International Financial Management
Paper Code: MS 509
Topic: International Monetary Fund (IMF)

Unit – 3: International Monetary Fund

Structure of Unit

3.1 Introduction

The International Monetary Fund (IMF) is an organisation of 188 countries, working to foster global monetary co- operation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

3.2 Establishment of IMF

In 1944, an international monetary conference known as Brettonwoods's conference was organized in America in which representatives of 44 countries participated. In this conference a decision was taken to establish two international institutions. First was International Monetary Fund for monetary cooperation among various member countries and another institute was International Bank for Re- construction and Development popularly known as World Bank for reconstruction of war devastated countries and development of backward countries. Decision for establishment of International Monetary Fund was taken on 22nd July 1944. Thirty countries signed letter of agreement in this regard on 27 December 1945 and it started working from 1 March 1947. In the beginning there were 44 members of this organisation and at present there are 188 members.

3.3 Objectives of IMF

According to the Articles of Agreement signed by member countries, the objectives of IMF are as under:

A. International Monetary Cooperation

The main objective of the fund is to enhance monetary cooperation among member countries and for this purpose it has a team of experts which provide advice for solving international monetary problems.

B. Balanced Growth of International Trade

According to section 8.2 (a) of letter of agreement of the fund, no member country can impose restrictions on international transactions and payments without permission from the fund. But fund also accords permission to impose restrictions to specific member nations to solve its economic difficulties, whenever so required.

C. Exchange Stability

Most of the countries of the world abandoned gold standard after 1934 and adopted paper currency standard. As a result, fluctuations in exchange rates became more frequent. These fluctuations had very adverse effects on international trade. To end competitive devaluation of money and stabilizing exchange rates is also one of the important objectives of IMF. For this purpose IMF provides expert advice to member countries and lends money if required.

D. Multilateral Payments

On account of paper currencies in different member countries difficulties arise in mutual payments and these difficulties are removed with the help of IMF. IMF promotes multilateral payment system.

E. Financial Aid

When the balance of payments of member country/ countries becomes adverse, the fund provides financial aid in the required currency. By this timely assistance, the member countries get time to improve their balance of payments situation.

F. Shortening the Duration and Lessening the Degree of Disequilibrium in International Balance of Payments

IMF provides timely advice and financial assistance to member countries to improve their balance of payments situation.

G. Balanced Economic Development

IMF promotes balanced economic development of backward member nations and provides loans and credit for this purpose in foreign currencies.

H. Promotion of Long Term Investment of Capital

The fund makes such arrangements so that the member countries can make long- term investments of capital among other.

3.4 Working of IMF

IMF is a very big international organisation. Various aspects of its working can be discussed in the following heads:-

3.4.1 Membership, Capital and Quota

The main features of Membership, Capital and Quotas are as under:-

a. Membership: -

Any country, which makes promise to accept and comply the rules and regulations of IMF, may become its member and similarly any country may quit its membership by giving notice to this effect. If any country does not follow the rules and orders of IMF, its membership can be terminated.

b. Capital and Quotas: -

The capital of the IMF has been created by the quotas of all the member countries. Quota of each member country is determined immediately after its joining membership. In determination of quota of a particular member country a number of factors such as national income, gold reserve, foreign exchange reserve, and position of balance of payments are taken into consideration. If a country decides to revise its quota, it may be done if 85 percent voting power favours it. In the beginning every country was required to deposit 25 percent of its total quota or 10 percent of its official gold and dollar resources (whichever is less) in gold and remaining 75 percent in its own currency. But after second amendments in the rules of agreement which came into force from April 1978, member countries are required to pay 25 percent of its quota, either through SDRs or in currencies of other countries, with the permission of the fund. Remaining 75 percent quota is paid in own currency of the member country.

In the beginning the capital fund of IMF was decided 1, 000 crore dollars and it was distributed among member countries. But Soviet Russia did not accept the membership and did not take its quota of 120 crore dollars, therefore effective quota and capital of the fund was only 880 crore dollars. This quota has been increased from time to time and it is increased to 14,600 crore SDRs or equivalent to 19,900 crore dollar in December 1997. In the year 2008 in fourteenth review, the quota of IMF was increased from 25,000 crore S.DRs. to 74,500 crore SDRs. Ten largest quota holder countries are USA, Japan, Germany, United Kingdom, France, Saudi Arabia, Italy, Canada, Russia and China.

3.4.2 Governance Structure

The IMFs mandate and governance have evolved along with changes in its global economy, allowing the organisation to retain a central role within the international financial architecture. IMF’s current governance structure is as under:-

a. Board of Governors

The Board of Governors is the highest decision- making body of the IMF. It consists of one governor and one alternate governor for each member country. The governor is appointed by the member country and is usually the minister of finance or the head of the central bank. While the Board of Governors has delegated most of its powers to the IMFs Executive Board, it retains the right to approve quota increase; special drawing rights (SDRs) allocations, the admittance of new members, compulsory withdrawal of members, and amendments to the Articles of Agreement and By- Laws.

The Board of Governors of the IMF normally meets once a year to discuss the working of IMF. The meetings, which take place in September or October, have customarily been held in Washington for two consecutive years and in another member country in the third year. The Annual Meetings usually include two days of plenary sessions, during which governors consult with one another and present their countries views on current issues in International economics and finance. During the Meetings, the Board of Governors also makes decisions on how current international monetary issues should be addressed and approves corresponding resolutions.

The Annual Meetings are chaired by the Governor of the IMF, with the chairmanship rotating among the membership each year. Every two years, at the time of their Annual Meetings, the Governor of the Bank and the Fund elect Executive Directors to their respective Executive Boards.

b. Ministerial Committees

The IMF Board of Governors is advised by two ministerial Committees, the International Monetary and Financial Committee (IMFC) and the Development Committee.

i. The IMFC has 24 members, drawn from the pool of 188 governors. Its structure mirrors that of the Executive Board and its 24 constituencies. As such, the IMFC represents all the member countries of the fund. The IMFC meets twice a year, during the spring and Annual Meetings. The Committee discusses matters of common concern affecting the global economy and also advises the IMF on the direction of its work. At the end of the meetings, the Committee issues a joint communiqué summarizing its view. These communiqués provide guidance for the IMF's work program during the six months leading up to the next spring or Annual Meetings. There is no formal voting at the IMFC, which operates by consensus.

ii. The Development Committee is a joint committee, tasked with advising Boards of Governors of the IMF and the World Bank on issues related to economic development in emerging and developing countries. The committee has 24 members (usually ministers of finance or development). It represents the full membership of the IMF and the World Bank and mainly serves as a forum for building intergovernmental consensus on critical development issues.

c. Executive Board

The IMFs 24 member Executive Board takes care of the daily business of the IMF. Together, these 24 board members represent all 188 countries. Large economies, such as the United States and China, have their own seat at the table but most countries are grouped in constituencies representing 4 or more countries. The largest constituency includes 24 countries.

The Board discusses everything from the IMF staff's annual health checks of member countries' economies to economic policy issues relevant to the global economy. The board normally makes decisions based on consensus but sometimes formal votes are taken. At the end of most formal discussions, the Board issues what is known as a summing up, which summarizes its views. Informal discussions may be held to discuss complex policy issues still at a preliminary stage.

d. Managing Director

The Board of Executive Directors appoints a Managing Director for performing day to day business of the fund. The tenure is five years. The Managing Director is a person from outside the Board of Executive Directors. He presides over the meeting of Board of Executive Directors. The Managing Director conducts day to day affairs of the fund, under the directions of Board of Executive Directors. He is the head of staff of the fund and is empowered to appoint or remove employees, under the general control of the Board of Executive Directors.

Governance Reform: - To be effective, the IMF must be seen as representing the interests of all its 188 member countries. For this reason, it is crucial that its governance structure reflect today's world economy. In 2010, the IMF agreed wide- ranging governance reforms to reflect the increasing importance of emerging market countries. The reforms also ensure that smaller developing countries will retain their influence in the IMF.

3.4.3 International Exchange Rate System

According to original system specified by the fund, every member country had to declare the value of its currency in terms of gold or American dollar. Thus, gold was the basis of valuation and exchange rate fluctuations were kept within a narrow margin of 1percent on either side. USA performed this process by buying and selling gold for US dollar, other countries did it through an intervention currency such as UK sterling or US dollar. But after dollar crises of 1971, relaxation was provided to the member countries to increase or decrease the par value by 2.25 percent, under Smith Sonian agreement. To maintain par value a country could devalue its currency with the concurrence of the IMF up to 10 percent change in par value, to make adjustments in balance of payments, the fund would not raise any objection but for any change beyond 10 percent, a country had to justify it. A number of reforms have been introduced with second amendments applicable from April 1978. According to Article IV of second amendment, now it is not necessary for member countries to declare the par value of their currency and the par values of currencies closed before these amendments have ceased to be operative. Every country will co-operate the IMF and other member countries, to establish systematic exchange rate system. After second amendments, now every country is free to adopt any type of exchange rate system provided by doing so, no competitive advantage is available to it over other countries. Now floating exchange rate system is prevalent and IMF keeps surveillance over it.

3.4.4 Financial Assistance

The fund provides various types of loans and assistance to its member countries. Brief description of some important loan and assistance schemes is given below:

(A) Regular Facilities:

Regular facilities provided by IMF are as follows:

a. Purchases of Foreign Currencies and Repurchase of Own Currencies:

The Monetary Fund provides loans to its member countries in foreign currencies to correct temporary disequilibrium in balance of payments. This activity of providing loans is known as purchase of foreign currencies by the member country. Under it, a member country may get loan up to 125 percent of its quota. It is to be repaid within five years, when the members returns the loan, it is known as repurchase of own currencies.

b. Standby Agreements:

Besides, selling currencies directly to its member countries, the fund also promises to sell foreign currencies to the member countries on additional requirement arises for these currencies. Under this facility, on receiving loan commitment from the fund, a member country can immediately obtain foreign currencies from the fund. Such standby agreements are for the period of 12 months to 18 months. These may be extended for a period up to 3 years. In these agreements, payments of each withdrawal are to be done within the period of $3^{1/4}$ years to 5 years.

c. Extended Fund Facility:

This facility has been started, since September, 1974 as the medium- term assistance to the member countries to remove disequilibrium in balance of payments. Assistance under it is provided for three years, which may be extended upto fourth year. Every withdrawal, under this facility has to be repaid by the member country to the Monetary Fund within a period of 4 ½ years to 10 years.

(B) Special Facilities:

It includes Compensatory and Contingency Financing Facility- CCFF, Buffer Stock Financing- BSFF and Supplemental Reserve Facility- SRF.

a. Compensatory and Contingency Financing Facility (CCFF):

Those member countries of Monetary Fund who in any particular year earn less income from exports, due to any particular reason and hence have to face the problem of temporary disequilibrium in balance of payments, may take loan under compensatory and contingency financing facility, in addition to other facilities of Monetary Fund. This scheme was started in 1963. This facility has not been used by any country after 1983.

b. Supplemental Reserve Facility (SRF):

The Board of Executive Directors of the Monetary Fund has opened a new window of assistance, in the form of supplemental reserve facility, in December 1997. This window has been opened for those member countries, by which short- term finance is much required, due to excessive pressure on capital account, owing to ending of trust of their markets. The basis of providing assistance, under it is that by adhering to strong adjustment policies, the difficulties of balance of payments will be quickly solved. The countries taking assistance under this scheme have to repay the amount to the fund, within a period of 1 to $1^{1/2}$ years. It may be further extended by the Board of Executive Directors by one year.

(C) Concessional Facilities

Facilities, like (i) Structural Adjustment Facility- SAF and (ii) Enhanced Structural Adjustment Facility- ESAF is included in these facilities, which are available to the poor countries, at concessional rates. SAF facility is in operation since 1986. ESA Facility was started in December, 1987. It was expanded in February 1994.Interest at the rate of 0.5 percent is charged on SAF facility and loans, taken under it are to be repaid, within 5 to 10 years. For ESAF, resources are kept separate, from the general funds of International Monetary Fund and the Monetary Fund manages those resources as the trustee of ESAF. Loans of ESAF are also to be repaid within 5 ½ to 10 years and interest rate on loans is 0.5 percent per annum.

3.5 Achievements of IMF

Since its establishment, the International Monetary Fund has made significant progress in various spheres and has achieved many successes. Following are the main achievements of the fund:

1. Increase in Membership:

Letter of agreement for establishment of Monetary Fund was signed by 30 countries. When it started functioning on 1 March 1947, it had 44 members, which gradually increased to 184 on 30 September, 2006. At present membership is 188. The members include developed, undeveloped, capitalist, democratic and communist countries have also become its members.

2. Increase in Capital Resources:

At the time of establishment of the fund, its authorized capital was fixed at 1, 000 crore dollars. But due to Russia’s not becoming its member, it was 880 crore dollars only. It has been increased, from time to time. By December, 1997, the capital of the fund had increased to 14,600 crore SDRs. After coming into force of eleventh review, it had become 21, 350 crore SDRs. After fourteenth review, it is 74, 500 crore SDRs.

3. Exchange Rate Management:

The Monetary Fund could successfully maintain fixed exchange rate system, inspite of certain obstacles, since its inception, to international monetary crisis of 1971. At the beginning, the members had the facility of 1percent change in the fixed exchange rates. It was increased to ±2.25 percent, in December 1971, under Smith Soniyan agreement. On 23 June, 1974, the Monetary Fund gave temporary recognition to fluctuating exchange rate system. Under second amendments, which came into effect since April, 1978 the Monetary Fund has given freedom to the member nations to adopt floating or fluctuating exchange rates. Now, this is the responsibility of the members to cooperate stability, the systematic exchange rate system is functional, due to efforts of I.M.F.

4. Increase in International Liquidity:

The Monetary Fund has increased international liquidity, by increasing its capital resources and starting and expanding special drawing rights scheme. In 1947, quotas of the member countries in the Monetary Fund were of 880 crore dollars, which increased to 1,46,000 crore SDRs in 1997. After January, 2002 these have increased to equivalent of 21,350 crore SDRs. Now, these are equivalent to 74,500 crore SDRs. This progress indicates increase in international liquidity. IMF has created scheme of special drawing rights (SDRs) which plays important role in international liquidity.

5. Various Types of Economic Assistance to the Member Countries:

In the beginning, the Monetary Fund used to provide loans to the member countries, in the form of purchase of currencies to correct short- term disequilibrium in their balance of payments. The fund has been providing assistance to the member countries, in various forms, like purchase and sale of currencies, standby agreements, general credit arrangements, compensatory financing, buffer stock facility, enhanced financing facility, assistance from grants account, supplemental financing from trust fund etc.

6. Technical Assistance and Training:

International Monetary Fund has also provided important technical assistance to the member countries by its institutes and experts. One institute runs the courses at the headquarters of the Fund at Washington D.C. and regional centers in Austria, Brazil, China, Singapore, Tunisia, and the United Arab Emirates. This institute also runs the courses financed by some other institutions and governments.

7. Co-operation with Other International Organizations:

The fund maintains close contacts with other organizations of the world. The officers of the fund participate in the meetings of several organizations. The fund maintains close contacts with GATT (now World Trade Organization), bank of International Settlements, World Bank, International Conference on Trade and Development (UNCTAD), Economic Co- operation and Development Association etc.

8. Collection and Publication of Statistical Information:

International Monetary Fund has its own statistical Bureau, which collects, analyses and publishes data, on international trade, balance of payments, fiscal operations, money and banking, price level, production, interest rates, etc. of all countries.