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A Review on International Financial Institutions

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ABSTRACT: This paper presents International Financial Institutions, three international institutions that will be discussed are International Monetary Fund, International Bank of Reconstruction and Development and International Finance Corporation. The two international financial institutions mentioned above were the result of a conference held at Bretton Woods, United States in 1944. Both institutions were the result of a compromise of plans made by two economists, namely Keynes and White. It is intended that deficit countries do not experience difficulties in term of international payment, in other words surplus countries give grant to deficit countries. White Plan proposed the establishment of two institutions called the United Nations Stabilization Fund and the Bank for Reconstruction and Development. The first institution aims at maintaining stabilization in term of exchange rate. Any change in exchange rate can only be held by a country if there is agreement from the UNSF. Only in small changes, the countries concerned do not need to seek UNSF approval. In this White plan, a quota is also determined, where each member pays contribution according to the quota taken.

KEYWORDS: International Monetary Fund, financial institution, government, economics, central bank

I. INTRODUCTION

Due to the difficulties experienced by almost all countries between World War I and World War II, several economics scholars have tried to solve these bitter conditions by drawing up plans for international cooperation in finance [1]. Two scholars who have devoted their attention to this field are John Maynard Keynes and H.D. White from United States. Keynes devised a plan which was later given the name Keynes Plan that basically has the following objectives:

a. There is a stable exchange rate;
b. Convertibility;
c. Surplus countries give grant to deficit countries, and;
d. Limiting capital flight.

To achieve four objectives above, Keynes stated the need to establish a Clearing Bank which was then given name with International Clearing Union (ICU). It is an international institution tasked with solving debts between countries. Fund from this institution is obtained by the existence of quota from each country. The amount of quota depends on the economic interest of each country. In addition, international currency was created, which was given the name Bancor. Each country does not owe to other countries, but it owes to the ICU [2].

A country's debt to the ICU is not paid directly but it is resolved by having to import goods from abroad in the specified time, then the receivables will be automatically deleted. This quota is the wealth for UNSF and the Bank for Reconstruction and Development. Countries that are experiencing difficulty, may owe from the bank after fulfill certain conditions. Loan is only intended to deal with the temporary deficit of Balance of Payment of the country concerned. For reconstruction and development, members can lend money for the long term from the Bank for Reconstruction and Development [3]. From the two plans that have been stated above, it appears

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that besides the differences, there are also similarities. Those similarities are later became the focal point for the establishment of two international financial institutions, which we will discuss further.

II. INTERNATIONAL MONETARY FUND

International Monetary Fund is one of two international institutions established after the conference at Bretton Woods in the United States in 1944 [4]. In that year, 44 countries negotiated to establish IMF and the World Bank. The result of the negotiation was actually a compromise between the White Plan and the Keynes Plan. Before 1946, only 39 countries had entered IMF and IBRD. The 39 countries are as follows:

1. Belgium
2. Bolivia
3. Canada
4. Chile
5. China (Formosa)
6. Brazil
7. Colombia
8. Costa Rica
9. Cuba
10. Czechoslovakia
11. Denmark
12. Dominica
13. Ecuador
14. Egypt
15. Ethiopia
16. France
17. Greece
18. Guatemala
19. Honduras
20. Iceland
21. India
22. Iran
23. Iraq
24. Luxembourg
25. Mexico
26. Netherlands
27. Nicaragua
28. Norway
29. Panama
30. Paraguay
31. Peru
32. Philippines
33. Poland
34. Salvador
35. Union of South Africa
36. England
37. United States of America
38. Uruguay
39. Yugoslavia

However, in the middle of 1947, five other countries joined to become members. The five countries are: Italy, Lebanon, Syria, Turkey and Venezuela.

III. THE ESTABLISHMENT PURPOSES OF INTERNATIONAL MONETARY FUND

The establishment purposes of IMF as stated in the Articles of Agreement are as follows:

1) To become a permanent center for meetings and negotiations to achieve international cooperation in the financial field.
2) To help balanced expand of international trade, thus benefiting members and helping members' economic.
3) To strive for the achievement of stable exchange rate and try to eliminate competitive depression.
4) Remove exchange restrictions.
5) Giving trust to members by helping them if they are in difficulties with foreign payments and loans, so they will not be forced to take actions that can harm themselves and other countries.
6) Reducing the time and disequilibrium in member balance of payments.

IV. SIMILARITIES AND DIFFERENCES BETWEEN IMF AND CENTRAL BANK

In reality, IMF became the Central Bank of the Central Banks of each country that was IMF member. Indeed, beside of similarities between IMF and Central Bank in each country, differences can also be seen. If a central bank is a source of credit from commercial banks in a country, then IMF is also a source of credit for the central banks of the countries that become IMF member. In addition, if a Central Bank in a country holds the head of the policy of granting credit, then the same case is for IMF that seeks to establish financial harmony and economic policy in general from countries that become the member [5].

The main difference between IMF and Central Bank is in the matter of duties. The Reserve in a Central Bank consists of a type of currency, the currency of the country concerned, then the reserve in the IMF consists of

various types of currency according to the number of countries that join or are IMF members [6]. Another difference is the Central Bank can create / issue additional currency if the Commercial banks need it in accordance with existing regulation, and IMF does not have the right to do so. In fact, IMF has absolutely no right to issue or print currency that applies throughout the world.

V. QUOTAS, SUBSCRIPTION DAN PURCHASING RIGHTS

Every IMF member pays a sum of money in the form of gold and member's own currency. This amount is called quota. So the source of IMF is the quotas from IMF members, consisting of their respective currencies and gold. For each IMF member, the amount of the quota is determined and calculated based on United States dollar (US $), which quota is related to the interest of the country concerned in international trade. This quota is the basis for self-voting power [7].

This quota reviews every five years and adjusts to the need of each member and the need of international trade. Apart from the quota, each country is also required to pay dues or subscription. In addition, each member has the right to buy foreign exchange from the IMF. Members' right of foreign exchange is limited. The restrictions are related or depend on the number of quota of the country concerned [8]. The example below is given.

Contoh: A country's quota amounts to 100 million dollars, in which it is deposited with its own currency of 75 million dollars, while another 25 million dollars is in gold.

In this case, IMF can sell 25 million dollars of foreign exchange in every 12 months period. The buying right of the member concerned is only for five years. This means that within a period of five years, the member has the right to buy 125 million dollars of foreign exchange after the member has no rights at all. This is why it is said that the right to buy foreign exchange from the IMF depends and is limited according to the number of quotas. The member must pay 25% of quota in gold and the member can pay the rest of quota in their own currency. 25% of quota paid in gold, commonly called a gold tranche. With the purchasing rights of each member, there is a time when a currency is sold out or rises to 200% of the quota.

First point, if the country concerned continues to experience a surplus in its balance of payments. Second point, it occurs because the country continues to use its purchasing rights for five year. If the first point occurs, then the country at the request of the IMF can sell its currency by accepting gold or simply lending its currency, it can also limit the use of the currency by members. Thus the reason why the quota of each member must be reviewed once every five years is to adjust their need to their international payment problem [9].

VI. THE ROLE OF IMF

1) IMF Form for Deficit Countries

Earlier it was said that there were similarities between IMF and Central Bank. This equation is more evident in term of providing IMF assistance to deficit countries, namely in term of providing assistance to IMF members that experience difficulties in international payment. If the Central Bank in a country can provide assistance to commercial banks experiencing liquidity difficulties [10], IMF can also help members experiencing liquidity difficulties in international payment, by providing loan through the Central Bank of the country concerned. This does not mean that lending can be done without significant reasons. The money in IMF belongs to all members and each member has the right to borrow. Therefore, in order to maintain the needs of all members to borrow from IMF to be served, a regulation was held concerning the maximum loan for each member. Loan that does not exceed the gold tranche will be given easily. If it exceeds the gold tranche, the country who lends the money from IMF must prove that the country really intends to improve the situation with a healthy domestic politics. The amount of money that IMF members can lend is limited to 25% of the quota within 12-month period. This can be done repeatedly for five years. If all buying rights have been used, then the member's own currency which already amounts to 200% of the quota must be repurchased with gold foreign exchange within a period of three to five years. In addition, the country that lends money to IMF must also pay interest of the loan.

2) The attitude of IMF towards Surplus Countries

What about IMF's attitude towards surplus countries? It has been said that 75% of each country's quota can be paid in its own currency. Any type of currency in IMF can be reduced if the country that has the relevant currency experiences surplus in its Balance of Payments. For example Indonesia's exports far exceed its imports and other balance sheets also experience a surplus, then Indonesia in its Balance of Payments experiences surplus which must be paid abroad with the Indonesian currency and the Indonesian currency in IMF will decrease [11]. If this continues, the IMF will investigate the reason. The investigation was mainly intended to help deficit countries. The results of the investigation were then announced, and if other countries had

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restrictions on Indonesia's imports (surplus countries) then the IMF could agree. Actions like this are intended to overcome temporary disequilibrium. What about the IMF's attitude towards the fundamental disequilibrium?

3) The attitude of IMF towards Countries experiencing Fundamental Disequilibrium.

A country is categorized to experience fundamental disequilibrium when the country experiences several points as follows:

a. The country concerned is experiencing enormous shortages in international reserves;
b. The country concerned to deal with such matters holds dividend exchange control and;
c. It found unemployment in the long period in the country.

If a country experiences fundamental disequilibrium, the country can ask assistance from IMF. In this case the IMF can give its approval to the country concerned to conduct devaluation. So the government concerned at its request can officially reduce the value of its currency against gold and against foreign exchange [12]. Each member country if it intends to carry out devaluation action, must always seek prior approval from IMF. IMF will always approve act of devaluation, if the devaluation does not exceed 10% of par value, if more than 10% of per value, then the IMF can refuse. Changes in parity can only be proposed up to 20%.

VII. IMF STRUCTURE AND ORGANIZATION

The chief of IMF is occupied by the Board of Governors, governor and successor, they are appointed by each member [13]. This council holds the highest authority. Usually this board meeting holds once a year, most of its powers and duties delegates to the Executive Directors. Only certain powers and duties remain by the Board of Governors. Some of them that very important are:

1) Acceptance of new members;
2) Review of quota and;
3) The right to request that a member should withdraw from the membership.

Executive Director is responsible for the daily work of IMF. All directors are always at the IMF headquarter in Washington [14]. There are 12 people occupied as Executive Director, five of them are directly elected by countries that have the biggest contribution to IMF, namely: the United States, England, Taiwan, France and India. Some people are elected by Latin America, the rest are chosen by other members from other countries. Regarding voting right, each member is given 250 votes without considering to the amount of contribution. The voting right is added to the voting right namely each $ 100,000 quota is for one vote. For example, a country has S 1 10 million quota, then the country will get voting rights: 250 + 1.100 1.350 voting rights. Furthermore, if another country has a subscription of $ 3.175 million, then that country has voting rights: 250 + 31.750 32.000 voting rights; etc.

VIII. INTERNASIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

IBRD or International Bank for Reconstruction and Development is another twin of Bretton Woods conference held in 1944 in the United States. The two international institutions - IMF and IBRD - are closely linked with each other. Only IMF members are allowed to take part in IBRD. Also like IMF, IBRD has a Board of Governors and an Executive Directors; thus there are similarities between IMF and IBRD in term of its organizational structure.

a. Purpose

IBRD objectives are as follows:

1) Reconstructing and developing war-damaged areas and economic development of developing countries, by providing facilities in capital investment for production purposes.
2) Promoting foreign private investment by securing or participating in private investments or investing with own capital or with capital obtained by selling bond.
3) Promoting balanced international trade and balance of payments.
4) Coordinating with loans provided by other international institutions.

Members of IBRD take part in IBRD capital. IBRD capital amounted to approximately $ 10.000 million, while the basis for taking part of the capital of each member was adjusted according to the way the quota was determined at the IMF. The capital of each member does not mean that all must be paid in. Only 20% of all the capital of each member has to be paid, while the remaining 80% of capital will only be requested if needed (the remaining four fifth are left uncalled for guarantee purposes). Of all the capital that must be paid, 90% of capital can be paid in the currency of each member, while the 10% of capital must be paid in gold or dollar. Apart from

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that, to increase the capital stock, IBRD loan was held in the form of bond. For example in October 1952, 60 million US $ of bonds were sold in the United States.

From the beginning people assumed that IBRD would be able to restore countries suffering from war and develop countries that were still underdeveloped. For some, the recovery of war-suffering countries can become a reality, but for others, the hope of developing undeveloped countries is not fully realized [15]. Most of the loan provided by IBRD goes to Western European countries and to several other countries that are actually industrialized countries that are already advanced while only a small portion is lent to develop countries that are not yet developed.

Indeed, the reason why this reality occurs because of the nature and condition of the undeveloped countries themselves. In other words, the lending procedure implemented by IBRD is too difficult for undeveloped countries. If a country wants to make loan to IBRD, it must prepare a plan, which plan must meet the high requirements as required by IBRD. Loans are only given if they are used for truly productive purposes. IBRD only provides loans for the project construction of IMF member, and only if the project is a public investment and which allows the grant concerned. With large finances for the country, in other words IBRD only provides loans to high priority projects that have fulfilled the requirements according to IBRD experts. It is also difficult because the possibility of providing benefits from a proposed project that investigated directly by IBRD staff, either through a plan or with the country concerned [16].

In addition, lending to a project that has been approved by IBRD, is only manifested if the leader of the project is in the condition be able to lead it (no project is likely to succeed unless it is put in the hands of able management). Thus it is clear that this lending procedure is not only difficult to get but also requires a considerable amount of time. This means delaying the implementation of a project that is very urgent for a particular country due to lack of capital [17].

There are some similarities between IMF and IBRD that the leadership of IMF is in the Board of Governors and Executive Directors, as is the same case with IBRD. IBRD capital is set at 10 billion dollars. Indonesia as a member of IBRD also took part in the capital. Indonesia was accepted as a member of IBRD in April 1954. Indonesia's membership in both IMF and IBRD was ratified by Law No. 5 year 1954.

IX. INTERNATIONAL FINANCE CORPORATION

If in the discussion above, it has been said that IBRD only provides loans to the government (public investment), then the institution that we are discussing now provides loans for private investment purposes [18]. It was intended that the establishment of IFC was the branch of IBRD (IFD would be an affiliated of IBRD). IFC will provide loans to private company without government guarantees. IFC will also take part with private capital in the same investment balance. The purpose of IFC is to help the flow of private foreign investment to undeveloped countries. The principles of IFC are as follows:

a. Invest in productive enterprises [19].
b. Do not give all the capital, but only help by adding to the existing capital.
c. It will not help if capital can be obtained on reasonable terms by normal process.
d. Not participating in leadership.
e. Do not participate in share capital, but only provide loan capital [20].

Those who can become IMF members are members of IBRD. IFC's authorized capital is 100 million dollars. Members are represented by their representatives in IBRD. Indonesia has become a member of IFC, which is ratified by Law No. 26 year 1956.

X. CONCLUSION

A more economical way to provide solid liquidity for the economy around the world has been implemented by International Monetary Fund (IMF), namely by the issuance of a new liquid tool called Special Drawing Rights (SDR). SDR is a kind of "international demand deposit" which is fully supported by IMF reserves and gold. It is also called "paper gold" because it can replace all the functions of gold as an international standard. However, there is no direct relationship between SDR and gold stock and price. The SDR exchange rate is a weighted index of several major currencies in the world. In other words, the value of this new monetary standard is associated with the value of a group of major currencies in the world (and not with a group of main trading goods in the world, as Hart Kaldor-Tinbergen suggested above). Each year Managing Director of IMF (in consultation with IMF members) determines how much additional "international demand deposits" will be created to support the growth of international trade.

The SDR system seems to be able to avoid the disadvantages of the systems suggested previously. Whether or not this system is successful in the long term depends a lot on:

a) Monetary discipline from IMF members (especially currencies that are included in SDR exchange rate calculation). Because this system does not impose elements of monetary discipline for each country as in the gold standard system or the goods standard system.
b) Good management and planning by IMF as an international banker regarding the size of SDR volume needed is to support world trade; it should not too little so it causes deflation and obstacles to the growth of world trade, but also not too much so it causes inflation and loss of confidence in SDR (as with the dollar).
c) Circumstances in the "real" sector of the economy and world trade (for example energy issues, the international political situation and so on). The "monetary" and "real" sectors are always interconnected and influence each other, whether for a country or for the world economy as a whole. Whatever is done in the monetary field will not mean much if the real sector is not addressed. A stable and fair world economy and political orde seems to underlie all of this.

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