Unit-4 (II-A)

[12 Marks]

Q.1) Evaluate IMF's policies and assistance in respect of developing countries with special reference to India.

12+

Q.2) Evaluate World Bank's assistance to India.

12+

Q.3) "IMF and World Bank serve the interests of industrialised nations rather than those of the developing countries". Comment. 12+

Q.4) Evaluate IFC's policies and assistance in respect of developing countries with special reference to India.

12+

International Trade and Finance - IIA

Unit - 4.

8 Marks

Q.1) Discuss the role of SDRs as an international reserve asset created by the IMF.

8+

Q.2) Write a short note on the objectives and functions of Asian Development Bank (ADB).

8+

Q.3) What are the procedures for nations to borrow from the IMF?

8+

Q.4) What is meant by (i) the Bretton-Woods systems being a gold-exchange standard

ii) General Arrangements to Borrow.

iii) Standby Arrangements

iv) Swap Arrangements

v) Gold pool & (vi) Two-tier gold market?

3+1+1+1+1+1 = 8

The International Monetary System: Past, Present, and Future

21.1 Introduction

In this chapter, we examine the operation of the international monetary system from the gold standard period to the present. Fragments of this experience were presented as examples as the various mechanisms of balance-of-payments adjustment were examined. We now bring it all together and evaluate the process of balance-of-payments adjustment and, more broadly, open-economy macroeconomic policies and performances as they actually occurred under the various international monetary systems that existed from 1880 to the present. Although the approach is historical, the evaluation of the operation of the various international monetary systems will be conducted in terms of the analytical framework developed in Chapters 16 through 20.

An **international monetary system** (sometimes referred to as an international monetary *order* or *regime*) refers to the rules, customs, instruments, facilities, and

organizations for effecting international payments. International monetary systems can be classified according to the way in which exchange rates are determined or according to the form that international reserve assets take. Under the exchange rate classification, we can have a fixed exchange rate system with a narrow band of fluctuation about a par value, a fixed exchange rate system with a wide band of fluctuation, an adjustable peg system, a crawling peg system, a managed floating exchange rate system, or a freely floating exchange rate system. Under the international reserve classification, we can have a gold standard (with gold as the only international reserve asset), a pure fiduciary standard (such as a pure dollar or exchange standard without any connection with gold), or a gold-exchange standard (a combination of the previous two).

The various classifications can be combined in various ways. For example, the gold standard is a fixed exchange rate system. However, we can also have a fixed exchange rate system without any connection with gold, but with international reserves comprised of some national currency, such as the U.S. dollar, that is no longer backed by gold. Similarly, we can have an adjustable peg system or a managed float with gold and foreign exchange or with only foreign exchange as international reserves. Under a freely floating exchange rate system, there is theoretically no need for reserves since exchange rate changes automatically and immediately correct any balance-of-payments disequilibrium as it develops. Throughout the period of our analysis, most of the international monetary systems possible were in operation at one time or another or for some nations, as described in this chapter.

A good international monetary system is one that maximizes the flow of international trade and investments and leads to an "equitable" distribution of the gains from trade among the nations of the world. An international monetary system can be evaluated in terms of adjustment, liquidity, and confidence. **Adjustment** refers to the process by which balance-of-payment disequilibria are corrected. A good international monetary system is one that minimizes the cost of and the time required for adjustment. **Liquidity** refers to the amount of international reserve assets available to settle temporary balance-of-payments disequilibria. A good international monetary system is one that provides adequate international reserves so that nations can correct balance-of-payments deficits without deflating their own economies or being inflationary for the world as a whole. **Confidence** refers to the knowledge that the adjustment mechanism is working adequately and that international reserves will retain their absolute and relative values.

21.3 The Bretton Woods System

In this section, we describe the Bretton Woods system and the International Monetary Fund (the institution created to oversee the operation of the new international monetary system and provide credit to nations facing temporary balance-of-payments difficulties).

21.3A The Gold-Exchange Standard (1947–1971)

In 1944, representatives of the United States, the United Kingdom, and 42 other nations met at Bretton Woods, New Hampshire, to decide on what international monetary system to establish after the war. The system devised at Bretton Woods called for the establishment of the **International Monetary Fund (IMF)** for the purposes of (1) overseeing that nations followed a set of agreed upon rules of conduct in international trade and finance and (2) providing *borrowing* facilities for nations in *temporary* balance-of-payments difficulties.

The new international monetary system reflected the plan of the American delegation, drawn up by *Harry D. White* of the U.S. Treasury, rather than the plan submitted by *John Maynard Keynes,* who headed the British delegation. Keynes had called for the establishment of a *clearing union* able to *create* international liquidity based on a new unit of account called the "bancor," just as a national central bank (the Federal Reserve in the United States) can create money domestically. The IMF opened its doors on March 1, 1947, with a membership of 30 nations. With the admission of the Soviet Republics and other nations during the 1990s, IMF membership reached 181 at the beginning of 1997. Only a few countries, such as Cuba, North Korea, and Vietnam, are not members.

The **Bretton Woods system** was a gold-exchange standard. The United States was to maintain the price of gold fixed at $35 per ounce and be ready to exchange on demand dollars for gold at that price without restrictions or limitations. Other nations were to fix the price of their currencies in terms of dollars (and thus implicitly in terms of gold) and intervene in foreign exchange markets to keep the exchange rate from moving by more than 1 percent above or below the par value. Within the allowed band of fluctuation, the exchange rate was determined by the forces of demand and supply.

Specifically, a nation would have to draw down its dollar reserves to purchase its own currency in order to prevent it from depreciating by more than 1 percent from the agreed par value, or the nation would have to purchase dollars with its own currency (adding to its international reserves) to prevent an appreciation of its currency by more

than 1 percent from the par value. Until the late 1950s and early 1960s, when other currencies became fully convertible into dollars, the U.S. dollar was the only **intervention currency**, so that the new system was practically a gold-dollar standard.

Nations were to finance temporary balance-of-payments deficits out of their international reserves and by borrowing from the IMF. Only in a case of **fundamental disequilibrium** was a nation allowed, after the approval of the Fund, to change the par value of its currency. Fundamental disequilibrium was nowhere clearly defined but broadly referred to large and persistent balance-of-payments deficits or surpluses. Exchange rate changes of less than 10 percent were, however, allowed without Fund approval. Thus, the Bretton Woods system was in the nature of an adjustable peg system, at least as originally conceived, combining general exchange rate stability with some flexibility. The stress on fixity can best be understood as resulting from the strong desire of nations to avoid the chaotic conditions in international trade and finance that prevailed during the interwar period.

After a period of transition following the war, nations were to remove all restrictions on the full convertibility of their currencies into other currencies and into the U.S. dollar. Nations were forbidden to impose additional trade restrictions (otherwise **currency convertibility** would not have much meaning), and existing trade restrictions were to be removed gradually in multilateral negotiations under the sponsorship of GATT (see Section 9.6B). Restrictions on international liquid capital flows were, however, permitted to allow nations to protect their currencies against large destabilizing, or "hot," international money flows.

Borrowing from the Fund (to be described below) was restricted to cover temporary balance-of-payments deficits and was to be repaid within three to five years so as not to tie up the Fund's resources in long-term loans. *Long-run* development assistance was to be provided by the **International Bank for Reconstruction and Development (IBRD** or **World Bank)** and its affiliates, the **International Development Association** (established in 1960 to make loans at subsidized rates to the poorer developing nations) and the **International Finance Corporation** (established in 1956 to stimulate *private* investments in developing nations from indigenous and foreign sources).

The Fund was also to collect and propagate balance-of-payments, international trade, and other economic data of member nations. Today the IMF publishes, among other things, *International Financial Statistics* and *Direction of Trade Statistics*, the most authoritative sources of comparable time series data on the balance of payments, trade, and other economic indicators of member nations.

21.3B Borrowing from the International Monetary Fund

Upon joining the IMF, each nation was assigned a quota based on its economic importance and the volume of its international trade. The size of a nation's quota determined its voting power and its ability to borrow from the Fund. The total subscription to the Fund was set in 1944 at $8.8 billion. As the most powerful nation, the United States was assigned by far the largest quota, 31 percent. Every five years, quotas were to be revised to reflect changes in the relative economic importance and international trade of member nations. At the end of February 2000, the total subscription of the Fund had grown to 210.3 billion SDRs ($281.6 billion) through

increases in membership and periodic increases in quotas. The U.S. quota had declined to 17.7 percent of the total, the quota of Japan and Germany was, respectively, 6.3 and 6.2, and that of France and the United Kingdom 5.1 percent.

Upon joining the IMF, a nation was to pay 25 percent of its quota to the Fund in gold and the remainder in its own currency. In borrowing from the Fund, the nation would get convertible currencies approved by the Fund in exchange for depositing equivalent (and additional) amounts of its own currency into the Fund, until the Fund held no more than 200 percent of the nation's quota in the nation's currency.

Under the original rules of the Fund, a member nation could borrow no more than 25 percent of its quota in any one year, up to a total of 125 percent of its quota over a five-year period. The nation could borrow the first 25 percent of its quota, the **gold tranche,** almost automatically, without any restrictions or conditions. For further borrowings (in subsequent years), the **credit tranches,** the Fund charged higher and higher interest rates and imposed more and more supervision and conditions to ensure that the deficit nation was taking appropriate measures to eliminate the deficit.

Repayments were to be made within three to five years and involved the nation's repurchase of its own currency from the Fund with other convertible currencies approved by the Fund, until the IMF once again held no more than 75 percent of the nation's quota in the nation's currency. The Fund allowed repayments to be made in currencies of which it held less than 75 percent of the issuing nation's quota. If before a nation (Nation A) completed repayment, another nation (Nation B) borrowed Nation A's currency from the Fund, then Nation A would end repayment of its loan as soon as the Fund's holdings of Nation A's currency reached 75 percent of its quota.

If the Fund's holding of a nation's currency fell below 75 percent of its quota, the nation could borrow the difference from the Fund without having to repay its loan. This was called the **super gold tranche.** In the event that the Fund ran out of a currency altogether, it would declare the currency "scarce" and allow member nations to discriminate in trade against the scarce-currency nation. The reason for this was that the Fund viewed balance-of-payments adjustment as the joint responsibility of both deficit and surplus nations. However, the Fund has never been called upon to invoke this scarce-currency provision during its many years of operation.

A nation's gold tranche plus its super gold tranche (if any) or minus the amount of its borrowing (if any) is called the nation's **net IMF position.** Thus, the nation's net IMF position is given by the size of its quota minus the Fund's holding of its currency. The amount of gold reserves paid in by a nation upon joining the Fund was called the nation's reserve position in the Fund and was added to the nation's other international reserves of gold, Special Drawing Rights (SDRs—see the next section), and other convertible currencies to obtain the total value of the nation's international reserves (see Section 13.3).

21.4B Evolution of the Bretton Woods System

Over the years, the Bretton Woods system evolved (until 1971) in several important directions in response to changing conditions. In 1962, the IMF negotiated the **General Arrangements to Borrow (GAB)** up to $6 billion from the so-called Group of Ten most important industrial nations (the United States, the United Kingdom, West Germany, Japan, France, Italy, Canada, the Netherlands, Belgium, and Sweden) and Switzerland to supplement its resources, if needed, to help nations with balance-of-payments difficulties. This sum of $6 billion was over and above the periodic increases in the Articles of Agreement that established the IMF. GAB was renewed and expanded in subsequent years.

Starting in the early 1960s, member nations began to negotiate **standby arrangements.** These refer to advance permission for future borrowings by the nation at the IMF. Once a standby arrangement was negotiated, the nation paid a small commitment charge of one-fourth of 1 percent of the amount earmarked and was then able to borrow up to this additional amount *immediately* when the need arose at a 5.5 percent charge per year on the amount actually borrowed. Standby arrangements were usually negotiated by member nations as a first line of defense against anticipated destabilizing hot money flows. After several increases in quotas, the total resources of the Fund reached $28.5 billion by 1971 (of which $6.7 billion, or about 23.5 percent, was the U.S. quota). By the end of 1971, the Fund had lent about $22 billion (mostly after 1956), of which about $4 billion was outstanding. The Fund also changed the rules and allowed member nations to borrow up to 50 percent of their quotas in any one year (up from 25 percent).

National central banks also began to negotiate so-called **swap arrangements** to exchange each other's currency to be used to intervene in foreign exchange markets to combat hot money flows. A central bank facing large liquid capital flows could then sell the foreign currency forward in order to increase the forward discount or reduce the forward premium on the foreign currency and discourage destabilizing hot money flows (see Sections 14.3 to 14.6). Swap arrangements were negotiated for specific periods of time and with an exchange rate guarantee. When due, they could either be settled by a reverse transaction or be renegotiated for another period. The United States and European nations negotiated many such swap arrangements during the 1960s.

The most significant change introduced into the Bretton Woods system during the 1947–1971 period was the creation of **Special Drawing Rights (SDRs)** to supplement the international reserves of gold, foreign exchange, and reserve position in the IMF. Sometimes called *paper gold,* SDRs are accounting entries in the books of the IMF. SDRs are not backed by gold or any other currency but represent genuine international reserves *created* by the IMF. Their value arises because member nations have so agreed. SDRs can only be used in dealings among central banks to settle balance-of-payments deficits and surpluses and not in private commercial dealings. A charge of 1.5 percent (subsequently increased to 5 percent and now

based on market rates) was applied on the amount by which a nation's holdings of SDRs fell short of or exceeded the amount of SDRs allocated to it. The reason for this was to put pressure on both deficit and surplus nations to correct balance-of-payments disequilibria.

At the 1967 meeting of the IMF in Rio de Janeiro, it was agreed to create SDRs in the amount of $9.5 billion to be distributed to member nations according to their quotas in the IMF in three installments in January 1970, 1971, and 1972. Further allocations of SDRs were made in the 1979–1981 period (see Section 21.6A). The value of one SDR was originally set equal to one U.S. dollar but rose above $1 as a result of the devaluations to the dollar in 1971 and 1973. Starting in 1974, the value of SDRs was tied to a basket of currencies, as explained in Section 21.6A.

In 1961 the so-called *gold pool* was started by a group of industrial nations under the leadership of the United States to sell officially held gold on the London market to prevent the price of gold from rising above the official price of $35 an ounce. This was discontinued as a result of the gold crisis of 1968 when a *two-tier gold market* was established. This kept the price of gold at $35 an ounce in official transactions among central banks, while allowing the commercial price of gold to rise above the official price and be determined by the forces of demand and supply in the market. These steps were taken to prevent depletion of U.S. gold reserves.

Over the years, membership in the IMF increased to include most nations of the world. Despite the shortcomings of the Bretton Woods system, the postwar period until 1971 was characterized by world output growing quite rapidly and international trade growing even faster. Overall, it can thus be said that the Bretton Woods system served the world community well, particularly until the mid-1960s (see Case Study 21-1).

TABLE 21.2. *International Reserves, 1950–1973, Selected Years (billions of U.S. dollars, at year end)*

	1950	1960	1969	1970	1971	1972	1973
Gold (at official price)	33	38	39	37	36	36	36
Foreign exchange	13	19	33	45	75	96	102
SDRs	—	—	—	3	6	9	9
Reserve position in the IMF	2	4	7	8	6	6	6
Total	48	61	79	93	123	147	153

Source: IMF, *International Financial Statistics Yearbook*, 1989.

supposedly operate to eventually correct the deficit. Inadequate liquidity hampers the expansion of world trade. On the other hand, excessive liquidity leads to worldwide inflationary pressures. But this raised a serious dilemma, according to *Robert Triffin* (1961). Under the Bretton Woods system, most liquidity was provided by an increase in foreign exchange arising from U.S. balance-of-payments deficits. However, the longer these balance-of-payments deficits persisted and the more unwanted dollars accumulated in foreign hands, the smaller was the confidence in the dollar. The dollar shortage of the 1950s had given way to the **dollar glut** of the 1960s.

It was in response to this problem and in the hope that the United States would soon be able to correct its deficits that the IMF decided to create $9.5 billion of SDRs in 1967. These SDRs were distributed in three installments in January 1970, 1971, and 1972, at the very time when the world was suffering from excessive increases in liquidity resulting from huge U.S. balance-of-payments deficits. Note that the increase in SDRs from 1970 to 1971 and 1972 shown in Table 21.2 reflects not only the new installments of SDRs distributed to member nations in January of 1971 and 1972 but also the increase in the dollar value of SDRs as a result of the dollar devaluation in December 1971. Similarly, there was no new distribution of SDRs between 1972 and 1973, but the value of one SDR rose from about $1.09 in 1972 to $1.21 in 1973.

As we have seen, the United States was unable to correct its large and persistent balance-of-payments deficits primarily because of its inability to devalue the dollar. Thus, the Bretton Woods system lacked an adequate adjustment mechanism that nations would be willing and able to utilize as a matter of policy. U.S. balance-of-payments deficits persisted, and this undermined confidence in the dollar. Thus, the fundamental cause of the collapse of the Bretton Woods system is to be found in the interrelated problems of adjustment, liquidity, and confidence.

21.6 The International Monetary System: Present and Future

In this section, we examine the operation of the present managed floating exchange rate system, discuss present IMF operation, identify the most important monetary and trade problems, and evaluate proposals for reforms.

21.6A Operation of the Present System

Since March 1973, the world has had a managed floating exchange rate system. Under such a system, nations' monetary authorities are entrusted with the responsibility to intervene in foreign exchange markets to smooth out short-run fluctuations in exchange rates without attempting to affect long-run trends. This could be achieved by a policy of leaning against the wind (see Section 20.6D). To be sure, this system was not deliberately chosen but was imposed on the world by the collapse of the Bretton Woods system in the face of chaotic conditions in foreign exchange markets and huge destabilizing speculation.

In the early days of the managed floating system, serious attempts were made to devise specific rules for managing the float to prevent competitive exchange rate depreciations (which nations might use to stimulate their exports), thus possibly returning to the chaotic conditions of the 1930s. However, as the worst fears of abuses did not materialize, all of these attempts failed. Indeed, the 1976 **Jamaica Accords** formally recognized the managed floating system and allowed nations the choice of foreign exchange regime as long as their actions did not prove disruptive to trade partners and the world economy. These Jamaica Accords were ratified and took effect in April 1978.

At the end of 2001, half of the 186 nations that were members of the IMF had opted for some form of exchange rate flexibility. These included practically all the industrial nations and many large developing nations (not mainland China), so that more than four-fifths of total world trade moved between nations that managed the exchange rate, either independently or jointly (as the European Union). Most of the remaining nations adopted the currency of another nation (i.e., dollarized), operated under a currency board arrangment (CBA), or pegged their currencies to the U.S. dollar, the euro, or a basket of currencies (see Section 20.6 and Table 20.4). During the period from 1974 to 1977, again from 1981 to 1985, and since the early 1990s, the United States generally followed a policy of **benign neglect** by not intervening in foreign exchange markets to stabilize the value of the dollar.

In March 1979, the European Union (EU) formed the European Monetary System (EMS) as part of its aim toward greater monetary integration among its members. This involved the creation of the European Currency Unit (ECU), keeping exchange rates of member countries fluctuating within a ±2.25 percent band (and jointly floating against the dollar and other currencies), and the establishment of the European Monetary Cooperation Fund (EMCF) to provide members with short- and medium-term balance-of-payments assistance. In June 1989, a committee headed by Jacques Delors, the president of the European Commission, recommended a three-stage transition to the goal of monetary union, with a single currency and a European Central Bank (ECB) by 1997 or 1999. This timetable for achieving a complete monetary union was agreed upon at a December 1991 meeting in the Dutch city of Maastrich. In the face of financial turmoil and recession in Europe, the United Kingdom and Italy abandoned the exchange rate mechanism in September 1992, and in August 1993 the remaining members of the European Monetary System increased the band of allowed exchange rate fluctuation to ±15 percent (see Case Study 20-2). On January 1, 1999, the euro was introduced as the

single currency of 11 of the 15 members of the European Monetary Union (EMU), and on January 1, 2002, the euro began to circulate as the currency of the now 12-member EMU (see Section 20.4D).

Under the present managed float, nations still need international reserves in order to intervene in foreign exchange markets to smooth out short-run fluctuations in exchange rates. At present, such interventions are still made mostly in dollars. In January 1975, U.S. citizens were allowed for the first time since 1933 to own gold (other than in jewelry), and the United States sold a small portion of its gold holdings on the free market. The price of gold on the London market temporarily rose above $800 an ounce in January 1980, but it soon fell and stabilized at about half of its peak price (and it was $320 in October 2002). As part of the Jamaica Accords, the IMF sold one-sixth of its gold holdings on the free market between 1976 and 1980 (and used the proceeds to aid the poorest developing nations) to demonstrate its commitment to eliminate gold (the "barbarous relic"—to use Keynes's words) as an international reserve asset. The official price of gold was abolished, and it was agreed that there would be no future gold transactions between the IMF and member nations. The IMF also continued to value its gold holdings at the pre-1971 official price of $35 or 35 SDRs an ounce. However, it may be some time before gold completely "seeps out" of international reserves—if it ever will. In the fall of 1996, the IMF agreed to sell about $2 billion of its gold holdings and use the proceeds to reduce the foreign debt of the poorest developing countries.

One SDR was valued at $1.00 up to 1971, $1.0857 after the dollar devaluation of December 1971, and $1.2064 after the subsequent dollar devaluation of February 1973. In 1974, the value of one SDR was made equal to the weighted average of a basket of 16 leading currencies in order to stabilize its value. In 1981, the number of currencies included in the basket was reduced to five and, with the advent of the euro, to the following four (with their respective relative weights in 2002 given in parentheses): U.S. dollar (43.6 percent); euro (31.6 percent); Japanese yen (13.4 percent); and British pound (11.4 percent). At the end of July 2002, one SDR was valued $1.3225.

Since 1974, the IMF has measured all reserves and other official transactions in terms of SDRs instead of U.S. dollars. Table 21.3 shows the composition of international reserves both in U.S. dollars and in SDRs (valued at $1.2567 in 2001). (For

TABLE 21.3. *International Reserves in 2001 (billions of U.S. dollars and SDRs, at year end)*

	U.S. Dollars	SDRs
Foreign exchange	2,033.8	1,618.4
SDRs	24.6	19.6
Reserve position in the IMF	71.5	56.9
Total minus gold	2,129.9	1,694.7
Gold at official price	41.5	33.0
Total with gold at official price	2,171.4	1,727.7

Source: IMF, *International Financial Statistics Yearbook*, 2002.

1.6B Current IMF Operation

Several recent changes have occurred in the operation of the IMF. The quotas of IMF member nations have been increased across the board several times, so that in 2002 the Fund's resources totaled $266.9 billion (up from $8.8 billion in 1947). Members are generally required to pay 25 percent of any increase in its quota in SDRs or in currencies of other members selected by the Fund, with their approval, and the rest in their own currency. New members pay in their quota in the same way. The old gold tranche is now called the **first-credit tranche**.

The IMF has also renewed and expanded the General Arrangements to Borrow (GAB) several times since setting them up in 1962, and in 1997 it extended it with the **New Arrangement to Borrow (NAB)**, so that in 2002 the IMF could lend up to SDR34 billion (about $43 billion) to supplement its regular resources. Central bankers also expanded their swap arrangements to over $54 billion and their standby arrangements to $50 billion. Borrowing rules at the Fund were also relaxed, and new credit facilities were added that greatly expanded the overall maximum amount of credit available to a member nation. However, this total amount of credit consists of several different credit lines subject to various conditions. IMF loans are now specified in terms of SDRs. There is an initial fee, and the interest charged is based on the length of the loan, the facility used, and prevailing interest rates. Besides the usual surveillance responsibilities over the exchange rate policies of its members, the Fund has recently broadened its responsibilities to include help for members to also overcome their structural problems.

The new credit facilities set up by the IMF include (1) the Extended Fund Facility (EFF), established in 1974 to make resources available, for longer periods and in larger amounts than under the credit tranche policies, to help member nations overcome serious structural imbalances; (2) the Supplemental Reserve Facility (SRF), established in December 1997 during the Asian crisis to provide short-term assistance for balance-of-payments difficulties related to crises of market confidence; (3) the Compensatory Financing Facility (CFF), set up in 1963 to enable a member country to draw up to 100 percent of its quota to make up for a shortfall in export earnings or for an increase in the cost of imported cereals due to an unanticipated adverse external shock beyond the member's control; (4) the Contingent Credit Line (CCL), set up in 1999 to provide short-term financing against balance-of-payments difficulties arising from contagion; (5) the Structural Adjustment Facility (SAF), set up in 1987, and its follow-up, the Poverty Reduction and Growth Facility (PRGF) set up in 1999, subsequently renamed the Enhanced Structural Adjustment Facility (ESAF), and now called the Systematic Transformation Facility (STF), to provide resources on concessionary terms to low-income member countries facing protracted balance-of-payments problems, in support of medium-term macroeconomic and structural adjustment programs; and (6) Emergency Assistance to provide quick help for balance-of-payments difficulties arising from natural disasters or in the aftermath of civil unrest, political turmoil, or international armed conflict.

A member country's overall access to Fund resources is now up to 300 percent of its quota in any single year, or three times the old cumulative limit of 100 percent. The recipients of the loans as well as the type of loans made by the Fund also changed significantly over time. During the first 20 years of its existence, industrial countries accounted for over half of the use of Fund resources, and loans were made primarily to overcome short-term balance-of-payments problems. Beginning in the early 1980s, most loans were made to developing countries, and an increasing share of these loans was made for the medium term in order to overcome structural problems.

Total Fund credit and loans outstanding were about $14 billion in 1980, $41 billion in 1986, and $73.7 billion as of April 2002. Of the total of $73.7 billion of Fund credit and loans outstanding in April 2002, $35.9 billion were provided under the standby credit tranches, $19.5 billion under the Extended Fund Facility (EFF), $7.4 billion under the Supplemental Reserve Facility (SRF), $0.9 billion under the Compensatory Financing Facility (CCFF) and Contingent Credit Lines (CCL), $1.6 billion under the Systemic Transformation Facility (STF), and smaller amounts under the other programs.

In the face of the huge international debt problems of many developing countries since 1982, particularly the large countries of Latin America, the IMF has engaged in a number of debt rescheduling and rescue operations. As a condition for the additional loans and special help, the IMF usually requires reductions in government spending, in growth of the money supply, and in wage increases in order to reduce imports, stimulate exports, and make the country more nearly self-sustaining. Such **IMF conditionality**, however, proved to be very painful and led to riots and even the toppling of governments during the late 1980s and 1990s. It also led to accusations that the IMF did not take into account the social needs of debtor nations and the political consequences of its demands, and that its policies were "all head and no heart." Partly in response to these accusations, the IMF has become more flexible in its lending activities in recent years and has begun to grant even medium-term loans to overcome structural problems (something that was traditionally done only by the World Bank).

By way of summary, Table 21.4 presents the most important dates in modern monetary history.

21.6C Problems with Present Exchange Rate Arrangements

The present international monetary system faces a number of serious and closely interrelated international monetary problems today. These are (1) the large volatility and the wide and persistent misalignments of exchange rates; (2) the failure to promote greater coordination of economic policies among the leading industrial nations; and (3) the inability to prevent international financial crises in emerging market economies or to deal with them adequately when they do arise.

We have seen in Sections 14.5A and 15.5A that since 1973 exchange rates have been characterized by very large volatility and overshooting. This state of affairs can discourage the flow of international trade and investments. Much more serious is the fact that under the present managed floating exchange rate system large exchange rate disequilibria can arise and persist for several years (see Section 20.6D and Case Study 21-2). This is clearly evident from the very large

Dates in Modern Monetary History

Date	Event
1880–1914	Classical gold standard period
April 1925	United Kingdom returns to the gold standard
October 1929	United States stock market crashes
September 1931	United Kingdom abandons the gold standard
February 1934	United States raises official price of gold from $20.67 to $35 an ounce
July 1944	Bretton Woods Conference
March 1947	IMF begins operation
September 1967	Decision to create SDRs
March 1968	Two-tier gold market established
August 1971	United States suspends convertibility of the dollar into gold—end of Bretton Woods system
December 1971	Smithsonian Agreement (official price of gold increased to $38 an ounce; band of allowed fluctuation increased to 4.5%)
March 1972	Beginning of European "snake" with band of allowed fluctuation limited to 2.25%
February 1973	United States raises official price of gold to $42.22 an ounce
March 1973	Managed floating exchange rate system comes into existence
October 1973	OPEC selective embargo on petroleum exports and start of sharp increase in petroleum prices
January 1976	Jamaica Accords (agreement to recognize the managed float and abolish the official price of gold)
April 1978	Jamaica Accords take effect
Spring 1979	Second oil shock
March 1979	Establishment of the European Monetary System (EMS)
January 1980	Gold price rises temporarily above $800 per ounce
August 1982	International debt problem becomes evident
September 1985	Plaza agreement to intervene to lower value of dollar
Fall 1986	New round of GATT multilateral trade negotiations begins
February 1987	Louvre agreement to stabilize exchange rates
October 1987	New York Stock Exchange collapses and spreads to other stock markets around the world
1989–1990	Democratic and market reforms begin in Eastern Europe and German reunification occurs
December 1991	Maastrich Treaty approved calling for European Union to move toward monetary union by 1997 or 1999
December 1991	Soviet Union dissolved and Commonwealth of Independent States (CIS) formed
September 1992	United Kingdom and Italy abandon Exchange Rate Mechanism (ERM)
January 1, 1993	European Union (EU) becomes a single unified market
August 1, 1993	European Monetary System allows ±15% fluctuation in exchange rates
December 1993	Uruguay Round completed and World Trade Organization (WTO) replaces GATT
January 1, 1994	North American Free Trade Agreement (NAFTA) comes into existence
January 1, 1994	European Free Trade Association joins European Union in custom union called European Economic Area (EEA)
January 1, 1994	Creation of the European Monetary Institute (EMI) as the forerunner of the European Central Bank by the European Union
January 1, 1999	Introduction of the single currency (the euro) and European Union-wide monetary policy by the European Central Bank (ECB)
October 2000	Euro falls to lowest level with respect to the dollar
January 2002	Euro begins circulating as the currency of the European Monetary Union

IMF and Development Banks

In 1944, even while the World War II was being fought, representatives of forty-four nations met in Bretton Woods, New Hampshire, USA, to discuss the major international economic problems including reconstruction of the economies ravaged by the War, and to evolve practical solutions for them. The Bretton Woods Conference proposed the setting up of:

1. International Monetary Fund (IMF) to alleviate the problems of international liquidity (i.e., to help the member countries meet their balance of payments deficits) and to achieve international monetary stability.
2. The International Bank for Reconstruction and Development (IBRD) to help the reconstruction and development of various national economies by providing long-term capital assistance; and
3. The International Trade Organisation (ITO) to work towards the liberalisation of international trade.

The IMF and the IBRD (World Bank), known as the '*Bretton Woods Twins* were estabilished in 1945. However, the proposal for the ITO did not materialise; instead the General Agreement on Tariffs and Trade (GATT), a less ambitious organisation, was formed.

INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF) is an organisation of countries that seeks to promote international monetary cooperation, facilitate the expansion of trade, and thus, to contribute towards increased employment and improved economic conditions in all member countries.

Membership in the IMF is open to every country that controls its foreign relations and is able and prepared to fulfil the obligations of membership. Membership of Fund is a prerequisite for membership in the World Bank (IBRD) and close working relationships exist between the two organisation, as well as between the Fund and the WTO and the Bank for International Settlements (BIS). The Fund is a specialised agency within the United Nations system, cooperating with the UN on matters of mutual interest.

Purpose and Functions of the IMF

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

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
2. 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 the productive resources of all members as primary objectives of economic policy.
3. To promote exchange stability, maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To assist in the establishment of a multilateral system of payments with respect to current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
5. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article.

The IMF combines three major functions namely regulatory, financial and consultative.

In its *regulatory* aspect, it acts as the guardian of a code set up by its Articles.

In its *financial* aspect, it functions as an agency with resources available for short term to medium term loans to meet balance of payments deficits of member countries.

In its *consultative* aspect, it provides a centre for international cooperation and a source of counsel and technical assistance to its members.

To achieve its purposes the Fund has a code of economic behaviour for its members, makes financing available to members in balance of payments difficulties, and provides them with technical assistance to improve their economic management.

Member countries undertake to collaborate with the Fund and with each other to assure orderly exchange arrangements and a stable system of exchange rates, together with a multilateral system of payments that is free from

restrictions and thus promotes balance in the payments among countries. Members are free to choose the form of exchange arrangements that they intend to apply, subject to their obligations to the Fund and to its surveillance of their exchange rate policies.

The Fund maintains a large pool of financial resources that it makes available to member countries—temporarily and subject to conditions—to enable them to carry out programmes to remedy their payments deficits without resorting to restrictive measures that would adversely affect national or international prosperity. Members make repayments to the Fund so that its resources are used on a revolving basis and are continuously available to countries facing payments difficulties. The policy adjustments that countries make in connection with the use of Fund resources support their credit-worthiness and thus facilitate their access to credit from other official sources and from private financial markets.

Both the regulatory and the financing features of the Fund's policies contribute to the promotion of adjustment of imbalances in members' international payments. These policies evolve in response to changing world economic conditions and the needs of Fund members. They apply equally to all member countries, whether industrial or developing, whether their payments are in deficit or surplus, and regardless of their economic system.

To enable the Fund to carry out its policies, member countries continuously supply it with a broad range of economic and financial information, and the Fund consults regularly with each member country on its economic situation. The Fund is, therefore, in a position to assist members in devising corrective steps when, or preferably before, problems arise in their balance of payments.

Having reponsibilities for the international payments system, the Fund is particularly concerned with global liquidity—that is, the level and composition of the reserves that are available to members for meeting their trade and payments requirements. In 1969, the Fund was given the responsibility for creating and allocating Special Drawing Rights (SDRs), the only worldwide reserve asset established by international agreement.

The Fund helps members to coordinate their national economic policies internationally. In effect, it provides a permanent international monetary forum. The focus of the Fund is not only on the problems of individual countries, but also on the structure of the international monetary system and on the development of policies and strategies through which its members can work together to ensure a stable world financial system and sustainable economic growth.

Structure and Management

The work of the Fund is carried out through a Board of Governors, an Executive Board, a Managing Director, and staff. Each member country is represented by a Governor and an Alternate governor on the Board of Governors, which is the Fund's highest authority and which meets annually and

may cast ballots by mail or cable between meetings. A member country's voting power primarily reflects its contribution to the Fund's financial resources, which, in turn, is related to its relative size in the world economy.

The highest authority of the Fund is the Board of Governors. In most cases, the Fund's Governors are ministers of finance or central bank governors in their countries, or they hold some other comparable rank. The Board of Governors meet once a year but may vote by mail at other times.

The Board of governors has delegated most of its powers to the Executive Board, which is responsible for conducting the business of the Fund and is therefore in permanent session at the Fund headquarters in Washington. The Executive Board is chaired by the Managing Director. Among other duties, the Executive Board acts on request by members for financial assistance, conduct consultations with members, takes decisions on general Fund policies, and makes recommendations to the Board of Governors on matters requiring a vote of the Governors, such as the admission of new members and increases in the Fund's resources.

The Executive Board appoints the Fund's Managing Director, who serves both as its chairman and as chief of the operating staff of the Fund, with a five-year term of office.

The professional and administrative staff of the Fund is comprised of international civil servants, appointed by and owing their duty exclusively to the Fund. The Fund's professional staff consists primarilly of economists, but there are, among others, accountants and legal experts. They are recruited on a wide geographical basis from the Fund's member countries. The staff numbers about 1500, are located mainly at the Washington headquarters.

Resources

The resources of the IMF come from two sources, viz., (i) Subscription by members, and (ii) Borrowings.

Quotas and Subsicriptions

Every member of the Fund is required to subscribe to the Fund an amount equivalent to its quota. The Fund's system of quotas is one of its central features. Each member is assigned a quota expressed in Special Drawing Rights (SDRs). Quotas are used to determine the voting power of members, their contribution to the Fund's resources, their access to these resources, and their share in allocations of SDRs. A member's quota reflects its economic size in relation to the total membership of the Fund. Each member pays a subscription to the Fund equivalent to its quota, and the Board of Governors decides on the proportion to be paid in SDRs or in the member's currency. A member is generally required to pay about 25 per cent of its quota in SDRs or in currencies of other members selected by the IMF; it pays the remainder in its own currency.

Quotas of all Fund members are reviewed at intervals of not more than five years. Several general increases have been agreed in the past to bring Fund

quotas in line with the growth of the world economy and the need for additional international liquidity, while special increases from time to time have been agreed to adjust for differing rates of growth among members and for changes in their relative economic positions.

As a result of members' payments of subscriptions, the Fund holds substantial resources in members' currencies and SDRs, which are available to meet member countries' temporary balance of payments needs.

Borrowings

The IMF is authorised under its Articles of Agreement to supplement its ordinary resources by borrowing. The Fund may seek the amount it needs in any currency and from any source i.e., from official entities as well as from private sources.

Under the *General Agreement to Borrow* (GAB), eleven industrial countries have undertaken to lend to the IMF "... if this should be needed to forestall or cope with an impairment of the international monetary system. By December 1983, the maximum credit available to the Fund under the GAB increased to SDR 17 billion. Under the revised GAB, the Fund can enter into *associated borrowing agreements*. The first such agreement to be concluded was with Saudi Arabia for SDR 1.5 billion.

The IMF has also entered into medium term and short-term borrowing agreements to supplements its ordinary resources.

FINANCING POLICIES AND FACILITIES

The principal way in which the IMF makes its resources available to members is by selling to them the currencies of other members or SDRs in exchange for their own currencies. Such transactions change the composition, but not the overall size, of the Fund's resources. A member to which the Fund sells currencies or SDRs is said to make 'purchases' (also referred to as 'drawings') from the Fund. The purpose of making the Fund's resources available to members is to meet balance of payments, needs. The Fund's resources are provided through:

(i) *Permanent policies* for general balance of payments purposes (the tranche policies)

(ii) *Permanent facilities* for specific purposes (the compensatory and contingency financing facility, the buffer stock financing facility, and the extended facility), and

(iii) *Temporary facilities* (i.e., the supplementary financing facility or the policy on enlarged access to the Fund's resource)

The IMF derives its finances from:

(a) Resources in the General Resources Account, which may be used to provide balance of payments financing to all members and are obtained from members' subscriptions and the IMF's borrowing.

(b) Resources in the Special Disbursement Account, which are used for concessional balance of payments assistance to low-income developing members through the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF), and are derived from the reflow of Trust Fund resources (originally derived from the proceeds of the sale of a part of the IMF's gold holdings during 1976-80).

(c) Resources in the ESAF Trust, which are used by the IMF, as trustee, for concessional balance of payments assistance to low-income developing members and are derived from members' loans and donations.

The rules governing access to the IMF's general resources apply uniformly to all members. Access to these resources, which is determined primarily by the member's balance of payments need and the strength of its adjustment policies, is set within well-defined limits in relation to the member's quota. However, under the IMF's Articles of Agreement, it may allow members access to its general resources in excess of these limits in exceptional circumstances.

General resources are used to finance standby and extended arrangements, as well as special facilities that are open to all members, including the compensatory and contingency financing facility and the buffer stock financing facility. Members may also make use of general resources under temporary policies and facilities that are financed with borrowed resources. For example, in 1981, as a follow-up to its supplementary financing facility, the IMF established a policy of 'enlarged access' to its resources. This policy helps members whose balance of payments needs are large relative to their quotas by augmenting its own resources with resources available through borrowing arrangements.

The IMF makes available other resources, in addition to its general resources, to provide low-income developing countries with relatively long-term balance of payments assistance at concessional rates of charge. Concessional assistance in amounts related to members' quotas is provided through loans under the SAF and the ESAF.

Tranche Policies

Reserve Tranche

A member has a reserve tranche position in the IMF to the extent that its quota exceeds the IMF's holdings of its currency in the General Resources Account, excluding holdings arising out of purchases under all policies on the use of the IMF's general resources. A member may purchase up to the full amount of its reserve tranche at anytime, subject only to the requirement of balance of payments need. A reserve tranche purchase does not constitute a use of IMF credit and is not subject to charges or to an expectation or obligation to repurchase.

Credit Tranches

The credit tranche policy is the IMF's basic policy on the use of its general resources. Credit is made available in four tranches, each equivalent to 25 per cent of a country's quota. Members may request standby arrangements in excess of this limit in the context of the enlarged access policy.

A first credit tranche purchase raises the IMF's holdings of the purchasing member's currency in the credit tranches to no more than 25 per cent of quota. Generally, a member may request use of the IMF's resources in the first credit tranche when confronted with relatively minor balance of payments difficulties; the financial assistance is made available if the member demonstrates that it is making reasonable efforts to overcome its difficulties. A member may also request the use of the first credit tranche as part of a standby arrangement.

Subsequent purchases are made in what are collectively known as the 'upper credit tranches'. A member may use the IMF's resources in the upper credit tranches if it adopts policies that provide appropriate grounds for expecting that the member's payments difficulties will be resolved within a reasonable period. Such use is almost always made under standby or extended arrangements.

Permanent Facilities

The Compensatory and Contingency Financing Facility

The Compensatory Financing Facility (CFF), which was established in February 1963, was to assist members, particularly primary producing countries, experiencing balance of payments difficulties attributable to shortfalls in earnings from merchandise exports and invisibles that were both temporary and due to factors largely beyond their control. In May 1981 the Fund decided to extend financial assistance to members facing balance of payments difficulties produced by rising cost of their cereal imports. This assistance was integrated with assistance available under the compensatory financing facility with respect to temporary shortfalls in export receipts. Outstanding purchases under the facility were subject to an individual ceiling of 83 per cent of quota for export shortfalls, or cereal import excesses, and to an overall ceiling of 105 per cent of quota for both export shortfalls and cereal import excesses.

The Compensatory and Contingency Financing Facility (CCFF) superseded the CFF in August 1988. The CCFF keeps the essential elements of the CFF and adds a mechanism for contingency financing to support adjustment programmes approved by the Fund.

Buffer Stock Financing Facility

The Buffer Stock Financing Facility, which was established in June 1969, is to provide assistance to members with a balance of payments need related to their participation in arrangement to finance approved international buffer

stocks of primary products. Under the present guidelines, a member can have outstanding purchases under the facility of up to 45 per cent of quota.

Extended Fund Facility

The Extended Fund Facility, which was established in September 1974, is to make resources available, for longer periods and in larger amounts than under the credit tranche policies, to members that are experiencing balance of payments difficulties owing to structural imbalances in production, trade and prices, or that are unable to pursue active development policies because of their weak balance of payments positions. Ordinary resources are made available in instalments under extended arrangements to cover purchases up to 140 per cent of quota over a period of up to three years.

Temporary Facilities

Apart from the facilities described above, the members may sometimes make use of temporary facilities established by the Fund with borrowed resources. For example, for 1974 and 1975, following the sharp rise in oil prices, the fund provided assistance under a temporary *Oil Facilities* desingned to help members meet the increased cost of imports of petroleum products. Purchases under the facilities were completed in May 1976.

The *Supplementary Financing Facility* (SFF) was established in February 1979 to provide assistance to members facing payments difficulties that are large in relation to their economies and their Fund quotas. Resources under the facility, which are borrowed and therefore not a part of the Fund's ordinary resources, are made available only in connection with an upper credit tranche standby arrangement and an extended arrangement.

The Policy on Enlarged Access to the Fund's Resources, which mainly continues the policies of the supplementary financing facility following the full commitment of the latter's resources, became operational in May 1981. Resources are provided only under standby extended arrangements. The amount of assistance available to a member under the policy is determined according to the guidelines adopted by the Fund from time to time.

Repurchases of Purchases

Since the Fund's resources are of a revolving character to finance temporary balance of payments deficits members that purchase from the Fund must subsequently repurchase their currencies with the currencies of other members, or via SDRs. A member is required to repurchase holdings of its currency by the Fund that are subject to charges; these include holdings resulting from purchases of currencies or SDRs, other than reserve tranche purchases, and all adjusted Fund holdings that are in excess of 100 per cent of the member's quota. Members may repurchase at any time the Fund's holdings of their currencies that are subject to charges, but they are expected to repurchase the Fund's holdings of their currencies resulting from purchases if their

balance of payments and reserve positions improve. In any event they must make repurchases, irrespective of their balance of payments positions, in instalments within limits of 3 to 5 years for purchases under the credit tranche policies, the compensatory financing facility and the buffer stock financing facility; four-and-a-half to 10 years for purchases under the extended facility financed by ordinary resources; and three-and-a-half to 7 years for purchases under the oil facilities, the supplementary financing facility, and the policy on enlarge access to resources.

Conditionality

A country making use of the resources of the IMF is generally required to carry out an economic policy programme aimed at achieving a viable balance of payments position over an appropriate period of time. This requirement in known as conditionality and it reflects the principle that the balance of payments financing and adjustment must go hand in hand.

Conditionality is an essential element of the Fund's role in helping alleviate the balance of payments problems of member countries and facilitating the international adjustment process. Fund conditionality requirements, linking Fund financial assistance to the adoption of economic adjustments policies by members, seek to ensure that the member's policies are adequate to achieve a viable balance of payments position over a reasonable period. They are also a means of ensuring that the revolving nature of Fund resources is maintained.

Criticisms have been levelled from some corners on the fund conditionality. One important criticism, particularly in India, is that the conditionalities endanger the nation's sovereignty. Such criticism should, however, be evaluated in proper perspective. Conditionalities are not something peculiar to the IMF. Any responsible financial institution will lend only after satisfying itself about the repaying capacity of the borrower and it will impose conditions necessary to ensure proper utilisation of the loan and its repayment. It is very much true of the public sector financial institutions in India too. The IMF and World Bank cannot be exceptions to this long-standing, well-accepted, and sound financing principle. However, just as the rehabilitation package drawn up by the public sector financial institutions in India for sick units need not necessarily be the most appropriate one, the IMF-Bank prescriptions need not necessarily be the most appropriate ones. A nation should, of course, ensure that it does not accept any conditionality which harms its interests. At the same time, there is no reason to hesitate to take their assistance as and when required because they have been established to help needy member countries. In fact, it is the right of every member country to obtain legitimate assistance from these institutions. It may be noted that, although, in the past, communists had a tendency to describe IMF and World Bank as organs of capitalist imperialism, the communists countries have themselves come to seek large assistance from these institutions. China and Russia are now among the largest borrowers from the world bank.

It is neither desirable nor feasible to finance balance of payments deficits over a protracted period without reducing or eliminating the underlying causes. The Fund conditionality aims at reducing or eliminating such underlying causes. In fact, the Fund conditionality is subject to periodic reviews to make it appropriate to the changing situations.

The Fund's guidelines regarding conditionality:

(i) Provide for the phasing of purchases and include the injunction that objective indicators for monitoring performance—performance criteria—be limited to those variables necessary to ensure the achievement of the objectives of the programmes.

(ii) Emphasise the need to encourage members to adopt corrective measures at an early stage of their balance of payments difficulties.

(iii) Stress the necessity of paying due regard to members' domestic social and political objective, as well as their economic priorities and circumstances, including the causes of their balance of payments problems.

(iv) Provide for a flexible approach on the number and content of performance criteria, which may vary because of members' diverse problems and institutional arrangements.

(v) Stress that IMF arrangements are not contractual agreements with the member, but are instead decisions of the IMF that set out the conditions for financial assistance from the IMF.

An outline of the important points of conditionality attached to the different Fund facilities is given below:

First Credit Tranche Programme representing reasonable efforts to overcome balance of payments difficulties, performance criteria and instalments not used.

Higher Credit Tranches Transactions requiring that a member gives substantial justification of efforts to overcome balance of payments difficulties; resources normally provided in the form of standby arrangements that include performance criteria and drawings in instalments.

Extended Fund Facility Medium-term programme for up to three years to overcome structural balance of payments maladjustments; detailed statement of policies and measures for first and subsequent 12-month periods; resources provided in the form of extended arrangements that include performance criteria and drawings in instalments.

Compensatory Financing Facility Existence of either a temporary export shortfall for reasons largely beyond the member's control or a temporary excess in the cost of cereal imports; member cooperates with Fund in an effort to find appropriate solutions for any balance of payments difficulties.

Buffer Stock Financing Facility Contribution to an international buffer stock accepted as suitable by Fund; member expected to cooperate with Fund as in the case of compensatory financing.

Enlarged Access Policy For use in support of programmes under standby arrangement reaching into the upper credit tranches or beyond, or under extended arrangements, subject to relevant policies on conditionality, phasing, and performance criteria.

While conditionality is essential, the appropriateness of any particular set of conditionalities for a country needs to be carefully evaluated.

It has been observed that the IMF's conditionality has generally been monetarist and deflationary, obliging governments to reduce their demand for imports by curtailing overall demand—cutting back on both private and public spending. These cutbacks have often reduced consumption, investment and employment.

"An alternative strategy would have been adjustment with growth, which would have aimed more at promoting production, both to increase exports and to meet a higher proportion of local demand from local production. Although there have been indications of a change of IMF policy in this direction, there is as yet no well articulated agenda of reform."[1]

IMF supported programmes emphasise certain key aggregate economic variables, including domestic credit, public sector deficits, international reserves, and external debt. They also emphasise key elements of pricing system—including the exchange rate, interest rates, and, in some cases, the prices of commodities—that significantly affect the country's public finances and foreign trade, and the supply response of the economy.

During a standby or extended arrangement in support of a member's programme of reform, its performance is monitored through performance criteria, which are selected according to the economic and institutional structure of the country, the availability of data, and the desirability of focussing on broad macroeconomic variables, among other considerations. The IMF approach also embraces all aspects of economic policies that affect the supply of, and demand for, resources.

Buffer Stock Financing Facility Contribution to an international buffer stock accepted as suitable by Fund; member expected to cooperate with Fund as in the case of compensatory financing.

Enlarged Access Policy For use in support of programmes under standby arrangement reaching into the upper credit tranches or beyond, or under extended arrangements, subject to relevant policies on conditionality, phasing, and performance criteria.

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