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ASSIGNMENT No. 01

Fundamental of Money and banking (1414) associate degree of commerce

Spring, 2025

Q. 1 Discuss the concept, role and function of money in a modern economy. (20)

The word money has been taken from latin word “moneta” which denotes godess juno in whose temple money was minted in rome. At present the latin word pecunia is used for money. It is generally believed that pecunia is derived from pecus meaning cattle which have served at one time or another as a medium of exchange and a measure of value. People think that man done nothing to discover money but it appeared at its own according to the needs of circumstances. This idea is known as theory of spontaneous growth. According to some people money was discovered to overcome the defects of barter system. This idea is known as theory of evolution.

Some people think that money arose as unit of account from customary ratios of exchange. There are others who hold that money originated as medium of exchange. This theory is more widely held and is generally believed that some articles general utility began to serve as a medium of exchange and became money. This was due to its general acceptability.

Throughout the history of civilization money has passed through different stages. Historically the development of money in the present form has evolved through the following stages. These stages are discussed as under.

Commodity money

The earliest money which came into use and was accepted in the exchange of goods was commodity money. A large number of item such as wheat, cotton, skins, arrows, bows, camels, goats etc have served as commodity money at different times and places depending upon the stage of development in that country. As time passed on it was found that these commodities were not best suited as general means of making payments.

The main problems with commodity money were that they lacked (a) durability (b) portability (c) divisibility (d) uniformity and standardization (e) regularity in supply (f) and had high opportunity cost, so search was made to find more suitable and convenient mean which is generally acceptable in payments for the goods and services. The search led to the discovery of precious metals like copper, silver and gold.

2. Metallic money

The next form of commodity money was the use of metals such as gold, silver, copper as medium of exchange. Such coins had in intrinsic value. Which was reflected in their face value? The use of un-coined metals as a medium of exchange created further difficulties; it became difficult for people to known the weight and value of the peiece of bullion at sight. The discovery of mines of gold and silver and their exhaustion caused fluctuations in the supply of money. Transaction and storage of precious metals also became dangerous. Debasement of metal further caused inconvenience and complications in exchange further advancement in the evolution of commodity money was the replacement of un-standardized metal ingnots with a standardized coinage. The metallic coins had a guaranteed weight of value by a competent authority. They had also the intrinsic value and so commanded a universal respect. With the passage of time these full bodied coins also proved a failure as a good medium of exchange. Coins were clipped abraded and melted down. They were also debased with the discovery or exhaustion of mines the intrinsic worth of the coins begins to depart from their face value efforts were made to find out a better unit of account.

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Convertible paper money

In the evolution of money the next stage was the discovery of convertible paper money as a commodity money substitute. The convertible paper money is paper money that may be redeemed for a specific commodity at a rate of specialized on the currency. Before 1914 the bulk of bank notes were convertible into gold. The bank notes of various denominations had a promise by the bank to pay to the bearer as specific amount of gold on demand. The practice of exchanging paper currency for gold was eliminated after 1914 in england and in 1933 in usa. In today's economy the paper notes are inconvertible notes. They are neither fully nor fractionally convertible into gold. The paper money developed into inconvertible money is called flat money.

4. Flat money

Flat money consists of paper money that derives its status as money from the power of the state. That money is money because government says it is money. It is not backed by promise to pay something of intrinsic value. It is accepted because government declares it legal tender. The creditors must accept it as a medium of exchange and as a payment for debts.

5. Credit money

Another most important component of money supply is the deposit money or credit money. Deposit money consists of deposits at bank and the financial institutions which are subject to withdrawal by cheques. In developed countries of the world 95% transactions are carried on with cheques. Cheques are a safe way of transferring the ownership of deposits in financial institutions. They are normally acceptable as medium of exchange.

6. Electronic banking

In all the developed and many developing countries of the world including pakistan the commercial banks have entered into an era of electronic banking. The customers of banks having deposits in their accounts can make purchase, pay bills, transfer money simple by electronic signals.

7. Near money

The final stage in evolution of money has been the use of bills of exchange, treasury bills, debentures, saving certificates etc. They are known as near money. They are close substitute for money and are liquid assets. The final stage of its evolution has become intangible. Its ownership ins now transferable simply by book entry.
Why does the typical million-dollar lottery winner end up broke within three years after earning his or her millions? Because while they had a sudden windfall of money, they had no concept of wealth. Wealth is not the same thing as money. Wealth is not measured by the size of income. Wealth is measured in time.

Wealth is not the same thing as money. Wealth is not measured by the size of income. If all I have to my name is $1,000 in savings and checking combined, and my living expenses are $100 a day, then my wealth equals ten days. (i.e. Wealth is the ability to survive so many number of days forward.)

Actually, let's deepen that definition. Wealth is measured by the richness of your life experience today plus the number of days into the future that you have the capacity to continue living at that level of experience. One reason the rich get richer is that the rich work for a different kind of money. They don't work to generate income—they work to build wealth. There is a vast difference between the two.

When most people hear the word "wealth," money immediately comes to mind. There are wealth management firms like mine, overseeing trillions of dollars of assets under management. There are shows, podcasts, books, and magazines galore touting how to build your wealth through the latest investment trends. Even those in pursuit of balance preach healthy and wealthy, as if they are two distinctly separate goals. The world is conditioned to associate wealth with being rich.

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The etymology of the word “wealth” comes from the Old English word “weal,” which refers to a state of well-being. Even going back to the Bible, weal is often referenced as a sound or healthy state. Notice that nowhere is there mention of money, investing, or finance.

It’s worth exploring the crossover point in which well-being came to mean financially successful. The connection isn’t by happenstance, finances certainly carry enormous weight in affecting the prosperity of a person, household, business, or government. But wealth is a state of mind, a unique personal definition, the sum of countless variables, of which money is but one.

3 reasons you should disconnect wealth and money

Having personally advised thousands of professionals from all walks of life over the past 15 years, I can vouch for the power money wields over its pursuers. While those who do not respect or care about their finances are bound for disaster, people on the other end of the spectrum risk another type of demise. The United States has been the richest country in the world for decades, yet according to the World Health Organization (WHO) has long been one of the most depressed countries, in terms of mental and behavioral disorders.

There are studies that show once a certain income threshold is crossed, increases in income are correlated to decreases in mental health. Some might argue that when one doesn’t have problems, they must think up problems (i.e., the real financial problem is eliminated so a novel mental one is created). However, it can’t be ignored that chasing money for the sake of itself can require important sacrifices in real well-being, only leading to a sense of emptiness once the monetary goal is reached.

Other side effects of putting money on the top pedestal can include poor work performance. The philosophy of care every company hopes to practice with their employees or customers can be shoved aside to make or save a few more dollars. At worse, blind pursuit of money can lead one to take corrupt action. I often talk about the three I’s needed for career satisfaction (income, independence, and impact). When income is the only one that matters, people can get trapped in the wrong profession without any independence or impact to appreciate.

On the financial planning side, money is at the route of people falling prey to “keeping up with the Joneses.” The urge to showcase financial status in competition among peers can force one to live beyond their means and wreck their budget. Lastly, once money has taken full control, it can breed an irrational investor. This type of investor may constantly watch their portfolio and begin making short-term emotional choices that deviate from their original strategy.

Reason # 2: Money takes time

Making money takes time. Time is considered the greatest asset of all—here today but gone tomorrow. There is only so much time in a day, in a week, and in a lifetime to balance relationships, hobbies, exercise, and health. The saying, “People can spend a lifetime wasting their health chasing their wealth, only to end up wasting their wealth chasing their health,” is partially true. If real wealth were the goal, this would not be the case. Money may not rhyme in that line, but it would be the correct choice of word.

More than two thousand years ago, Aristotle summed it up nicely in saying, “The life of money-making is one undertaken under compulsion, and wealth is evidently not the good we are seeking; for it is merely useful and for the sake of something else.” Perhaps including wealth was a mistake in the translation, but this famous quote underscores how a mound of currency and mound of dirt carry no different value until they can translate into some improvement in well-being.

Reason # 3: Money dies on its own

Money is undoubtedly an integral part of wealth. But it only makes up one letter in "MICE" (Money, Ideology, Compromise, and Ego), the acronym that governs human motivation. Similarly, it provides context around the price of every transaction, but hardly helps when evaluating the costs and values

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inherent to choices.

Money can't survive on its own, it needs somewhere to go, or it dies. There need to be goals to feed the balance sheet, to motivate workers, companies, and investors. As a financial advisor, when getting to know the goals of a client in our initial discovery, I don't think I've ever heard someone simply say, "I just want more money," and truly believe that was the life goal. The answers always involve goals such as retirement, funding college, buying a home, traveling, and other end results.

Economics invades every subject that matters, whether micro or macro. Money by itself has never solved issues like entitlements, education, tech, environment, war, and religion, but generating mutual wealth within these domains has routinely led to progress. So, just as investing is one part of financial planning, financial planning is one part of wealthy living.

Q. 2 What is the value of money? Discuss the theories determining the value of money. (20)

Understanding the Value of Money

The value of money refers to the purchasing power of a currency, or how much goods and services one unit of currency can buy. This concept is crucial in economics as it affects consumer behavior, business decisions, and government policies. The value of money is not static; it fluctuates due to various factors such as inflation, interest rates, and economic growth.

The Role of Money in the Economy

Money serves as a medium of exchange, a unit of account, and a store of value. Its value underpins economic transactions by facilitating trade and providing a common measure of value. Without a stable value of money, economies would struggle with inefficiencies and uncertainties.

Money as a Measure of Purchasing Power

The purchasing power of money indicates how much goods and services can be bought with a unit of currency. When the value of money decreases (as in inflation), purchasing power falls, meaning more money is required to buy the same amount of goods. Conversely, when the value of money increases (as in deflation), purchasing power rises.

Inflation and the Erosion of Money's Value

Inflation is the rate at which the general level of prices for goods and services rises, leading to a decrease in the value of money. When inflation is high, money loses its value rapidly, and people may rush to spend money before it loses more value, which can further drive up inflation.

Deflation and the Increase in Money's Value

Deflation is the opposite of inflation, where the general level of prices falls, increasing the value of money. While this might seem beneficial, deflation can lead to reduced consumer spending, lower profits for businesses, and an economic slowdown, as people wait for prices to fall further before making purchases.

The Quantity Theory of Money

The Quantity Theory of Money is one of the oldest theories for determining the value of money. It posits that the value of money is determined by the money supply in an economy. According to this theory, if the amount of money in circulation increases faster than the economy's output of goods and services, inflation will occur, reducing the value of money.

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The Fisher Equation

The Fisher Equation, named after economist Irving Fisher, is a formal representation of the Quantity Theory of Money. It states that MV = PT, where M is the money supply, V is the velocity of money, P is the price level, and T is the volume of transactions. This equation illustrates how changes in the money supply can affect the value of money.

The Demand for Money Theory

The Demand for Money Theory, advanced by economists like Keynes, suggests that the value of money is influenced by the demand for it. People demand money for transactions, precautionary reasons, and speculative purposes. The value of money increases when the demand for holding money rises, assuming the money supply remains constant.

Keynesian Liquidity Preference Theory

John Maynard Keynes introduced the Liquidity Preference Theory, which explains how interest rates influence the demand for money. According to Keynes, people prefer to hold money in liquid form rather than invest it, especially during uncertain times. The value of money is thus linked to interest rates: higher interest rates make holding money less attractive, potentially decreasing its value.

The Real Bills Doctrine

The Real Bills Doctrine posits that as long as money is issued against short-term commercial loans (real bills), it will retain its value. This theory suggests that money should be backed by real economic activity, and when this condition is met, the money supply can expand without causing inflation.

The Purchasing Power Parity (PPP) Theory

The Purchasing Power Parity Theory is used to determine the value of money in the context of exchange rates. It states that in the long run, exchange rates should adjust so that identical goods cost the same in different countries when priced in the same currency. This theory implies that the value of money is tied to its purchasing power relative to other currencies.

The Interest Rate Parity Theory

The Interest Rate Parity Theory suggests that the value of a currency is determined by the interest rates in different countries. If one country offers higher interest rates, its currency should appreciate, increasing the value of its money relative to other currencies. This theory links the value of money to international capital flows and exchange rates.

The Austrian School's Theory of Money

The Austrian School, particularly through economists like Ludwig von Mises, argues that the value of money is subjective and determined by individual preferences. According to this theory, money's value is derived from its utility as a medium of exchange and is influenced by people's expectations and choices.

The Cost-Push Inflation Theory

Cost-push inflation occurs when the rising cost of production leads to an increase in prices, thereby reducing the value of money. Factors like higher wages, raw material costs, or taxes can push prices up, causing money to lose its purchasing power.

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The Demand-Pull Inflation Theory

Demand-pull inflation happens when the demand for goods and services exceeds their supply, driving up prices and eroding the value of money. This type of inflation often occurs in a growing economy where consumer spending increases faster than production.

The Role of Central Banks in Controlling Money's Value

Central banks play a crucial role in controlling the value of money through monetary policy. By adjusting interest rates and regulating the money supply, central banks aim to stabilize the value of money, ensuring low and predictable inflation.

The Gold Standard and Money's Value

Under the Gold Standard, a country's currency was directly linked to gold. The value of money was determined by the amount of gold it could be exchanged for. While the Gold Standard helped stabilize the value of money, it also limited governments' ability to respond to economic crises by adjusting the money supply.

Fiat Money and Its Value

Fiat money is currency that has value because a government decrees it as legal tender, rather than because it is backed by a physical commodity like gold. The value of fiat money is determined by public confidence and government policy. While fiat money allows for greater flexibility in monetary policy, it also requires careful management to prevent inflation.

The Role of Expectations in Determining Money's Value

Expectations about future inflation, interest rates, and economic conditions can influence the value of money today. If people expect higher inflation in the future, they may rush to spend money now, leading to a decrease in its value. Conversely, if deflation is expected, people might hoard money, increasing its value.

Cryptocurrencies and the New Concept of Money's Value

Cryptocurrencies like Bitcoin have introduced a new way of thinking about money's value. Unlike fiat currencies, cryptocurrencies are decentralized and their value is determined by supply and demand dynamics in a digital marketplace. The value of cryptocurrencies is highly volatile, reflecting their speculative nature and the novelty of blockchain technology.

The Future of Money's Value in a Digital Economy

As economies become increasingly digital, the determinants of money's value are likely to evolve. Digital currencies, changes in monetary policy, and shifts in consumer behavior will all play roles in shaping the future value of money. Understanding these dynamics will be crucial for navigating the complexities of modern economic systems.

Q. 3 Describe in detail the concept and types of inflation along with remedies to reduce it. (20)

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...ducing their purchasing power...
...e, households may need to adjust their...
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...on on Investments

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Q. 4 What are the financial assets? Discuss the types and structure of the financial assets. (20)

Understanding Financial Assets

Financial assets are intangible assets that derive their value from contractual claims. These include stocks, bonds, bank deposits, and other instruments that represent ownership or a claim on future cash flows. Unlike physical assets, financial assets do not have inherent value but instead rely on the issuer's ability to meet financial obligations.

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Types of Financial Assets

Financial assets come in various forms, including equity instruments like stocks, debt instruments like bonds, and hybrid instruments like convertible bonds. Each type serves different purposes for investors and issuers, providing a range of risk and return profiles to suit different financial goals.

Equity Instruments

Equity instruments, such as common and preferred stocks, represent ownership in a company. When you purchase a share, you own a portion of the company and are entitled to a share of the profits through dividends. Equity instruments are a key component of financial markets, enabling companies to raise capital by selling ownership stakes.

Debt Instruments

Debt instruments include bonds, loans, and other forms of borrowing. When you purchase a bond, you are lending money to the issuer in exchange for periodic interest payments and the return of the principal at maturity. Debt instruments are vital for both governments and corporations to finance large projects and operations.

Hybrid Instruments

Hybrid instruments combine features of both equity and debt. Convertible bonds, for example, are bonds that can be converted into a predetermined number of shares of the issuing company. These instruments offer investors the potential for capital appreciation while providing the safety of fixed interest payments.

Money Market Instruments

Money market instruments are short-term debt securities that typically mature in less than a year. These include Treasury bills, commercial paper, and certificates of deposit. Money market instruments are used by governments, financial institutions, and corporations to manage short-term liquidity needs.

Derivatives as Financial Assets

Derivatives are financial contracts whose value is derived from an underlying asset, such as stocks, bonds, commodities, or currencies. Common derivatives include options, futures, and swaps. These instruments are often used for hedging risks or speculative purposes in financial markets.

Role of Financial Assets in Capital Formation

Financial assets play a crucial role in capital formation, which is essential for economic growth. By issuing stocks and bonds, companies can raise the capital needed for expansion, innovation, and the development of new products and services. This capital formation drives job creation, productivity, and overall economic development.

Financial Assets and Wealth Accumulation

For individuals, financial assets are a primary means of accumulating wealth. Through investments in stocks, bonds, and other financial instruments, individuals can grow their savings over time, benefiting from capital gains, dividends, and interest payments. This wealth accumulation is vital for long-term financial security, retirement planning, and intergenerational wealth transfer.

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Liquidity and Financial Assets

Liquidity refers to the ease with which financial assets can be converted into cash without significantly affecting their value. Financial assets like stocks and bonds are typically more liquid than physical assets like real estate. High liquidity in financial markets ensures that investors can quickly buy or sell assets, which promotes market efficiency and stability.

Risk Management through Financial Assets

Financial assets play a critical role in risk management. Investors can diversify their portfolios by holding a mix of stocks, bonds, and other assets, reducing exposure to any single asset's risk. Additionally, derivatives such as options and futures allow investors to hedge against potential losses in their portfolios.

Financial Assets and Interest Rates

Interest rates have a direct impact on the value of financial assets, particularly debt instruments like bonds. When interest rates rise, the value of existing bonds typically falls, and vice versa. Central banks use interest rate adjustments as a tool to influence economic activity, making the relationship between interest rates and financial assets crucial for both investors and policymakers.

Financial Assets and Economic Stability

Financial assets contribute to economic stability by providing mechanisms for saving and investment. Well-functioning financial markets allow for efficient allocation of resources, which supports economic growth and reduces the likelihood of financial crises. However, excessive speculation in financial assets can lead to bubbles and economic instability.

Inflation and Financial Assets

Inflation affects the real value of financial assets. While some financial assets, like stocks, may provide a hedge against inflation, others, such as fixed-income securities, may lose value as inflation erodes the purchasing power of future cash flows. Investors need to consider inflation risks when managing their portfolios.

Globalization and Financial Assets

Financial assets are increasingly global, with investors able to buy and sell assets in markets around the world. This globalization of financial markets allows for greater diversification and access to capital, but it also introduces new risks, such as currency fluctuations and political instability in foreign markets.

Technology and Financial Assets

Technology has revolutionized the trading and management of financial assets. Online trading platforms, algorithmic trading, and financial technology (fintech) have increased market access, reduced transaction costs, and provided new tools for managing investments. However, the rapid pace of technological change also introduces new challenges, such as cybersecurity risks.

Regulation of Financial Assets

Regulation plays a key role in ensuring the integrity and stability of financial markets. Governments and regulatory bodies oversee the issuance, trading, and disclosure practices related to financial assets to protect investors and maintain confidence in the financial system. Regulations are designed to prevent fraud, market manipulation, and systemic risks.

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Financial Assets in Retirement Planning

Financial assets are central to retirement planning, providing individuals with the means to save and invest for their future. Retirement accounts, pensions, and other investment vehicles allow individuals to grow their wealth over time, ensuring financial security in retirement. The choice of financial assets in a retirement portfolio is crucial for balancing risk and return.

Social Impact of Financial Assets

Financial assets can also have a social impact through socially responsible investing (SRI) and environmental, social, and governance (ESG) criteria. Investors increasingly seek to align their investments with their values by supporting companies that prioritize sustainability, ethical practices, and social responsibility. This shift is influencing corporate behavior and driving positive change.

Financial Assets and Corporate Governance

Ownership of financial assets, particularly stocks, gives shareholders a voice in corporate governance. Shareholders can influence company decisions through voting rights, including decisions on executive compensation, corporate strategy, and social responsibility initiatives. Effective corporate governance ensures that companies are managed in the best interests of shareholders and stakeholders.

Challenges and Risks of Financial Assets

While financial assets offer numerous benefits, they also come with risks. Market volatility, interest rate changes, credit risk, and liquidity risk are some of the challenges investors face. Moreover, the complexity of some financial instruments, such as derivatives, can lead to misunderstandings and mismanagement, contributing to financial crises. Managing these risks is essential for maintaining the stability and confidence in financial markets.

The Future of Financial Assets in the Economy

As economies evolve, the role of financial assets will continue to grow. Innovations in fintech, the rise of digital currencies, and the increasing importance of sustainable investing are reshaping how financial assets are created, traded, and valued. Understanding these trends and their implications will be crucial for investors, policymakers, and businesses as they navigate the future of finance.

Q. 5 Write a note on the following: (20)

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

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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.

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.

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 180 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.

Recipients of Funding

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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 $865. 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.

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.

ii. IMF

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.

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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 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,

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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

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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 182 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.

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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

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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.

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