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THE INTERNATIONAL MONETARY FUND
PAST AND PRESENT

by

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Bachelor of Business Administration
University of Massachusetts, 1978

An Independent Study
Submitted to the Graduate Faculty of
The University of North Dakota
in partial fulfillment of the requirements
for the degree of
Master of Business Administration

The University of North Dakota Graduate Center

March
1987

This independent study submitted by Christopher W. Roy in partial fulfillment of the requirements for the Degree of Master of Business Administration from the University of North Dakota is hereby approved by the Faculty Advisor under whom the work has been done. This independent study meets the standards for appearance and conforms to the style and format requirements of the Graduate School of the University of North Dakota.

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Department: School of Business and Public Administration

Degree: Master of Business Administration

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ABSTRACT

THE INTERNATIONAL MONETARY FUND
PAST AND PRESENT

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The International Monetary Fund (IMF) is a complex organization whose procedures and policies have a significant impact on the world economy. From its inception in 1944, the IMF has expanded from its original charter as an organization which promotes free trade and monetary exchanges to an institute that maintains a robust international economy through various facilities that assist in maintaining the liquidity necessary for a viable economy.

The IMF has consistently added to its operations and influence through the manipulation of the economies of nations who use its credit. The IMF has created, over the past two decades, new ways to obtain and make available additional funds. The quota system, which requires a member to deposit funds based on the nation's economic health, is but one of many accounts available to member nations to assist in temporary balance-of-payments deficits.

The 144 member nations of the IMF have an unrivaled source of funds available to them. Unconditionally, funds

can be borrowed from the IMF up to 100 percent of a member nation's quota. The IMF can loan additional funds with certain conditions to be met and monitored by the IMF. The IMF is a unique organization with no equal in the international economy.

Evolutionary changes since its creation in 1944 have kept the IMF in the forefront of international trade relations and financing agreements. With the creation of its own measure of money, special drawing rights, the IMF may in fact begin to even further involve itself with private banking and thus increase its influence even more on the world economy.

INTRODUCTION

Geographical, social, economic and political trends contribute to what might loosely be called the "international economy;" that is, a system of patterns and institutions that sustains the flow of goods, services and money among the nations of the world. It is not as well organized and centralized a system as exists in most domestic economies. Unlike domestic economies, where the government has the authority to make major decisions that affect the entire economy, the international economy has no central authority to implement broad economic policies.

It is well recognized that the world economy has become much more interdependent, integrated, and internationalized. The aforementioned economic characteristics may be traced to the policies adopted in the aftermath of World War II to prevent a recurrence of the unstable and dangerous state of the international economy during the 1930s.

Economic developments on the international plane have become critically important to the U.S. No longer can the U.S. be perceived as a self-contained economic entity, but as an integral component of a deeply interdependent global economy. The recent suspension of payments on the interest of its foreign debt by Brazil, about $12 billion in yearly interest, will have both near- and long-term effects on the

international as well as the U.S. economy. About one-fourth of this debt is held by U.S. banks, over $28B to international lending institutes of the $70B total.[1] Primarily because of debt, reduction in the relative weight of the U.S. in the global economic system as other countries have and continue to move to positions of greater influence will the international systems, specifically the International Monetary Fund (IMF), continue to be of significant importance to the global economy.

This decline in the objective power of the U.S. in world economic affairs was accelerated by politics and the establishment of the international institutes like the IMF.

The IMF has had significant impacts on the international economy. Capital movement and, for the past decade, flexible exchange rates have given major impetus to the rapid growth of international capital flows. The IMF has been, and more than likely will continue to be, the largest of the agencies to regulate international finance. It stands today at the center of the international monetary system.

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[1]"Brazil Says Payments to Resume After Talks," Omaha World Herald, 22 Feb 87, No. 145, p. 9-A.

CHAPTER I

INTERNATIONAL MONETARY FUND BACKGROUND

Recovery and Renewal: The Brenton Woods Institute

When peace was restored in 1945, the outlines of the postwar international monetary system had already been agreed upon. The need for increased international cooperation in money, finance and trade was clearly recognized. This was largely the result of intensive work during the war by Lord Keynes and his colleagues in the United Kingdom[2] and by Harry Dexter White and his colleagues in the U.S.[3].

Late in 1942 Keynes and White began to exchange drafts, and from the ensuing negotiations there ultimately emerged a compromise proposal which was agreed to at the International Monetary and Financial Conference of the United and Associated Nations, held at Brenton Woods, New Hampshire, in July 1944. This agreement, signed by 44 nations, was the constitution, the Articles of Agreement, of the International Monetary Fund.

Both England and the U.S. were anxious to construct an international economic order within which trade would

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[2]R. F. Harrod, The Life of John Maynard Keynes (New York: Harcourt Brace Javanovich, Inc., 1951).

[3]David Rees, Harry Dexter White: A Study in Paradox (New York: Coward-McCann, 1973).

flourish. In particular, efforts were devoted to avoiding the explicitly competitive "beggar-they-neighbor" foreign economic policies that had characterized international commerce during the 1930s.

> "Intensive economic nationalism marked the decade. Exports were forced; imports were curtailed. All the weapons of commercial warfare were brought into play; currencies were depreciated, exports were subsidized, tariffs raised, exchanges controlled, quotas imposed, and discrimination practiced through preferential systems and barter deals. Each nation sought to sell much and buy little. A vicious spiral of restrictionism produced a further deterioration in world trade."[4]

To further encourage free international movement of goods and capital and stimulate prosperity during this post-war period, two complementary organizations to the IMF were also agreed to at Brenton Woods. The General Agreements on Tariffs and Trade (GATT) and the International Bank for Reconstruction and Development (IBRD) (more commonly known as the World Bank) promoted "multilateralism in a universal system with clear rules in which nations could expect fair treatment in economic affairs regardless of political affiliations."[5]

THE IMF Charter

Those responsible for designing the IMF were aiming to establish a system of multilateral trade and payments

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[4]Clair Wilcox, A Charter for World Trade (New York: Macmillan, 1949) p. 28.

[5]Commonwealth Study Group, Towards a New Brenton Woods (London: The Commonwealth Secretariat, 1983), p. 9.

compatible to maintain high levels of income and employment. They wanted to prevent countries from using, as in the 1930s, trade restrictions, subsides, and competitive depreciation of exchange rates in attempts to solve the shifting of domestic problems to other countries.

FIGURE 1

The purposes of the IMF, as set out in the Articles of Agreement are:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on monetary problems.
(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of members' productive resources.
(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of trade.
(v) To give confidence to members by making the general resources of the Fund temporarily available to them, under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments, without resorting to measures destructive of national or international prosperity.
(vi) In accordance with the above, to shorten the duration of and lessen the degree of disequilibrium in the international balances of payments of members.

The IMF was brought into existence on the basis of a set of Articles of Agreement (See Figure 1) which laid down the conditions all countries had to accept in international monetary relationships. The most important of these related to the problems of exchange rates and convertibility of money. The original IMF agreements required all countries to endeavor to maintain stable exchange rates. Secondly,

the IMF required all countries to establish fully convertible currencies to promote unfettered trade.

The first role of the Fund was to establish and regulate exchange rates. Each IMF member was required to declare a par value of its currency in relation to the gold content of the U.S. dollar in 1944. The dollar had become the main currency in which international transactions were made because of the central role the U.S. held in the financial system. The value of the dollar was directly related to gold (at U.S. $35 per ounce). Thus everyone believed that they could rely on the dollar as a stable currency, partly because the U.S. agreed to exchange dollars for gold and partly because foreign governments trusted the U.S. government to insure that gold would not depreciate in value.

IMF Quota System

As a condition of membership in the IMF, all countries were required to contribute a quota to the Fund. This contributed to the second role allotted to the Fund by its charter, that of an international financial institution for the purpose of providing additional liquidity to its members, for use in official transactions in the foreign exchange market.

The IMF's capital pool was established by the contributions of the original 44 members in 1944 ($8.8 billion). This capital was raised in accordance with quotas assigned

on the basis of countries´ relative economic capabilities (as reflected in such indicators as size of GNP, volume of trade, and reserves holdings). This contribution was paid into the IMF up until 1970 in the form of gold (25 percent of quota) and the member state´s national currency (75 percent of quota).

Quotas are reviewed at intervals of not more than five years to take into account the state of the world economy and members´ different rates of development. General increases were made in 1959, 1966, 1970, 1978 and 1980. An increase in a quota causes a nation to also increase its subscription. This could result in an increase in the number of votes held by a nation and ultimately increases the amount of IMF funds. Figure 2 shows the total votes and relative percentages of the Board of Directors as of September of 1985.

Fund Organization

The IMF is based in Washington, D.C. It´s current managing director is Jacques De Larosiere De Champfeu of France; its deputy director is Richard D. Erb of the U.S. The IMF has 149 member nations and is one of the 17 United Nations Specialized Agencies. The highest authority of the Fund is exercised by the Board of Governors, on which each member country is represented. Normally, the Board of Governors meets once a year. The Board of Governors has delegated many of its powers to the Executive Directors

FIGURE 2

Board of Executive Directors (September 1985)

Director	Casting Votes of	Total Votes	%
Appointed:			
Charles H. Dallara	USA	179,433	19.29
Timothy P. Lankester	United Kingdom	62,190	6.69
Gunter Grosche	Federal Republic of Germany	54,287	5.84
Bruno De Maulde	France	45,078	4.85
Hirotake Fujino	Japan	42,483	4.57
Yusuf A. Nimatallah	Saudi Arabia	32,274	3.47
Elected:			
Pedro Perez Fernandez (Spain)	Costa Rica, El Salvador, Guatamela, Honduras, Mexico, Nicaragua, Spain, Venezula	44,401	4.77
J. J. Polak (Netherlands)	Cyprus, Israel, Netherlands, Romania, Yugoslavia	40,425	4.35
Jacques De Groote (Belgium)	Austria, Belgium, Hungary, Luxembourg, Turkey	40,178	4.32
Robert K. Joyce (Canada)	Antigua and Barbuda, Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, Saint Christopherand Nevis, Saint Lucia, Saint Vincent and the Grenadines	38,709	4.12
Salvatore Zecchini (Italy)	Greece, Italy, Malta, Portugal	38,307	4.12
Hohamed Finaish (Libya)	Bahrain, Iraq, Jordan, Kuwait, Lebanon, Libya, Maldives, Oman, Pakistan, Qatar, Somalia, Syria, United Arab Emirates, Yemen Arab Republic, People's Democratic Republic of Yemen	34,642	3.72
C. R. Rye (Australia)	Australia, Republic of Korea, New Zealand, Papua New Guinea, Philippines, Seychelles, Solomon Islands, Vanuatu, Western Somoa	32,979	3.55
Hans Lundstrom (Sweden)	Denmark, Finland, Iceland, Norway, Sweden	32,338	3.48
Arjun K. Sengupta (India)	Bangladesh, Bhutan, India, Sri Lanka	28,208	3.03
Alexandre Kafka (Brazil)	Brazil, Colombia, Dominican Republic, Ecuador, Guyana, Haiti, Panama, Suriname, Trinidad and Tobago	27,582	2.97
E. I. M. Mtei (Tanzania)	Botswana, Burundi, Ethiopia, The Gambia, Guinea, Kenya, Lesotho, Liberia, Malawi, Mozambique, Nigeria, Sierra Leone, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe	27,567	2.96
Julius Emmanuel Ismael (Indonesia)	Burma, Fiji, Indonesia, Laos, Malaysia, Nepal, Singapore, Thailand, Viet-Nam	26,812	2.88
Zhang Zicun	People's Republic of China	24,159	2.60
Fernando Luis Nebbia (Argentina)	Argentinia, Bolivia, Chile, Paraguay, Peru, Uruguay	23,373	2.51
Ghassem Salehkhou (Iran)	Afghanistan, Algeria, Chana, Iran, Morocco, Oman, Tunisia	21,691	2.33
Abderrahmane Alfidja (Niger)	Benin, Burkina Faso, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Congo, Djibouti, Equatorial Guinea, Gabon, Guinea-Bissau, Ivory Coast, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, Sao Tome and Principe, Senegal, Togo, Zaire	18,111	1.95

identified in Figure 2. However, the conditions governing the admission of new members, adjustment of quotas, election of executive directors, as well as certain other important powers remain the sole responsibility of the Board of Governors. The voting power of each member in the Board of Governors is related to its quota in the fund (Figure 2). The Interim and Development Committees of the Board of Governors were established in 1974 to review the international monetary system and development policy issues and financing requirements respectively.

Overall authority within the IMF rests with the governing body, the 22-member Board of Executive Directors. Six members are appointed, the U.S., France, the United Kingdom, West Germany, Japan and Saudi Arabia, 15 members are elected by various country groupings and vote on behalf of all the countries in the respective groups. China is a permanent member in its own right.

Although decisions within the Executive Board are normally reached by consensus, the weight attached to each member´s point of view reflects the votes they command. Four main voting blocks can be identified. The first is the U.S., which alone controls 20 percent of the votes. The second is a group of powerful west European nations, which hold about 28 percent of the votes. The third is an intermediate group, which includes many less developed countries (LDCs) but which are represented on the Board by rich nations. The fourth group is the LDCs (including Saudi Arabia) which controls about 34 percent of total votes.

Although the Executive Board holds decision-making power, the managing director and his staff have considerable influence. Discussions concerning international financial affairs also take place outside the confines of the IMF, between groups of like-minded countries. Sometimes, these groups influence the Fund´s policies. The main developed countries meet monthly at the Bank for International Settlements, which regulates the relations between the central banks of the various countries. The Group of Ten, representing the ten most powerful western nations, meets regularly to decide joint policy on financial issues. This group, together with the Group of Five (five permanent Western members of the IMF Executive Board) decide on many policy matters that the Executive Board endorses as official IMF policy.

How the IMF Operates

"The Fund´s financing arrangements are extraordinarily complicated and unconducive to brief explanation."[6] The IMF does not, strictly speaking, make loans. It sells hard, or usable currencies to its members´ governments up to a certain percentage of their quotas, in return for their own currencies. This money supports a country´s balance of payments deficits. A deficit country is one that has been unable to earn enough foreign currency to meet all its overseas commitments. When this happens the IMF sells foreign currency to the debtor nation in exchange for that nation´s own currency. When the country concerned comes to "pay back" the IMF, it has to buy back its own currency, paying for it with the hard currencies that it has earned abroad.

Article V, Section 3 of the IMF agreements governs the use of the Fund´s resources:

> "The Fund shall adopt policies on the use of its general resources . . . that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund."

Thereafter Section 7 sets out the conditions under which a member must repay Fund credit by repurchasing its currency. The debtor nation is expected to do so when its balance of payments and reserve position improve and is required to do so when: ". . . the Fund represents to the member that it

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[6]Latin American Bureau, The Poverty Brokers: The IMF and Latin America (Nottinhgam: Ressell Press Ltd, 1983), p. 23.

should repurchase because of an improvement it its balance of payments and reserve position." Furthermore, a member must purchase its currency ". . . not later than five years after the date on which the purchase was made. . ." and the Fund may require that repurchases be made in installments "during the period beginning three years and ending five years after the date of a purchase."[7]

IMF Tranche Policies

Fund resources are available on essentially a short-term and revolving basis to provide members with temporary assistance to contribute to the solution of their payments problems. A member must show that its balance of payments or reserve position make the purchase necessary. Apart from this requirement, purchases that do not bring the Fund's holdings of the member's currency to a level above its quota are permitted unconditionally. This use of IMF funds is called a purchase within a particular country's reserve tranche (see Figure 3).

Purchases outside the reserve tranche are made in four credit tranches, each equivalent to 25 percent of the member's quota. However, with these further purchases the Fund's policy of conditionality means that a member requesting assistance must agree to adjust its economic policies, as stipulated by the IMF. All requests outside of

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[7]International Monetary Fund, Articles of Agreement, Article V, Sections 7(b) and (c) (December, 1945).

the reserve tranche are examined by the Executive Board to determine whether the proposed use would be consistent with the Fund's policies; and a member must discuss its proposed adjustment program to include fiscal, monetary, exchange and trade policies with the IMF staff.

FIGURE 3

Possible drawings from the IMF (% of quota)

Facility		Use of Resources	
Reserve tranche		Whatever % of quota brings Fund holding of member's currency up to 100% quota	
Credit tranches:	1	25%	100%*
	2	25%	
	3	25%	
	4	25%	
Extended facility		140%, reduced by any drawings in tranches 2, 3, and 4	

* Under special circumstances these limits may be exceeded.

The core of the agreement program for borrowing in the upper credit tranches comprises a number of "performance criteria" which are written into a "letter of intent" from the member and continuing access to the credit is conditional upon adequate progress in the fulfillment of these criteria. These criteria vary from case to case but typically include quarterly ceilings on total domestic credit

expansion and on credit to the public sector, and ceilings on borrowing. Exchange rate depreciations, lowering the relative value of one's currency, may also be included in these programs, most frequently as a precondition for an agreement.

IMF Impact on the World Economy

It is hard to analyze IMF impact on the post WWII economy in isolation from other institutes and agreements that were implemented to complement the stability and liberalization of international transactions that the IMF was to promote. The IMF, the General Agreement on Tariffs and Trade along with the International Bank for Reconstruction and Development (World Bank), became the foundation for multilateral efforts to prevent a repeat of the economic isolation that preceded WWII.

These institutions made important contributions to post-war reconstruction and to the remarkable period of sustained growth of world production and trade in the 1950s and 1960s. Clearly, they encouraged a level of international cooperation far in advance of anything achieved in the pre-war period. The decline in tariffs on trade, together with the widespread liberalization of exchange rates and the advent of balance-of-payments controls promoted by the IMF, contributed to the dramatic and sustained expansion in international trade, finance, and real investment. The IMF provided, during this period, the stability necessary to establish a new international economy. Its importance in the early world economy cannot be overstated.

CHAPTER II

EVOLUTIONARY CHANGES OF THE IMF

The IMF, in keeping with its charter, has assisted its member states to absorb unavoidable internal and external shocks in an orderly manner, without resorting to measures unduly destructive to national and international prosperity. The IMF has also shown ingenuity in adjusting to changing circumstances without losing sight of its basic purpose.

The following highlights some of the more important fact-of-life changes made to the IMF in order to more fully support a healthy world economy.

The General Arrangements to Borrow

An important turning point in the history of the IMF was the recognition by the U.S. that its balance of payments deficit had become a major problem. In 1961, it was realized that the U.S. should draw on the IMF to mop up any excess of dollars held abroad. As a further precaution, arrangements were devised whereby a group of larger and richer members should agree to lend their currencies to the Fund.

The arrangements made became known as the General Arrangements to Borrow (GAB). This action provided for ten

industrial countries (Group of Ten) to make, if necessity arose, supplementary resources available to the Fund. This changed the nature of the Fund, making it dependent in part on its ability to borrow from one group of members in order to meet the needs of others.

The GAB became the second source of funds available for IMF members (first source being a country's quota). GAB funds, which came into effect in 1962, were based on Article VII of the IMF Articles of Agreements and were designed explicitly to protect the Fund's liquidity.[8] GAB funds originally available to only a small group of rich Western nations have now been made available to all IMF members. It is becoming an increasingly important source of IMF resources. The GAB has become part of the broader credit network built up by the Fund, though it remains distinct, in that it can be invoked only for the purpose of defending the stability of the monetary systems as a whole.[9]

Compensatory Financing Facility (CFF)

This fund was meant to meet the special needs of a subset of Fund members--developing countries heavily dependent on exports of primary products. Created in 1963, the CFF chiefly assists with exporters experiencing payment

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[8] International Monetary Fund, Annual Report of The Executive Board for the Financial Year Ended April 30, 1962 (Washington: IMF Press, 1962), pp. 234-45.

[9] International Monetary Fund, Annual Report, 1983 (Washington: IMF Press, 1983) pp. 146-153.

deficits arising from export shortfalls due to sudden falls in world prices, harvest failures, and other causes. Access to this fund is determined by a formula which measures deviations of exports from an average value. Members may draw up to 83 percent of their quota for export shortfall and cereal import compensation respectively, or up to 105 percent for the two together.

Special Drawing Rights (SDR)

In 1969, the Fund Articles of Agreement were amended to authorize the creation of special drawing rights, which would be treated as reserve assets and, therefore, a form of international money. SDR value was based on a weighted composite of the dollar, mark, pound, franc and yen. This amendment authorized the Fund to create and distribute SDRs without comparable credit creation on the part of the Fund itself. SDRs are a form of "inside" money versus money borrowed from outside of the fund. SDRs are allocated to each member in proportion to its quota.

When it was introduced, the SDR was often described as paper gold because of the basic reason for creating it--to impart greater elasticity to the supply of reserves and thus "meet the need, as and when it arises, for a supplement to existing reserve assets" (Article XV, Section 1). An SDR in fact resembled an increase in reserve position which raises a countries quota. As discussed earlier, the first 25 percent of a country's quota deposited into the fund was to be

in gold, hence the association of an SDR with gold. SDRs may be used to buy national currencies, to settle loans, or as security for loans. All funds held by the IMF are expressed in SDRs. Gold and SDRs share the feature of being internationally accepted in exchange for national currency without being a legal debt of any one nation, institution, or organization.

SDRs are the third type of money resources available through the IMF (along with borrowing on quotas and from other IMF members). SDRs were issued first in 1970-1-2 and resulted in a total of $9.5B to IMF reserves. Additional allocations of SDRs were made recently bringing the total of SDRs in existence to five percent of international nongold reserves. The SDR is intended to eventually become the principal reserve asset in the international monetary system. The average value of the SDR was $1.0250 in 1984.[10] The Second Amendment to the Articles of Agreement (1978) altered and expanded the possible uses of the SDR in transactions with other participants.

Other IMF Facilities

The Buffer Stock Financing Facility (1969) was designed to assist in the financing of member´s contributions to international buffer stocks of primary products. Drawing for buffer stock financing may be made up to the equivalent of 45 percent of quota.

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[10] International Monetary Fund, World Economic Outlook, April 1985 (Washington: IMF Press, 1985), p. 252.

The member is expected to cooperate with the Fund in an effort to solve its balance of payments difficulties. To date, the Fund has authorized use of resources in connection with tin, cocoa, and sugar buffer stocks. Repurchase provisions are basically the same as for purchases in the credit tranches.

Under the Extended Facility (1974), the Fund may provide assistance to members to meet balance of payments deficits for longer periods and in amounts larger in relation to quotas than under the credit tranche policies. Drawings from the Fund may take place over periods of up to three years. Purchases outstanding under the extended facility may not exceed 140 percent of the member´s quota (reduced by any tranche drawing beyond the first tranche). Repurchases must be made within four to ten years after each purchase in 12 equal installments. (See Figure 3)

During 1974 and 1975, Oil Facilities funded by IMF borrow-ings from OPEC were set up. These facilities were to assist countries whose balance-of-payments had been seriously affected by the 1974-75 oil crisis. Credits from this facility were only available until March 1976 and much of the money has now been repaid.

The Trust Fund was established in 1976 as part of efforts to reduce the monetary role of gold, a third of the Fund´s gold holdings was sold between 1976 and 1980. Part of the resulting $4,640M was allotted to the Trust Fund for

making low-interest loans. By the time the Trust Fund was wound up in April 1981, it had disbursed $3,560M. Trust Fund repayments are used to build up other IMF funds and facilities and to make further concessionary loans.

The Supplementary Facility (1979) was yet another fund to provide supplementary financing in conjunction with the use of the Fund´s ordinary resources to all members of the Fund facing serious payment imbalances that are large in relation to their quotas. Unlike the facilities already detailed, this facility was financed by borrowings from member countries, and bore a higher interest. However, a subsidy was established to reduce the cost of funds to low-income countries. Funds available in this facility became fully committed early in 1981 but were followed by what is known as the "enlarged access policy." This allowed the maximum total amount available to a member from credit tranches, the extended facility, and the supplementary financing facility to be set at 150 percent of quota per annum or 450 percent of quota over three years. A member´s cumulative drawings under these arrangements is not to exceed 600 percent of quota.

Debtor Nation Relationships

Bearing in mind the resources at its disposal and the constraints imposed by its Articles of Agreement, the Fund has made a significant contribution toward helping countries to correct deficits efficiently by providing temporary

financial assistance, policy advice, and incentives. The Fund has been of significant benefit to less developed countries through its normal operations and its range of specialized facilities discussed earlier.

Nations seeking funds from the IMF outside of their reserve tranche submit themselves to a Fund stabilization program. These programs can be broken down into: preconditions, performance criteria, and other measures written into a letter of intent when seeking Fund support.

Preconditions are policy measures that must be executed before an agreement is presented for approval by the Executive Board. Such measures will not necessarily be written into a letter of intent, which is largely concerned with measures to be taken in the months ahead. It may be difficult, in fact, to distinguish actions taken by the government at the insistence of the IMF from actions that would have been taken irregardless of IMF guidance to control whatever may be causing the unfavorable economic condition. Precondition actions normally involve: exchange rate actions, pricing policies, interest rate policies, tax measures, liberalization of trade and payments, and reduction of specified public sector expenditures.

Performance criteria comprise the majority of program conditions to be met by the country seeking IMF tranche support. According to Fund practices, these criteria should be few in number and intended to help evaluate implementation of the program for recovery. These benchmarks determine the

countries continuing access to successive installments of agreed funds. Typically, performance criteria involve credit ceilings which regulate not so much the volume of credit both domestic, government/public and private, but the speed at which credit should expand. Other performance criteria include: devaluation, reduction in current payments arrears, minimum levels for foreign exchange reserves and restrictions on new internal debt.[12]

Other program elements which are neither preconditions nor performance criteria may be numerous and wide-ranging. These elements may involve tax measures, specific actions with regard to the overall budget deficit, wages of public sector employees, consumer goods subsidies, and pricing policies. These performance criteria may not, in fact, be confined to fiscal topics but may include monetary policy and improvements in the efficiency of public administration. Not meeting or completing these other program elements, however, does not result in any financial sanction by the Fund. They are meant as suggested areas of reform to help a specific government out of its situation.

The policies and criteria written into a program are meant to be implemented by the end of the fund support period. In most cases, this is one year. IMF managing director de Larosiere has stated that programs must aim "primarily to entertain a viable balance of payments

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[12]International Monetary Fund, Special Survey, 1981.

position in a reasonable period of time and, if possible, before the end of the program, although this may not be possible in all cases."

As shown, IMF loans have conditions attached. In recent cases, this conditionality has discouraged countries from going to the IMF until they are in severe trouble. More severe measures in this case are necessary, further complicating the already complex relationship between the borrower and the IMF. Conditions and timing of successful balance-of-payments adjustment programs vary from country to country. In general, IMF programs are most likely to be effective when they are genuinely adopted as their own by borrowing governments.

CHAPTER III

REFORMED IMF ROLE

Summary of IMF Changes

As discussed earlier, the IMF was created for two main purposes. To provide an institute to monitor and regulate exchange rate arrangements and as a financial institute, more like a credit union than a bank, to help members with balance-of-payment equilibriums by providing funds on a short-term basis. The IMF has evolved into an institute which has tried to ensure an adequate and appropriately distributed supply of international liquidity. This is clearly recognized as a fundamental requirement of an effective functioning international monetary system. The IMF has done this through creation of additional funds, through special accounts and arrangements like the General Arrangements to Borrow (GAB), Compensatory Financing Facility, Buffer Stock Financing Facility, and, when the need arose, other funds such as the Oil Facilities brought about by the oil shocks to the global economy in the ´70s. SDR creation and allocation is an obvious and noninflationary means of further financing Fund expansion. The allocation of SDRs, though small and intermittent, suggests an unrivaled means of increasing liquidity and, in fact, the use of SDRs as a

unit of account outside the Fund could be promoted as an additional means to foster an interbank market for SDRs.

New private bank lending has dropped off since the changes made to the IMF in the early 1970s and additional SDR allocations of the 1980s. Fund´s resources have been increased to rescue banks which had engaged in unwise lending. Banks now demand that agreements be reached with the IMF before rescheduling debts, thus increasing the IMF´s power base and role in private lending. The importance of the IMF to the financial community has been recognized with the concern of the Western financial establishment over deficit nations´ commitments to Western banks. The Fund is generally looked at as the main remaining pillar propping up the world banking system. Fund initiatives in the early 80s gave the IMF nearly 50 percent extra usable funds. It has also borrowed from member states to increase the CAB to $1.7B.

The IMF is the only international body that can directly perform the function of reconciling the policies and performance of nations in order to promote general well-being of the whole monetary system. The IMF has its fault and has been criticized severely for some of its practices and policies. However, no other organization of its type exists to promote order to the entire economic system.

Today´s IMF

The IMF plays an important role in coordinating financial policies and improving the functioning of the world

economy. The IMF has taken new initiatives to strengthen growth and support needed adjustments in the economies of developing countries. Although only briefly mentioned in this paper, the World Bank has begun to cooperate with the IMF to insure that the Bank´s structural adjustment lending operations and the IMF programs are complementary and are mutually reinforcing. Cooperation has continued to a point where it is now usual for a member of the Bank´s staff to be attached to Fund missions. Similarly, the Bank is supposed to consult with the Fund before it makes recommendations and demands in fields which are clearly recognized to be in the competence of the Fund. The Fund must be concerned with growth and equity, and the Bank must concern itself with macro-economic balance.

Recent events have proven that governments should not rely on private markets for balance-of-payments financing. They can be fair-weather friends. The Fund was created for this purpose and has proven its worth. The Fund has also played an important role, of late, in insuring that markets for developing country exports are kept open and growing. This has been not only through the contribution of Fund financial resources, but because of its function of assisting countries to design, implement, and monitor growth-oriented adjustment programs.

The Fund has evolved into an important organization with far-reaching world economic implications. Improvements

of the functioning of the international monetary system is currently under study by the Fund´s Executive Directors. A key element in this study is reaching agreement on the kinds of policies and institutional arrangements that will promote greater stability of exchange rates, an orderly basis for providing international liquidity, and a reliable source of resource transfers to developing countries. This study and Fund programs clearly show the Fund´s commitment to improving nations´ economies and where possible influencing the world economy.

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