What Do We Know About International Monetary Fund

Imf

Introduction:

We are all aware of the enormous difficulty that the Asian countries have been having in regard to their economies having large trade deficits and the devaluation of their currencies. Asia's crisis was classified as "The Great Asian Slump that is for the record books" ("Saving Asia it's time to get radical," 75) making the Latin America's crisis of 1995 look like a minor wobble.

Hong Kong announced that its economy shrank 2.8% in the first quarter of 1998. Economist forecast Indonesia's GDP to fall an overwhelming 15.1% this year. Comparing that to Americas worst post war recession when the economy shrank 2.1% ("Saving Asia, It's time to get radical," 75). This record-breaking crisis has had an enormous effect on our economy as well, and had to be handled as quickly and as painlessly as possible.

Therefore, the IMF had to step in and advise the nations on stabilizing their economies by restoring confidence in the currencies. As well as making their currencies look more attractive, which demanded increased interest rates, among many other actions that the IMF implemented.

However, there are always individuals who are for and against any actions taken in an attempt to resolve a certain predicament. As anywhere else, here we also find that there are some who feel that IMF did a very poor job at providing the right treatment for the 'wound', and yet others who content that IMF did the best that it could and in fact helped the "ailing tigers".

A Brief History of the IMF

In July 1944 the United Nations Monetary and Financial Conference met at Bretton Woods, New Hampshire, to find a way to rebuild and stabilize a world economy that had been severely devastated by World War II. One result of the conference was the founding of the International Monetary Fund (IMF) through the signing of its Articles of Agreement by 29 countries.

The stated purposes of the IMF were to create international monetary cooperation, to stabilize currency exchange rates, to facilitate the expansion and balanced growth of international trade, and to make its general resources temporarily available to its members experiencing balance of payments difficulties under adequate safeguards. There were 143 member nations in the IMF in the early 1980s. Most of the Communist countries, including the Soviet Union, did not join; and, of the Western nations, Switzerland has not participated (Compton's Interactive Encyclopedia, 1996). However there are now 182 members (www.imf.com, last updated August '98).

On joining the IMF, each member country contributes a certain sum of money called a quota subscription, as a sort of credit union deposit.

IMF appraises its members' exchange rate policies within the framework of a comprehensive analysis of the general economic situation and the policy strategy of each member. "The IMF

edubirdie.com

fulfills its surveillance responsibilities through: annual bilateral Article IV consultations with individual countries; multilateral surveillance twice a year in the context of its World Economic Outlook (WEO) exercise; and precautionary arrangements, enhanced surveillance, and program monitoring, which provide a member with close monitoring from the IMF in the absence of the use of IMF resources" (www.imf.org).

Total Fund Credit and

Outstanding

Furthermore, to achieve its goals, the Bretton Woods Conference stated a number of conditions with which member nations were required to comply. Each nation agreed to establish a par value for its currency; that is, the value of a unit of its currency would be fixed in relation to the dollar or to gold. This would prevent great fluctuations of national currencies in relation to each other. This part of the agreement was abandoned in 1971, when the United States removed the dollar from the gold standard. Currencies have since been allowed to float in value in relation to each other and in relation to the conditions of the world economy.

Member nations also agreed upon the principle of currency convertibility. Thus, if one nation owned the currency of another, it would be able to sell it back at par value.

eduzaurus.com

A third agreement was that member governments would contribute to the operating funds of the IMF according to the volume of their international trade, national income, and their international reserve holdings. Part of the contribution is in gold, the remainder in the nation's own currency. A nation may borrow funds against the gold portion of its contribution if it encounters financial difficulties due to an unfavorable balance-of-payments situation.

The IMF has other devices to assist members in balance-of-payments difficulties. The Standby Arrangements adopted in 1954 enable nations to negotiate lines of credit in anticipation of current needs. The General Arrangements to Borrow, instituted in 1961, provide standby credit for emergencies. The Compensatory Financing of Export Fluctuations, introduced in 1963, enables developing countries to cope with sudden drops in export receipts without injuring the country's economy through currency exchange restrictions.

The IMF makes its financial resources available to member countries through a variety of financial windows. Except for the Enhanced Structural Adjustment Facility (ESAF) drawings, which are loans and not purchases of other members' currencies, members benefit themselves of the IMF's financial resources by purchasing (drawing) other members' currencies or SDRs with an equivalent amount of their own currencies. The IMF levies charges on these drawings and requires that members repay their own currencies from the IMF over a specified time.

The Origin of the Crisis

The forthcoming of the crisis was for the most part unexpected due to the previously seen decades of outstanding economic performance in Asia. Nevertheless, the crisis unfolded rather rapidly and many place the blame on the weakness of the financial systems and governance. The combination of inadequate financial sector supervision, poor assessment and management of financial risk, and the maintenance of relatively fixed exchange rates led banks and corporations to borrow large sums of international capital. However, vast inflows can quickly

become huge outflows. “The five worst affected Asian economies (South Korea, Indonesia, Thailand, Malaysia, and the Philippines) received $93 billion of private capital in 1996. In 1997, you saw an outflow of $12 billion. This shift of $105 billion in one year was the equivalent of 11 percent of their combined gross domestic product. (“ A fix for the world markets”, 30)”

Although private sector expenditure and financing decisions led to the crisis, governance issues played a major role. Limited transparency, meaning lack of availability of fiscal accounting and economic data has made it very difficult for investors to obtain the information needed for investment expenditures.

In addition to the issues listed above, what furthermore intensified the crisis was the fact that the nations seeing all of elements that are comprising the crisis occur in their economies have lost confidence in their currencies and the financial institutions. However, what turned this bad financial situation into a catastrophe was the loss of confidence that turned into self-reinforcing panic.

Although, the world was shocked at the intensity of the crisis they - meaning the United Nations, the IMF and the affiliated countries began getting involved in order to start the recovery process as soon as possible. This aided Asia’s troubled markets from spreading their ‘virus’ onto the nearby, vulnerable markets and then to the apparently unconnected markets.

What did the IMF do?

Assessing the complex situation on the matter, the IMF had formulated a few propositions to help reestablish confidence in the affected countries. They are as follows:

eduzaurus.com