

International Monetary Fund

Post Mid-sem

UNIT 3

CLASS 1

MISSION OF IMF

- Its stated mission is "working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world."



The International Monetary Fund (IMF)

- It is a major financial agency of the United Nations
- It is an international financial institution funded by 190 member countries, with headquarters in Washington, D.C.
- It is regarded as the global lender of last resort to national governments
- It is a leading supporter of exchange-rate stability.
- It now plays a central role in the management of balance of payments difficulties and international financial crises.

ORIGIN OF IMF

- It was established on December 27, 1945 at the Bretton Woods Conference.
- It originated on the ideas of Harry Dexter White and John Maynard Keynes.
- It started with the goal of reconstructing the international monetary system after World War II, with 29 member countries.

Bretton Woods Agreement 1944

- The Bretton Woods system of monetary management established the rules for commercial relations **among the United States, Canada, Western European countries, and Australia among 44 other countries after the 1944 Bretton Woods Agreement.**
- It is the first example of a **fully negotiated monetary order intended to govern monetary relations among independent states.**
- The Bretton Woods system required countries to guarantee convertibility of their currencies into U.S. dollars to within 1% of fixed parity rates, with the dollar convertible to gold bullion for foreign governments and central banks at US\$35 per troy ounce of fine gold (or 0.88867 gram fine gold per dollar).
- It also envisioned greater cooperation among countries prevent future competitive devaluations
- established the International Monetary Fund (IMF) to monitor exchange rates and lend reserve currencies to nations with balance of payments deficits.

IMF and IBRD(Now World Bank)

- Setting up a system of rules, institutions, and procedures to regulate the international monetary system, these Bretonwoods accords established the IMF and the International Bank for Reconstruction and Development (IBRD), which today is part of the World Bank Group.
-
- The United States, which controlled two-thirds of the world's gold, insisted that the Bretton Woods system rest on both gold and the US dollar.

These organizations became operational in 1945 after a sufficient number of countries had ratified the agreement.

- According to critics, the Bretton Woods system operated successfully due to three factors: **low international capital mobility, tight financial regulation, and the dominant economic and financial position of the United States and the dollar.**
- On 15 August 1971, **the US terminated convertibility of the US dollar to gold,** effectively bringing the Bretton Woods system to an end and **rendering the dollar a fiat currency.**
- Shortly thereafter, many fixed currencies (such as the pound sterling) also became free-floating, and the subsequent era has been characterized by floating exchange rates.
- **The end of Bretton Woods was formally ratified by the Jamaica Accords in 1976.**

Class Activity 4: Answer the following questions now in your own words.

- Q1. What were the bases of the creation of the Breton Woods Monetary system?
- Q2. Why did the Breton Woods monetary system failed?
- Q3. Describe the role of the United States in the creation and termination of the Breton Woods Monetary system.
- Q4. Write about the SDR status of India in IMF.



IMF funds come from two major sources:
quotas and loans.

- Quotas, which are pooled funds from member nations, generate most IMF funds.
- The size of members' quotas increase according to their economic and financial importance in the world.
- The quotas are increased periodically as a means of boosting the IMF's resources in the form of **special drawing rights**.

Special drawing rights(SDRs)

- They are supplementary foreign exchange reserve assets defined and maintained by the IMF
- SDRs are units of account for the IMF, and not a currency per se.
- They represent a claim to currency held by IMF member countries for which they may be exchanged.
- SDRs were created in 1969 to supplement a shortfall of preferred foreign exchange reserve assets, namely gold and U.S. dollars.

Special drawing rights(SDRs)

- The value of a SDR is based on a basket of key international currencies reviewed by IMF every five years.
- The weights assigned to the currencies in the SDR basket are adjusted to take into account their current prominence in terms of international trade and national foreign exchange reserves.
- SDR basket consists of the following 5 currencies:
- U.S. dollar 43.38%, euro 29.31%, Chinese yuan 12.28%, Japanese yen 7.59%, British pound sterling 7.44%

What is a Special Drawing Right (SDR), and what is it used for?

-
- The SDR (Special Drawing Right) is an artificial "basket" of currencies used by the IMF (International Monetary Fund) for internal accounting purposes.
- The SDR is also used by some countries as a peg for their own currency, and is used as an international reserve asset.

What is the value of an SDR?

- Initially, the value of the SDR was defined in terms of one US-\$, which in turn was defined in terms of an ounce of gold: \$35/oz until 18-Dec-1971; \$38/oz between 18-Dec-1971 and 11-Feb-1973; \$42.22/oz between 12-Feb-1973 and 30-Jun-1974.
- Since July 1974 the SDR has been defined in terms of a basket of currencies. This basket consisted initially of 16 currencies and was reduced to five in 1981.
- When the German Mark and French Franc were replaced by the Euro in 1999, the number of currencies shrank to four.
- Every five years the IMF determines which five currencies will enter the basket, and which weight will be applied to each currency.

Which exchange is considered?

- The exchange rates used by the IMF to calculate the official SDR are the noon rates in the London foreign exchange market.
- When the London market is closed, noon rates in the New York market are used, and Frankfurt fixing rates are employed when the New York market is also closed.

How can one calculate the value of an SDR?

- To calculate the value of the SDR in national currency (say, INR), multiply the four exchange rates of the home country vis-à-vis the basket-currency countries (i.e., INR/USD, INR/EUR, INR/JPY, and INR/GBP) with the basket values.
- Add these four numbers together to obtain the INR/SDR exchange rate.

The 3 primary functions of the IMF are :

- help the national governments in managing their exchange rates and thus **maintain exchange rate stability**
- to provide short-term capital to help **correct balance of payments disequilibrium**.
- **to prevent the spread of international economic crises**, such as those in Mexico in 1982, Brazil in 1987, East Asia in 1997-98.
- to allow the governments to **prioritize economic growth**
- to help mend the international economy **(re-construction)** after crisis like the Great Depression and World War II by capital investments for economic growth and rebuilding infrastructure

Some Star Facts:

- The current managing director (MD) and chairwoman of the IMF is **Bulgarian economist Kristalina Georgieva**, who has held the post since October 1, 2019.
- **Indian-American economist Gita Gopinath**, previously the chief economist, was appointed as first deputy managing director, effective January 21, 2022.
- **Pierre-Olivier Gourinchas** was appointed chief economist on January 24, 2022.

Some Star Facts--contd.

- The countries that are not a part of the IMF are Cuba, North Korea, Monaco, Taiwan, Vatican City, and East Timor Liechtenstein.

THANK YOU

- THANK YOU

-

THANK YOU