The IMF and the World Bank
How Do They Differ?

If you have difficulty distinguishing the World Bank from the International Monetary Fund, you are not alone. Most people have only the vaguest idea of what these institutions do, and very few people indeed could, if pressed on the point, say why and how they differ. Even John Maynard Keynes, a founding father of the two institutions and considered by many the most brilliant economist of the twentieth century, admitted at the inaugural meeting of the International Monetary Fund that he was confused by the names: he thought the Fund should be called a bank, and the Bank should be called a fund. Confusion has reigned ever since.

Known collectively as the Bretton Woods Institutions after the remote village in New Hampshire, U.S.A., where they were founded by the delegates of 44 nations in July 1944, the Bank and the IMF are twin intergovernmental pillars supporting the structure of the world's economic and financial order. That there are two pillars rather than one is no accident. The international community was consciously trying to establish a division of labor in setting up the two agencies. Those who deal professionally with the IMF and Bank find them categorically distinct. To the rest of the world, the niceties of the division of labor are even more mysterious than are the activities of the two institutions.

Similarities between them do little to resolve the confusion. Superficially the Bank and IMF exhibit many common characteristics. Both are in a sense owned and directed by the governments of 180 member nations. The People's Republic of China, by far the most populous state on earth, is a member, as is the world's largest industrial power (the United States). In fact, virtually every country on earth is a member of both institutions. Both institutions concern themselves with economic issues and concentrate their efforts on broadening and strengthening the economies of their member nations. Staff members of both the Bank and IMF often appear at international conferences, speaking the same recondite language of the economics and development professions, or are reported in the media to be negotiating involved and somewhat mystifying programs of economic adjustment with ministers of finance or other government officials. The two institutions hold joint annual meetings, which the news media cover extensively. Both have headquarters in Washington, D.C., where popular confusion over what they do and how they differ is about as pronounced as everywhere else. For many years both occupied the same building and even now, though located on opposite sides of a street very near the White House, they share a common library and other facilities, regularly exchange economic data, sometimes present joint seminars, daily hold informal meetings, and occasionally send out joint missions to member countries.

Despite these and other similarities, however, the Bank and the IMF remain distinct. The fundamental difference is this: the Bank is primarily a development institution; the IMF is a cooperative institution that seeks to maintain an orderly system of payments and receipts between nations. Each has a different purpose, a distinct structure, receives its funding from different sources, assists different categories of members, and strives to achieve distinct goals through methods peculiar to itself.

Purposes

At Bretton Woods the international community assigned to the World Bank the aims implied in its formal name, the International Bank for Reconstruction and Development (IBRD), giving it primary responsibility for financing economic development. The Bank's first loans were extended during the late 1940s to finance the reconstruction of the war-ravaged economies of Western Europe. When these nations recovered some measure of economic self-sufficiency, the Bank turned its attention to assisting the world's poorer nations, known as developing countries, to which it has since the 1940s loaned more than $330 billion. The World Bank has one central purpose: to promote economic and social progress in developing countries by helping to raise productivity so that their people may live a better and fuller life.

The international community assigned to the IMF a different purpose. In establishing the IMF, the world community was reacting to the unresolved financial problems instrumental in initiating and protracting the Great Depression of the 1930s: sudden, unpredictable variations in the exchange values of national currencies and a widespread disinclination among governments to allow their national currency to be exchanged for foreign currency. Set up as a voluntary and cooperative institution, the IMF attracts to its membership nations that are prepared, in a spirit of enlightened self-interest, to relinquish some measure of national sovereignty by abjuring practices injurious to the economic well-being of their fellow member nations. The rules of the institution, contained in the IMF's Articles of Agreement signed by all members, constitute a code of conduct. The code is simple: it requires members to allow their currency to be exchanged for foreign currencies freely and without restriction, to keep the IMF informed of changes they contemplate in financial and monetary policies that will affect fellow members' economies, and, to the extent possible, to modify these policies on the advice of the IMF to accommodate the needs of the entire membership. To help nations abide by the code of conduct, the IMF administers a pool of money from which members can borrow when they are in trouble. The IMF is not, however, primarily a lending institution as is the Bank. It is first and foremost an overseer of its members' monetary and exchange rate policies and a guardian of the code of conduct. Philosophically committed to the orderly and stable growth of the world economy, the IMF is an enemy of surprise. It receives frequent reports on members' economic policies and prospects, which it debates, comments on, and communicates to the entire membership so that other members may respond in full knowledge of the facts and a clear understanding of how their own domestic policies may affect other countries. The IMF is convinced that a fundamental condition for international prosperity is an orderly monetary system that will encourage trade, create jobs, expand economic activity, and raise living standards throughout the world. By its constitution the IMF is required to oversee and maintain this system, no more and no less.

Size and Structure

The IMF is small (about 2,300 staff members) and, unlike the World Bank, has no affiliates or subsidiaries. Most of its staff members work at headquarters in Washington, D.C., although three small offices are maintained in Paris, Geneva, and at the United Nations in New York. Its professional staff members are for the most part economists and financial experts.

The structure of the Bank is somewhat more complex. The World Bank itself comprises two major organizations: the International Bank for Reconstruction and Development and the International Development Association (IDA). Moreover, associated with, but legally and financially separate from the World Bank are the International Finance Corporation, which mobilizes funding for private enterprises in developing countries, the International Center for Settlement of Investment Disputes, and the Multilateral Guarantee Agency. With over 7,000 staff members, the World Bank Group is about three times as large as the IMF, and maintains about 40 offices throughout the world, although 95 percent of its staff work at its Washington, D.C., headquarters. The Bank employs a staff with an astonishing range of expertise: economists, engineers, urban planners, agronomists, statisticians, lawyers, portfolio managers, loan officers, project appraisers, as well as experts in telecommunications, water supply and sewerage, transportation, education, energy, rural development, population and health care, and other disciplines.

Source of Funding

The World Bank is an investment bank, intermediating between investors and recipients, borrowing from the one and lending to the other. Its owners are the governments of its 179 member nations with equity shares in the Bank, which were valued at about $176 billion in June 1995. The IBRD obtains most of the funds it lends to finance development by market borrowing through the issue of bonds (which carry an AAA rating because repayment is guaranteed by member governments) to individuals and private institutions in more than 100 countries. Its concessional loan associate, IDA, is largely financed by grants from donor nations. The Bank is a major borrower in the world's capital markets and the largest nonresident borrower in virtually all countries where its issues are sold. It also borrows money by selling bonds and notes directly to governments, their agencies, and central banks. The proceeds of these bond sales are lent in turn to developing countries at affordable rates of interest to help finance projects and policy reform programs that give promise of success.

Despite Lord Keynes's profession of confusion, the IMF is not a bank and does not intermediate between investors and recipients. Nevertheless, it has at its disposal significant resources, presently valued at over $215 billion. These resources come from quota subscriptions, or membership fees, paid in by the IMF's 180 member countries. Each member contributes to this pool of resources a certain amount of money proportionate to its economic size and strength (richer countries pay more, poorer less). While the Bank borrows and lends, the IMF is more like a credit union whose members have access to a common pool of resources (the sum total of their individual contributions) to assist them in times of need. Although under special and highly restrictive circumstances the IMF borrows from official entities (but not from private markets), it relies principally on its quota subscriptions to finance its operations. The adequacy of these resources is reviewed every five years.

Recipients of Funding

Neither wealthy countries nor private individuals borrow from the World Bank, which lends only to creditworthy governments of developing nations.The poorer the country, the more favorable the conditions under which it can borrow from the Bank. Developing countries whose per capita gross national product (GNP) exceeds $1,305 may borrow from the IBRD. (Per capita GNP, a less formidable term than it sounds, is a measure of wealth, obtained by dividing the value of goods and services produced in a country during one year by the number of people in that country.) These loans carry an interest rate slightly above the market rate at which the Bank itself borrows and must generally be repaid within 12–15 years. The IDA, on the other hand, lends only to governments of very poor developing nations whose per capita GNP is below $1,305, and in practice IDA loans go to countries with annual per capita incomes below $805. IDA loans are interest free and have a maturity of 35 or 40 years.

In contrast, all member nations, both wealthy and poor, have the right to financial assistance from the IMF. Maintaining an orderly and stable international monetary system requires all participants in that system to fulfill their financial obligations to other participants. Membership in the IMF gives to each country that experiences a shortage of foreign exchange, preventing it from fulfilling these obligations, temporary access to the IMF's pool of currencies to resolve this difficulty, usually referred to as a balance of payments problem. These problems are no respecter of economic size or level of per capita GNP, with the result that over the years almost all members of the IMF, from the smallest developing country to the largest industrial country, have at one time or other had recourse to the IMF and received from it financial assistance to tide them over difficult periods. Money received from the IMF must normally be repaid within three to five years, and in no case later than ten years. Interest rates are slightly below market rates, but are not so concessional as those assigned to the World Bank's IDA loans. Through the use of IMF resources, countries have been able to buy time to rectify economic policies and to restore growth without having to resort to actions damaging to other members' economies.

World Bank Operations

The World Bank exists to encourage poor countries to develop by providing them with technical assistance and funding for projects and policies that will realize the countries' economic potential. The Bank views development as a long-term, integrated endeavor.

During the first two decades of its existence, two thirds of the assistance provided by the Bank went to electric power and transportation projects. Although these so-called infrastructure projects remain important, the Bank has diversified its activities in recent years as it has gained experience with and acquired new insights into the development process.

The Bank gives particular attention to projects that can directly benefit the poorest people in developing countries. The direct involvement of the poorest in economic activity is being promoted through lending for agriculture and rural development, small-scale enterprises, and urban development. The Bank is helping the poor to be more productive and to gain access to such necessities as safe water and waste-disposal facilities, health care, family-planning assistance, nutrition, education, and housing. Within infrastructure projects there have also been changes. In transportation projects, greater attention is given to constructing farm-to-market roads. Rather than concentrating exclusively on cities, power projects increasingly provide lighting and power for villages and small farms. Industrial projects place greater emphasis on creating jobs in small enterprises. Labor-intensive construction is used where practical. In addition to electric power, the Bank is supporting development of oil, gas, coal, fuelwood, and biomass as alternative sources of energy.

The Bank provides most of its financial and technical assistance to developing countries by supporting specific projects. Although IBRD loans and IDA credits are made on different financial terms, the two institutions use the same standards in assessing the soundness of projects. The decision whether a project will receive IBRD or IDA financing depends on the economic condition of the country and not on the characteristics of the project.

Its borrowing member countries also look to the Bank as a source of technical assistance. By far the largest element of Bank-financed technical assistance—running over $1 billion a year recently—is that financed as a component of Bank loans or credits extended for other purposes. But the amount of Bank-financed technical assistance for free-standing loans and to prepare projects has also increased. The Bank serves as executing agency for technical assistance projects financed by the United Nations Development Program in agriculture and rural development, energy, and economic planning. In response to the economic climate in many of its member countries, the Bank is now emphasizing technical assistance for institutional development and macroeconomic policy formulation.

Every project supported by the Bank is designed in close collaboration with national governments and local agencies, and often in cooperation with other multilateral assistance organizations. Indeed, about half of all Bank-assisted projects also receive cofinancing from official sources, that is, governments, multilateral financial institutions, and export-credit agencies that directly finance the procurement of goods and services, and from private sources, such as commercial banks.

In making loans to developing countries, the Bank does not compete with other sources of finance. It assists only those projects for which the required capital is not available from other sources on reasonable terms. Through its work, the Bank seeks to strengthen the economies of borrowing nations so that they can graduate from reliance on Bank resources and meet their financial needs, on terms they can afford directly from conventional sources of capital.

The range of the Bank's activities is far broader than its lending operations. Since the Bank's lending decisions depend heavily on the economic condition of the borrowing country, the Bank carefully studies its economy and the needs of the sectors for which lending is contemplated. These analyses help in formulating an appropriate long-term development assistance strategy for the economy.

Graduation from the IBRD and IDA has occurred for many years. Of the 34 very poor countries that borrowed money from IDA during the earliest years, more than two dozen have made enough progress for them no longer to need IDA money, leaving that money available to other countries that joined the Bank more recently. Similarly, about 20 countries that formerly borrowed money from the IBRD no longer have to do so. An outstanding example is Japan. For a period of 14 years, it borrowed from the IBRD. Now, the IBRD borrows large sums in Japan.

IMF Operations

The IMF has gone through two distinct phases in its 50-year history. During the first phase, ending in 1973, the IMF oversaw the adoption of general convertibility among the major currencies, supervised a system of fixed exchange rates tied to the value of gold, and provided short-term financing to countries in need of a quick infusion of foreign exchange to keep their currencies at par value or to adjust to changing economic circumstances. Difficulties encountered in maintaining a system of fixed exchange rates gave rise to unstable monetary and financial conditions throughout the world and led the international community to reconsider how the IMF could most effectively function in a regime of flexible exchange rates. After five years of analysis and negotiation (1973–78), the IMF's second phase began with the amendment of its constitution in 1978, broadening its functions to enable it to grapple with the challenges that have arisen since the collapse of the par value system. These functions are three.

First, the IMF continues to urge its members to allow their national currencies to be exchanged without restriction for the currencies of other member countries. As of May 1995, 101 members had agreed to full convertibility of their national currencies. Second, in place of monitoring members' compliance with their obligations in a fixed exchange system, the IMF supervises economic policies that influence their balance of payments in the presently legalized flexible exchange rate environment. This supervision provides opportunities for an early warning of any exchange rate or balance of payments problem. In this, the IMF's role is principally advisory. It confers at regular intervals (usually once a year) with its members, analyzing their economic positions and apprising them of ac-

The International Monetary Fund and the World Bank at a Glance

International Monetary Fund

- oversees the international monetary system
- promotes exchange stability and orderly exchange relations among its member countries
- assists all members—both industrial and developing countries—that find themselves in temporary balance of payments difficulties, by providing short- to medium-term credits
- supplements the currency reserves of its members through the allocation of SDRs (special drawing rights); to date SDR 21.4 billion has been issued to member countries in proportion to their quotas
- draws its financial resources principally from the quota subscriptions of its member countries
- has at its disposal fully paid-in quotas now totaling SDR 145 billion (about $215 billion)
- has a staff of 2,300 from 180 member countries

World Bank

- seeks to promote the economic development of the world's poorer countries
- assists developing countries through long-term financing of development projects and programs
- provides to the poorest developing countries whose per capita GNP is less than $865 a year special financial assistance through the International Development Association (IDA)
- encourages private enterprises in developing countries through its affiliate, the International Finance Corporation (IFC)
- acquires most of its financial resources by borrowing on the international bond market
- has an authorized capital of $184 billion, of which members pay in about 10 percent
- has a staff of 7,000 from 179 member countries

tual or potential problems arising from their policies, and keeps the entire membership informed of these developments. Third, the IMF continues to provide short- and medium-term financial assistance to member nations that run into temporary balance of payments difficulties. The financial assistance usually involves the provision by the IMF of convertible currencies to augment the afflicted member's dwindling foreign exchange reserves, but only in return for the government's promise to reform the economic policies that caused the balance of payments problem in the first place. The IMF sees its financial role in these cases not as subsidizing further deficits but as easing a country's painful transition to living within its means.

How in practice does the IMF assist its members? The key opening the door to IMF assistance is the member's balance of payments, the tally of its payments and receipts with other nations. Foreign payments should be in rough balance: a country ideally should take in just about what it pays out. When financial problems cause the price of a member's currency and the price of its goods to fall out of line, balance of payments difficulties are sure to follow. If this happens, the member country may, by virtue of the Articles of Agreement, apply to the IMF for assistance.

To illustrate, let us take the example of a small country whose economy is based on agriculture. For convenience in trade, the government of such a country generally pegs the domestic currency to a convertible currency: so many units of domestic money to a U.S. dollar or French franc. Unless the exchange rate is adjusted from time to time to take account of changes in relative prices, the domestic currency will tend to become overvalued, with an exchange rate, say, of one unit of domestic currency to one U.S. dollar, when relative prices might suggest that two units to one dollar is more realistic. Governments, however, often succumb to the temptation to tolerate overvaluation, because an overvalued currency makes imports cheaper than they would be if the currency were correctly priced.

The other side of the coin, unfortunately, is that overvaluation makes the country's exports more expensive and hence less attractive to foreign buyers. If the currency is thus overvalued, the country will eventually experience a fall-off in export earnings (exports are too expensive) and a rise in import expenditures (imports are apparently cheap and are bought on credit). In effect, the country is earning less, spending more, and going into debt, a predicament as unsustainable for a country as it is for any of us. Moreover, this situation is usually attended by a host of other economic ills for the country. Finding a diminished market for their export crops and receiving low prices from the government marketing board for produce consumed domestically, farmers either resort to illegal black market exports or lose the incentive to produce. Many of them abandon the farm to seek employment in overcrowded cities, where they become part of larger social and economic problems. Declining domestic agricultural productivity forces the government to use scarce foreign exchange reserves (scarce because export earnings are down) to buy food from abroad. The balance of payments becomes dangerously distorted.

As an IMF member, a country finding itself in this bind can turn to the IMF for consultative and financial assistance. In a collaborative effort, the country and the IMF can attempt to root out the causes of the payments imbalance by working out a comprehensive program that, depending on the particulars of the case, might include raising producer prices paid to farmers so as to encourage agricultural production and reverse migration to the cities, lowering interest rates to expand the supply of credit, and adjusting the currency to reflect the level of world prices, thereby discouraging imports and raising the competitiveness of exports.

Because reorganizing the economy to implement these reforms is disruptive and not without cost, the IMF will lend money to subsidize policy reforms during the period of transition. To ensure that this money is put to the most productive uses, the IMF closely monitors the country's economic progress during this time, providing technical assistance and further consultative services as needed.

In addition to assisting its members in this way, the IMF also helps by providing technical assistance in organizing central banks, establishing and reforming tax systems, and setting up agencies to gather and publish economic statistics. The IMF is also authorized to issue a special type of money, called the SDR, to provide its members with additional liquidity. Known technically as a fiduciary asset, the SDR can be retained by members as part of their monetary reserves or be used in place of national currencies in transactions with other members. To date the IMF has issued slightly over 21.4 billion SDRs, presently valued at about U.S. $30 billion.

Over the past few years, in response to an emerging interest by the world community to return to a more stable system of exchange rates that would reduce the present fluctuations in the values of currencies, the IMF has been strengthening its supervision of members' economic policies. Provisions exist in its Articles of Agreement that would allow the IMF to adopt a more active role, should the world community decide on stricter management of flexible exchange rates or even on a return to some system of stable exchange rates.

Measuring the success of the IMF's operations over the years is not easy, for much of the IMF's work consists in averting financial crises or in preventing their becoming worse. Most observers feel that merely to have contained the debt crisis of the 1980s, which posed the risk of collapse in the world's financial system, must be counted a success for the IMF. The Fund has also gained some recognition for assisting in setting up market-based economies in the countries of the former Soviet Union and for responding swiftly to the Mexican peso crisis in 1994, but its main contribution lies in its unobrusive, day-to-day encouragement of confidence in the international system. Nowhere will you find a bridge or a hospital built by the IMF, but the next time you buy a Japanese camera or drive a foreign car, or without difficulty exchange dollars or pounds for another currency while on holiday, you will be benefiting from the vast increase in foreign trade over the past 50 years and the widespread currency convertibility that would have been unimaginable without the world monetary system that the IMF was created to maintain.

Cooperation Between Bank and IMF

Although the Bank and IMF are distinct entities, they work together in close cooperation. This cooperation, present since their founding, has become more pronounced since the 1970s. Since then the Bank's activities have increasingly reflected the realization that the pace of economic and social development accelerates only when sound underlying financial and economic policies are in place. The IMF has also recognized that unsound financial and economic policies are often deeply rooted in long-term inefficient use of resources that resists eradication through short-term adaptations of financial policies. It does little good for the Bank to develop a long-term irrigation project to assist, say, the export of cotton, if the country's balance of payments position is so chaotic that no foreign buyers will deal with the country. On the other hand, it does little good for the IMF to help establish a sound exchange rate for a country's currency, unless the production of cotton for export will suffice to sustain that exchange rate over the medium to long term. The key to solving these problems is seen in restructuring economic sectors so that the economic potential of projects might be realized throughout the economy and the stability of the economy might enhance the effectiveness of the individual project.

Around 75 percent of the Bank's lending is applied to specific projects dealing with roads, dams, power stations, agriculture, and industry. As the global economy became mired in recession in the early 1980s, the Bank expanded the scope of its lending operations to include structural- and sector-adjustment loans. These help developing countries adjust their economic policies and structures in the face of serious balance of payments problems that threaten continued development. The main objective of structural-adjustment lending is to restructure a developing country's economy as the best basis for sustained economic growth. Loans support programs that are intended to anticipate and avert economic crises through economic reforms and changes in investment priorities. By using so-called policy-based lending, the Bank stimulates economic growth in heavily indebted countries—particularly in Latin America and in sub-Saharan Africa—that are undertaking, often at much social pain, far-reaching programs of economic adjustment.

In addition to its traditional function as provider of short-term balance of payments assistance, the advent of the oil crisis in the mid-1970s and the debt crisis in the early 1980s induced the IMF, too, to rethink its policy of restricting its financial assistance to short-term lending. As balance of payments shortfalls grew larger and longer-term structural reforms in members' economies were called for to eliminate these shortfalls, the IMF enlarged the amount of financial assistance it provides and lengthened the period within which its financial assistance would be available. In doing so, the IMF implicitly recognizes that balance of payments problems arise not only from a temporary lack of liquidity and inadequate financial and budgetary policies but also from long-standing contradictions in the structure of members' economies, requiring reforms stretching over a number of years and suggesting closer collaboration with the World Bank, which commands both the expertise and experience to deal with protracted structural impediments to growth.

Focusing on structural reform in recent years has resulted in considerable convergence in the efforts of the Bank and IMF and has led them to greater reliance on each other's special expertise. This convergence has been hastened by the debt crisis, brought on by the inability of developing countries to repay the enormous loans they contracted during the late 1970s and early 1980s. The debt crisis has emphasized that economic growth can be sustained only when resources are being used efficiently and that resources can be used efficiently only in a stable monetary and financial environment.

The bedrock of cooperation between the Bank and IMF is the regular and frequent interaction of economists and loan officers who work on the same country. The Bank staff brings to this interchange a longer-term view of the slow process of development and a profound knowledge of the structural requirements and economic potential of a country. The IMF staff contributes its own perspective on the day-to-day capability of a country to sustain its flow of payments to creditors and to attract from them investment finance, as well as on how the country is integrated within the world economy. This interchange of information is backed up by a coordination of financial assistance to members. For instance, the Bank has been approving structural- or sector-adjustment loans for most of the countries that are taking advantage of financial assistance from the IMF. In addition, both institutions encourage other lenders, both private and official, to join with them in cofinancing projects and in mobilizing credits to countries that are in need. Cooperation between the Bretton Woods Institutions has two results: the identification of programs that will encourage growth in a stable economic environment and the coordination of financing that will ensure the success of these programs. Other lenders, particularly commercial banks, frequently make credits available only after seeing satisfactory performance by the borrowing country of its program of structural adjustment.

Cooperation between the Bank and the IMF has over the past decade been formalized with the establishment in the IMF of procedures to provide financing at below market rates to its poorest member countries. These procedures enable the IMF to make available up to $12 billion to those 70 or so poor member countries that adjust the structure of their economies to improve their balance of payment position and to foster growth. The Bank joins with the IMF in providing additional money for these countries from IDA. But what IDA can provide in financial resources is only a fraction of the world's minimum needs for concessional external finance. Happily, various governments and international agencies have responded positively to the Bank's special action program for low-income, debt-distressed countries of the region by pledging an extra $7 billion for cofinancing programs arranged by the Bank.

The Bank and the IMF have distinct mandates that allow them to contribute, each in its own way, to the stability of the international monetary and financial system and to the fostering of balanced economic growth throughout the entire membership. Since their founding 50 years ago, both institutions have been challenged by changing economic circumstances to develop new ways of assisting their membership. The Bank has expanded its assistance from an orientation toward projects to the broader aspects of economic reform. Simultaneously the IMF has gone beyond concern with simple balance of payment adjustment to interest itself in the structural reform of its members' economies. Some overlapping by both institutions has inevitably occurred, making cooperation between the Bank and the IMF crucial. Devising programs that will integrate members' economies more fully into the international monetary and financial system and at the same time encourage economic expansion continues to challenge the expertise of both Bretton Woods Institutions.