Chapter Five
The International Monetary System and the International Monetary Fund

International Monetary System

It is a framework designed that aims to establish a unit for settling international trade transactions, and links the national monetary units of the different countries of the world.

History Evolution of Monetary Systems

1 Gold rule System

2 Exchange Base In gold

3 Exchange Base in Dollar.

4 Private withdrawals Rights

The Gold Standard Framework

- England was the first country to adopt the gold standard, followed by other nations until the early 20th century.
- Under the gold standard, there was free import and export of gold between countries that adhered to it.
- The system of gold coins and currencies remained in effect until the outbreak of World War I in 1914. During the war, large amounts of currency were printed without gold backing to cover war expenses. Consequently, the gold standard was abandoned as people could no longer convert currency into gold. It was replaced with the gold bullion standard to reduce demand for gold.

The Gold Exchange Standard

- The gold exchange standard was introduced following the Genoa Conference in 1922.
- Under this system, monetary payments were settled using a foreign currency directly linked to gold.
- England's economy was primarily based on gold, making the British pound sterling the central currency tied to gold.
- By 1934, all governments had abandoned any connection to gold except the United States. The U.S. maintained the convertibility of the dollar into gold, setting the price of an ounce of gold at $35.

The Dollar Exchange Standard

- After World War II, the world experienced a period of global monetary chaos, during which the U.S. emerged as the largest economy and held the largest gold reserves.
- In 1944, the International Monetary Fund (IMF) was established based on the Bretton Woods Agreement. This agreement set the rules for determining currency exchange rates, linking the dollar directly to gold.
- Any country pegging its currency to the dollar was indirectly linking it to gold.
- The dollar maintained its dominant position until other economies began to compete with it, leading to a U.S. balance of payments deficit.

The Dollar Exchange Standard

- The Vietnam War further exacerbated the situation by increasing the issuance of dollars without gold backing to cover war expenses. As a result, the market value of the dollar declined, and global confidence in it wavered.
- Eventually, the U.S. announced it would no longer convert dollars into gold, leading to the collapse of the global monetary system based on the dollar exchange standard. A new system emerged, relying on floating exchange rates.

Special Drawing Rights (SDR)

- The Special Drawing Rights (SDR) are accounting monetary units that grant the holder the right to access credit facilities in convertible currencies from IMF member countries.
- In 1974, the Bretton Woods Agreement was amended, designating SDRs as the primary reserve asset in the international monetary system.
- Initially, the value of SDRs was tied to the U.S. dollar. However, it was later determined based on the weighted average of the currencies of 16 IMF member countries.

Core Functions of an International Currency

- An international currency performs three main functions:

1. Reserve Asset: Countries rely on it to build their official reserves.

2. Settlement of International Trade: It is used to facilitate external trade transactions.

3. Accounting Unit: It serves as a standard for calculating loans and investments between nations.

The International Monetary Fund (IMF)

- The IMF is a specialized agency of the United Nations, established through an international treaty in 1945 to promote global economic stability. Its headquarters are located in Washington, D.C.
- The IMF agreement was signed on July 22, 1944, by 28 participating countries during the Bretton Woods Conference and became effective on December 27, 1945. The Fund officially began operations from its Washington headquarters in March 1947.
- The IMF is the central institution of the international monetary system, overseeing the global payment system and exchange rate mechanisms that enable trade transactions among countries.

Objectives of the IMF

- 1. Promote international monetary cooperation.
- 2. Facilitate the balanced growth and expansion of international trade.
- 3. Work toward stabilizing exchange rates.
- 4. Support the establishment of a multilateral payment system and eliminate exchange restrictions.
- 5. Strengthen member countries' confidence by providing temporary access to its financial resources under adequate safeguards.
- 6. Help minimize the duration and severity of balance-of-payments imbalances for member nations.

Exchange Rate

- between 1945 and 1971, countries that joined the IMF agreed to peg their exchange rates to the U.S. dollar.
- Exchange rates could only be adjusted under one condition: to correct a "fundamental imbalance" in the balance of payments, and with IMF approval. This system was known as the Bretton Woods Exchange Rate System.
- The system remained in place until 1971, when the U.S. government ceased converting dollars and other countries' reserves into gold.
- Since then, different exchange rate systems have emerged:
- Some countries now allow their currencies to float freely.
- Others peg their currencies to another country's currency or a basket of currencies.
- Some nations have adopted foreign currencies for domestic use.
- Others participate in monetary unions.

IMF Governance

1. Board of Governors

- The highest supervisory authority.
- Composed of representatives from all member countries.
- Meets once annually.
- Each country appoints a governor, often its finance minister.

2. Executive Board

- Composed of the Managing Director, three deputy managing directors, and 24 executive directors.
- Manages the daily operations of the IMF.
- Typically meets three times per week.

IMF Governance

3. International Monetary and Financial Committee (IMFC)

- A committee of governors that meets twice annually.
- Addresses key policy issues related to the international monetary system.

4. Development Committee

- A joint committee of the IMF and World Bank governors.
- Advises on development policies and issues of interest to developing countries.

- **Voting System**

The IMF operates a weighted voting system, where a country's voting power depends on its financial contribution (quota). The higher the quota, the greater the number of votes.

- **Role of Central Banks and the IMF**

The central bank manages a country’s domestic monetary system.

The IMF oversees the international monetary system.

Resources of the IMF

- The primary source of the IMF's resources is quota subscriptions paid by member countries upon joining the organization.
- These quotas determine:

1. The amount a member country is required to pay as its subscription.
2. The number of votes the country holds in the IMF.
3. The amount of funding the country can access from the IMF.
4. The country’s share in the allocation of Special Drawing Rights (SDR).

- Quotas are generally designed to reflect the relative size of a member country's economy in the global economy.

Special Drawing Rights (SDR)

- The SDR represents a financial claim or ownership by a country of a specific share in the IMF's financial resources.
- It is an international reserve asset created by the IMF in 1969 to supplement member countries' official reserves.
- At the time of its creation, the primary reserve assets were gold and the U.S. dollar, and the SDR became known as "paper gold."

Supervision of the Global Monetary System

- The International Monetary Fund (IMF) carries out its supervisory role in three main ways:

1. Country Surveillance
2. Global Surveillance
3. Regional Surveillance

Country Surveillance

- Country surveillance involves regular, comprehensive consultations, usually conducted annually, with individual member countries regarding their economic policies.
- These consultations are called Article IV Consultations, as they are mandated by Article IV of the IMF's Articles of Agreement.

The process of Article IV consultations includes the following steps:

- 1. Data Collection and Discussions:

An IMF team visits the country to gather economic and financial data and holds discussions with government officials and the central bank.

- 2. Assessment:

The team evaluates the soundness of the financial system and the policies influencing macroeconomic performance.

- 3. Reporting:

The team submits a report to the IMF's Executive Board outlining its findings and conclusions.

Global Surveillance

- Global surveillance occurs after the IMF's Executive Board reviews global economic trends and developments.

Key elements of global surveillance include:

- **World Economic Outlook (WEO):**

Prepared by IMF experts and reviewed twice a year, usually before the semi-annual meetings of the International Monetary and Financial Committee (IMFC).

- **Capital Markets Discussions:**

The IMF holds annual discussions focusing on developments, future prospects, and policy issues in international capital markets.

These efforts aim to monitor and address global economic challenges and maintain financial stability worldwide.

Regional Surveillance

- The IMF examines policies implemented under regional agreements.
- The Fund’s management and staff participate in surveillance discussions with groups such as:
- ✓ The Group of Seven (G7), comprising the major industrialized nations.
- ✓ The Asia-Pacific Economic Cooperation (APEC) forum.

Lending to Assist Struggling Countries

- The IMF provides foreign currency loans to countries facing balance-of-payments problems.
- These loans aim to support policies, including structural reforms, that can improve the balance-of-payments position and foster sustainable economic growth.

Distinguishing Features of IMF Lending

1. Not an Aid Agency or Development Bank:

- The IMF is neither an aid organization nor a development bank.
- Its loans are designed to help member countries address balance-of-payments issues and restore economic growth.

2. Policy-Conditioned Loans:

- Loans are subject to conditions, meaning the borrowing country must adopt policies to correct its balance-of-payments problems.

3. Temporary Loans:

- Loan durations vary based on the lending facility.
- Disbursement periods may range from six months to four years.

Technical Assistance

- **The IMF provides technical assistance in five key areas:**

1. Designing and Implementing Fiscal and Monetary Policies.
2. Building and Developing Institutions, such as central banks.
3. Collecting Statistical Data and improving its accuracy.
4. Training Government Officials.
5. Reviewing Legislation and assisting in its reformulation.

Thank you