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# The Role of IMF in the Reinforcement and Development of International Economic Relations

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## Abstract

The IMF, with purpose of helping balance growth in the world economy by monitoring Member's economy – especially their exchange rates and balance of payments and acting as an international lender, has established a close relationship between international monetary system and international economic law. The paper is seeking to introduce IMF and its role in the reinforcement and development of international economic relations.

## Keywords

International Monetary Fund, International Monetary System, International Economic Law, International Economic Relations, Bretton Woods Conference, Globalization

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## 1. Introduction

Between the two World Wars, world leaders became aware that the impediments to sustainable peace were economic in nature, and that to address these factors it was desirable to institutionalize economic development cooperation among states. Although this goal was not achieved prior to WWII, the efforts towards this goal were quickened afterwards.

Broadly defined, international economic law straddles the fields of public international law, international financial law, international business law, international trade law, private international law, international investment law, international monetary law, international law of development and involves all other categories that influence transnational economic activity.

The Bretton Woods conference resulted in the creation of three key international institutions regulating trade and finance: the international Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), as a part of the World Bank Group and subsequently the General Agreement on Tariffs and Trade (GATT), now replaced by the World Trade Organization (WTO) (Olowu, 2010:201).

Monetary relations are necessary means for facilitating trade and the gains that it provides, but they can also be a mechanism for transmitting shocks. The most persistent problem facing monetary policymakers has been the spill over of potentially damaging effects from the outside world through the international system. The most enduring debate has been over the extent to which human ingenuity can invent an abstract procedure or rule, or a way of looking at the world, that makes the instrument of exchange less controversial, avoids the need for consultation or negotiation and eliminates the possibility of arguments, clashes and mutually destructive behaviour.

Initially, the purpose of the IMF was to enforce rules about

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adjustment in international monetary relations as well as to provide temporary resources to deal with balance of payments problems. It was intended in this way to help to ease the constraint that the open international economy had previously placed on national economic development: with what happens-simply stated- when the rest of the world does not buy sufficient goods and services to pay for the items consumed as imports by a country (James, 1996:1-3).

The paper deals with international economic law and monetary system, IMF history and purpose, issues raised in Bretton Woods conference, sovereignty member of IMF, the fund's role in globalisation and some recommendations for improving the IMF.

There are four definitions for globalization which we need to mention before addressing to the role of IMF.

- "The integration of the political, economic and cultural activities of geographically and/or nationally separated peoples, (not new or irresistible, not a "policy option.")
- The increase of globalism with "is the state of the world involving networks or interdependence at multi-continental distances … through flows and influences of capital and goods, information and ideas, and people and forces, as well as environmentally and biologically relevant substances.
- The defining international system based on "the inexorable integration of markets, nation-states and technologies.
- Rapid movement toward international economic integration; consensus on political values, processes and principles; and the revolution in information and communication technologies". (Wells et al., 2001:38).

## 2. International Economic Relations in the Framework of a Global Monetary System

International economic relations are the core subject of international economic law. In understanding the concept of International economic law it would be appropriate to start with an anecdote from Zamora:

> *When asked what kind of law I teach, I usually reply International economic law."After the inevitable pause, I offer the necessary explanation: "I teach and write about the legal aspects of international trade, international business, international banking and other subjects that involve economic relations between nations, as well as between private parties."*

As it can be understood from this expression, there are some problems relating to the definition and the content of international economic law. Both in theory and in practice it is not possible to find a clear definition of this branch of international law. This is why it is not an easy task to define it, since it covers a broad range of topics.

In general terms, international economic law can be explained or evaluated in a broader and narrower manner. In the broadest sense, international economic law could be defined as the law including all legal subjects that have both international and economic components. In the narrower sense, international economic law is defined as "International law rules dealing with some of the economic conduct of international law subjects, and with some of their economic relations inter se." In this sense, international economic law is considered as a branch of international law and also be referred to as "international law of the economy" (Aksar, 2011:6-7).

International monetary law constitutes a core sector of international economic law. International trade in goods and services and other international business transactions rest on cross-border payments and capital movements which, as rule, affect two or more currency areas. The system established by the conference of Bretton Woods (1944), with the Articles of Agreement of the international monetary fund (IMF), aims to create an international monetary order based on the free convertibility of currencies. It also aims to ensure free movement of payments and capital in conformity with the requirements of internal trade. The articles of Agreement of the IMF clearly reflect the understanding that a functional and open world trade order requires a stable international monetary system. According to Article IV, section 1 of the Agreement, the Members of the Fund expressly recognize " that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services and capital among countries and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability".

The regulation of currency exchange vitally affects competitive conditions in international trade and business. Again and again, states resort to currency manipulation as an instrument to place their own economy in an advantageous position on the international markets. By means of an undervalued exchange rate, either by devaluation or by artificially keeping its own currency down (e.g. by massive purchase of foreign currencies), states may distort international competition in favour of their own export industry. The consequence may be serious trade and monetary conflicts as between the United States and China over the low exchange rate of the Chinese Yuan. The restriction of payments and capital movements hamper

international business transactions and affect the repatriation of profits by foreign investors. The ban on stabilization clauses related to the value of money may affect the contractual balance in long-term business relations under depreciating currencies.

Financial aids to countries with balance of payment problems, in particular heavily indebted countries, provided by governments and international organizations such as the IMF has become an important mechanism to stabilize currencies. The financial assistance to some euro countries granted by the European Union, other Members of the Eurozone and the IMF demonstrates the interrelation between financial sustainability and currency stability in a hitherto unknown hard currency context.

Not only states, but also private actors may influence the valuation of currencies and exchange rates. Free movement of capital allows massive speculations with currencies. 'Carry trades' may distort capital flows. In this kind of deal, an investor sells or borrows currency with a relatively low interest and uses the funds to purchase a currency yielding higher interest, attempting to derive profit from the difference between the rates. With the assessment of the financial standing of states, rating agencies (US companies) influence the interest rates for sovereign borrowing as well as the exchange rates. Credit default swaps and other instruments of insurance against the risk of sovereign default also affect the standing of states in the capital markets (Herdegen, 2013:427-428).

## 3. IMF at a Glance

The International Monetary Fund and the International Bank for Reconstruction and development (World Bank) were established at the United Nations Monetary and Financial Conference, held at Bretton Woods, New Hampshire, 1-22 July 1944. Officially, the fund did not come into existence until 27 December 1945, after the delegates of twenty-nine of the countries participating in the conference had signed the articles of agreement, which form the charter or constitution of the fund (Salda, 1992: xi).

The origin of the IMF lies in the experience of countries during the inter-war period, including the Great Depression. In the 1920s and 1930s, many countries attempted to maintain domestic income in the face of shrinking markets through competitive devaluation of their currencies and resort to exchange and trade restrictions. Such measures could achieve their objectives only by aggravating the difficulties of trading partners who, in self-defence, were led to adopt similar policies, leading to a destructive vicious cycle. There was growing recognition of the largely self-defeating nature of these policies at the country level and the increasing global welfare losses, resulting in a widening acceptance of the need for a globally agreed code of conduct in international trade and financial matters (Fritz-krockow et al, 2007:4).

The IMF is an independent international organization and specialized agency of the United Nations which possesses full juridical personality. The IMF membership is open to every country and every member is free to leave the IMF at any time (Riesenhuber, 2001:3). Considerable confusion reign about why it exists and what it does. Some observers, confusing it with the World Bank or another aid institution, are under the impression that the IMF exist to subsidize economic development in the poorer nations. Other imagines it as an international central bank controlling the creation of money on a world scale. Still others regard the IMF as a powerful and disapproving political institution, imbued with a missionary zeal for fiscal rectitude that somehow compels its members to tread a path of economic austerity. The IMF is in fact none of these it is neither a development bank, nor a world central bank, nor an agency that can or wishes to coerce its member to do very much of anything. It is rather a cooperative institution that several countries have voluntarily joined because they see the advantage of consulting with one another in this forum to maintain a stable system of buying and selling their currencies so that payments in foreign money can take place between countries smoothly and without delay (Driscoll, 1998:1).

## 4. The Purpose of IMF

At the 1944 United Nations Monetary and Financial Conference in Bretton Woods, 730 representatives from 44 countries decided the goals for a new organization called the International Monetary Fund. According to the articles of agreement, one goal of the IMF is to encourage international monetary cooperation. This means countries work together in matters that involve money. For example, the IMF's Development Committee arranges for countries to discuss economic issues and then offers its advice.

Another original IMF goal is to encourage the growth of international trade. Trading between countries involves imports and exports. Imports are goods and services bought from other countries, like when Americans buy Japanese cars. Exports are goods and services sold to other countries, such as American companies selling computers to England. Exports add to a country's total production of goods and services. They also put more money into the economy, which helps a country's economy to grow (Hollander, 2013:15-16).

So the IMF was established to promote international monetary cooperation, exchange stability and orderly exchange arrangement; to provide temporary financial

assistance to countries with balance of payments difficulties; and to foster sustainable economic growth. To achieve these objectives, the IMF carries out three types of operational activities: surveillance, financial assistance and technical assistance. To serve these purposes, the IMF:

- Monitors economic and financial developments and policies.
- Lends to member countries with balance to payments problems.
- Provides the governments and central banks of its member countries with technical assistance and training in its areas of expertise (Clift, 2004: 3-4).

*Surveillance* is the process by which the IMF maintains a policy dialogue with each of its members and appraises country and global macroeconomic conditions. Generally once a year, it appraises members' exchange rate policies within the overall framework of their economic policies in what is known as an Article IV consultation. The IMF also carries out multilateral surveillance, the results of which are summarized in the *World Economic Outlook*, prepared and published twice a year and in the *Global Financial Stability Report*, which is also published twice a year.

*Financial assistance* includes credits and loans extended by the IMF to member countries with balance of payments problems so that they can restore conditions for financial and macroeconomic stability and sustainable economic growth. The financial assistance provided by the IMF enables countries to rebuild their international reserves, stabilize their currencies and continue paying for imports without having to impose trade restrictions or capital controls. The IMF makes its financial facilities, such as Stand-By Arrangements and the Extended Fund Facility. It also provides concessional assistance under its Poverty Reduction and Growth Facility and debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative.

*Technical assistance* consists of expertise and training provided by the IMF to help member countries strengthen their human and institutional capacity and design and implement effective macroeconomic and structural policies. Technical assistance is offered in several broad areas-namely, fiscal policy and management, monetary policy and financial systems and macroeconomic and financial statistics (International Monetary Fund, 2008:1-2).

## 5. The Sovereignty of Member States in IMF

Throughout IMF's history, the organization has played a central role within the international financial architecture. With its near-global membership of 188 countries, the IMF is uniquely positioned to help member governments take advantage of the opportunities and manage the challenges posed by globalization and economic development more generally[1].

As a result, the duty of states not to intervene in the affairs of another state has to be respected by the IMF. But it is sometimes argued that IMF loan conditionality cannot unduly interfere in the sovereignty of Member-States as the members agree to them in their letters of intent. According to this view, a state is entitled to the observance of the principle of non-interference in its domestic affairs, but a matter ceased to be domestic if the state concerned has assumed some international commitment in this respect. Therefore some analysts conclude that a state having asked the IMF for a stand-by "credit" cannot complain that the IMF proposals to correct the states' financial situation amount to an intervention in its domestic affairs.

According to this theory, the consent of the member in the interference in its sovereign affairs prevents a legal analysis of the legitimacy of the Fund's conditionality according to the IMF's own "guidelines on conditionality" (Riesenhuber, 2001:306).

Art V (3)(b) of agreement of the International Monetary Fund lays down four conditions for drawing from the IMF: the use of the resources must be coherent with the policies of the organization; the interested country must represent that the need to purchase resources derives from its balance of payments or its reserve position; the purchase should not exceed 200% of the quota; and the requesting country must be eligible to use resources.

In addition to these statutory conditions, the IMF has developed a policy of conditionality connected with the use of resources. Lord Gold has defined conditionality as "the policies that the IMF wishes to see a member follow in order that it can use the IMF resources in accordance with the purposes and the provisions of the Articles". In this regard, conditionality constitutes a *compendium* of the policies and procedures developed by the IMF with reference to access and use of resources. Towards the end of the 1980s, the policy of conditionality broadened in scope so as to encompass structural reforms to be implemented by the countries drawing on resources. In this respect, it is important to stress that, unlike the Articles of agreement of the International Bank for Reconstruction and Development, the Articles of Agreement of the IMF do not establish a clear prohibition on interference in the domestic sphere of member states, and with the result that conditionality may lawfully

[1] IMF Financial Operation (2014), Washington, D.C, International Monetary Fund, p1

affect the choices of political economy in these countries.

In partial response to the criticism that there was excessive interference in the domestic affairs of member states, in 2002 the IMF adopted the new Guidelines on Conditionality. The keystone of these new guidelines can be identified with the rule under which the drawing of the resources must be linked to the achievement of specific macroeconomic objectives consistently with the internal growth of the interested country. Coherently with this view, the new Guidelines have introduced the principle of "ownership", establishing that it is the primary responsibility of the Member State drawing on resources to draft and implement a reform program (Guidelines 2002, point A.3). Complementary to ownership, the principle of "parsimony" assures that the program-related conditions should be reduced to the minimum necessary to achieve the objectives set forth in the program. This principle comes particularly into play with reference to less-developed countries, where it is essential to strike a balance between the structural measures and the need to preserve social and economic growth. In fact, one of the major criticisms encountered by the 1979 Guidelines was that the adaptation of the rigorous policies required by the IMF often caused negative social and economic impacts on the population.

Conditionality divides into three levels. The first level is constituted by the adaptation of general policies applicable to all the situations characterized by a disequilibrium in the balance of payments (credit tranche policies) as much as of special policies for special balance of payment problems (Art V(3)(a) Articles of Agreement). The second level is constituted by conditions laid down in the Letter of Intent, which may be roughly gathered in two groups: "performance criteria" and "program reviews" (Guidelines 2002, point B.11). "Performance criteria", which can be distinguished as quantitative and structural, principally concern the attainment of macroeconomic objectives in accordance with the IMF, while "program review" consists in the periodical review of the former. The last level is constituted by recommendations made by the IMF staff to the Executive Board in relation to the approval of an arrangement or the completion of a review. These recommendations contain prior actions or benchmarks to be satisfied by the requesting State, which, although not genuine conditions like performance criteria, are taken into consideration in the decision to grant access to further resources (Megliani, 2015:130-133).

# 6. Conclusion

Theoretically the IMF is situated within the United Nations system. It is the central institution of the international monetary system, the system of international payments and exchange rates among national currencies that prevents crises in the payments system. It does so by monitoring the economic policies of member countries and acting as a reserve fund that can be used by members needing temporary financing to address balance of payments problems. The IMF focuses mainly on the macro-economic policies of governments including: policies relating to the state budget, the management of money and credit, and the exchange rate; and financial policies of governments, including the regulation and supervision of banks and other financial institution (peet, 2007:58-59).

The international monetary fund plays an important role in international economic life in two respects. Having abandoned its attempts to ensure par-values of currencies, the IMF's main role is an attribution of Special Drawing Rights (SDR) out of the funds filled by the quotes of the members. This Special Drawing Rights (SDR) is an artificial currency composed of the value of specified amounts of several currencies. The SDR are usable only by monetary authorities. The SDR represents the right to obtain an equivalent amount of freely usable currency.

Whereas a grant of SDR was originally a stop-gap measure to overcome sudden payments difficulties, such grants nowadays play an important role in the rescheduling of the debts of developing countries, that is, by agreeing to an extension of the date of repayment and to a reduction of interest. The IMF is ready to offer standby credits only on condition that the country concerned adopts reforms which sometimes lead to social unrest. The IMF has been accused by third world countries of dictating to them such reforms as a condition for its help. Spokesman of the IMF claim however that the IMF does not require the adoption of specific measures, but wants to see merely a result, that is, a reduction of government spending. The IMF representatives will only make suggestions and the responsibility for the ensuing consequences resting with the country concerned. When the IMF, in the Asian debt crisis of 1998, advanced large sums to stabilize the currencies of the countries concerned, critics blamed the IMF for not having obtained a sufficient participation of the creditor banks in these rescue efforts. After all, the over-optimistic lending practices of these banks were at least one of the causes of this crisis. The banks, therefore, should bear at least a part of this burden.

The effect of the IMF's grant of stand-by credit is greatly enhanced by the fact that government and private creditors of the country concerned often make their own willingness to reschedule the debts of the country dependent on the attitude of the IMF. They do so, not so much in view of the financial importance of the IMF's grant, but because they see in this grant the sign that the country has been willing to adopt reforms which will improve its financial position and will thus enable it to satisfy all its creditors.

Loans by private banking consortia usually contain a cross default clause. Thus if the debtor state fails to satisfy even one creditor, the entire debt becomes due immediately. As some large American banks have granted huge credits to developing countries the default of such countries would oblige them to write off these credits as a loss. These losses may threaten the very existence of the creditor bank. This fact not only explains the relative willingness of the creditors to agree to debt-rescheduling, the leading banks may even buy out a lone hold-out creditor, usually one of the weaker members of the consortium, who refuses to agree to the rescheduling proposal. However, there are no general international law rules on debt rescheduling (Seidl-Hohenveldem, 1999:87-88).

As stated above, IMF has done its best in improving international economic law and monetary system, but nevertheless, needs to work harder financial markets and crises prevention at the heart of its activities. To ensure the maximum beneficial impact it will be important for this work to move forward with the full participation of the IMF's membership.

Furthermore in the IMF in recent years the scope and content of conditionality have been questioned. So it advocates a set of policies that emphasize good governance and the need for political and legal institutions as a prerequisite for effective economic policy is felt. Although IMF is targeted in globalization by lending loans to countries, but has been subjected to two sorts of criticisms. The first has been concentrated on their regressive consequences and second the ineffectiveness of loans which could be resolved by review of lending practices.

The greatest success of the IMF and World Bank is that they have acted as globalisers. They have integrated a large number of countries into the world economy by requiring governments to open up to global trade, investment, and capital. They have not done this out of pure economic zeal. Politics and their own rules and habits explain much of why they have presented globalization as a solution to challenges they have faced in the world economy (Woods, 2006:3).

During the 1980s and 1990s, the first phase of globalization of the developing countries, opening up to international trade and payments, and getting integrated with each other through current account convertibility, was accelerated and almost universalized. Most countries adopted major economic reforms liberalizing the internal and external movement of goods and services, adjusting their production structures and monetary, fiscal and exchange rate policies to a freer trade and payments system. However, although almost all these countries made significant progress towards current convertibility, very few of them adopted measures for making their capital account also convertible. Their globalization process, therefore, remained confined to the first phase, when the integration of their economies was being affected more through the markets of trading in goods and services and of current payments, and not so much through capital markets for free cross-border movements of savings and investments.

This phase of globalization of the developing countries is expected to last quite some time, as the overwhelming majority of these countries are still far short of being graduated to the second phase of integration through capital markets. As these countries would be facing all the problems of adjustment to the first phase of opening up, they would depend on the IMF for the balance of payments support in accordance with the original articles of agreement. Only if they can successfully implement their programs, adjusting their production structures along the lines of their comparative advantage and producing sustainable growth, will private investment from international capital market flow into these countries? It is then that they would be moving to the second phase of globalization.

It is imperative, therefore, that during this phase the IMF is bestowed with sufficient international resources, through increases in quotas or through the creation of SDRs so that it should be able to meet the financing requirements in full of the adjusting countries. It should try to attract or catalyze financing from other sources, but in case such outside finances fall short of the full requirements the IMF should step in to make the programs fully funded (Sengupta, 2001:116-117).

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