12.2. International Monetary Fund (IMF)

In Bretton Woods Conference in July, 1944, it was decided by 44 nations that two international financial institutions would be established to solve the problems of international liquidity. These institutions would try to solve the multilateral trade problems among nations and to increase the co-operation among them. One institution was the International Monetary Fund (IMF) or simply the Fund and the other was the International Bank for Reconstruction and Development (IBRD) or the World Bank as it is popularly known. The IMF started its activities in 1945 with 44 member states. In July 1996, the number of its members was 181.

The IMF has a fund based on quotas allocated to its members. When a country joins the IMF, it is assigned a quota. This quota has 3 implications : (i) It determines the amount of subscription to be made by the member country. Higher the quota, higher is the subscription. Of this quota, 25% is to be paid in gold or any usable currency and the residual 75% in the currency of the member state. (ii) Higher the quota of the member country, higher will be its power to get loans from the IMF. (iii) Higher the quota of the member country, higher will be the value of its vote. The highest quota in the IMF is of the U. S. A. Naturally, the U. S. A. is the most powerful and influential member country in the IMF.

12.2.1. Organisation and Structure of the IMF

The Second Amendment of 1978 made important changes in the organisation and structure of the IMF. It has a three-tier structure. The main structure of the IMF consists of a Board of Governors, Executive Board and a Managing Director. The Board of Governors and the Executive Board are decision-making organs of the IMF. Their decisions are binding on the IMF and its members. The Board of Governors is constituted by taking one representative from each member state. The members of the Board of Governors meet once in a year. As a matter of practice, most of decision-making powers of the Board of Governors have been delegated to the Board of Executive Directors or the Executive Board. Hence, the Executive Board regulate all activities of the IMF. It is the most powerful organ of the Fund. The Executive Board has 22 members. Among them, six members or Executive Directors are appointed by six member countries having the largest quotas. These members are permanent members. The rest 16 members are elected at intervals of two years by the remaining member states. A Managing Director is elected from among the Executive Directors. He is the chief executive of the IMF. He is the non-voting chairman of the Executive Board. The head office of the IMF is situated in Washington.

12.2.2. Objectives of the IMF

The IMF was established with the following objectives :

(1) To promote international monetary co-operation ;

(2) To facilitate the expansion and balanced growth of international trade and thereby to maintain high employment ;

(3) To promote exchange stability and to avoid competitive exchange depreciation ;

(4) To establish multilateral exchange system and to eliminate foreign exchange restrictions ;

(5) To help the member countries to correct maladjustment in their balance of payments ;

(6) To expand capital movement in underdeveloped countries ; and

(7) To develop confidence among the member countries by rescuing them at the hour of crisis by giving monetary help.

12.2.3. Functions of the IMF

The IMF performs various functions keeping in view its objectives. We briefly mention them. (i) The IMF tries to promote international monetary co-operation. (2) It provides monetary help to the member countries to remove maladjustment in their balance of payments. (3) The IMF tries to promote exchange stability. It directs its member countries to avoid competitive exchange rate depreciation. (4) The Fund aims at reducing tariffs and other trade restrictions by member countries. It is the function of the IMF to have a surveillance of the policies being adopted by the member states. (5) The Fund provides technical advice to its member countries on monetary and fiscal policies. It also conducts short training courses on fiscal, monetary and balance of payments policies for personnel from member states. (6) The IMF provides technical experts to member nations suffering from balance of payments difficulties (7) The Fund conducts many research studies and publishes their results.

Among these functions, the most important function of the IMF is its financial help to member nations. The Fund has a variety of facilities for lending its resources. The notable among them is the special drawing rights. From economic standpoint, it is the most important aspect of the Fund. Each country's drawing right is determined by its quota. It has 5 parts. The first part is called Gold Tranche because it corresponds to the country's subscription in gold. The next 4 are called First, Second, Third and Fourth Credit Tranches. Any member country can automatically borrow from its Gold Tranche without much difficulty. Thereafter, drawing on the Fund depends on the approval of the Fund. The condition of approval becomes more and more stringent as a member country goes beyond its First Credit Tranche. Usually a country must repay the Fund within 3 – 5 years. There is an increasing rate of interest on drawings that go beyond the Gold Tranche.

12.2.4. An Evaluation of the Performance of the IMF

The IMF started its operation in December, 1947. Since then, the IMF has been helping its member countries for making adjustments in their balance of payments. Both the developed and the developing countries have been benefitted from the Fund. However, there are some **limitations of the activities of the IMF.** We summarize them one by one.

(1) The resource of the Fund is limited in relation to its need. With this limited resources, it is not possible to meet the need of all the member states, particularly of the less-developed countries. The Fund has failed to solve the balance of payments problem of the developing countries.

(2) Due to inequality in the distribution of quota, very few developed nations (specially USA) dominate over the policies of the IMF.

(3) Very often, the IMF interferes with the internal activities of a country in the pretext of the conditions of the loan taken by the country.

(4) The IMF has not been completely successful to eliminate different trade restrictions imposed by different member states.

(5) The Fund's attitude is very conservative. It imposes stringent conditions for lending to member countries and charges high rate of interest.

(6) To remove the fundamental disequilibrium in the balance of payments of the primary producing countries, the prices of their primary products should be stabilised first. But nothing concrete was done by the Fund in this respect.

(7) The initial aim of the IMF was to maintain stability in exchange rate. But the IMF failed to attain this goal. Hence, it was decided later that the member states may follow either fixed or flexible exchange rate. At present, most of the member states have opted for flexible exchange rates.

(8) During the first 20 years, the IMF was far from its goal of multilateral trade and payments without restriction. Most of the Latin American countries together with Spain followed multiple exchange rates for a long time. Free convertibility of currencies has also been checked by regional groups, such as, Sterling Block, European Union, etc.

(9) The IMF has not also been successful in eliminating foreign exchange restrictions which inhibit the growth of world trade. Today's world trade is hamperd by a variety of exchange controls.

(10) The Fund has been discriminatory in its policies against the developing countries and in favour of the developed countries. Hence, it is called "Rich countries' club."

(11) The Executitive Directors of the IMF are the political representatives, not the technical representatives. Hence, many decisions are taken on political grounds, not by economic or technical considerations.

In spite of these criticisms, the role of the IMF to promote international economic co-operation is great. Its importance is increasing day by day, particularly in less developed countries. To play a more active role, the IMF has introduced Special Drawing Rights (SDR) in 1970. The objective of the new scheme is to create new international reserves with the Fund. It aims at removing the shortage of international liquidity. As the SDR has no real entity, its supply can easily be increased with the increase in need. A member country participating in the SDR scheme is free to use its holding of SDRs to meet the deficit in her balance of payments. Thus, by introducing SDR, the IMF has ensured the supply of international liquidity. It has provided a fair amount of liquidity to the members. The normal drawing rights of members have been increased by the IMF from time to time. The Fund also allows stand-by arrangements. Now the SDR is a further addition to international liquidity. Thus, the IMF is now playing a vital role in the world economy as an international financial institution.

12.2.5. Problem of International Liquidity