is supervised. The Bank is required to make arrangements to ensure that funds are used only for authorized purposes.[84]

The World Bank never changed its traditional approach towards the idea of financing all kinds of capital infrastructure (such as roads and railways, telecommunication and port and power facilities). Notwithstanding this persistent objective of the Bank to invest in capital infrastructure, its present development strategy had differed in some ways. First, greater attention started to be paid on projects that are capable of directly affecting the well-being of the underprivileged population of developing countries by making them more productive and by involving them in the development process as active partners. In addition, the need of developing countries to refurbish their local energy sources brought about an increased emphasis by the Bank on such projects.[85]

any legal dispute arising directly out of an investment between a contracting state or any consituent subdivision or agency designated by the contracting state and a national of another contracting state. (Convention, Chp. II Art. 25)

81 IBRD Articles, Art. III. sec. 4(i) If more than one country is to host a project, guarantees are required from each of the member country.

82 IBRD Articles, Art. III. sec. 4(ii)

83 IBRD Articles, Art. III. sec. 4(v)

84 IBRD Articles, Art. III. sec. 5(b)

85 See www.miga.org/projects/index_sv.cfm?srch=s&stid=1517&sector=22&dispset=10 &srow=1&erow=10 Last visited on July 3 2009.

The Bank has two basic lending instruments: *investment loans* and *development policy loans.*[86] Investment loans have a longer-term focus (5 to 10 years) compared with development policy loans (1 to 3 years). Development policy loans are used to provide rapid external financing to support institutional and policy reforms while investment loans are to finance works, goods and services in support of economic and social development projects in a wide range of sectors. Both type of loans are used to fit in a variety of purposes, and are infrequently employed together in hybrid operations.

The investment loans finance a broad range of activities aimed at creating the physical and social infrastructure essential for poverty reduction and sustainable development. Investment loans hold a wide variety among themselves. The most commonly used types of investment loans are either *specific investment loans* or *sector investment* and *maintenance loans*. The other instruments offered by the Bank to the borrowers are: *adaptable program loans, learning and innovation loans, technical assistance loans, financial intermediary loans,* and *emergency recovery loans.*[87]

The *specific investment loans* are used for the creation, rehabilitation and maintenance of social, economic and institutional infrastructure as well as ensuring the technical, financial, environmental, economic and institutional feasibility of a specific investment. The *sector investment* and *maintenance loans* are used for public expenditure programs in particular sectors. The *adaptable program loans* provide phased support for long-term development programs which involve systemic reforms or restructuring in such sectors as power, health, education where time is required to build consensus and convince diverse actors of the benefits of politically and economically difficult reforms. The *learning and innovation loan* supports small pilot-type investment and capacity-building projects that, if successful, could lead to larger projects. They are used to

86 The Development Policy Loans, which are also called Poverty Reduction Suppport Credits (PRSCs) replaced the Adjustment Loans in 2004. The new framework unifies policy that applies to instruments including sectoral adjustment loans, structural adjustment loans and poverty reduction support credits.

87 www.worldbank.org/Wbsite/External/Projects/0,,html Last visited on June 26 2009.

assess new approaches, often in start-up situations and with new borrowers.[88] The *technical assistance loan* is used to develop institutional capacity in the borrower country by focusing on staffing methods, organizational arrangements and technical, physical or financial resources in key agencies. The *financial intermediary loans* provide long-term resources to local financial institutions to finance real sector investment needs. They aim to help to develop sound financial sector policies and institutions. The *emergency recovery loans* support the restoration of assets and production levels immediately after an extraordinary event such as natural disaster, civil unrest or war.[89]

Development policy loan*s* provide quick-disbursing assistance to countries with external financing needs to support structural reforms in a sector or the economy as a whole. They support the policy and institutional changes needed to create an environment contributing to sustained and equitable growth. The most commonly used ones amongst these development policy instruments are the *structural* and *sector adjustment loans.* Other types of *development policy loans* are the *programmatic* and *special structural adjustment loans, rehabilitation loans* and *debt reduction loans.*[90]

The *structural adjustment loans* support reforms that promote growth, efficient use of resources, and sustainable balance of payments over the medium and long term. In order to implement this objective the structural adjustment loans focus on main macroeconomic and structural issues that sever sectors such as trade policy, resource mobilization, public sector management, social safety nets and private sector development. The *sector adjustment loans* support policy changes and institutional reforms in a specific sector. *The programmatic structural adjustment loans* are provided in the context of a multiyear framework of phased support for a medium-term government program of policy reforms and institution building. *The special sector structural adjustment loans* support struc-

[88] ibid.

[89] ibid.

[90] Adjusment Lending Retrospective Final Report, Operations Policy and Country Services, June 15 2001.

tural and social reforms by creditworthy borrowers close to a possible crisis, or already in crisis, and with exceptional external financing needs. These types of loans help countries to prevent a crisis, or if one occurs, to lessen its adverse economic and social impacts. The *rehabilitation loans*[91] support government policy reform programs aimed at creating an environment conducive to private sector investment, where foreign exchange is required for urgent rehabilitation of key infrastructure and productive facilities. They are typically used when a country is committed to overall economic reform but a structural adjustment loan cannot be obtained because the structural reform agenda is still merging. The *debt reduction loans*, introduced in 1989, assist eligible highly indebted countries lower commercial debt and debt service to a manageable level, as part of a medium-term financing plan in support of sustainable growth. Although not a development loan, the debt reduction loan is often processed in conjunction with an development loan, part of which may also be used to finance the debt reduction operation.[92]

All these loans are made in accordance with the lending program set out in the Country Assistance Strategy (CAS) that adapts Bank assistance to each borrower's development needs as laid down in her Poverty Reduction Papers and the Bank's comparative advantage.[93] The lending operations are developed in several phases where each phase leads to the other and altogether form a kind of cycle named the *project cycle*.[94] The project cycle works as follows: First, the borrower brings in a project to be identified by the Bank. Then the Bank performs economic and sector analyses to compose a framework for evaluating national and sectoral policies and problems and an understanding of the development poten-

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91 Generally in the form of 'Programmatic Financial Rehabilitation Loan' or 'Financial Sector Rehabilitiation Loan'.

92 Adjusment Lending Retrospective Final Report, Operations Policy and Country Services, June 15 2001.

93 www.worldbank.org/cas Last visited on June 12 2009.

94 Baum, p. 2. On Project Cycle see also Baum, W.C. & Tolbert, Stokes.: Investing in Development, *Finance and Development*, Vol. 22 No. 4, pp. 26-32 (1985), Price, A.D.F.: Financing International Projects, pp. 66- 81 (1995), Buljevich, E.C. & Park, Y.S.: Project Financing and the International Financial Markets, pp. 1-20 (1999).

tial of the country.[95] The Bank also assesses a country's creditworthiness for lending. Only after than, the identification of the project, which is concerned with the project's appropriateness to fit into and support a sound development strategy and meet sectoral objectives, becomes possible. The basic elements of the project are set forth in a Project Concept Note which identifies proposed objectives, imminent risks, alternative scenarios and a timetable for the particular project.[96] Once identified, projects are incorporated into a multi-year lending program for each country that forms the basis for the Bank's future work in the country. After an early screening by the World Bank staff, the borrower could also be asked to prepare an Environmental Assessment Report, that analyzes the project's likely environmental affects, should the planned project is deemed to have a likely environmental or social impact that are included in the World Bank's safeguard policies.

After the incorporation of the project into the lending program, an extensive period of close cooperation between the Bank and the eventual borrower commences. As the project develops and moves near completion, the project is scheduled for the appraisal phase. During the appraisal phase, all aspects of the project (technical, institutional, economic and financial aspects) are reviewed for the confirmation of the project's consistence with the Bank's operation requirements. The availability of institutional arrangements made by the government for the implementation of the project is also taken into consideration. Agreement is reached on the viability of all aspects of the project. The outcome is presented in a report[97], that recommends the terms and conditions of the loan, which is subjected to the consideration and approval of the Bank's Board of Executive Directors.

Following the loan's approval by the management of the Bank, the parties go through the negotiation stage. The Bank and the borrower

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[95] Baum, p. 2-3.

[96] Two additional documents are also generated during this process: The Project Information Document and the publicly available Integrated Safeguards Data Sheet.

[97] Project Appraisal Document for investment lending and Program Document for policy lending.

endeavour to agree on the measures necessary to assure the success of the project. These agreements are then converted into legal obligations, set out in the loan documents. The next stage in the project cycle is its actual implementation over the period of construction and subsequent operation. The role of the Bank during this stage is mostly to supervise the project with the financial management and procurement specialists on the Bank's project team ensure that adequate fiduciary controls on the use of project funds are in place. In the final step of supervision, which can also be seen as the final phase of the cycle, the regular projects staff or the borrower prepare a completion report on the project documenting the results achieved or the problems encountered. Then these evaluation reports are reviewed by the Operations Evaluation Department, which then prepares a separate audit report to send to the Executive Directors so that the experiences gained in one particular project can be beneficiary for the design and preparation of future projects.[98]

C- The Fund

The International Monetary Fund is a cooperative inter-governmental monetary and financial institution with near global membership. It is a cooperative institution on the grounds that its 186 members had voluntarily joined in.[99] Furthermore, the Fund seems to have no effective authority over the domestic economic policies of its members with the exception of IMF funded economic stabilization programs that are to be implemented by member governments according to the principles both sides consented.

Each member country is obliged to contribute a certain amount of money as a kind of membership fee, which is called *quota subscription*. Quotas have great significance on the Fund's operations to the extent that credit facilities, payment obligations and voting rights of members are based on them.[100] The allocation of quotas amongst the member coun-

98 www.worldbank.org/oed Last visited at May 27 2009.

99 Driscoll, D.D.: What is The International Monetary Fund? (1992)

100 www.imf.org/external/pubs/ft/mfs/manual Last visited June 3 2009.

tries[101] is determined by the Fund according to a method, which includes countries' national income, gold and foreign exchange reserves, export dependence and the size and fluctuations of their foreign trade with different weightings given to those factors.[102] They are reviewed every 5 years and are subject to change along with the needs of the Fund and the economic prosperity of the member. Quotas, as mentioned above, serve numerous and vital purposes. They form a pool of money from where the Fund can withdraw and lend to members facing balance of payments problems. They also function as determinants[103] for how much the member country can borrow from the Fund or receive from the Fund in periodic allocations of special assets known as SDRs (Special Drawing Rights)[104]. Last but not least, the quotas determine the voting power of

[101] Articles of IMF do not determine how the quotas should be allocated.

[102] Korner, P. & Maas, G. & Siebold, T. & Tetzlaff, R.: The IMF and The Debt Crisis, p. 45 (1992)

[103] The Board of Governors' Resolution in 2006 had advised the Executive Board to set a new quota formula that reflects the weight and role of members in global economy in accordance with the dynamic nature of international finance. There are currently five main quota formulas. The oldest, Bretton Woods formula, originally contained five variables which were: national income, offical reserves, export variability, imports and the ratio of exports to national income. In the 1960s a multi-formula approach was introduced, in which the Bretton Woods formula was supplemented with four other formulas; as a result national income was replaced by gross domestic product and trade variables were expanded to include services and transfers while current account transactions and variability were given more consideration. The quota formulas were last modified in 1982–83 by reducing the weight of the variability variable and reintroducing reserves as a variable, while retaining the basic structure of the formulas. (www.imf.org/External/NP/EXR/ib/2007/041307.htm Last visited on July 5 2009) Due to this new approach as regards with the quota allocations, the Fund agreed to initial ad hoc quota increases for four 'underrepresented' countries (China, Korea, Mexico and Turkey) owing to the dynamism of their economies. This new package of reforms also consists a new quota formula to guide the assessment of the adequacy of members' quotas in the IMF and a second round of ad hoc quota increases based on the new formula. The second round of quota increase will be made available to member countries that are underpresented under the new formula and had requested quota increase subject to the agreement of members exercising 85 percent of total voting power. (www.imf.org/external/np/exr/ib/2007/041307.htm Last visited on July 5 2009)

[104] There are some other international uses of the SDRs. They are the basis of the international fees for the Universal Postal Union and limit the carrier liability on international flights as well as the ship owner liability for oil pollution and cargo damages. (Roushdy,

the member in the way that each member is allocated 250 votes, plus one vote for every 100,000 of SDRs in its quota.[105] SDR is an asset, which members add to their holdings of foreign currencies and gold held in their central banks. The Fund uses the SDR as its unit of account. The value of SDR is determined on the basis of a basket of four currencies (US Dollar-44 %, Euro-34 %, Yen-11% and Pound-11%).[106] Consequently, the holdings of SDRs by member countries bear significant importance particularly for the voting power. The five largest shareholders (US, UK, Germany, France and Japan) posses nearly 40% of total voting power and with the addition of only two or three other industrialized states[107] have the power to obtain an ordinary majority over the opposition of some 180 other members.[108]

The main role of the Fund is to provide its members with financial aid to cover short-term gaps in their balance of payments so that deficit countries refrain from turning to restrictive measures that can be hazardous for international trade and money transfers.[109] Their financial assistance offered by the Fund comes in the form of the purchase of the foreign exchange required in the currency of the deficit country.[110] As

J.: The Role of SDR in International Monetary System, p. 56, 1987; see also Convention for the Unification of Certain Rules for International Carriage by Air, Article 23; Warshaw Convention, Article 22; International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea; International Convention on Civil Liability for Oil Pollution Damage)

105 Articles of IMF, Art. XII sec. 5(a), (b). The quota asigned by the Fund is also used to determine the number of shares alotted to each new member of the Bank.

106 www.imf.org/external/np/tre/sdr/basket.htm Last visited on April 19 2009. On the valuation of SDRs see also International Monetary Fund, International Financial Statistics Yearbook, p.623 (2006).

107 f.e. China (3.66%), Italy (3.19%), Saudia Arabia (%3.16), Canada (%2.89) and Russia (%2.69).

108 Apart the top 20 member countries in terms of voting power, the remaining 165 member countries hold a total of 28% of the voting power (www.imf.org/external/np/sec/memdir/members.htm Last visited on June 27 2009).

109 For a detailed discussion of the Fund's financial organization and operations see International Monetary Fund, Financial Organization and Operations of the IMF, No. 45 (1998).

110 Driscoll, p. 48.

mentioned above, the sum a member is permitted to purchase is determined by its actual quota. The Fund attaches conditions to the granting of loans and the conditionality is subject to the use of loan facilities and can range from non-binding recommendations to detailed conditions. No conditions are attached to the first 25% of the quota, which is known as the Gold or Reserve Tranche. Four more tranches each equaling 25% of the quota, are also available. The first Credit Tranche is not strictly conditioned but the next three Credit Tranches may only be drawn if the country concerned has agreed a stabilization program with the Fund and signed a stand-by agreement committing its government to carry out the economic changes stipulated by the Fund.

The stand-by agreements run for a short period of time[111], which certainly is not sufficient since the balance of payments problems many developing countries experience are the result of structural imperfections that cannot be overcome in such short periods. As past experiences emphasized this fact stronger, the Fund responded by creating the Extended Fund Facility (EFF)[112], which permits the drawing up to 140% of the quota within a period of two years if the member country concludes an extended agreement with the Fund. The conditions attached to EFF are not less strict than those attached to the upper Credit Tranches.[113]

Although there is an access policy and access limits set by the Fund for the use of the credit tranches and the EFF, the limits are not to be regarded as targets and the amount of access in individual cases may vary

[111] Usually a year or two although they can be extended up to three years.

[112] Extended Fund Facility was established in 1974 to assist member countries in overcoming balance of payments problems that derives mainly from structural problems and require a longer period of adjustment than is possible under a Stand-By Arrangement. A member requesting an Extended Arrangement outlines the objectives and policies for the whole period of the arrangement (typically three years) and presents a detailed statement each year of the policies and measures it plans to pursue over the next 12 months. The phasing and performance criteria are comparable to those of Stand-By Arrangements. Countries must repay EFF resources over a period of four and a half to 10 years. On Extended Fund Facility see International Monetary Fund: Selected Decisions and Selected Documents of th International Monetary Fund , pp. 283- 294 (2005).

[113] IMF, External Debt Statistics: Guide for Compilers and Users – Appendix III, Glossary (2003).

due to the circumstances of the member. Therefore, faced with an exceptional case the Fund holds the discretion for its approval of stand-by or extended arrangements that exceed the access limits. Over the years, the insistence of the developing countries rendered the introduction of further finance windows by the Fund, such as the Emergency Financing Mechanism, the Compensatory Financing Facility, the Supplemental Reserve Facility etc.[114]

As mentioned above, the Fund has no effective authority over the domestic economic policies of the members unless there is a stabilization program which the Fund and the member country agreed on implementing. However, it is vital to stress the fact that the IMF agreement not only authorizes the Fund to grant loans to member countries, but it also stipulates that the "Fund shall exercise firm surveillance over the exchange rate policies of the members".[115] This 'surveillance'[116] has been interpreted to mean that members shall regularly inform and consult the Fund over their exchange rate policies. In addition, IMF experts visit member states to discuss with the authorities all other vital economic issues and insist on the observance of IMF rules, such as the easement of existing restrictions on trade and on money transfers, as well as the

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[114] Starting from May 1 2009 IMF has announced that the structural performance criteria have been discontinued for all IMF loans. The new framework which does away with the 'hard' structural conditionality will apply to all IMF lending programs including the ones with low-income countries. This new lending framework is deemed to focus on the underlying objectives of a country's structural reform program rather than on specific actions required to be adopted according to a specific timeline. As part of its lending reform package, the IMF also announced the creation of a flexible credit line (FCL), a type of insurance policy for strong performers, mainly emerging market countries. Access to the FCL is restricted to countries that meet strict qualification criteria. But once a credit line has been approved, a country can draw on it without having to meet specified policy goals, as is normally the case for IMF loans. (Anderson, Camilia: New Rules of Engagement for IMF Loans, IMF Survey Online, April 2009)

[115] Article IV. sec. 3(b)

[116] On the evolution of the practice of 'surveilance' and its implications on global finance see James, Harold: Historical Development of the Principle of Surveilance, IMF Staff Papers Vol. 42 No. 4 (1995). On the recent change in the bilateral monitoring policy of IMF see '2007 Decision of on Bilateral Surveilance over Members' Policies', Public Information Notice, No. 07/69, 21 June 2007.

exchange rate policies.[117] If no stand-by agreement is being negotiated, the Fund has no power of sanction in such consultations and discussions. Still, to say that the Fund holds no effective authority over its members' economic decisions and lacks the influence over the economic policies of –especially- many developing countries would be only superficially right.

D- The Fund and the Bank

The distinction between the Fund and the Bank had been relatively clear till 1970s.[118] The Fund was established to tackle monetary issues. As set forth in its Articles of Agreements, the main purposes of the Fund were intended to be; the facilitation of the expansion and balanced growth of international trade, the promotion of exchange stability and the correction of maladjustments in member countries' balance of payments by making its general resources temporarily available to member countries under adequate safeguards in order to prevent them from resorting to measures destructive of national or international prosperity.[119] On the other hand, the Bank had been set up to undertake two vital tasks. First, it would deal with the reconstruction of Europe after the II World War and then focus on making long-term development loans.[120] In other words, the Bank's primary objective was to better the consequences of the war in Europe while the secondary primary duty laid upon it was to develop the resources and productive capability of the world. It has also been assured that exchange rate matters would fall under the scope of the Fund not the Bank. Consequently the Fund's course was the short run

[117] Hood, C.: Surveillance Over The Exchange Rates, *Finance and Development* I, pp. 9-12 (1982).

[118] The Fund and the Bank have little in common as regards to their structure. Compared to the Bank which has over 7000 staff members and 40 offices around the world, the Fund is relatively small in size (approximately 2300 staff members) and has no affilates or subsidaries. While the Bank is an investment bank acting as an intermediate between investors and recipients the Fund is more like a credit union whose members have access to a common pool of resources which corresponds to their individual contributions

[119] Article I. (ii), (iii), (iv), (v).

[120] Bordo & Eichengreen, p. 368.

more concerned with the surface-the balance of payments, the monetary sector- whereas the Bank's orientation was towards the long run willing to go deeper- economic development, the real sector-. The anticipated distinction between the two institutions can be better seen in the words of John Meynard Keynes whom argued that the Bank should be composed by imaginative expansionists and that of the Fund by cautious bankers.[121] The profile of member countries resorting most to each one of the institutions hold a divided variety on the grounds that the Fund was never expected to be dealing primarily Less Developed Countries (LCD) whereas assisting these particular kind of countries was amongst the main objectives foreseen for the Bank. This distinct nature of both institutions prevented any kind of problems that could be the consequence of the rather blur line between the 'balance of payments' and 'development'.

The definitive clarification of the division of labor between the two Bretton Woods Institutions finds its roots in an internal memorandum written in 1966. The memorandum had assigned primary responsibilities to each institution such as: the Fund had jurisdiction 'for exchange rates and restrictive systems, for adjustment of temporary balance of payments disequilibria and for evaluating and assisting members to work out stabilization programs as a sound basis for economic advice while the Bank was 'for the composition and appropriateness of development programs and project evaluation, including development priorities'.[122]

However, it did not take a long time for the distinction between the two institutions to become clouded.[123] In less than a decade, it started to be acknowledged that the payment deficits member countries experience could be the outcome of structural imperfections therefore needed

[121] ibid.

[122] Gold, Joseph: The Relationship Between The International Monetary Fund and The World Bank, *Creighton Law Review*, Vol. 15, p. 513 (1982).

[123] For a detailed analysis of the division of labor between IMF and World Bank and the new course its taking see: Feinberg, R.E.: The Changing Relationship between the World Bank and International Monetary Fund, *International Organization*, Vol. 42 No. 3, pp. 545-560 (1988).

longer-term financial support to be corrected.[124] The Fund responded with creating a new facility that would mix up the areas of involvement for both institutions. The new policy instrument, the Extended Fund Facility (EFF), under which a program could last up to three rather than one year, was introduced in 1974.[125] EFF was the Fund's answer to longer-term adjustment needs but some other issues were left unanswered. There was the short-term balance of payment support by the Fund and there was the medium and long term project lending by the Bank but assistance to countries in need of medium to long term balance of payment adjustments did not exist. So came the Bank's initiation of structural adjustment lending program, which served to create further overlap in between the Fund's and the Bank's responsibilities. Then in 1985, the establishment of the Structural Adjustment Facility (SAF) rendered new complications in the areas of involvement between the two institutions as SAF was designed to be jointly managed by both the Fund and the Bank.[126] This trend towards convergence also raised the question of both the Fund's and the Bank's relative roles. However; notwithstanding the overlapping responsibilities of the two institutions, the extent of convergence between the Fund and the Bank should not be exaggerated. The Fund still retains a series of activities, which does not fall under the scope of the Bank's responsibilities, such as the surveillance of exchange rate policies, issuance and administration of the SDRs, oversight of international liquidity, supervision of trade and payment restrictions. And still %80 of the Bank lending is project type, with a ceiling fixed for policy related Bank lending to %20 of total lending.[127]

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124 Bird, Graham: IMF Lending to Developing Countries, p. 49 (1995).

125 Decision No. 4377- (74/114) September 13 1974. See also fn. 111.

126 The Structural Adjustment Facility was replaced by the Enhanced Structural Adjustment Facility (ESAF) which had been established in 1987 on a temporary basis only to be made permanent in 1996. ESAF was renamed as Poverty Reduction and Growth Facility (PRGF) in 1999. The PRGF which supports programs that are consistent with strategies elaborated by the borrowing country in a Poverty Reduction Strategy Paper (PRSP) is available to those countries that are facing protracted balance of payments problems and are eligible to borrow on concessional terms under the IDA. (www.imf.org/external/pubs/ft/eds/Eng/Guide/index.htm Last visited on May 11 2009)

127 Havnevik, J.K.: The IMF and the World Bank in Africa, p. 26 (1987)

Despite all the efforts for the convergence of the two institutions, they still remain distinct related to their formal statues and objectives, which give them different roles and different governing bodies. The Fund still preserve a series of activities that is beyond the reach of the Bank such as; surveillance of exchange rate policies, issuance and administration of the SDRs, oversight of international liquidity and supervision of trade and payment practices.[128] The institutions have different tempo of work, different approaches, different source of funding and emphasize different policy variables as well as having different governance styles.[129] Notwithstanding the fact that private sector related initiatives had been forced in the World Bank institutionalizing a new agenda of private sector progress, the Bank is still considered as primarily a development institution whereas the Fund is deemed to be a cooperative institution seeking to maintain an orderly system of payments and receipts between nations.

III- Conclusion

The Bretton Woods Institutions and the system they constituted were aiming to avoid the anarchy after the abandonment of the gold standard and support the reconstruction of Europe after the II. World War. As a result, the first two decades after their foundation saw the Fund encompassing mainly monetary issues and the Bank assisting first in the reconstruction of Europe then in the development of the low-income

[128] ibid.

[129] Traditionaly, the president of the World Bank is nominated by the president of the United States (the largest shareholder) and elected by the Board of Governors for a renewable five year term. (www.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS.html Last visited on May 11 2009.) All the previous presidents of the World Bank since its establishment in 1944 had been US nationals with the exception of the ninth president, James David Wolfensohn, who is Australian. On the other hand the formal guidelines of selecting the president of IMF are laid out in the Articles of Agreements. In Article XII section 4(a) it states that 'The Executive Board shall select a Managing Director who shall not be a Governor or an Executive Director....The Managing Director shall cease to hold office when the Executive Board so decides.' This decision may be reached by a 50% majority. (Art. XII sec. 5(c)) There is no nationality requirement for the selection of the Managing Director.

countries. The liberal economic system foreseen in the Bretton Woods Conference was to do away with monetary fluctuations which proved to stall the free flow of trade. This newly perceived system required an accepted vehicle for payments, trade and investment. The gold standard was not considered as a feasible option for the post-war economy so a new system of fixed exchange rates managed by international institutions using the US dollar as a reserve currency was founded. The replacement of the automatic control of the gold standard with some form of political authority brought about the structural adjustment requirements and conditionalities for the member wishing to borrow large amounts.

The restrictions, requirements and supervision tactics stipulated by the Bretton Woods twins have been seen as an excessive interference with more socialist-oriented economic policies which thwart the growth of wellfare state policies in nations with economic problems.

The introduction of the standby agreements and structural adjustment loans which were accompanied by the conditionality requirements have been the centre of debate around the Bretton Woods twins in the last decades. However it is not fair to say that the Bretton Woods twins are not paying attention to all the debate surrounding them. Both the Fund and the Bank are eager in introducing new facilitites showing a tendency of not holding back to replace an old instrument with a new one in search of better results in the light of past experiences.[130]

The broadening of their mandate also has raised the questioning of their relative roles. The extent of the emergence of the Fund as a *de facto* international lender of last resort (LOLR), a role the Fund was forced to assume because of the contagious nature of the 21th century economic crises driven by the increase in capital mobility, will remain vague in the future unless the Fund takes steps to enhance its own legitimacy as a LOLR.[131] On the other hand, the growth of the capital mobility had its effect on the Bank as well. The Bank compensated its shrinking role as a development bank by participating more in IMF support packages

[130] See above pp. 18-21.

[131] Lastra, p. 521-523.

and being involved further in macroeconomics support especially during crises when market access is suspended.[132] The fact that both institutions started to address the same structural and financial issues, may increase the calls for a merge between the twins.

Setting aside all the criticisms these institutions face, the Bretton Woods Institutions are still the most influential and financially significant inter-governmental organization. The type of the globalization that has been promoted by the Bretton Woods Institutions has predominated but that did not prevent both the IMF and the World Bank to reinvent themselves in the wake of the contagious global crises by changing policies and introducing new credit facilities (as well as lending instruments) while at the same time taking a more flexible approach by overhauling its general lending framework to make it better suited to country needs and streamlined conditions attached to loans.

The main question that awaits its answer in the light of all these instititutional changes both organizations go under is whether the Bank influences the Fund rather than the Fund influences the Bank when it comes to internalizing the need to integrate poverty reduction, social welfare and environmental perspectives with macro-economic policy. Both institutions have succeded in promoting a financial globalization but the outcome of their success can only be measured by their collaboration to devise programs that will integrate their members' economies more fully into the international monetary and financial system while at the same time encouraging controlled economic expansion with a special attention paid to social welfare provisions and enviromental concerns.

[132] De Gregorio, Jose & Eichengreen, Barry & Ito, Takatoshi & Wyplosz, Charles: An Independent and Accountable IMF, pp. 16-17 (1999)