6.1 INTRODUCTION

This sixth Chapter, being the concluding Chapter of the Thesis, brings together the conceptual and analytical strands in the preceding Chapters and presents certain meaningful conclusions about the IMF’s role in strengthening the international monetary system and maintaining the international liquidity during the study period from 2001 to 2007 AD.

6.2 INTERNATIONAL MONETARY FUND (IMF)

6.2.1 The Institution

The representatives of 44 countries that gathered for the United Nations Monetary and Financial Conference in the little resort town of Bretton Wood in New Hampshire in the USA in July, 1944, reached two important agreements: one recommended the establishment of an International Monetary Fund (IMF) and the other called for the establishment of an International Bank for Reconstruction and Development (IBRD - the World Bank). Both the agreements have been recorded in history as important milestones in international economic cooperation.

By 2007, the IMF had 185 member countries, had bailed so many countries (including India) out of the balance of payment crises, trained an army of financial bureaucrats worldwide in detecting the looming crises and avoiding them, and done so many other things for maintaining international liquidity and international financial flows from one country to another, and also had done remarkable work in helping highly indebted poor countries to bring about their dilapidated economies to the functional level. The IMF’s celebrated motto is “Making the Global Economy Work for All”.

The highest decision-making body of the IMF is the Board of Governors, which is appointed by the member countries. Some of the Board of Governor’s powers are delegated to the Fund’s Executive Board, which is composed of 24 Executive Directors, who are appointed or elected by the member countries.

The Board of Governors consists of one governor and one alternate governor from each of the IMF’s 185 member countries. The governor is usually the member country’s minister of finance or the head of its central bank. All governors meet once a year at the IMF-World Bank Annual Meetings.
There are two committees of governors that represent the whole membership. The International Monetary and Financial Committee (IMFC) is an advisory body composed of 24 IMF governors (or their alternates) representing the same countries or constituencies (groups of countries) as the 24 Executive Directors. The IMFC normally meets twice a year, in March or April and at the time of the Annual Meetings in September or October. Its responsibilities include providing guidance to the Executive Board and advising and reporting to the Board of Governors on issues related to the management of the international monetary system.


The day-to-day work of the IMF is conducted at its Washington, D.C., headquarters by its Executive Board; this work is guided by the IMFC and supported by the IMF’s staff. The Managing Director is the Chairman of the Executive Board and head of the IMF staff; he is assisted by a First Deputy Managing Director and two other Deputy Managing Directors. The Executive Board has a central role in policy formulation and decision-making in the IMF, and exercises all the powers for conducting the institution’s business, except those that the Articles of Agreement reserve for the Board of Governors or the Managing Director. The Board meets in “continuous session,” that is, as often as the business at hand requires, usually for three full days each week.

The IMF’s Board of Governors is accountable to the International Monetary and Financial Committee as well as the Joint IMF-World Bank Development Committee. The Board of Governors supervises over the Executive Board, which, in turn, obtains the needed feedback from the Independent Evaluation Office. The Managing Director and the Deputy Managing Directors, while reporting to the Executive Board, also supervise over the Offices of Staff Retirement Plan Investment, Budget and Planning, Internal Audit and Inspection, and Technical Assistance Management. Further downwards, the IMF’s organization is divided into various Departments, broadly classified as Area Departments (Africa, Asia & Pacific, Europe, Middle East & Central Asia, and Western Hemisphere), Functional and Special Services Departments (Special Drawing Rights, Fiscal Affairs, Law, Monetary and Capital Markets, Policy Development & Review, Research, Statistics, and the IMF Institute), Information and Liaison Departments (External Relations, and IMF Office at the United Nations), and Support Services Departments (Human Resources, IMF’s Secretary, and Technology and General Services).

6.2.2 Purpose and Organization

The IMF is an international organization of 185 member countries, established to promote international monetary cooperation and exchange stability and to maintain orderly exchange arrangements among members; to facilitate the expansion and balanced growth of international trade, and contribute thereby to the promotion and maintenance of high
levels of employment; and to provide temporary financial assistance to member countries under adequate safeguards to assist in solving their balance of payments problems in a manner consistent with the provisions of the IMF’s Articles of Agreement.

The IMF conducts its operations and transactions through the General Department and the Special Drawing Rights Department (the SDR Department). The General Department consists of the General Resources Account (GRA), the Special Disbursement Account (SDA), including the Multilateral Debt Relief Initiative-I Trust (MDRI-I Trust), over which the SDA has substantial control, and the Investment Account.

The IMF also administers trusts and accounts established to perform financial and technical services and financial operations consistent with the purposes of the IMF. The resources of these trusts and accounts are contributed by members or the IMF through the SDA.

6.2.3 Special Drawing Rights (SDRs)

The Special Drawing Right (SDR) is an international interest bearing reserve asset created by the IMF following the First Amendment of the Articles of Agreement in 1969. All transactions and operations involving SDRs are conducted through the SDR Department. The SDR may be allocated by the IMF, as a supplement to existing reserve assets, to members participating in the SDR Department. Its value as a reserve asset derives, essentially, from the commitments of participants to hold and accept SDRs and to honor various obligations connected with its proper functioning as a reserve asset.

The SDR is also used by a number of international and regional organizations as a unit of account or as the basis for their units of account. Several international conventions also use the SDR as a unit of account, notably those expressing liability limits for the international transport of goods and services.

Members and prescribed holders can use and receive SDRs in transactions and operations by agreement among themselves. Participants can also use SDRs in operations and transactions involving the General Resources Account, such as the payment of charges and repurchases. By designating participants to provide freely usable currency in exchange for SDRs, the IMF ensures that a participant can use its SDRs to obtain an equivalent amount of currency if it has a need because of its balance of payments, its reserve position, or developments in its reserves.

6.2.4 IMF Institute

The IMF Institute offers courses and seminars for officials from member countries in four core areas - macroeconomic management in general, policies related to the financial sector, the budget, and the balance of payments, including how to strengthen the statistical, legal, and administrative framework in these areas. Close to 80 percent of the training benefits low-income countries. The training is delivered by Institute staff or by staff from other IMF departments, occasionally assisted by outside academics and experts at IMF headquarters in Washington, D.C., and at various overseas locations. In recent years, the Institute programmes have accounted for about three-fourths of all training for officials delivered by the IMF, including training delivered by the regional technical
assistance centers located in Austria, Brazil, China, Singapore, Tunisia, and the United Arab Emirates.

6.3 IMF’s Role in Strengthening International Monetary System (2001-2007)

6.3.1 FY 2001

During FY 2001, the IMF made progress on a range of initiatives launched over the past several years to strengthen the architecture of the international monetary system and also to strengthen the IMF as a centre of excellence for the stability of the international monetary system. Among the major steps taken towards strengthening the IMF’s operations were:

• further increasing the transparency of the IMF’s operations and policy deliberations and of its members’ economic policymaking and data;
• moving beyond the pilot phase of the Financial Sector Assessment Programme (FSAP) - the joint IMF-World Bank programme designed to help strengthen member countries’ financial sectors - with the goal of covering about 24 countries each year;
• taking steps to improve the IMF’s analytical framework for assessing countries’ external vulnerability to financial crisis, developing a framework for evaluating the adequacy of reserves, and with the World Bank, developing guidelines for both public debt and foreign exchange reserves management;
• establishing a new International Capital Markets Department to improve the IMF’s understanding of international financial markets and financial flows;
• establishing a Capital Markets Consultative Group as a channel for regular, informal and constructive dialogue with private sector representatives;
• moving forward with assessments of offshore financial centers and, at the request of the International Monetary and Financial Committee and in collaboration with the World Bank, enhancing the IMF’s contribution to international efforts to combat money laundering.

Further, a framework for the involvement of the private sector in crisis prevention and management had already been agreed in the previous year. The IMF subsequently gained experience in the practical issues involved in applying the framework in financial crises. Work also advanced on two issues that have a bearing on the development of the framework - restructuring international sovereign bonds and corporate sector workouts.

6.3.2 FY 2002

During FY 2002, IMF’s Board discussed two main aspects of strengthening its own capacity to assist members to resolve crises. First, it examined how to help members cope with difficulties, when they arise, of maintaining their access to capital markets in a fashion that also maintains the stability of the international monetary system.
Second, in relation to extreme cases when a member needs to restructure its financial obligations, the IMF investigated frameworks for sovereign debt restructuring that would lead members to be more inclined to approach their creditors at an early stage, before delay destroys the value of the credit and increases the scale of economic disruption. At the same time, it was also recognized that care should be taken in the design of a new framework to avoid inducing countries to look to default as an easy way of avoiding needed adjustments.

Another key area of work to strengthen the international monetary system - the international effort against money laundering - took on heightened importance in the wake of the events of September 11, 2001. Those events prompted a reexamination at national and international levels of mechanisms to promote and enforce laws combating not just money laundering but also the financing of terrorism. In this connection, the IMF discussed how it should intensify its contribution to these international efforts, and work advanced on several fronts.

It was further agreed that a key element in combating money laundering and terrorism financing was more effective information-sharing and cooperation among national authorities and international agencies. The country governments were called upon to create mechanisms to enable collection and sharing, including cross-border sharing of financial information with appropriate supervisory and law enforcement authorities. It was stressed that the primary responsibility for enforcement of anti-money laundering and anti-terrorism financing measures would continue to rest with national authorities.

6.3.3 FY 2003

During FY 2003, the IMF's board discussed and endorsed a new framework for judging debt sustainability. The new framework provides a reality check on the baseline projections on the basis of which sustainability is assessed, by clarifying the underlying assumptions regarding key variables, including growth, real interest rates, exchange rates, and primary fiscal or external imbalances, and by highlighting their implications. It introduces a set of standardized parameters for stress-testing the programme baseline, to identify the extent to which sustainability hinges on the assumption of a macoeconomic outcome more favourable than experienced in the past and to help ensure the robustness of the programme in the face of plausible shocks.

It was noted that the assessments of sustainability are necessarily based on judgement, given that they depend upon a complex assessment of the interrelationships among several factors - macroeconomic developments, political and social constraints on adjustment, and the availability and cost of private and official financing. The new framework helps strengthen the analytical basis for making these judgements. It does not provide a mechanistic approach, which would be inappropriate given the wide variation in the debt-bearing and adjustment capacities of different economies over time. Rather, it is framework for informing these judgements and expressing them in a transparent manner. As greater experience is gained, efforts will continue on further refining the framework.

The IMF has also been engaged in an active debate on how best to deal with the
relatively rare cases in which sovereign debts have become unsustainable. The challenges to a successful restructuring are several. Sound macroeconomic and structural policies are clearly critical. Transparency and predictability in restructuring process are also important, to permit better-informed due diligence and decision-making, and ease the task of achieving adequate intercreditor equity. Another challenge is effective collective action by creditors. In particular, there is a danger that individual creditors will decline to participate in a voluntary restructuring in the hope of recovering payment on the original contractual terms, even though creditors, as a group, would be best served agreeing to a restructuring.

The IMF has been working with its members and other representatives of the international financial community on possible approaches to improving the framework for the resolution of sovereign restructuring cases, and in particular on:

- The inclusion of collective action clauses (CACs) in sovereign bond contracts,
- The establishment of a statutory framework through a sovereign debt restructuring mechanism (SDRM).

These approaches could be complemented through the development of a voluntary code of conduct, that is, a set of standards for transparency and best practices, that could help guide the conduct of the debtors and their creditors across a broad spectrum of circumstances, ranging from relative tranquility to acute stress. The IMF welcomed the private and public sector initiatives in this area and supports their development. It is clear, in this context, that a code could be effective only to the extent that it is able to attract broad support among the debtors and their creditors.

In July 2002, the IMF’s board discussed proposals to advance the IMF’s contribution to international efforts to combat money laundering and the financing of terrorism (AML/CFT). The IMF had begun a new chapter in its work on this subject by taking two key steps:

- conditionally adding the Financial Action Task Force (FATF) 40 Recommendations and the 8 Special Recommendations (FATF +40+8) to the list of areas and associated standards and codes useful to the operational work of the IMF; and
- endorsing a 12-month pilot programme of AML/CFT assessments and accompanying ROSCs that would involve participation of the IMF and the World Bank, the FATF, and FATF-style Regional Bodies (FSRBs).

A 12-month pilot programme of AML/CFT assessments was initiated in October 2002, with the participation of the IMF, the World Bank, FATF and many of FSRBs. The Fund and the Bank undertook the assessments of the FATF 40+8 in the context of the FSAP. The assessments are identifying weaknesses in AML/CFT regimes, and technical assistance has been significantly stepped up in response.

### 6.3.4 FY 2004

During FY 2004, the IMF focused on improving its analytical tools for the early identification of vulnerabilities, including in the financial sector, sharpening its focus on
balance sheet weaknesses in the context of large and volatile international capital flows, and looking at accounting issues related to public investment.

In FY 2003, debt sustainability assessments based on the standard framework were progressively introduced and became routine in connection with requests for use of Fund’s resources under the General Resources Account and Article-IV consultations with countries with significant market access. It was agreed that sustainability assessments had, on the whole, contributed to more realistic projections of debt dynamics. Agreeing that debt sustainability assessments should become an integral part of the analyses underlying staff reports, it was noted that further improvements might be needed. It underscored the importance of continued efforts to ensure technical understanding of the framework by markets and country authorities and of engaging the latter fully in discussing debt sustainability assessments.

The IMF, together with the World Bank, also helped to support further international cooperation on trade, including through stepped-up surveillance of trade policies, especially in countries whose trade policies are of fundamental importance to the world trading system, with focus on increasing market access.

Efforts to strengthen the analytical underpinnings of financial system stability assessments are supported by the IMF’s ongoing work to develop Financial Soundness Indicators (FSIs), which are used to assess the soundness of financial institutions and identify vulnerabilities in the corporate and household sectors that may pose risks to the stability of the financial system. In June 2003, the IMF’ Executive Board endorsed further work to encourage the compilation and dissemination of FSIs and to develop their role in financial stability analysis. FSIs were considered to be a key tool that enhances the overall effectiveness of IMF’s surveillance, increases the transparency and stability of the international financial system and strengthens market discipline. It was also noted that the FSIs differed from country to country because of differences in accounting and bank supervision practices and varying levels of financial sector development, but the convergence towards internationally-accepted accounting standards should result in greater data comparability.

In its March 2004 review of the 12-month pilot programme of AML/CFT assessments jointly undertaken by the IMF and the World Bank, the IMF’s Board endorsed the 40+8 Recommendations of the Financial Action Task Force (FATF) as the new, expanded standard for AML/CFT assessments. The Board decided to expand the IMF’s AML/CFT assessment and technical assistance work to cover the full scope of the expanded recommendations. It was noted that the pilot programme had achieved its initial goals. It had led to a considerable deepening of international attention to AML/CFT issues and to the provision of substantial technical assistance in this area. It was encouraging to note that most jurisdictions had responded positively to the assessments. The IMF’s board welcomed the heightened awareness among jurisdictions of the need for some legislative and institutional frameworks in this area and emphasized that the key element of raising global compliance with the FATF standard is the delivery of technical assistance.
6.3.5 FY 2005

In February 2005, the IMF’s Directors Board endorsed the **trade policy agenda and policy positions**. They reaffirmed the importance of successfully concluding the Doha Round of multilateral trade negotiations to promote efficiency and growth, reduce poverty and support the achievement of the Millennium Development Goals. Developed countries had a critical role to play in addressing the remaining impediments to trade by removing restrictions to exports from developing countries, reducing tariff escalation, and cutting agricultural and other subsidies. Developing countries, for their part, had to commit to further trade liberalization.

With regard to the IMF’s work in providing financial support for member countries’ adjustment and reform programmes, the IMF welcomed the recent reduction in trade conditionality, which was due to, among other things, the general streamlining of the IMF’s structural consolidation and the adoption of more open trade policies by many countries. Also endorsed was the IMF’s recent emphasis on trade-related macroeconomic vulnerabilities, which remained a pressing issue for the poorest countries with IMF-supported programmes, together with the introduction of the Trade Integration Mechanism (TIM) as a means of dealing with this issue.

In March 2005, the IMF looked forward to further reflection on how the needs of members could be met through Fund arrangements, and whether new instruments or revisions to existing facilities were needed. Many directors felt that further progress needed to be made toward reaching clearer understanding on the appropriate circumstances and scale of IMF lending, a number of directors stressed the importance of specifying eventual exit strategies from IMF financial support. They also exchanged views on instruments that could meet the needs of members who wished to signal their adherence to sound policies or that could provide a degree of insurance against potential crises. Regarding the appropriate role of the IMF in helping to resolve financial crises, there was recognition of the role of market-based mechanisms as well as interest by a number of directors in a clearer and more consistent role for the IMF in **sovereign debt restructuring** and assessment of the adequacy of the instruments available for this purpose.

6.3.6 FY 2006

FY 2006 was a period of remarkably resilient global expansion, but one in which the downside risks to future growth increasingly engaged the attention of policymakers. As such, it provided the IMF with an opportunity to sharpen the focus of its work and reorient its role in the modern global economy.

During FY 2006, the IMF continued to urge its member countries to adopt policies that would foster macroeconomic stability, raise growth and promote higher living standards, and help reduce poverty. Given the global environment, the IMF also made the case for preemptive action, to take full advantage of the window of opportunity presented by the expansion.
The IMF continued its efforts to help low-income countries achieve more rapid growth and poverty reduction, introducing a new facility to help low-income countries deal with exogenous shocks, and also a new Policy Support Instrument designed to help low-income countries that do not want or need financial support enjoy the benefits of IMF endorsement of their policy programmes.

The prolonged global economic expansion brought other challenges for the IMF. The absence of financial crises in recent years is, of course, an unambiguously positive development - attributable partly to policy improvements in recent years, at the national and international levels, to which the IMF has contributed. But the benign global economic environment enables member countries and the IMF itself to press ahead with further measures that can mitigate the impact of any future crises and reduce the vulnerability of the international economy, as a whole.

6.3.7 FY 2007

The common thread running through the IMF’s activities in FY 2007 was the continued acceleration of globalization, the greatest challenge facing both the IMF and its members in the early-21st century. With this challenge in mind, the IMF made considerable progress toward key objectives set forth in its Medium Term Strategy (MTS) - strengthening and modernizing surveillance, seeking new ways to support emerging market countries, deepening IMF’s engagement with low-income countries, reforming governance and strengthening internal management to make the IMF a more efficient and effective institution, and placing the IMF’s finances on a sustainable footing.

In FY 2007, the IMF considered ways to strengthen its support for emerging market economies. Given their growing reliance on international capital flows, the deepening of financial sector and capital market surveillance would have particular relevance for these economies’ crisis prevention efforts. The IMF also explored the ways to deepen its engagement with low-income countries, in collaboration with the World Bank, while focusing on helping them to achieve macroeconomic stability and accelerate growth, the areas in which the IMF is best equipped to assist as these countries strive to reduce poverty and achieve the Millennium Development Goals.

The IMF has consistently underscored the importance of financial soundness indicators (FSIs) in facilitating financial sector surveillance, increasing the transparency and stability of the international monetary system and strengthening market discipline. After developing a core set and an encouraged set of FSIs in consultation with the international community, the IMF launched a 3-year pilot Coordinated Compilation Exercise (CCE) to (i) build the capacity of 62 participating countries to compile FSIs, (ii) promote cross-country comparability of FSIs; (iii) coordinate efforts by national authorities to compile FSIs; and (iv) disseminate the FSI data compiled in the CCE, to increase transparency and strengthen market discipline. Many countries also regularly compile and disseminate FSIs on their own, and these indicators are included in their FSAP documents.
6.4 IMF’S SURVEILLANCE IN ACTION (2001-2007 AD)

In accordance with Article-IV of its Articles of Agreement, the IMF oversees the international monetary system to ensure its effective operation. The IMF also oversees that each member country complies with its obligations under Article-IV “to collaborate with the IMF and others to assure orderly exchange arrangements and to promote a stable system of exchange rates”. The IMF discharges these responsibilities partly by monitoring economic developments and policies in its 185 member countries. It also monitors economic and financial developments at the global level. The IMF’s overseeing of policies and economic developments at the global, country and regional levels is known as ‘surveillance’. It is an elaborate three-part procedure, termed as ‘global surveillance’, ‘country surveillance’ and ‘regional surveillance’.

The IMF’s Executive Board conducts global surveillance through its reviews of world economic and financial market developments and prospects. Twice a year in each case, these reviews are based on the IMF staff’s World Economic Outlook (WEO) report and issues of the Global Financial Stability Report (GFSR), which are published, together with a summing up of the Executive Board’s discussion, ahead of the semi-annual International Monetary and Financial Committee (IMFC) meetings. The WEO reports provide analysis of global, regional and national economic prospects and policies, and the GFSR analyzes developments and risks in international capital markets.

Through Article-IV consultations individually with member countries, the IMF seeks to identify policy strengths and weaknesses, indicate potential vulnerabilities and advise countries on appropriate corrective actions, if needed. Article-IV consultations also examine the cross-border effects of countries’ economic conditions and policies, particularly for systemically or regionally important member countries. This is known as country surveillance.

The IMF has recently been putting more emphasis on the regional surveillance to draw common policy lessons and capture cross-country spillovers. In addition to the Executive Board discussions of the policies of four currency unions - the Eastern Caribbean Currency Union, the euro area, the Central African Economic and Monetary Community, and the West African Economic and Monetary Union, the IMF area departments also produce Regional Economic Outlook Reports for sub-Saharan Africa, Asia and the Pacific, Europe, the Middle East and Central Asia and Latin America and the Caribbean.

6.4.1 FY 2001

At its September 2000 meeting, the IMF’s Board observed that the policymakers worldwide faced important, though widely varying, challenges. The advanced economies had to continue efforts to facilitate an orderly rebalancing of growth and demand across the three main currency areas. In some advanced economies, a further tightening of macroeconomic policies might be needed to reduce the risks of overheating, particularly if higher energy prices fed through to underlying inflation; in others, where there were margins of slack, macroeconomic policies had to continue to support recovery. More broadly, it was stressed that progress with structural reforms had to continue in most
advanced, and almost all developing, countries so as to strengthen prospects for sustained economic growth.

In April 2001, the IMF’s Board of Directors agreed that the prospects for global growth had weakened significantly led by a marked slowdown in the US, a stalling of the recovery in Japan, and a slowing of growth in Europe and in a number of emerging market countries. It was mostly agreed that the outlook remained subject to a considerable uncertainty and that a deeper and more prolonged downturn was possible. Hence, it was emphasized that the extent of the slowdown would be affected by policy decisions by all countries. In view of the prevailing fragility of external financing conditions, prospects in emerging markets depended critically on maintaining investor confidence. For these countries, the IMF underscored the need to maintain prudent macroeconomic policies and to press ahead with corporate, financial and institutional reforms.

Given the change in the global economic outlook, the IMF felt that it was particularly important to it, in its dialogue with member countries and through multilateral surveillance, to continue to support actively the implementation of policies that promote economic stability and prosperity.

6.4.2 FY 2002

In September 2001, the IMF’s Board agreed that prospects for global growth had weakened since May 2001. Slower GDP growth in almost all regions had been accompanied by a sharp decline in trade growth. Financing conditions for emerging markets had also deteriorated, although it was encouraging that the effects of contagion had been more moderate than in preceding episodes.

In December 2001, the IMF’s Board discussed the impact of the September 11 attacks on the world economy and observed that before the attacks, there appeared to be a reasonable prospect for recovery in late-2001. However, more recent data indicated that the situation before the attacks was weaker than had earlier been projected in many areas, including the US, Europe and Japan. It was concluded that the tragic events of September 11 had exacerbated an already very difficult situation for the global economy.

There had been a marked improvement in global economic prospects by the time of the IMF Board’s March 2002 discussions. The Board welcomed the increasing signs that since December 2001, the slowdown had bottomed out and that a global recovery was under way. Financial markets had bounced back strongly after the September 11 shock, commodity prices had begun to pick up, and emerging market financing conditions had strengthened markedly.

6.4.3 FY 2003

At its September 2000 meeting, the IMF’s Board noted that economic and financial market developments had been mixed. Negative developments had occurred on several fronts, including the sharp decline in global equity markets since the end of March, 2002; the deterioration in financing conditions facing most emerging market borrowers; and weaknesses in a number of current and forward-looking indicators of the US, Europe and several other regions. These developments were especially disappointing in the light
of the strengthening of several global economic indicators, including trade and industrial production, seen since the end of 2001, as well as the first-quarter growth that exceeded expectations in several regions.

In March 2003, the IMF’s Board noted that the pace of the global recovery had slowed down amid rising geopolitical uncertainties related to Iraq, the continued adverse effects of the fallout from the bursting of the equity market bubble and rapidly changing conditions. It was underscored that policymakers would need to remain vigilant to changing circumstances and be flexible and ready to adapt to them as events unfold. Close international cooperation and dialogue and concerted efforts would be required to confront global uncertainties and boost global confidence. It was considered that a strong push to advance the multilateral trade negotiations under the Doha Round should be a key ingredient of such efforts.

6.4.4 FY 2004

In August 2003 discussions, economic data in some countries and forward-looking indicators, particularly in financial markets, pointed to a strengthening of global growth in the second half of 2003 and 2004 and there were prospects for a gradual, albeit moderate, recovery. Given this environment, the Directors called for macroeconomic policies to remain appropriately supportive and for reinvigorated structural reform efforts to strengthen confidence and reduce vulnerabilities over the medium term. In particular, monetary policies in industrial countries should remain supportive for the time being, and with inflationary pressures being very moderate, it was considered that most regions had scope for further monetary easing if the recovery faltered or inflation significantly undershot policy objectives.

The nascent recovery apparent in mid-2003 had begun to spread by the time of the IMF Board’s second meeting in March 2004. The Directors welcomed the strengthening and broadening of the global economic recovery, noting especially rapid upturns in the US and emerging Asia; a sharp pickup in industrial production and global grade; strengthened business and consumer confidence; and positive investment growth in most regions. It was emphasized that the relatively benign economic outlook provides an advantageous window of opportunity to address vulnerabilities. In particular, efforts to restore sustainable medium-term fiscal positions should be pursued vigorously. In addition, for emerging market and other developing countries, the priority should be to address remaining public debt sustainability concerns through tax reforms to reduce revenue volatility, steps to strengthen fiscal institutions, and measures to improve the structure of debt.

Turning to emerging market and other developing countries, the IMF’s Directors welcomed the recovery, which had been aided by improved fundamentals, strong private capital inflows, and historically low spreads. GDP growth was expected to strengthen in most regions, although the outlook, particularly in countries where public debt remains high, could be affected by a deterioration in external financing conditions, for example, as a result of an abrupt or unexpected increase in interest rates.
In view of the rapid growth and increasing sophistication of the activities of local institutional investors involved in both local and international markets, it was observed that it would also be important to persevere with strong efforts to enhance the risk-management skills of both investors and regulators.

6.4.5 FY 2005

In September 2004 discussions, the Directors welcomed the strengthening of global financial stability. The combination of broadening global economic growth and low inflation expectations had created a favourable environment for financial markets. Strong economic growth had boosted corporate and banking sector earnings, facilitated further balance sheet strengthening, and improved credit quality. At the same time, subdued inflationary pressure had contributed to stability and relatively low yields in the major bond markets. This had also benefitted emerging markets, boosting their growth prospects and credit quality and facilitating the availability of external financing at relatively low cost.

In discussing world financial markets in March 2005, the IMF’s Executive Board welcomed the further strengthening of the financial system in the preceding six months, supported by solid global economic growth and continued improvements in the balance sheets of the corporate, financial and household sectors in many countries. Prospects for continued financial stability were based on the still favourable outlook for the world economy and the growing financial market sophistication that had helped spread risk.

To enhance global financial stability and mitigate potential risks, the IMF’s Directors considered a number of steps; in particular, the need for cooperative efforts and credible policy measures to enhance the market’s confidence that global imbalances would be reduced in an orderly manner. Emerging market country authorities should continue to adopt prudent macroeconomic policies that reduce financing needs, while taking advantage of the prevailing benign conditions to fulfill their external financing requirements, improve the structure of their debt, and press ahead with efforts to develop local financial markets. In addition, structural reforms to enhance growth prospects remained a critical avenue for reducing debt-to-GDP ratios to more manageable levels.

6.4.6 FY 2006

In August 2005, it was observed that the configuration of solid growth, low inflation, low bond yields, flat yield curves, and tight credit spreads were contributing to the resilience of the global financial system. Furthermore, the much-improved balance sheets of the sovereign, corporate and household sectors, together with structural changes such as the growing importance and diversity of institutional investors, were providing an important cushion to financial markets. However, although near-term risk had been reduced, potential vulnerabilities, mainly in the form of larger global imbalances and higher debt levels, had been stored up for the medium term.

Emerging financial markets had become increasingly resilient, but it was cautioned that the positive global economic environment might be masking underlying vulnerabilities in some countries. The IMF’s Board took note of the ongoing broadening of the investor
base for emerging markets and the extension of investor interest into local instruments. The Board also welcomed improvements in the balance sheets of key sectors in mature market economies. Indicators of market and credit risk and financial strength underscored the resilience of the banking and insurance sectors in both mature and emerging markets.

In April 2005, while cyclical changes could well expose weaker segments and pockets of financial markets, it was considered that these were unlikely to pose systemic risks. The market regulators were mostly urged to pursue a ‘no-bail-out’ policy to contain risks of investor complacency. Broadly, regulators should place greater reliance on self-correcting forces of financial markets, while focusing attention on ensuring robust market infrastructure, particularly for credit derivative markets. In particular, it was emphasized that financial regulators should require rigorous risk-management practices. The regulators were also urged to provide guidance on the content of business continuity plans to address possible vulnerabilities related to even risks, such as an avian flu pandemic.

6.4.7 FY 2007

In their August 2006 meeting, the IMF’s Executive Board welcomed the continued strong, broad-based expansion of the global economy during the calendar year 2006, noting that activity in most regions met or exceeded expectations. It was believed that the global expansion would slow only modestly in 2007 and 2008 and that inflationary pressures would remain contained. It was generally viewed that the market turbulences in February and March 2007 represented a correction after a period of asset price buoyancy that did not require a fundamental revision in the positive global economic outlook.

In March 2007, it was agreed that global financial and macroeconomic stability continued to be underpinned by solid economic prospects, although downside risks had increased somewhat in a few areas. Because fluctuations in both oil and non-fuel commodity prices have important policy implications, the IMF has been increasing its coverage of these markets in multi-lateral surveillance. It has consistently advised oil-importing countries, for example, on the importance of market-based pricing, that is, putting an end to subsidies and allowing the pass-through of oil prices to consumers. The IMF’s Board recognized the possibility that inflationary pressures could revive as resource utilization constraints start to bind. It was also observed that sharply rising prices of non-fuel commodities, particularly metals, had underpinned strong growth in many emerging market and developing countries and advised these countries to invest current revenue windfalls to support future growth in non-commodity sectors. The Board also stressed the risk of a reversal of the recent decline in oil prices given continuing geopolitical tensions and limited spare production capacity.
6.5 IMF’s Role in Maintaining International Liquidity (2001-2007 AD)

6.5.1 FY 2001

Lending

Favourable global and economic conditions contributed to a decline in new IMF commitments in FY 2001. Total commitments fell to SDR 14.5 billion in FY 2001 from SDR 23.5 billion in FY 2000. During FY 2001, the IMF disbursed SDR 9.5 billion in loans from its General Resources Account (GRA). The amount of new credit was more than offset by continued substantial repayment of loans extended in earlier years. Total repayments were SDR 11.2 billion, including advance repayments by Korea (SDR 2.0 billion) and Mexico (SDR 2.3 billion). Consequently, IMF credit outstanding at the end of FY 2001 amounted to SDR 42.2 billion, a little lower than a year earlier and some SDR 18 billion below the peak attained during the recent financial crises.

International Liquidity

Total international reserves, including gold, increased by 11 percent during 2000 and stood at SDR 1.7 trillion at the end of FY 2001. Total non-gold reserves grew by 12 percent, the result of a 14 percent rise in foreign exchange reserves (the largest component of official reserve holdings), to SDR 1.5 trillion, and a 10 percent fall in IMF-related assets, to SDR 66 billion. The market value of gold held by monetary authorities (central banks, currency boards, exchange stabilization funds and treasuries) declined by 2 percent, to SDR 200 billion at the end of 2000.

6.5.2 FY 2002

Total commitments increased to SDR 39.4 billion in FY 2002 from SDR 13.1 billion in FY 2001. During FY 2002, the IMF disbursed SDR 29.1 billion in loans from its GRA. The amount of new credit exceeded the repayment of loans extended in earlier years. Total repayments were SDR 19.2 billion, including advance repayments by Brazil (SDR 3.3 billion), Korea (1.9 billion) and Turkey (SDR 4.5 billion). Consequently, IMF credit outstanding at the end of the FY 2002 amounted to SDR 52.1 billion, SDR 9.9 billion higher than a year earlier but some SDR 8.5 billion below the peak attained during the recent financial crises.

International Liquidity

Total international reserves, including gold, increased by 9 percent during 2001 and stood at SDR 1.9 trillion at the end of FY 2002. Foreign exchange reserves, which constitute the largest component of official reserve holdings, grew by 9 percent, to SDR 1.6 trillion. IMF-related assets, which make up the rest of non-gold reserves, increased by 16 percent, to SDR 76 billion. The market value of gold held by monetary authorities increased by 2 percent in 2001, to SDR 203 billion at year-end.

6.5.3 FY 2003

During FY 2003, the IMF disbursed SDR 21.8 billion in loans from its GRA. The amount of new credit exceeded the repayment of loans extended in earlier years. Total
repayments were SDR 7.8 billion, including advance repayments by Croatia (SDR 0.1 billion, which eliminated its outstanding IMF credit), Thailand (SDR 0.1 billion), and Estonia and Lithuania. Consequently, IMF credit outstanding at the end of the year amounted to a record high SDR 66.0 billion, SDR 13.9 billion higher than a year earlier.

International Liquidity

Total international reserves, including gold, increased by 9 percent during 2002 and stood at SDR 2.1 trillion at the end of the year. Foreign exchange reserves, which constitute the largest component of official reserve holdings, grew by 8 percent, to SDR 1.8 trillion. IMF-related assets, which make up the rest of non-gold reserves, increased by 12 percent, to SDR 86 billion. The market value of gold held by monetary authorities increased by 13 percent in 2002, to SDR 235 billion at year-end.

6.5.4 FY 2004

Lending

Improving global economic and financial conditions, combined with an accumulation of foreign exchange reserves by many emerging market economies, contributed to a decline in new IMF commitments, from SDR 29.4 billion in FY 2003 to SDR 14.5 billion in FY 2004.

IMF credit outstanding reached an all-time high of SDR 70 billion in September 2003, with disbursements in the first months of the financial year to Argentina, Brazil, Indonesia, Turkey, and Uruguay, but declined rapidly in the second half of FY 2004. During FY 2004, total repayments reached SDR 21.6 billion, including large repayments by Argentina, Brazil, Russia, and Turkey and advance repayments by Thailand (SDR 0.1 billion), which eliminated its outstanding IMF credit, exceeding the SDR 17.8 billion disbursed by the IMF in loans from the GRA. As a result, IMF credit outstanding amounted to SDR 62.2 billion at the end of the financial year, SDR 3.5 billion less than a year earlier.

During the year, five members, Bosnia and Herzegovina, Brazil, Pakistan, Romania, and Turkey, made repayments on the expectations schedule in the amount of SDR 10.8 billion, of which SDR 8.4 billion constituted SRF repayments by Brazil. Six members requested and were granted extensions of repurchase expectations. As of April 30, 2004, IMF outstanding credit amounting to SDR 30.6 billion was subject to time-based repurchase expectations under the policies adopted in November 2000.

International Liquidity

Total international reserves, including gold, increased by 14 percent during 2003 and stood at SDR 2.4 trillion at the end of the year. Foreign exchange reserves, which constitute the largest component of official reserve holdings, grew by 15 percent, to SDR 2.0 trillion. IMF-related assets, which make up the rest of non-gold reserves, remained broadly unchanged at SDR 86 billion. The market value of gold held by monetary authorities increased by 9 percent to SDR 256 billion in 2003.
6.5.5 FY 2005

Lending

During FY 2005, IMF credit outstanding declined from its all-time high reached in FY 2004. At the end of FY 2005, credit outstanding stood at SDR 49.9 billion, down from SDR 62.2 billion in April 2004. Disbursements during FY 2005 totalled SDR 1.6 billion, the largest disbursements were made to Turkey and Uruguay under their Standby Arrangements. Disbursements totalling SDR 312.9 million were made under Emergency Post-Conflict Assistance to the Central African Republic, Haiti and Iraq. Disbursements totalling SDR 110.4 million were made under Emergency Natural Disaster Assistance to Grenada, Maldives and Sri Lanka.

International Liquidity

Total international reserves, including gold, increased by 15 percent during 2004 and stood at SDR 2.7 trillion at the end of the year. Foreign exchange reserves, which constitute the largest component of official reserve holdings, grew by 18 percent, to SDR 2.4 trillion. IMF-related assets, which make up the rest of non-gold reserves, declined by 12 percent to SDR 76 billion, reflecting the recent decline in outstanding credit to member countries. The market value of gold held by monetary authorities decreased by 1 percent to SDR 254 billion in 2004.

6.5.6 FY 2006

Lending

During FY 2006, repayments on loans increased sharply, to SDR 32.8 billion. Many countries - Algeria, Argentina, Armenia, Brazil, the Republic of Congo, Georgia, Papua New Guinea, Uzbekistan and Zimbabwe repaid all of their GRA obligations to the IMF; some ahead of schedule. Advance repayments totalling SDR 21.9 billion were made by Algeria (SDR 246 million), Argentina (SDR 6.7 billion), Brazil (SDR 14.2 billion), Bulgaria (SDR 249 million), and Uruguay (SDR 519 million).

International Liquidity

Total international reserves, including gold, increased by 20 percent during 2005 and stood at SDR 3.3 trillion at the end of the year. Foreign exchange reserves grew by 21 percent, to SDR 2.9 trillion. IMF-related declined by 36 percent to SDR 49 billion, reflecting the recent decline in outstanding credit to member countries. The market value of gold held by monetary authorities increased by 25 percent to SDR 317 billion in 2005.

6.5.7 FY 2007

Lending

The IMF’s credit outstanding at the end of FY 2007 declined to SDR 7.3 billion from SDR 19.2 billion in April 2006, owing to continued early repayments of outstanding loans and a low level of new disbursements. During FY 2007, nine members - Bulgaria, the Central African Republic, Ecuador, Haiti, Indonesia, Malawi, the Philippines, Serbia, and Uruguay - repaid their outstanding obligations to the IMF ahead of schedule, for a
total of SDR 7.1 billion. The IMF disbursements totalled SDR 2.3 billion, the bulk of which went to Turkey.

**International Liquidity**

Total international reserves, including gold, increased by 14 percent during 2006 and stood at SDR 3.8 trillion at the end of the year. Foreign exchange reserves grew by 15 percent, to SDR 3.3 trillion. IMF-related assets declined by 27 percent to SDR 36 billion, reflecting the recent decline in outstanding credit to member countries. The market value of gold held by monetary authorities increased by 16 percent to SDR 367 billion in 2006.

### 6.6 Testing of Hypotheses of the Study

A cursory scrutiny of the primary data statistics gleaned from the IMF’s annual reports for the study period revealed that the following five hypotheses could be taken up for testing under this work:

**Hypothesis-1:**

Over the study period (FY 2001 to 2007), the global official holdings of reserve assets of the developing countries increased significantly compared to the industrial countries.

**Proof:** As shown in Table 5.1 and Graph 5.1, the global official holdings of reserve assets of the developing countries have shown a rising trend, registering a growth of 251.50% in the year 2007 over the base year 2001, while the official holdings of reserve assets of the industrial countries also showed a rising trend registering a growth of merely 147.75% in the year 2007 over the base year 2001. **The hypothesis thus stands accepted.**

**Hypothesis-2:**

Over the study period, the global official holdings of gold of the developing countries increased significantly compared to the industrial countries.

**Proof:** As shown in Table 5.1 and Graph 5.2, the global official holdings of gold of the developing countries have shown a marginally rising trend, registering a growth of 192.00% in the year 2007 over the base year 2001, while the official holdings of gold of the industrial countries also showed a marginally rising trend, registering a growth of 180.50% in the year 2007 over the base year 2001. Both these growths may be may not be taken as significant. **The hypothesis thus stands partly accepted.**

**Hypothesis-3:**

Over the study period, the share of US Dollar in the global official holdings as foreign exchange reserves has decreased, the share of Euro has increased.

**Proof:** As shown in Table 5.2 and Graph 5.3, the share of US Dollar in the global official holdings as foreign exchange reserves has decreased by 9.50% in 2007 over the
base year 2001, while the share of Euro has increased by 35.80% in 2007 over the base year 2001. **The hypothesis thus stands accepted.**

**Hypothesis-4 :**

(a) the share of US Dollar in global official holdings as foreign exchange reserves increased significantly in the developing countries as compared to the industrial countries.

**Proof:** As shown in Table 5.2 and Graph 5.4, the share of US Dollar in global official holdings as foreign exchange reserves has gone down by 1.10% in 2007 over the base year 2001 in the industrial countries and by 14.70% in 2007 over the base year 2001 in the developing countries. **The hypothesis thus stands rejected.**

(b) the share of Euro in global official holdings as foreign exchange reserves increased significantly in the developing countries as compared to the industrial countries.

**Proof:** As shown in Table 5.2 and Graph 5.4, the share of Euro in global official holdings as foreign exchange reserves has gone up by 44.40% in 2007 over the base year 2001 in the industrial countries and by 13.97% in 2007 over the base year 2001 in the developing countries. **The hypothesis thus stands accepted.**

**Hypothesis-5 :**

Over the study period, the total reserves of IMF-related assets held by the member countries have gone on decreasing.

**Proof:** As shown in Table 5.4 and Graph 6.2, the total reserves of IMF-related assets held by the member countries have decreased by -55.70% in 2007 over the base year 2001. **The hypothesis thus stands accepted.**

### 6.7 Concluding Remarks

The observations regarding the international liquidity for the FYs 2001 to 2007 in the preceding paragraphs show that many borrower countries have weaned themselves away from the IMF’s credit; some countries have paid their dues ahead of schedule, while there is noticeable decline in IMF’s commitments to provide credit.

Graph 6.1 alongside shows that from a peak of SDR 86.4 billion in 2003, the total reserves of the IMF-related assets have fallen to SDR 34.0 billion in 2007, a downturn of 55.50 percent over

Source: IMF’s Annual Reports for the respective years
the study period. Evidently, countries have built up their own reserves as well as have tapped alternative sources, such as private capital markets, to meet their international liquidity needs.

This is further corroborated by Graph 6.2 alongside, showing that the collective total reserves of the countries (including gold) that stood at SDR 1,915.3 billion in 2001 have shown a steady rise to stand at SDR 3,921.7 billion in 2007, a rise of 204.75%. This can indeed be taken as a sign of improved international liquidity among countries.

Graph 6.2
Total Reserves (including Gold) held by Member-Countries

<table>
<thead>
<tr>
<th>Years</th>
<th>Billions of SDRs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>1915.3</td>
</tr>
<tr>
<td>2002</td>
<td>2092.4</td>
</tr>
<tr>
<td>2003</td>
<td>2379.4</td>
</tr>
<tr>
<td>2004</td>
<td>2743.1</td>
</tr>
<tr>
<td>2005</td>
<td>3285</td>
</tr>
<tr>
<td>2006</td>
<td>3750.9</td>
</tr>
<tr>
<td>2007</td>
<td>7126.5</td>
</tr>
</tbody>
</table>

Source: IMF’s Annual Reports for the respective years

The researcher’s perceptions of these phenomena are being presented below.

Although back in 1940’s, as the gold standard began waning for the settlement of the balance of payments between countries, the IMF was brought into being as a watchdog organization for monitoring and disciplining the international monetary system. During next 60 or so years, it has done the job extremely well - extended international credit to the countries in need; trained the member countries’ financial bureaucrats in sensing, preventing and resolving internal and external financial crises as well as in planning and executing prudent macroeconomic policies, building up reserves for exigencies; monitored their internal and external financial performance, while all the time, monitoring the pulse of international liquidity. All this has begun to bear fruit now and it can be reasonably said that the global economy is in a position to absorb balance of payments shocks.

It may be noted, in passing, that the international monetary system is not an end in itself. Its main function is to enable the fundamental economic processes of production and distribution to operate as smoothly and efficiently as possible. Where these processes operate effortlessly, international monetary relations become inconspicuous. However, when the processes are inefficient, the international flow of goods and services gets interrupted with grave consequences for the economic welfare of nations. It is particularly during such crises that the significance of the international monetary system becomes magnified.

It is, therefore, clear that the ultimate objectives of the international monetary system are:

(a) the maximization of the total world output and employment, and
(b) the achievement of a desirable distribution of economic welfare among nations as well as among different groups within each nation.

These are, however, predicated on, and presuppose, the free flow of goods and services, capital, labour and even ideas, among nations. It, therefore, follows that direct controls for balance of payments reasons have no place in a well-organized international monetary system.

The International Monetary Fund (IMF) is an international financial institution that promotes economic cooperation among member countries for ensuring rapid economic development throughout the world. The main purpose of the IMF is to create an economic system that can instil stability and growth in the world economy by economic cooperation among nations. It aims at establishing exchange rate stability and elimination of the shortage of international liquidity. The IMF also acts as an institution for ensuring international monetary cooperation.

In meeting these obligations, the IMF provides assistance to its member countries for correcting balance of payments disequilibrium, particularly to the developing countries, as well as technical assistance for promoting their economic growth and stability. This is done with the help of the resources at its disposal.

The IMF’s assistance, however, has almost always been accompanied with ‘conditionalities’, including Structural Adjustment Programmes’ (SAP). These conditionalities, e.g. economic performance targets established as a precondition for IMF loans, retard social stability and thus inhibit the stated goals of the IMF, while SAP leads to an increase in poverty in recipient countries.

The IMF has, at times, advocated “austerity programmes”, increasing taxes even when the economy is weak, in order to generate government revenue and balance budget deficits. Countries are often advised to lower their corporate tax rate. This has given an image of the IMF converting to a more monetarist approach, but it was designed to provide funds for countries to carry out Keynesian relations. It appears that the IMF was reflecting the interests and ideology of the Western financial community. 1

Overall, however, the IMF’s success record has been perceived as ‘mixed’. The IMF has been instrumental in enhancing international liquidity, particularly when the use of gold has become minimal or almost non-existent and the SDRs appear to be considered as ‘passive’ reserves. The current financial crisis has, however, shown the need for deeper analysis of the linkages between the real economy and the financial sector.

References: