THE INTERNATIONAL MONETARY FUND

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Summary

The International Monetary Fund was formed to promote exchange rate stability and co-operation in macroeconomic policy-making. Initially exchange rates were fixed by the Fund, but since 1973 the major currencies have floated. The highest authority is the Board of Governors, in which every country is represented. Policy implementation is shared between the Staff and a small Executive Board. The number of votes held by the members in each Board is proportional to the size of their economies. This voting system is controversial, because legally a few rich countries can dominate the decision-making. An Interim Committee (since renamed the International Monetary and Financial Committee) was established in 1974, to provide a political forum for finance ministers.

The Fund's basic resources come from members' subscriptions, which are known as their quotas. Various facilities have been created to allow members to draw foreign exchange, when they face financial difficulties. In the 1960s, it was realized that the Fund's resources might be inadequate to handle a financial crisis for one of the larger members. As a result, the General Arrangements to Borrow were established, with ten of the larger countries providing supplementary resources. Following the financial collapse in South East Asia in 1997, the GAB were substantially extended as the New Arrangements to Borrow.

To gain access to resources, a government must submit an economic program for approval by the Executive Board. This conditionality has been highly controversial. Many governments, NGOs and UN bodies became increasingly critical from the mid-1980s of a rigid reliance on the free market model, described as the Washington consensus. The Fund started to adapt in the early 1990s by accepting the need for social safety nets and, in the late 1990s, a wider process of reform to tackle poverty and prevent crises was undertaken.

1. The Creation of the IMF

It is a measure of the importance attached to reform of the global economic system that the Allied Powers convened the International Monetary and Financial Conference in July 1944, more than a year before the end of the Second World War and even before the first multilateral discussion on the formation of the United Nations. This conference took place in a hotel in a remote part of New Hampshire, USA, called Bretton Woods. It produced both the Articles of Agreement of the International Monetary Fund and a similar document for the International Bank for Reconstruction and Development, which is now part of the World Bank. These two organizations, including the later additions to the World Bank, are often referred to jointly as the Bretton Woods Institutions. A third pillar, an International Trade Organization, was intended to support the new system of economic co-operation, but no such body was established until 1995. (See *The World Bank* and *The World Trade Organization*)

It was generally agreed that financial crises, competitive devaluations, trade wars and the Great Depression in the inter-war years had contributed to the rise of Hitler and hence to the Second World War. Each country – supposedly pursuing its own interests – damaged the common interest and failed to improve its own economy. As early as 1942, White in the USA and Keynes in the UK were circulating formal proposals for a post-war financial institution. These two men provided the main leadership and dominated the discussion right through to the signing of the IMF’s Articles. White’s main goal was to stabilize exchange rates between currencies, while Keynes wanted to promote international trade and full employment. The result was a powerful supranational institution, supervising stable exchange rates.

2. The Operation of the Gold Exchange Standard

It cannot be emphasized too strongly that the Fund created in 1944 and in operation until 1973 was totally different from the institution operating at the beginning of the twenty-first century. The intellectual and political context in which it operated was also totally different. In this first period of the Fund’s history, there was an overwhelming consensus that governments had a major role to play in the economy. They should promote full employment; inflation was of secondary significance; and fiscal and monetary policy should contribute to exchange rate stability. Free trade was a long-term goal, but not an immediate option, and the technology did not even exist to envisage the creation of global capital markets.

The initial exchange rate system was based on each government declaring the central par value of its currency. The US dollar was valued at $35 to one ounce of gold and all other currencies were similarly valued against gold. The dollar had a central role in the system, because of the overwhelming importance of the US economy at that time. In addition, the US government agreed it would in reality exchange dollars for gold at the par value, whereas other governments would not do so. For this reason, the system was known at the time as the gold exchange standard. Now it is more often described as an adjustable peg system. If economic problems meant that the currency could not be maintained within narrow margins, then the country concerned was supposed to seek the approval of the Fund for a change in its par value. Thus markets did not in any direct manner influence short-term or medium-term exchange rates. In the longer-term, market pressures could force a change, but the new rate was established by the government and the Fund.

Immediately after the Second World War, the system was not functioning effectively, because many countries were unable to allow their currencies to be freely convertible. The Articles of the Fund allowed for a transition period of restrictions on international payments and transfers, while post-war recovery to normal economic conditions was achieved. In December 1958, ten West European countries were able to announce that there would be no restrictions on the use of their currencies and in February 1961 eight of them took on the formal legal obligation with the IMF to maintain convertibility. As these eight included France and Britain, with each maintaining a currency union with their former colonies, both the majority of countries and the majority of world trade then came under the Bretton Woods financial system.

The system that had taken so long to bring into operation did not last for very long. Gradually market pressures challenged the valuation of gold at $35 per ounce and the par values of individual currencies: eventually the whole system came under threat. In October 1961, eight central banks agreed to form a Gold Pool, to defend the price of gold on the private markets. Soon afterwards, worries that the IMF would not be able to respond to one of the major countries facing financial difficulties led to the creation of the General Arrangements to Borrow (GAB). Ten countries – Belgium, Canada, Germany, France, Italy, Japan, Netherlands, Sweden, UK and USA – agreed in January 1962 to provide up to $6 bn in supplementary resources to the Fund. Switzerland also contributed from June 1964 and formally joined the GAB in April 1984.

Successive waves of speculation affected the major currencies throughout the 1960s. In November 1967, sterling was devalued from $2.80 to $2.40 to the pound. This was of great significance as sterling had a status close to that of the dollar, with more than forty other currencies tied to the pound in the Sterling Area. In March 1968, the price of gold in the private markets could no longer be kept down and a two-tier system was created, with the official price of gold for intergovernmental transactions maintained at $35 while the market price spiraled upwards. The French franc was devalued in August 1969 and the Germans were forced to float the Deutschmark in September 1969, for four weeks, before fixing at a higher par value. Finally in August 1971 the US Treasury announced that they were no longer willing to exchange dollars for gold. Attempts were made to find a new defensible set of exchange rates, with four months of negotiations culminating in an agreement reached at the Smithsonian Institution in December. As a result, the dollar was effectively devalued, in May 1972, by changing the dollar price of gold. The new par values could not be maintained. In mid-February 1973 a second devaluation of the dollar quickly resulted in all the major currencies floating, with exchange rates determined by the markets. The whole Bretton Woods gold exchange system had been abandoned.

3. The Membership of the IMF

At the time of the inaugural meeting of the Board of Governors in March 1946, the Fund had 38 members. The numbers increased thereafter broadly in line with the increase in the membership of the UN. By the end of 2000, there were 183 members, consisting of Switzerland and all the members of the UN, except two communist countries (Cuba, North Korea) and four micro-countries (Andorra, Liechtenstein, Monaco and Nauru).

While it is a requirement for membership of the World Bank that a country should be a member of the Fund, there is no formal link to UN membership. Indeed, there have been some significant differences. There have always been some UN members that are not members of the Fund. The Soviet Union participated fully in the Bretton Woods conference, signed the Final Act and attended the inaugural meeting, but never proceeded to join the Fund. As a result of the Cold War virtually all the communist governments remained outside the IMF until the 1990s. Czechoslovakia, which had been a founder member, changed its par value unilaterally in June 1953 and, as a consequence of the disputes this generated, was expelled from the Fund in January 1955. Cuba also had been a founder member, but, following a period of dispute, withdrew from the Fund in April 1964. Many former colonial territories delayed several years after independence before they joined the Fund. On the other hand, some countries that were not UN members have long been members of the Fund. West Germany joined the IMF in August 1952, but was not able to join the UN until September 1973. Similarly, South Korea joined the IMF in August 1955 and South Vietnam in September 1956. Switzerland joined in May 1992, but still remains outside the UN.

The Articles of the Fund are unusual in specifying the members must be ‘countries’, a term that has no legal significance, but must be assumed to mean ‘states’. Major transnational corporations and other financial entities cannot engage in financial transactions with the Fund or use its resources in any way. It is clearly an intergovernmental organization. Difficult questions may arise about the membership of the countries of the European Union that use the Euro as their currency. Initially, in January 1999, at the start of the transition period to create the Euro, the European Central Bank was granted observer status at the IMF.

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www.imf.org [The official website of the IMF, containing documents, research papers and news releases.]

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www.oneworld.org [A gateway, giving access to many NGOs concerned with the IMF.]

Biographical Sketch

Peter Willetts has a personal chair as a Professor of Global Politics at City University, London. He has written two books on the Non-Aligned Movement, two books on NGOs and many articles or book chapters both on NGOs and on aspects of the UN system. In 2000, he was funded for two years by the UK Department for International Development to study what procedures might provide formal participation rights for NGOs at the IMF and the WTO.