 

INSTITUTIONS OF THE INTERNATIONAL MONETARY SYSTEM (IMS): THE ROLE OF THE INTERNATIONAL MONETARY FUND (IMF) IN THE WORLD ECONOMY

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Abstract
The analysis of IMF activity in its more than 60 years of existence highlights a difference between the primarily objectives and actual results of policies pursued. How it was at the very beginning and how is in our days? In the following paper we want to point out this major divergence considering the context of nested financial markets globalization.

Rezumat
Analiza activităţii FMI pe o perioadă de peste 60 de ani[1] *evidenţiază o divergenţă între obiectivele sale şi rezultatele efective ale politicilor promovate. În cele ce urmează ne propunem să punctăm această divergenţă în contextul crizei globalizării pieţelor financiare.*

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[1] *IMF was established in 1944 and became operational in 1947.*

Brief history

The International Monetary fund (IMF) originates in the economic recession of the 1930s. Several international monetary conferences were organised with the purpose to reinstate the order and to restart the economic growth, but they failed due to the lack of cooperation.

During the early 1940s, during World War Two, *John Maynard Keynes* from UK treasury and *Harry Dexter White* from USA treasury conceived almost simultaneously the instauration of a fully new monetary system.

The final negotiations took place at Bretton Woods (New Hampshire, USA), in July 1944, when the delegates from 45 countries, the Soviet Union included, decided to establish the IMF and the World Bank. These are the Bretton Woods institutions.

The establishment of the IMF and the World Bank, in a world characterized by fixed exchange rates and capitalist control, proved to be the most inspired decision of the Bretton Woods Conference. Indeed, while international monetary system (IMS) conceived with this occasion, resisted until 1971, and while the fixed exchange rates system collapsed in 1973, the Bretton Woods institutions survived until our times and the IMF continues to play an important role in the world economy.

From 29 member countries in 1945, IMF reached 186 member states currently.

Thus, while the initial role of the IMF was to defend the fixed exchange rates (it monitored the harmonious functioning of the exchange agreements and the stability of currencies, it banned the competitive devaluing, assisted the member states to surmount the temporary deficits of the payment balance, etc.), to boost currency convertibility (IMF supports the elimination of the exchange restrictions and plays an important role in the European reconstruction) and to support the exchange policy (IMF intervenes, for instance, in support of the developed countries which have foreign trade problems). As of 1991/1992, the role of this institution, as presented in IMF Report, refers to the following aspects:

– It supervises the international monetary system and promotes the international monetary cooperation;

– It promotes the currency exchange and ordered exchange relations between its members;

– It grants assistance to its members experiencing temporary difficulties of the balance of payments, by short- or medium-term financing, thus allowing them to correct the imbalance of payments;

– It supplements the reserves of its members by allocating SDR[2] when there is a long-term global demand;

– It forms its resources mainly from the contributions of its members.

IMF belongs to the specialised UN institutions; it is dependent on its relations with the UN and with other international organisations and is a legal person in relation with the member and non-member states. IMF is an intergovernmental institution with universal vocation, expression of the developing international monetary cooperation.

IMF organisation and financial structure

The most important organism which sets IMF policy, which approves the functioning of the IMS, is the Interim Committee, while a Development Committee rules on the problems of the poorest countries.

Brief description of IMF organisation

IMF leadership goes to the Council of Governors. Each member state appoints a governor (usually the ministry of finance of the governor of the central bank) and a delegate-governor for a period of five years.

The contribution (share) of each member state, set by the Council of Governors, in agreement with IMF statute consists of SDR or free convertible currencies (25% of the total, and of the national currency of the particular state (the balance of 75%). Because the national currencies have the highest share of the contribution, and most of them are not convertible, IMF resources are affected in terms of quality and much of them cannot be used.

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[2] *SDR I, in agreement with IMF definition, an international reserve asset established by the IMF in 1969, with the purpose to supplement the official reserves of the member countries. Initially, the value of one SDR was the equivalent of 0.888671 grams of gold, but after the collapse of the Bretton Woods system, its value has been redefined according to a basket of currencies currently consisting of the euro, yen, sterling pound and US dollar.*

The shares give the voting right and the amount of the drawing rights of the member states on IMF resources. They also reflect objectively the importance of the member states within the economic world. They are reviewed every five years according to the growth of the world economy and the relative classification of the member states.

The decisions of the Council of Governors are mandatory. The Council of Governors can change the statute, can accept new members, can approve the revision of the national contribution and the change of the member states currency parity.

The current political decisions are taken by the Board of Administration (executive) empowered by the governors to enforce IMF policy.

The funds available to the IMF are in different national currencies and in SDR. So IMF distributes upon request by its member states, the currency of other member states, which is mission of IMF as international financial institution. The IMF uses a special currency[3] for loans when a country demands such loan.

The ordinary (normal) drawings have two components: the drawings from the reserves and the drawings from the credit. For the first component, the drawings are automatic, are unconditional, and their dimension is determined by the proportion of SDR of convertible currencies within the national contribution of the particular country. These drawings are listed among the monetary reserves of the member states. The drawings are unconditional for the second component, and a country uses them when it finished the drawing rights from the first component, the reserves.

As of 1952, IMF introduced an elastic technique, borrowed from the banking practice, of the “confirmed credits”, establishing the “stand-by agreements”. Since then, almost all the drawings outside the reserves component were done under such agreements. As of 1997, IMF introduced an additional very short-term facility in this category, in order to solve the crises affecting the capital account of a particular member state.

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[3] *The accepted IMF currency is received and the payback is done in the national currency. This operation is called “drawing”.*

The stand-by agreements became an essential instrument of the multilateral monetary cooperation.

The single financial structure of the IMF is aimed to ensure, at any, time, liquidities for the member states, upon request. This means that IMF resources cannot be borrowed on the long-term.

IMF uses mechanisms, improved in time, to assist the countries in difficulty, developing countries or former communist states under transition to the market economy. IMF supports the efforts of these countries to define and apply policies allowing to eliminate the dysfunctionalities, to curb inflation, to reduce the budget deficit and to support a balanced development.

The following can be included among the mechanisms used by the IMF:

– The facility of compensating financing (introduced in 1963), addressed mainly to the basic goods confronted with the failure of exports;

– The mechanisms of the regulatory stocks (facility of the buffer stock) introduced in 1969 and which refers to the possibility to maintain buffer stocks of basic goods for which there are acknowledged international agreements;

– The enlarged crediting mechanism (which appeared in 1974) and the policy of enlarged access (1981) are facilities supporting the efforts of structural adjustment of the developing countries;

– The facility of structural adjustment is a special facility, completely different from the monetary character of the Fund. It became accessible to the poor countries in 1986, when it was noticed that the poorest member countries cannot cope with the crediting modalities of the time. This facility provides funds for the programs of economic reform under favourable terms (low interest rate, 10 years or more to pay the debts);

– The facility of enlarged structural adjustment (introduced in 1987) uses small loans and donations from the wealthy states. IMF collaborates with the World Bank for this facility and for the structural adjustment facility;

– The facility for systemic transformation (introduced in 1993) is a mechanism aiming to respond the needs of the states under transition to the market economy.

The crediting facilities proliferated immediately after the Bretton Woods system collapsed. Financing instruments were created which exceeded the initial task of the Fund (protection of the circulation of the goods and capital against the exchange rates fluctuations). The system became increasingly sophisticated and the types of demands also changed.

To prevent adverse effects on IMF credibility, several prudential conditions have been introduced in the statute of the institution regarding the crediting operations. IMF guarantees the payback of the loans both with the special reserves and by some measures such as the prudential evaluation of the central banks, granting loans on the basis of accurately determined requirements, setting specific conditions for the use of funds within specific programs, measures to prevent faulty reports, follow-up monitoring of the programs, technical assistance from IMF to the beneficiary,

IMF can supplement its resources through two agreements of direct loan from the member countries: the general agreement of loan and the new loan agreements. The executive council approved the enlargement of the new loan agreements by including 13 new countries among which the emerging economies of Russia, china, India and Brasilia.

Some aspects regarding IMF involvement in the world economy

As mentioned before, the conditionality of support for the member states has been introduced to make sure that the member states using IMF resources will be able to return the loans in due time so that the rotational character of the resources remains functional.

In agreement with article IV, IMF monitors the policies of the member states. The counselling stipulated in this article allows the technical staff and the Board of Administration to benefit of the extensive experience of the member states.

Ever since the USA gave up US dollar convertibility into gold, the global financial crises intensified both in terms of frequency and in terms of intensiveness. This results from the volume of credits granted by the IMF.

IMF programs for the Latin America in the 1990s reported successes. Thus, Argentina and Mexico gained back their markets, Brasilia and Venezuela increased the volume of bond issuing, Chile and Uruguay returned on the markets in 1993, while Columbia, Guatemala and Peru entered on the markets for the first time.

Mexico is a special case; it turned into the "Mexico case" as standard for the enforcement of the measures promoted by the IMF. While in 1988-1993 Mexico was supported actively by the IMF for macroeconomic stabilization and structural transformation, in 1994 it was again in trouble. The country had taken increasingly larger loans to support an overvaluated exchange rate and to cover the excessive expenditure during the 1994 elections. The national peso depreciated and the economic vulnerability increased because of the exchange of the existing governmental bonds with *Tesobonus,* treasury bonds issued by the US Treasury and denominated in pesos, but indexed according to the US dollar. In December 1996 IMF came in aid to solve he economic crisis, with a massive support from the US Treasury.

The Mexican crises revealed several aspects concerning the role and necessity of the IMF in the world economy:

– It plays a major role in orienting and assisting the member countries within an environment characterized by violent reactions on the financial markets;

– IMF can rebalance the financial markets if the solvability of a country changes, by displaying a true transparency;

– IMF must play (according to some opinions, among whom *Jeffrey Sachs* from the Harvard University) a coordinating role in the process of rescheduling the national debts and in similar situations;

– IMF must have available enough resources to support the processes from the member countries.

The "Mexico case" proved that the crises of the countries in difficulty can be solved, unless adverse effects of the international integration take effect.

The increasing integration of the financial markets over the past 20-25 years brought not only benefits, but also caused problems. Thus, the increasing integration of the financial markets eased a better allocation of the global savings, supported the investments and the economic growth in many countries. At the same time, the enhanced financial flows across the national borders made the participating countries more vulnerable to the adverse effects of these flows. There were concerns for the viability of the adopted policies, for the capacity to prevent the economic instability because globalization increases the propagation speed of the economic disturbances from one country to another. One may say that the financial globalization is, at the same time, cause and effect of the economic progress in our days.

During the 1997-1999 crisis of the emergent countries, IMF intervention (with its programs) in Thailand, Indonesia and South Korea, had no effect, the contagion spreading almost throughput the entire periphery of the global financial system.

In the case of the Asian crisis, IMF applied the wrong prescriptions: floating exchange rate of the currencies, increase of the interest rates so they also include the currency devaluation, cut of the administrative expenditure to cope with the budget deficit. IMF also imposed several conditions which targeted mainly the banking system. There have also been other structural deficiencies, such as the sectoral monopolies from Indonesia. The result of IMF programs was an aggravation of the economic collapse. The monetary and fiscal measures imposed by the IMF during the Asian crisis were criticised. Thus, while the monetary constraints in Thailand and Korea served the main objective to stabilise the exchange rate, in Indonesia, the massive injection of liquidities aimed to daunt the assault on the banks actually caused an implosion of the monetary basis and the continuous depreciation of the national currency and IMF was not able to save the banks in this region.

The contagion reached Russia, and when it broke down in August 1998, the international financial system was near the “boiling point”. IMF couldn’t save the Russian banks either. Only the resolute intervention of the US Federal Reserve Bank avoided an extremely complicated situation.

Throughout the 1997-1999 crisis, the IMF changed position by 180 degrees: rather than “saving the private system from drowning”, it preferred to “sink it”. The countries at the centre of the system can apply anti-cyclic policies. Thus, under recession conditions, the US reduced drastically the interest rates and the taxes. But the conditions imposed by IMF are exactly the opposite. The Fund pushes the states towards recession by forcing them the increase the interest rates and to cut the administrative expenditure – requirements in complete contradiction with the way the US acted under similar circumstances.”(Soros, 2001, p. 106)

The 1997-1999 crisis invites us to identify the problems and to find solutions if not “miraculous”, at least able to minimize the unfavourable conditions.

The theory of the extreme solutions such as a monetary board or free exchange rate, theory advanced after the Asian crisis, proved to be wrong. The monetary boards are rigid and they don't allow the national monetary authority to issue currency if it doesn't have an equivalent reserve of hard currency (see the case of Argentina). The floating exchange rate also caused the apparent appreciation of the US dollar.

The practical experience and the many studies show that the policies imposed by the IMF do not create a proper economic framework for economic development. Very many countries used to return ahead of schedule the loans after 2000. Thus, Russia returned the last debts to IMF in early 2005, while Argentina and Brasilia announced the same intention by late 2005.

The current global economic and financial crisis proved to be beneficial for the IMF. The Fund itself contributed directly or indirectly to setting the global economic and financial framework favourable for crises.

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