UNIT 16 WORLD BANK

Structure

16.0 OBJECTIVES

After studying this unit, you should be able to:

- Describe the objectives of the World Bank
- Explain the various functions of the World Bank
- Discuss the role of the World Bank as the mobiliser of resources for reconstruction and development
- Describe the operations of the World Bank and identify the problem associated with its operations
- Explain the contribution of the World Bank
- Identify the failures of the World Bank,

16.1 INTRODUCTION

The International Bank for Reconstruction and Development (IBRD), often referred to as the World Bank, was set up as a sister organisation of the International Monetary' Fund. The decision to create IBRD was taken at the Bretton Woods Conference in 1944. The World Bank started its operations in 1946. Its main purpose was to promote the long-term foreign investment to help in transforming War devastated economies and to encourage less developed economies to accelerate the pace of their development. Obviously the activities of the World Bank were to remain confined to assisting only the member countries. In this unit you will study the objectives, functions, operations and performance of the World Bank.

16.2 OBJECTIVES OF THE WORLD BANK

The objectives of the World Bank have been clearly stated in the **Articles of Agreement.** These are as follows:

1) **Financing reconstruction of the war-devastated economies: During World** War II many countries of Europe had suffered heavily in terms of the destruction

of their infrastructure and industries. The economies of these countries were in bad shape and could not generate adequate resources internally for the reconstruction work. Even the flow of private foreign capital to these countries was not certain. Of course some foreign aid was expected from the USA, as this was the only developed country which had escaped the destruction from the war. But it was not enough. Keeping these realities in view, it was decided at the Bretton Woods Conference that the World Bank would provide finance for the reconstruction of the war-devastated economies.

2) **Financing development of economically backward countries:** By the time the Bretton Woods Conference was held, it had become clear that in the post-World War II period economically backward countries having inadequate domestic resources would need considerable amount of private foreign capital as well as foreign aid to tread on the path of economic development. Given the requirements of resources of these countries both these sources of external finance were likely to be inadequate and uncertain. The World Bank was thus expected to provide long-term financial help for development projects in underdeveloped countries. However, considering the capital requirements of these countries, the resources of the World Bank were meagre in the beginning and continue to remain so even till today.

3) **Promotion of private foreign investment:** At the time of Bretton Woods Conference, international credit structure was in shambles because the principles of sound international private lending were not followed between World War I and World War II. Foreign loans were obtained for aon-viable projects, sometimes at exorbitant rates of interest. Short-term credits were used for long-term investment purposes creating repayment problems. In the light of these experiences it was unlikely that private foreign capital would be freely available for reconstruction and development projects. Even if some private foreign capital was available, its terms being highly unfavourable, it was not expected to be allocated according to sound economic principles. This called for a system whereby flow of private foreign capital could be promoted. The World Bank was thus entrusted with the task of promoting private foreign investment by means of guarantees or participations in loans and other investment made by private investors. The World Bank was not to replace the flow of private foreign capital; it was only to provide finance for productive purposes on appropriate terms and conditions when private foreign capital is not available at reasonable terms.

4) **Promotion of long-term balanced growth of international trade:** It is generally agreed that international trade is beneficial to all the participants in it. Therefore. balanced growth of international trade should be encouraged. In a highly unevenly developed world the prospects of balanced growth of international trade would be dim. Hence, it was rightly conceived by the architects of the World Bank that less developed economies should overcome their structural handicaps by developing their productive resources and acquire export capabilities. This would help them in maintaining equilibrium in balance of payments while their quantum of foreign trade increases. However, economically backward economies could not accomplish this task on their own. They had to be assisted in realising this objective. The World Bank, keeping this reality in view encourages international investment in developing countries.

5) **Assisting member countries in bringing about an easy transition from a war time economy to a peace time economy:** During World War II economies of most countries were consciously oriented to the requirements of the war, Therefore, there was considerable stress on the growth of defence industries. After the war was aver the production capacities that were created in these industries were not required and the massive employment which was provided in these industries had become redundant. In contrast, the industries which produced consumer goods and machines to be used in consumers goods industries did not have the required capacities. This imbalance could not be corrected immediately. It needed smooth transition otherwise it could create serious unemployment and recessionary problems. The founders of the World Bank thus decided that it would assist member countries in bringing about a smooth transition from their war time economies to peace time economies.

From the above discussion it must have become clear to you that the World Bank's basic objective is to assist member countries in raising resources for the reconstruction and development projects. The priority in raising the resources is to be given to private foreign investment while the World Bank's own resources are to be used only to supplement this flow. The World Bank does not give grants and, however, loans are provided only for non-military projects.

Check Your Progress A

1) State the basic objectives of the World Bank.

....

....

....

2) State which of the following statements are True and which are False:

   i) The World Bank is a sister organisation of the International Monetary Fund.

   ii) The World Bank provides finance for military projects.

   iii) The World Bank is expected to encourage private foreign resources for the reconstruction of war-devastated economies and development of economically backward economies.

   iv) The intention of establishing the World Bank was to replace the flow of private foreign capital by its lendings.

   v) The World Bank promotes long-teem balanced growth of international trade.

   vi) The World Bank assists developed countries to bring about an easy transition of their peace time economies to war time economies.

   vii) The World Bank does not give grants to its member countries.

16.3 FUNCTIONS OF THE WORLD BANK

In the previous section you have learnt about the objectives of the World Bank. You may like to know how they are accomplished. From this point of view it is necessary to know the functions of the World Rank which can be broadly classified under the three heads: i) Lending and guaranteeing private loans: ii) Technical assistance; and iii) Stimulating private investment,

16.3.1 Lending and Guaranteeing Private Loans

The World Bank generally channelises transfer of funds from developed countries to developing countries, though transfer of resources from one developed country to another developed country through the World Bank is also permissible. The World Bank provides loans to the member countries in the following ways:

1) Loans out of the World Rank's own resources
2) Loans out of the World Bank's borrowed resources
3) Loans on the guarantee of the World Bank

1) **Loans out of the World Bank's** own resources: The paid-up capital and retained earnings constitute the World Bank's own resources. Share capital of the World Bank has been allocated to the member countries. The shares subscribed by the governments of the member countries are not transferable. The members have contributed 2 per cent of their subscription in the form of gold or the US dollars, which is available to the World Bank for lending purposes. In addition, members have contributed 18 per cent of their subscription in their own currencies which can be used for lending with the consent of the members whose currencies are to be used for this purpose. The remaining 80 per cent of subscription is not available for lending but can be called for meeting the World Bank's obligations which may arise out of its borrowing or guaranteeing loans.

   The World Bank generally provides direction to its members in foreign currencies. However, in exceptional cases it can grant loans to a member in its own currency (that is, in the currency of the borrowing country). The terms and conditions of loans are decided by the World Bank. The interest rate that it charges on its loans is higher than the one it pays on its borrowings. The margin thus provides it for its earnings.

2) **Loans out of the World Bank's borrowed resources:** The World Bank's own resources are small vis-a-vis the amount of loans it has to give to its member countries. It augments its capability to provide loans to member countries by borrowing from the capital markets of the countries in whose currencies it is generally expected to give loans. The advantage of this arrangement is that whereas the capital surplus countries find an outlet for their excess resources, the capital deficit countries manage to get loans at reasonable interest rates which on their own they may not be able to get.

The World Bank has placed its securities with investors in more than 100 countries, both developed and developing. It sells its securities through direct placement with the government, the central banks and the government agencies and in securities markets where they are offered to investors through commercial banks and certain other financial institutions engaged in this work. The World Bank's borrowings range from 2 to 25 years. A careful study of the World Bank's borrowings reveals that it has followed a policy of diversifying its debt by currency, country, source, maturity and technique of borrowing.

3) **Loans on the guarantee of the World Bank:** The World Bank also aims at inducing private foreign capital to flow to developing countries. For this the World Bank guarantees in whole or in part the loans provided by the private investors for which it charges a guarantee commission from the latter. The Bank's policy of guaranteeing loans has stimulated international flow of piivate capital. In order to safeguard its own interest the World Bank usually asks the govemment of the borrower's country to guarantee the loan before it agrees to give its own guarantee. In case of default in repayment of such loans the World Bank has the option of buying up the loan at its par value. This obviously helps the lender. As far as the borrower is concerned, the World Bank may decide a somewhat more convenient schedule for the repayment of the loan. This naturally helps the borrower. Thus, the World Bank manages to avert its losses arising from the defaults of the borrower and the guarantor.

The World Bank's role in international finance is at best extremely modest. This is evident from the fact that as late as 1987-88 the World Bank's lending commitments amounted to $ 14.8 billion and the disbursements were only $ 11.6 billion. In this year though 112 countries received financial support from the World Bank, 6 countries, viz., India, Mexico, Indonesia, Brazil, Turkey and China secured loan commitments in amounts exceeding $ 1 billion each and together they accounted for 61.9 per cent of the loans approved.

Having realised the insufficiency of its resources to meet the capital needs of the developing countries, the World Bank has undertaken certain measures to expand the opportunities for co-financing. There are three major sources of the co-financing, viz., aid-giving agencies (such as OPEC), export-credit institutions and commercial banks. In the past contribution of official aid-giving agencies in co-financing activities' of the Bank has been quite significant. The World Bank tries to involve export-&edit institutions in co-financing capital intensive projects. In recent years the projects financed by the World Bank are being increasingly co-financed by commercial banks.

16.3.2 Technical Assistance

Another important function of the World Bank is to provide technical assistance to member countries. This is necessary from' the point of view of the effective utilisation of financial aid. Most of the developing countries lack technical capabilities to evaluate feasibility of development projects, They also cannot judiciously determine the priorities of the various projects.

The World Bank therefore provides technical assistance usually at the stage of the preparation of a project to member-countries, The World Bank conducts surveys in different countries with a view to identify the resource potential of a country as well as the obstacles in its utilisation. It also tries to find out the most appropriate technology for the country given its conditions. These techno-economic surveys and studies on the performance of the member countries help the World Bank and other investors in taking decisions on the requests for loans from the member-countries, The aid recipients also benefits from these studies as it helps them in deciding their policy mix and improving the management of their economic organisations.

The World Bank has also set up an institute to provide training to senior officials of the developing countries in various aspects of economic development. The institute known as the Economic Development Institute conducts training programmes in management of resources, project evaluation, rural development, development of infrastructure, development banking, and so on.

16.3.3 Stimulating Private Foreign Investment

The founders of the World Bank had expected that it would stimulate a direct inter-country flow of capital between private lenders and borrowers. The World Bank reiterated this objective in its Fourth Annual Report. It stated that "over the long run, it is only the sustained flow of private capital that can provide external financial assistance in amounts sufficient to make a significant inroad on the world's development needs." The direct private foreign investment has been considered desirable for two reasons: i) to avoid fixed interest charges, and ii) to obtain essential technical and managerial skills which are available with such investments and generally not obtainable in any other way.

In practice, however, the World Bank has not succeeded much in stimulating a direct international flow of private capital. There are twa main reasons for this failure:

1) To create conditions for self-sustained growth most underdeveloped countries need investments of the kind which are undoubtedly productive in the long run, but are not quick yielding. Such investments, therefore, do not interest private lenders belonging to developed countries.

2) Over the past few decades extensive investment opportunities have existed in potential creditor countries. Hence, private capital has little desire to make investments in developing countries where risks in the form of discrimination, double taxation, transfer problems and even nationalisation are not entirely imaginary.

Check Your Progress B

1) State the three main functions of the World Bank.

....

....

....

....

2) In what ways the member countries receive financial assistance from the World Bank or on its guarantee?

....

....

....

....

3) State which of the following statements are True and which are False:

i) The World Bank channelises only the transfer of funds from developed countries to developing countries.

ii) The paid up capital and retained earnings of the World Bank constitute its own resources.

iii) The entire amount of the subscribed capital is available to the World Bank for lending purposes.

iv) The World Bank generally provides direct loans to its members in foreign currencies.

v) The World Bank has followed a policy of diversifying its debt.

vi) The World Bank renders a free guarantee service to the borrowers of private loans.

vii) The World Bank does not provide any other service to the member countries except the financial assistance.

viii) The World Bank has greatly succeeded in stimulating private investment.

16.4 OPERATIONS OF THE WORLD BANK

Operations of the World Bank are guided broadly by some general lending principles. However, under special circumstances the World Bank provides loans for structural adjustment in the borrowing countries. These special circumstances loans and the loans to finance a part of the local cost of a project have been a subject of controversy. Therefore, we shall also attempt to examine if there is any rationale for these loans.

16.4.1 General Lending Principles

The World Bank usually follows the following principles while giving direct loans or guaranteeing the private loans so as not to expose its funds to unwarranted risks.

1) The amount of loan or loans which a country may get from the World Bank or from private foreign investors on the guarantee of the Bank is not limited by the recipient country's subscribed capital. However, the World Bank takes into consideration the credit worthiness of the borrower and the guarantor. This is done to ensure that, amongst other things, the borrowing country should be in a position to meet its debt servicing obligations out of its foreign exchange earnings.

2) The World Bank gives loans for non-military productive projects. Under no circumstances loans are given for non-productiye purposes. Though the World Bank claims that while making loan commitments it is guided entirely by economic considerations, its critics accuse it of sanctioning loans often on political considerations.

3) The World Bank gives loans to member governments or on their guarantee to other agencies for particular projects. The loan given for a project cannot be diverted to any other use. This approach has its limitations and the programme lending technique has been designed to meet some of them. Programmes can be made of projects and it is possible for funds provided to fill a calculated foreign exchange or savings gap to be used for specific purposes.

4) The World Bank insists on a written report specifying both the desirability and feasibility of the project for which a loan is sought. After satisfying itself about the financial soundness of the projects, the World Bank sanctions or guarantees a loan. The bank also ensures that besides yielding return that would be enough to meet debt service obligations and generate some surplus, the project concerned would also contribute to the economic growth of the borrowing country.

5) Before agreeing to give a loan to a member country the Bank must ensure that under the prevailing market conditions the borrowing country cannot obtain loans elsewhere on terms and conditions which in its opinion are reasonable for the borrower. The World Bank normally gives a loan only to cover foreign exchange component of the project. Only in special circumstances the World Bank may finance a part of the local cost of the project. Since the World Bank's lendings are normally in foreign exchange, it insists that the repayment of the

loan and the payment of interest earned on it should be in currencies in which the loan was given.

6) The World Bank has a right to determine the amount of loan and decide its terms and conditions. However, the rates of interest and other charges should be reasonable and payment schedules must be appropriate to the proyect. Among the conditions laid down for giving a loan the World Bank cannot include a condition that the loan would be country-tied implying that the amount of loan should be spent in a specific country. In this regard the only valid condition is that the borrowing country spends the amount of loan in the economies of the World Bank's member countries.

16.4.2 Structural Adjustment Loans

In the previous section it has been mentioned that under special circumstances non-profit Ioans and loans to finance a part of the local cost of a project can bc provided by the World Bank. The World Bank has used these provisions stated in the **Articles of Agreement** for giving loans for structural adjustment in the economies of the borrowing countries since 1979-80.

According to the World Bank, the need for structural adjustment loans arose on account of certain serious developments during the late 1970s when most of the developing countries (non-oil exporting) faced serious balance of payments problems. The deficits in their balance of payments rose rapidly due to continuous increase in the prices of imports while their export earnings showed no sign of improvement. The prices of imports had risen on account of repeated oil price hikes and raging inflation in the advanced countries of the west. The situation did not change during the 1980s and for the developing countries the task of improving balance of payments position looked rather difficult under these circumstances. A number of developed countries which had taken loans from the World Bank found it difficult to meet their debt service obligations. Economic inter dependence between the developed and developing countries could adversely affect the former, as it could lead to shrinking of their export markets. Repayment of the loans given by developed countries to less developed countries could be defaulted.

Solution to these problems lay in lowering the protectionist walls and thereby allowing imports from the developing countries. But the western countries did not accept this solution; rather they imposed the burden of adjustment on less developed countries. With their dominant position in the World Bank they influenced the policy of the Bank and a programme in support of their approach was launched. In a nutshell the approach requires that the less developed countries restructure their economies so as to be able to improve their balance of payments position. In this attempt they could not hope for any cooperation from the developed countries. In the broad framework of this approach in 1979-80 the World Bank began a policy of 'structural adjustment lending' which was designed to provide support to those governments which (i) had requested for such support and (ii) had also recognised the need to introduce, as a matter of urgency, a package of measures designed to adjust the structure of productive activities of their economies to the deteriorating balance of payments situation. Such lending is subject to a number of stringent conditions dictated by the World Bank to the borrowing countries. These conditions require major changes in the government policies.

The structural adjustment loans are generally medium term. The World Bank's assertion in favour of structural adjustment loans is that they aim at achieving two important objectives. **First,** such loans support programmes to restructure productive sectors with **a** view to improve the balance of payments position of the borrowing countries. **Second,** these loans act as a catalyst for the inflow of other foreign capital which may improve the balance of payments position.

The World Bank's policy of structural adjustment lending has invited serious criticism in some countries. Critics are not wrong when they assert that the structural adjustment lending of the Bank carries with it a high degree of conditionality which is prejudicial to the interests of the borrowing countries. **Structural adjustment loans are generally a** small **portion of the current account deficits of the balance of payments of the country.** The World Bank while sanctioning structural adjustment loans insists that the borrowing country adopts a package of pricing policies, liberalisation measures, monetary and fiscal policies and the public investment priorities recommended to it by the Bank. In this policy framework the entire burden of adjustment falls on the less developed countries. In brief, structural adjustment loans have been used by the World Bank to interfere in the economic management of sovereign governments.

16.4.3 Local Currency Expenditures and Other Problems

The operations of the World Bank reveal that there are some practical difficulties in adhering to the lending principles which we have discussed earlier in this section. **First,** under normal circumstances the World Bank will not finance local investment component of a project. But such a policy would imply inequity in the World Bank's lending. On the one hand, the least developed countries in the world who need the maximum external assistance often even fail to mobilise enough of domestic resources for meeting the local investment expenditure component. The World Bank, therefore, denies them loan for the importation of capital equipment. In contrast, developing countries in the middle income group do not find much difficulty in raising resources for the local investment component of the project. This easily entitles them for loan from the World Bank. Thus, the World Bank's insistence on the exceptional circumstances clause for providing loan in local currency violates the norms of fairness.

A multilateral system is defined as the one where all currencies are convertible and a loan received in any currency can be used for paying for imports from any **country.** Hence the borrowing country is not obliged to import goods only from the country in whose currency it has received a loan. However, in practice due to lack of convertibility of currencies and absence of multilateralism the countries getting loans from the World Bank has to import goods often from those countries only in whose currencies the loans have been provided. Thus, the **second** difficulty is that though the World Bank has imposed no condition about spending the loan amount in a particular country, in practice most aid becomes country tied due to the absence of multilateralism.

Finally, a borrowing country sometimes fails to live up to its promises due to acute foreign exchange problem. In this case, the failure of the country may not necessarily be the result of its economy's non-performance. In fact, often a deficit or a surplus in the balance of payments of a country is determined by a number of such factors on which the country may not have any control whatsoever. Under these circumstances the borrowing member may apply to the World Bank for a relaxation of the conditions of repayment. If the World Bank is satisfied that the basis on which a relaxation of the conditions of repayment of loans is justified and the relaxation itself is in the interest of the member, the other members and the World Bank, it can do two things: (i) it can accept service payment in the currency of the borrowing member and advise it to repurchase such currency over time on appropriate terms; and (ii) it can modify the terms and conditions of amortisation or extend the life of loan; or both.

Check Your Progress *C*

1) What are structural adjustment loans?

....

....

....

....

2) State which of the following statements are True and which are False:

   i) The amount of loan which a country can get from the World Bank is Limited by its subscribed capital.

   ii) The World Bank sometimes gives loans for military projects.

   iii) In making loan commitments the World Bank is guided by political considerations only

iv) The World Bank loans are generally project-tied and not country-tied.

v) The World Bank generally gives loans to cover only the foreign exchange component of the projects.

vi) Before making commitment for a loan to a member country the World Bank need not ensure that the country could obtain loan from an alternative source on appropriate terms.

vii) Structural adjustment loan carries with it a high degree of conditionality which may be prejudicial to the interests of the borrowers.

viii) Under no circumstances the World Bank is allowed to give local currency loans.

ix) Due to lack of multilateralism most of the loans given by the World Bank in practice become country-tied,

x) It a borrowing country fails to meet its debt service obligations in respect of loans received from the World Bank, it can apply for a relaxation of the terms and conditions of amortization.

16.5 EVALUATION OF THE PERFORMANCE OF THE WORLD BANK

The role of the World Bank as a source of finance and other services, should be considered in the context of the increased importance of international finance in economic development. By and large, it is agreed that it has assisted in arranging transfer of financial resources from capital surplus developed countries to capital deficit developing countries. Moreover, it has rendered other services including technical assistance on a reasonable scale. This is the positive side of the World Bank's activities. The World Bank's performance over the years has been criticised from two angles: (i) that the contribution of the World Bank in terms of resource mobilisation vis-a-vis the needs of the developing countries has been only marginal; and (ii) that the World Bank's policies have been discriminatory and prejudicial to the interests of the developing countries. In this section, we shall examine both the contribution and the failures of the World Bank.

16.5.1 The World Bank's Contribution

In the earlier period of its existence the World Bank had paid greater attention to reconstruction of industrial economies which were devastated by World War II. Having completed this task, **The World Bank directed its attention to the development needs of the relatively underdeveloped countries.** The task of development in economically backward economies is really gigantic and the World Bank's resources from this point of view are meagre. However, within its resources the World Bank has provided loans to countries whose projects, seem economically sound but who cannot get loans from any other source at appropriate rates of interest and other reasonable terms and conditions.

The World Bank's real importance, however, lies not in the loans that it sanctions out of its own resources, but in the bonds that it floats in developed capital markets to accumulate funds for providing loans. In this way **The World Bank has become a major channel whereby the developing counties have acquired an access to the international bond** market and other financial markets. This is of critical importance, particularly for those countries which rely heavily on commercial capita and are sensitive'to impact of fluctuations in the world economy.

In order to augment resource transfer from capital surplus developed countries to capital deficit developing countries the Bank has been collaborating with export credit agencies and commercial banks. In response to growing demand for resources from the World Bank and other financial institutions various co-financing instruments have been developed. The World Bank with technical expertise at its disposal has the capability to evaluate investment programmes and individual projects for which aid is sought. It uses this expertise to support the efforts of both the export-credit agencies and the commercial banks to improve the quality of lending.

Low income economies need finance on concessional terms. The World Bank itself is not able to provide concessional finance in a large quantity. However, if one takes into account the activities of the International Development Association, an affiliate of the World Bank, then the position is not as disappointing as it apparently looks. The International Development Association is often referred to as the "soft loan window" of the World Bank, as it has given loans on easy terms and has not ignored the claims of the low-income economies.

Private foreign investment is an important aspect of the World Bank's catalytic role in international capital flows. In the past, the World Bank together with its affiliate the International Finance Corporation, has attempted to stimulate private foreign investment both directly and indirectly. The system of guaranteeing loans has encouraged direct private foreign investment. The, World Bank's indirect contribution to encouraging the flow of private foreign investment has been in terms of financing investments in physical and human infrastructure in developing countries which in turn has improved the prospects for private investment in these countries.

Finally, **the World Bask has lately played an important role in the area of poverty alleviation.** Earlier the thinking in the World Bank was that the benefits of economic growth would trickle down and thus would reach the poorest of the poor. Therefore, the major emphasis of the World Bank was on financing infrastructural project in the field of power generation and distribution, transportation, ports development, telecommunications, and irrigation. Loans for these projects accounted for about 75 per cent of the total loans sanctioned by the World Bank till 1971-72. Agriculture and rural development until 1971-72 received very little project aid. In his tenure as the President of the World Bank, McNamara made a radical change in the lending policy of the World Bank. Stressing the point that the bottom 40 per cent of the people in less developed countries had not benefited from the economic growth that had taken place during the 1960s, he asserted that the World Bank's lending policy would be guided in future by its relevance for the disadvantaged 40 per cent people of the underdeveloped countries. This requred a change in the choice of the projects. Under McNamara's influence agriculture and rural development projects received a high priority. This explains why the World Bank's lending for agriculture rose from 13.3 per cent during the 1960s to 28.4 per cent during the 1970s and 1980s. Samuelson is right when he asserts that McNamara has shifted the World Bank's "focus toward a concern for the very poorest in the developing countries. The best private commercial banks, by their nature, cannot have such a concern for human hunger and disease, for minimum life standards and the mitigation of inequality of opportunity and position."

16.5.2 Failures of the World Bank

In quantitative terms if one attempts to evaluate the performance of the World Bank, then its role in international capital flows has been certainly marginal. During the 1960s the World Bank's loans accounted for a mere 4 per cent of the total international capital flows. Since then there has been no significant change in this share and in no year the World Bank's loans have exceeded 10 per cent of the international capital flows. Hence, the World Bank's role in' international finance should not be exaggerated.

Moreover The World Bank charges a high rate of interest and other charges which reflect its commercial approach. This seems to be inevitable, because the Bank is dominated by developed countries which have no interest in loans on concessional terms to the developing countries.

The World Bank has often been criticised for pursuing policies which are prejudicial to the interests of developing countries. From this point of view the following criticisms deserve particular attention:

First The World Bank generally attempts to tie its loan with a particular project. The project approach can be defended principally on the basis of accountability. However, from the borrowing country's point-of view, it is not the most appropriate approach. Projects are often inter linked and an attempt to stick strictly to a project in isolation may not always yield the maximum returns. A programme-tied aid is no doubt preferable to a project-tied aid. Programmes can be made up of projects and if the aid is for the programme, then borrower has greater freedom to use aid at the programme implementation level.

Secondly, it is alleged that due to the domination of the USA and other western developed countries The World Bank has become an instrument in the hands of neo-imperialists. The main purpose of encouraging flow of foreign capital from the developed to the developing economies is to acquire a firm control over the less developed countries. This allegation against the World Bank is at least partially true.

Finally, the structural adjustment lending is being done with the objective of influencing the domestic policies of the borrowing countries. The western countries which dominate the World Bank are aware of the fact that economically backward countries facing capital shortages are in a highly vulnerable position. They can be made to accept any conditions when they seek loans from the World Bank. They can, therefore, be advised to follow a policy package tailor-made to serve the interests of the dominant members of the World Bank. This criticism of the World Bank in respect of structural adjustment loans is not entirely false.

Check Your Progress D

1) State which of the following statements are True and which are False:

   i) The positive side of the World Bank's activities is that it has encouraged international flow of capital.

   ii) Considering the needs of developing countries the World Bank's lending to these countries has been significant.

   iii) The World Bank's policies are prejudicial to the interests of developed countries.

   iv) The real importance of the World Bank arises from the fact that it has emerged as a channel by which the developing countries have an access to international bond market.

   v) Neither the World Bank nor its affiliate IDA gives loans on concessional terms.

   vi) The World Bank's distribution of loan purposewise has changed since McNamara became its President.

   vii) Alleviation of poverty has always been a criterion for the World Bank's lendings.

   viii) A programme-tied aid rather than a project-tied aid is more flexible from the point of view of the borrowing country.

   ix) Encouragement of private foreign capital involves the risk of serving the interests of the neo-imperialists,

16.6 LET US SUM UP

Discussion to set up the International Bank for Reconstruction and Development, also known as the World Bank, was taken up at Bretton Woods in **1944.** It started functioning in **1946.** The main objectives of the World Bank, as stated in the Articles of Agreement, are:

1) To provide finance and technical help for the reconstruction of war devastated economies;

2) To give financial and technical assistance to developing countries for their development projects.

3) To promote international flow of private foreign investment with the hope that capital surplus economies will find an outlet for their excess financial resources while the capital deficit countries will be able to raise their investment level

despite low level of domestic savings.

4) To aim at promoting long term balanced growth of international trade with the hope that it would increase the welfare of the people the world over.

5) To assist member countries in bringing about an easy transformation of their war time economies into peace time economies.

In order to realise these objective; the World Bank performs a number of functions which can be classified broadly under three heads: i) lending and guaranteeing private foreign loans; ii) providing technical assistance; and iii) stimulating private foreign investment. Among these the first one is the most important. The member-countries can get financial assistance from the World Bank in three ways. First, the World Bank lends out of its own resources. Second, the Bank also lends out of resources borrowed from the capital markets of the world. Third, in order to induce international flow of private capital it guarantees loans given by private investors. In addition, it participates in the co-financing with certain aid-giving agencies, export-credit institutions and commercial banks. Technical assistance which is essential from the point of view of the effective utilisation of financial assistance, is also provided by the World Bank.

The lending operations of the World Bank are guided by certain principles. The main principles are: i) Lending to a country is not limited by its subscription but by its debt servicing capacity, ii) Loans are normally project tied and are to be given only for productive purposes on entirely economic considerations. The project must be feasible and necessary from the country's development point of view. iii) The Loan should be granted only when the country seeking financial assistance cannot raise capital on reasonable terms from any other source. iv) The World Bank normally gives loan to cover only foreign exchange component of the project. Hence, its lendings are in foreign exchange and repayment is also expected in the currency in which the loan was given.

Countries with persistent deficits in their balance of payments can get structural adjustment loans from the World Bank to finance projects which will bring about such structural changes in their economies that their balance of payments position improves. However, these loans carry with them stringent terms and conditions. Moreover, the World Bank recommends a package of price, income, money and fiscal policies along with the priorities in respect of productive activities to the country receiving structural adjustment loan. This approach of the World Bank has resulted in its interference in the domestic matters of the borrowing country.

The lending activities of the World Bank involve a number of problems. First, the World Bank's policy of not financing local investment component of a project often results in denial of credit to least developed countries. Second, due to lack of multilateralism the World Bank loans, in practice, have become country-tied. Third, often failure of the borrowing country in meeting debt service obligations eventually results in modifications in the terms and conditions of amortisation and this in turn puts premium on default.

Taking an overall view of the World Bank's performance, it has to be admitted that the World Bank has certainly played an important role in international transfer of financial resources. However, considering the needs of the developing countries the amount of resource transfer through the World Bank is relatively small. Moreover, some of its policies are prejudicial to the interests of the developing countries.

16.7 KEY WORDS

Amortisation: Setting aside money at regular intervals from the point of view of the repayment of debt.

Co-financing: Financing by more than one agencies jointly.

Country-tied Loan: Loan carrying a condition that its amount is to be spent in a particular country.

Debt-servicing: Payment of interest and repayment instalments

Development Projects: Projects aimed at economic development

Foreign Aid: Official external assistance that includes both grants and loans.

Grants: External assistance that carries no repayment obligations

International Investment: Investment involving savings of a foreign country.

Less Developed Economy: An economically backward economy, also now referred to as an under-developed economy or a developing economy.

Local Cost of a Project: Cost of a project that is expected to be met out of the resources domestically mobilised.

Paid-up Capital: That component of the share capital which has been paid by the share holders of the corporate enterprise.

Peace-time Economy: Economy oriented to development rather than war.

Private Foreign Capital: Capital provided by foreign individuals or private institutions.

Project-tied Aid: Financial assistance for a particular project only.

Retained Earnings: Undistributed profits of the corporate enterprise.

Structural Adjustment Loan: Loan with the objective of enabling the borrowing country to make required structural adjustments.

Subscribed Capital: That component of the share capital which has been subscribed by the interested investors.

Technical Assistance: Assistance in respect of technical knowhow.

War-time Economy: Economy oriented to war rather than development.

16.8 ANSWERS TO CHECK YOUR PROGRESS

A) 2) i) True ii) False iii) True iv) False v) True vi) False vii) True

B) 1) i) Lending and guaranteeing private loans
ii) Providing technical assistance
iii) Stimulating private investment

2) i) Loans out of the World Bank's own resources
ii) Loans out of its borrowed resources
iii) Loans on its guarantee

3) i) False ii) True iii) False iv) True
v) True vi) False vii) True viii) False ix) True

C) 2) i) False ii) False iii) False iv) True
v) True vi) False vii) True viii) False ix) True x) True

D) 1) i) True ii) False iii) False iv) True
v) False vi) True vii) False viii) True ix) True

16.9 TERMINAL QUESTIONS

1) What are the objectives of the World Bank?
2) Discuss the functions of the World Bank. Does its performance solve the capital scarcity problems of less developed countries?
3) What is the rationale for structural adjustment loans provided by the World Bank? Why are they being criticised?
4) Critically evaluate the contribution of the World Bank to international capital, flow.

5) What are the failures of the World Bank? Could it perform better if it was not dominated by the developed countries?

Note: These questions will help you to understand the unit **better.** Try to write answers for them. But do not submit your answers to the University for assessment. These are **for** your practice **only.**

SOME USEFUL BOOKS

Ghosh, B.N. and Rama Ghosh, 1989. *Fundamentals* of Monetary ***Economics,*** **Himalaya Publishing House: Bombay** (Chapter **39).**

Halm, George, N, 1956. Economics *of Money and Banking*, Richard ***D. Irwin,*** **Inc: Homewood,** Illinois (Chapter **45).**

Mithani, D.M., 1988. *Money, Banking, International Trade and Public Finance,* Himalaya Publishing **House: Bombay** (Chapters **33 and** 34).

Misxa, S.K. 1990. Money, *Income and Financial Institutions,* **Pragati Publications:** Delhi (Chapters 24 and 25).

The World Bank, 1985. World ***Development Report, 1985,*** **Oxford** University **Press: New York** (Chapter 10).