[Bullion](https://dc.cbn.gov.ng/bullion)

Volume 35 | Number 4 Article 5

12-2011

Understanding the Bretton Woods Institutions (BWIs) with particular reference to the International Monetary Fund (IMF)

Adeniyi O. Adenuga
Central Bank of Nigeria, aoadenuga@cbn.gov.ng

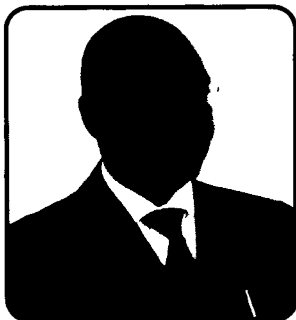
Osaretin Evbuomwan
Central Bank of Nigeria, oevbuomwan@cbn.gov.ng

Follow this and additional works at: https://dc.cbn.gov.ng/bullion

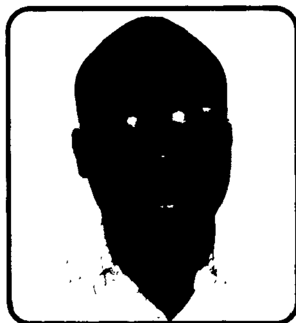
Part of the Economics Commons

Recommended Citation
Adenuga, A. O. & Evbuomwan, O. (2011). Understanding the Bretton Woods Institutions (BWIs) with particular reference to the International Monetary Fund (IMF). CBN Bullion, 35(4), 36-46.

This Article is brought to you for free and open access by CBN Institutional Repository. It has been accepted for inclusion in Bullion by an authorized editor of CBN Institutional Repository. For more information, please contact dc@cbn.gov.ng.



A. O. ADENUGA



O. EVBUOMWAN**

UNDERSTANDING THE BRETTON WOODS INSTITUTIONS (BWIs) WITH PARTICULAR REFERENCE TO THE INTERNATIONAL MONETARY FUND (IMF)*

INTRODUCTION

The Bretton Woods Institutions (BWIs) comprise mainly the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) – the World Bank. The focus will be on the IMF. The IMF was conceived in July, 1944 at a United Nations conference held at Bretton Woods, New Hampshire, United States of America, when representations of 45 Governments agreed on a framework for economic cooperation designed to avoid repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s. Today, the number of countries has grown to 188 and any new sovereign country joining the United Nations had automatically become a member of IMF and World Bank.

In that decade, economic activities in the major industrial countries weakened, with the application of restrictions on imports. In spite of this, world trade, output and employment worsened. In order to stem the downward spiral trend in the economies of member countries, some countries devalued their currencies and introduced complicated restrictions on foreign exchange. All these controls, however, proved self-defeating and the possibility for competitive edge was lost.

At the end of the Second World War, the leading allied countries considered various plans to restore order in the comity of nations and restructure the world economy in order to prevent the recurrence of such painful crises. The country representatives drew up the charter (or Articles of Agreement) of an international institution to oversee the international monetary system and promote both the elimination of exchange restrictions relating to trade in goods and services, and the stability of exchange rates.

The IMF came into existence in December 1945, when the first 29 countries signed its Articles of Agreement. Since then, the world has experienced unprecedented growth in real incomes. Although, the benefits of growth have not flowed equally to all-either within or among nations, there has been increase in prosperity that contrast sharply with the interwar periods, in particular. The improvements were attributed to the IMF's conduct of economic policy, including policies that have encouraged the growth of international trade and helped to make the economic cycle of boom and bust smoother.

In terms of membership, members subscribed to the articles of agreement, by undertaking to conform to set of norms of behaviour that are combined in the article and also participate in the Fund's decision-making process. To be a member of the institution, countries apply and are allocated quotas, in consonance with members' relative size in the world economy: the larger a country's economy in terms of output, and the larger and more varied its trade, the higher its quota tends to be. The original members: the United States of America (USA), the United Kingdom (UK), France, Germany and Japan were more favoured in the allocation of quotas such that each could overrule the decision of several members whose quota allocation is very insignificant.

Unlike some international organizations (such as the United Nations General Assembly)that operate under a one-country-one vote principle, the IMF has a weighted voting system: the larger a country's quota in the Fund, the more votes it has. However, the Board decisions are based on consensus among its members and are supported unanimously.

The objective of this paper is to examine and discuss the workings of the Bretton Woods Institution with particular focus on the International Monetary Fund (IMF). This is to enhance understanding of the expanded role of the IMF.

For ease of exposition, the paper is divided into five parts. Following this introduction, Part II explains the IMF's role in the world economy, while Part III presents relationships between the Fund and its members, highlighting member

*The viewzs expressed in this paper are those of the author and do not represent the official position of the Central Bank of Nigeria or its Board of Directors.

** Messrs Adenuga and Evbuomwan are Assistant Director and Assistant Economist, respectively, in Modeling and Forecasting Office, Macroeconomic Modeling Division, Research Department of the Central Bank of Nigeria.

obligation to the Fund and Fund's obligation to its members. In Part IV, the expanded roles of the Fund are discussed, while the conclusion is contained in Part V.

2. IMF'S TRADITIONAL ROLE IN THE WORLD ECONOMY

2.1 Purposes

In a globalised world, the IMF, with its universal membership, is a cornerstone for promoting growth and stability. The Fund is the central institution of the international monetary system that fosters international payments and exchange rates among national currencies and encourage trade relations among countries. It aims to prevent crises in the system by encouraging countries to adopt sound economic policies, and also assist members in need for temporary financing to address balance of payments difficulties.

The purposes of the International Monetary Fund are:

(i) To promote international monetary cooperation through a permanent institution, which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and contribute thereby to the promotion and maintenance of high levels of employment and real income and to development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, maintain orderly exchange arrangements among members, and avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions, which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing then with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article.

To serve these purposes, the IMF:

• Monitors economic and financial developments and policies, in member countries and at the global level, and gives policy advice to its members based on its more than fifty years of experience. For example:

• In its annual review of the Japanese economy, the IMF Executive Board urged the Japanese government to stimulate growth by keeping interest rates low, encouraging corporate and bank restructuring, and promoting deregulation and competition.

• The IMF commended the Mexican authorities for their prudent economic management. It supported a move toward gradual implementation of inflation targeting and expressed concern about the undercapitalization of the banking system.

• In its Spring 2001 World Economic Outlook, the IMF highlighted the risks of a further weakening of global growth and the need for a proactive policy approach to support demand and for growth-oriented structural reforms.

• lends to member countries with balance of payments problems, not just to provide temporary financing but to support adjustment and reform policies aimed at correcting the underlying problems. For example:

• During the 1997-98 Asian financial crises, the IMF acted swiftly to help Korea bolster its reserves. It pledged $21 billion to assist Korea reform its economy, restructure its financial and corporate sectors, and recover from recession. Within four years, Korea had recovered sufficiently to repay the loans and, at the same time, rebuild its reserves.

• Provides the governments and central banks of its member countries with technical assistance and training in its areas of expertise. For example:

• Following the collapse of the Soviet Union, the IMF stepped in to help the Baltic States, Russia, and other former Soviet constituents set up treasury systems for their respective central banks as part of the transition from centrally planned to market-based economic systems.z discussing not only national economic policies in a global context, but also issues important to the stability of the international monetary and financial system. These included countries' choice of exchange rate arrangements, the avoidance of destabilizing international capital flows, and the design of internationally recognized standards and codes for policies and institutions.

The fund is helping to make globalization work for the benefit of all by strengthening to strengthen the international financial system and accelerating progress toward reducing poverty, as well as promoting sound economic policies among all its member countries.

Apart from rising prosperity, the world economy and monetary system In the decades since World War II have undergone other major changes. Rapid advances in technology and communications have contributed to the increasing international integration of markets and closer linkages among national economies. As a result of this, whenever financial crises erupt, they now tend to spread more rapidly among countries.

The IMF medium of exchange is the special drawing right (SDR). The SDR is an international reserve asset introduced by the IMF in 1969 (under the First amendment to its Articles of Agreement) out of concern among IMF members that the current stock, and prospective growth, of international reserves might not be sufficient to support the expansion of world trade. The main reserve assets were gold and U.S. dollars, and members did not want global reserves to depend on gold production, with its inherent uncertainties, and continuing U.S. balance of payments deficits, which would be needed to provide continuing growth in U.S. dollar reserves. The SDR was introduced as a supplementary reserve asset, which the IMF could "allocate" periodically to members when the need arose, and cancel, as necessary.

Although SDRs – sometimes known as "paper gold" – have no physical form – have been allocated to member countries (as book-keeping entries) as a percentage of their quotas. So far, the IMF has allocated SDR 21.4 billion (about $29 billion) to member countries. The last allocation took place in 1981, when SDR 4.1 billion was allocated to the 141 countries that were then members of the IMF. Since 1981, the membership has not seen a need for another general allocation of SDRs, partly because of the growth of international capital markets. However, in light of the IMF's expanded membership – which included countries that had not received an allocation – the Board of Governors, in September 1997, proposed a Fourth Amendment to the Articles of Agreement. When approved by the required majority of member governments, this will authorize a special one-time "equity" allocation of SDR 21.4 billion, to be distributed so as to raise all members' ratios of cumulative SDR allocations to quotas to a common benchmark.

IMF member countries may use SDRs in transactions among themselves, with 16 "institutional" holders of SDRs, and with the IMF. The SDR is also the IMF's unit of account. A number of other international and regional organizations and international conventions use it as a unit of account or as a basis for a unit of account.

The SDR's value is set daily using a basket of four major currencies: the Euro, Japanese yen, pound sterling, and U.S. dollar. On December 30, 2011, SDR 1.535270 = US$1. The composition of the basket is reviewed every five years to ensure that it is representative of the currencies used in international transactions, and that the weights assigned to the currencies reflect their relative importance in the world's trading and financial system.

2.II Advice on Policies and Global Oversight

The IMF's Articles of Agreement empowered it to oversee the international monetary system, including exercising firm "surveillance" – that is, oversight – over the exchange rate policies of its member countries. Each member country undertakes to collaborate with the IMF in its efforts to ensure orderly exchange arrangements and promote a stable system of exchange rates. The regular monitoring of economies and associated provision of policy advice, that IMF surveillance involves can help signal dangers ahead and enable members to act in a timely way to avoid trouble.

The IMF conducts its oversight in three ways:
Country surveillance, which takes the form of regular (usually yearly) comprehensive consultations with individual member countries about their economic policies, with interim discussions as needed. The consultations are referred to as "Article IV consultations" as they are mandated by Article IV of the IMF's charter.

The IMF staff review the country's macroeconomic (fiscal, monetary, and exchange rate) policies, assess the soundness of the financial system, and examine industrial, social, labour, governance, environmental and other policy issues that may affect macroeconomic policies and performance. The staff team then submits a report on its findings, approved by management, to the Executive Board, which discusses the analysis by the Staff. And the Board's views, summarized by its Chairman, are transmitted to the country's government. In this way, the views of the global community and the lessons of international experience are brought to bear on the policies of the country concerned.

Global surveillance entails review by the IMF's Executive Board of global economic trends and developments. The main reviews of this kind are based on World Economic Outlook reports prepared by IMF staff, normally twice a year, before the semi-annual meetings of the International Monetary and Financial Committee (IMFC). The

reports are published in full prior to the IMFC meetings, together with the Chairman's summing up of the Executive Board's discussion.

Regional surveillance, under which the IMF examines policies pursued under regional arrangements. These include, Board discussions focusing on developments in the European Union, the euro areas, the West African Economic and Monetary Union, the Central African Economic and Monetary Community, as well as the Eastern Caribbean Currency Union. IMF management and staff also participate in surveillance discussions of such groups of countries as the G-7 (the Group of Seven major industrial countries) and the Asia-Pacific Economic Cooperation (APEC) forum.

2.III IMF Lending Role

The IMF lends foreign exchange to countries with balance of payments problems. An IMF loan eases the adjustment that a country has to make to bring its spending in line with its income so as to correct its balance of payments problems. But IMF lending is also intended to support policies, including structural reforms and growth prospects in a lasting way.

The IMF also provides the country's authorities with advice on the economic policies that may be expected to address the problems most effectively. For the IMF to provide financing, it must agree with the authorities on a programme of policies aimed at meeting specific, quantified goals, regarding external viability, monetary and financial stability, and sustainable growth. Details of the programme are spelled out in a "letter of intent" from the government to the Managing Director of the IMF.

A programme supported by IMF financing is designed by the national authorities in close cooperation with IMF staff, and is tailored to the special needs and circumstances of the country. This is essential for the programme's effectiveness and for the government to win national support for the programme. Such support – or "local ownership" – of the programme is critical to its success. Each programme is also designed flexibly, so that, during its implementation, it may be reassessed and revised if circumstances change. Many programmes are, in fact, revised during implementation.

2.IV IMF Facilities

The IMF provides loans under a variety of policies of "facilities" that have evolved over the years to meet the needs of the membership. The duration, repayment terms, and lending conditions attached to these facilities vary, reflecting the types of balance of payments problem and circumstances they address.

Most of the IMF's financing is provided through some of the following lending policies:

Stand-By-Arrangements: It provides assurance to a member country that it can draw up to a specified amount, usually over 12 – 18 months, to deal with a short-term balance of payments problem.

Extended Fund Facility: Provides assurance that a member country can draw up to a specified amount, usually over three to four years, to help it tackle structural economic problems that are causing serious weaknesses in its balance of payments.

Poverty Reduction and Growth Facility (PRGF): This facility replaced the Enhanced Structural Adjustment Facility in November 1999. A low interest rate facility helps the poorest member countries facing protracted balance of payments problems solve their difficulties. The cost to borrowers is subsidized with resources raised through past sales of IMF-owned gold, together with loans and grants provided to the IMF for the purpose by its members.

Supplemental Reserve Facility (SRF): Provides additional short-term financing to member countries experiencing exceptional balance of payments difficulty because of a sudden and disruptive loss of market confidence reflected in capital outflows. The interest rate on SRF loans includes a surcharge over the IMF's usual lending rate.

Contingent Credit Lines: Precautionary lines of defense enabling members pursuing strong economic policies to obtain IMF financing on a short-term basis when faced by a sudden and disruptive loss of market confidence because of contagion from difficulties in other countries.

Emergency Assistance: Introduced in 1962 to help members cope with balance of payments problems arising from sudden and unforeseeable natural disasters, this form of assistance was extended in 1995 to cover certain situations in which members have emerged from military conflicts that have disrupted institutional and administrative capacity.

2.V Key features of IMF lending

- The IMF is not an aid agency or a development bank. It lends to help its members tackle balance of payments problems and restore sustainable economic growth. The foreign exchange provided, the limits on which are set in relation to a member's quota in the IMF, is deposited with the country's central bank to supplement its international reserves and thus to give general balance of payments support. Unlike the loans of development

agencies, IMF funds are not provided to finance particular projects or activities.

- IMF lending is conditional on policies: the borrowing country must adopt policies that promise to correct its balance of payments problem. The conditionality associated with IMF lending helps to ensure that by borrowing from the IMF, a country does not just postpone hard choices and accumulate more debt, but is able to strengthen its economy and repay the loan. The country and the IMF must agree on the economic policy actions that are needed. Also the IMF disburses funds in phases, linked to the borrowing country's meeting its scheduled policy commitments. During 2000-2001 the IMF worked to streamline its conditionality – making it more sharply focused on macroeconomic and financial sector policies, less intrusive into countries' policy choices, more conducive to country ownership of policy programmes, and thus more effective.

- IMF lending is temporary. Depending on the lending facility used, loans may be disbursed over periods as short as six months and as long as four years. The repayment period is 3 - 5 years for short-term loans (under Stand-By-Arrangements), or 4 - 10 years for medium-term financing (under Extended Arrangements); but in November 2000, the Executive Board agreed to introduce the expectation of earlier repayment – over 2 to 4 years for Stand-By Arrangements and 4 - 7 years for Extended Arrangements. The repayment period for loans to low-income countries under the IMF's concessional lending facility, the PRGF, is 10 years, with a 5 - year grace period on principal payments.

- The IMF expects borrowers to give priority to repaying its loans. The borrowing country must pay back the IMF on schedule, so that the funds are available for lending to other countries that need balance of payments financing. The IMF has in place procedures to deter the building-up of any arrears, or overdue repayments and interest charges. Most important, however, is the weight that the international community places on the IMF's status as a preferred creditor. This ensures that the IMF is among the first to be repaid even though it is often the last lender willing to provide a country with funds, after the country's ability to fulfill its obligation has clearly come into question.

- Countries that borrow from the IMF's regular, non-concessional lending windows – all but the low-income developing countries – pay market-related interest rates and service charges, plus a refundable commitment fee. A surcharge can be levied above a certain threshold to discourage heavy use of IMF funds. Surcharges also apply to drawings under the Supplemental Reserve Facility. Low-income countries borrowing under the Poverty Reduction and Growth Facility pay a concessional fixed interest rate of 0.5% per cent a year.

- In most cases, the IMF, when it lends, provides only a small portion of a country's external financing requirements. But because the approval of IMF lending signals that a country's economic policies are on the right track, it reassures investors and the official community and helps generate additional financing from these sources. Thus, IMF financing can act as an important lever, or catalyst, for attracting other funds.

3. RELATIONSHIP BETWEEN IMF AND ITS MEMBERS

Members' relationship with the IMF and vice versa is determined by each member's role to the IMF through Management of the IMF and provision of the resources; and the Fund's role to members are as provided by the Articles of Agreement.

3. I Members' Role to the Fund

The members' role to the Fund does not start and end with the provision of Funds' resources. The day-to-day running of the Fund lies in the hands of the Executive Board of Governors, on which all member countries are represented. The Board of Governors is the highest decision-making and governing body of the IMF institution. The staff of the Fund are recruited from member countries, but since these staff are international civil servants, their responsibility is to the Fund and not to national authorities.

The IMF's resources come mainly from the quota subscriptions that countries pay when they join the Fund or following periodic review; although the Fund can also borrow. The larger a country's economy in terms of output and the larger and more variable its trade, the higher its quota tends to be. Currently, USA is the World's largest economy and contributor to the IMF. Quota also determines a country's voting power, the amount of financing that a country can receive from IMF and its share in Special Drawing Right (SDR) allocations.

3. II Fund's Role to its Members

The IMF is accountable to its member countries and this accountability is essential to its effectiveness. Unlike other international organisations, most decisions of IMF are based on consensus among its members and are supported unanimously.

In line with the Articles of Agreement, IMF helps its members by:

- Reviewing and monitoring national and global economic and financial developments.

- Lending them hard currencies to support adjustment and reform

CENTRAL BANK OF NIGERIA
LIBRARY

policies designed to correct balance of payments problems and promote sustainable growth; and

- Offering a wide range of technical assistance, as well as training for government and Central Bank Officials, in its areas of expertise.

The IMF therefore, conducts its oversight surveillance functions in three ways.
(a) Country surveillance, which is often referred to as Article IV consultation. In this process, IMF staff takes regular comprehensive consultations with individual member countries about their economic policies. The Executive views of such consultations are subsequently transmitted to the country's government. In conformity with recent changes, the Board's discussions and findings of such Article IV consultations are now being published for public information.

(b) Global surveillance entails the reviews by the IMF's Executive Board of global economic trends and developments. The main reviews are based on world economic outlook reports prepared by IMF Staff. The reports are normally published in full prior to International Monetary and Financial Committee meetings, together with the Chairman's summing up of the Executive Board's discussion. It is also after such meetings that international global development, prospects and policy issues affecting international capital markets are published.

(c) Regional surveillance under which IMF examines policies pursued under regional arrangements. Here IMF Staff participate in discussions/meetings on developments for example, European Union, the Euro area and the likes.

IMF lends to countries in difficulty to make such countries bring its spending in line with its income, so as to correct its balance of payments problem. IMF lending is also intended to support policies including structural reforms that will improve a country's balance of payments position and growth prospects in a lasting way. Such loans enable countries in difficulty to make external payments and maintain an appropriate level of reserves, without taking measures that will be destructive of national or international prosperity. To prevent countries in difficulty adopting such measures which included trade restrictions and payments, a sharp compression of demand in domestic economy, or a sharp depreciation of the domestic currency, in among the purpose which IMF exists to serve.

The IMF provides loans under a variety of facilities that have evolved over the years to meet the needs of the membership. The duration, repayment terms and lending conditions attached to these facilities vary, but reflect the types of balance of payments problem a member may have and circumstances they address.

Most of the IMF financing are provided through three different types of lending policies:

3.II.I Stand-By Arrangements (SBAs)

This forms the core of the IMF lending policies and deals mainly with short-term balance of payments problems. IMF seal of approval, implied by the granting of a standby arrangement after discussion with a country about its economic plans, is an important factor in encouraging private capital flows to such country. Stand-by Arrangement provides assurance to a member country that it can draw up a specified amount, over 12 – 18 months period, to deal with short-term balance of payment problem.

An IMF Stand-By Arrangement is a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account (GRA) in accordance with the terms of the decision during a specified period and up to a specified amount. This arrangement is a contract designed to provide short-term balance of payments assistance for deficits of a temporary nature. SBA usually cover a period of one to two years (although they can also be for periods of less than a year or up to three years), with quarterly performance criteria and semi-annual reviews.

A member having a Stand-by Arrangement will have the right to engage in the transactions covered by the Stand-by Arrangements without further review by the Fund. The right could be suspended only with regards to request received by the Fund after a formal ineligibility i.e a decision of the Executive Board to suspend transactions either generally or in order to consider a proposal made by an Executive Director, or the Managing Director, formally to suppress or to limit the eligibility of the member. Usually, there would be consultations between the Fund and the member and an agreement would be reached on the terms for the resumption of such purchases.

The benefits derivable from proper implementation of SBA include the following:
- Reduction in the growth of money supply.
- Increase in the net international reserves.
- Achievement of stable and market determined exchange rate.
- Strengthen supervisory and regulatory activities over the financial sector to improve the system's soundness.
- Enhancement of effective and efficient monetary policy.

The use of IMF resources under an SBA is subject to the observance of economic performance criteria and reviews of progress under the programme supported by the arrangement. The performance criteria typically include: budgetary and credit ceilings, avoidance of restrictions on current international payments transfers, limits on the amount and maturity of new short-and medium term external debt, avoidance of external payments arrears, and maintenance of minimum levels of net foreign reserves. Often, these criteria may be directly linked to certain actions, such as specific reforms in tax administration or the financial sector necessary for the attainment of the objectives of the economic programme. In addition, members are expected to adopt economic policies that will resolve their balance of payments difficulties within a reasonable period.

The SBA conditionality provides assurances to the country that as long as it implements the agreed policies; it will continue to receive financing commitment from the Fund while it provides safeguards to the IMF that the financing commitment obtained would be utilized for the intended purposes thus guaranteeing repayment.

3.II.II SBA Conditionality Guidelines

It is worthy of note that the use of Fund's General Resources and Stand-By Arrangements follows the guidelines on conditionality as enumerated below:

- Members should be encouraged to adopt corrective measures, supported by the use of the Fund's general resources at an early stage of their balance of payment difficulties.

- The normal period for an SBA is one year. However, it may be extended up to, but not beyond, three years.

- Due regard is paid to the domestic economic, social and political objectives of member countries.

- The number and content of performance criteria may vary due to the diversity of problems and institutional arrangements of members.

- The Managing Director will ensure adequate coordination in the application of policies relating to the use of the Fund's general resources with a view to maintaining the non-discriminatory treatment of members.

- There will always be provision for a review if the performance criteria could not be met.

3.II.III The Extended Fund Facility (EFF)

This is a medium term extended facility intended for countries with balance of payments difficulties related to structural problems that take longer time to correct than macroeconomic weaknesses. It was a major innovation in IMF policy aimed at providing finance for poor countries outside the quota resources of IMF. It is financed by member industrial or middle income countries in the form of loans and grants.

A special feature of the facility was the submission of a policy frame- work paper (PFP) by the country need of the funds' facility. The paper (PFP) details public investment programmes, financing needs over a period of three years, as well as structural adjustment policies to be undertaken to reduce obstacles to sustainable growth and balance of payments viability.

Loans under the programme are highly concessional, with interest rate of 0.5% and repayment periods ranging from 6 – 10 years after disbursement. Access to the facility ranges from an average of 150% of quota to a maximum access of 350 percent, in exceptional cases.

3.II.IV Poverty Reduction and Growth Facility (PRGF)

The Extended Structural Adjustment Facility (ESAF) which has now been changed into the Poverty Reduction and Growth Facility (PRGF) in the context of debt relief initiative for the Heavily Indebted Poor Countries (HIPC) is reviewed every five years. This change from ESAF to HIPC came into being in November 1999; aimed at making poverty reduction and economic growth the central objectives of policy programmes in the countries concerned.

According to the Managing Director of International Monetary Fund (IMF), IMF should play an active part in making global economic integration work for the benefit of all members. Therefore, the IMF should remain engaged in the poor developing countries through the Poverty Reduction and Growth Facility (PRGF) and the Highly Indebted Poor Countries (HIPC) initiative. Reducing poverty requires sustained global expansion and the industrial countries must recognise that it is in their own interest to come forward with bold initiatives to open their markets, to provide generous debt relief and higher levels of official development assistance.

The IMF is a monetary not a developmental institution but has an important role to play in reducing poverty in its member countries. At the heart of IMF mandate is sustainable economic growth, which is essential for reducing poverty and requires sound macroeconomic policies. In past years, various policy options had been adopted but with little or no impact on poverty reduction. In 1999, therefore, at the annual meeting of IMF and the

World Bank, Ministers and member countries endorsed a new approach to poverty reduction strategies. They decided to make countries generate poverty Reduction Strategies Papers (PRSPs), the basis of all IMF and World Bank concessional lending and debt relief.

The New approach to poverty reduction focuses on the poor as their needs get first priority with broad participation of the civil society when formulating the strategy. It places the poor countries on the "driving seat" of their own development, with a clearly articulated vision for their future and a systematic plan to achieve their goals. The approach has four basic principles, which have guided the development of poverty reduction strategies. These include:

- A comprehensive approach to development and a broad view of poverty are essential.

- Faster economic growth is critical for sustained poverty reduction and greater participation by the poor can increase a country's growth potentials.

- Country "ownership" of the goals, strategy and direction of development and poverty reduction is vital.

The development community must work together closely and the focus clearly on result.

4. THE EXPANDED ROLE OF THE FUND

The changing circumstances in the world economy have required IMF to redefine, reassess and refocus its priorities. Refocusing of priorities has been a continuous process in the workings of IMF and this has had a salutary impact on the IMF's development and governance.

One of the remarkable developments of the past years has been that the developing countries have occupied an increasingly central position in the institutions functioning. This was due to deteriorating living conditions in developing countries and the Latin American debt crisis which made IMF to strengthen its focus on growth, structural adjustment, and external debt management.

In the 1990s, the transformation of centrally planned economies into free market societies and the issues of poverty alleviation in the poorest countries as well as concerns regarding the functioning of global financial markets and the soundness of financial systems have prompted a major widening of the core tasks of the IMF and other specialised institutions. Surveillance continues to be the key instrument for crisis prevention. The IMF has, therefore, taken the lead in concerted vigilance over the soundness of financial systems. **One of these expanded role and surveillance activities of the fund included.**

4. I Combating and Financing of Terrorism

The abuse of the international financial system to finance terrorism and launder the proceeds of illegal activities had long been identified as issues of global concern. The issue became more worrisome after the September 11, 2001 terrorist attack on the United States of America. The Fund and the World Bank had been playing an active role in the international efforts to fight money laundering. The Financial Sector Assessment Programme (FSAP) developed by the Fund and World Bank is contributing to the strengthening of sound financial systems in member countries. The in-depth analysis conducted during the exercise are very helpful in identifying and correcting weaknesses in the financial system and are, therefore, contributing to enhancing financial stability and sound national and regional institutions.

The Fund Board at their meeting of July 2002 endorsed adding Anti-Money Laundering and Combating Financing Terrorism (AML/CFT) to the list of 11 areas where standards and codes are useful to the operational work of the Fund. They agreed also to adopt the Financial Action Task Force (FATF) associated standards.

Four principles highlighted for the Fund/Bank Staff involvement in AML/CFT assessment include:

(a) The assessment of non-prudential regulated financial sector activities.

(b) All assessment procedures should be transparent and consistent with the mandate and core expertise of the different institutions involved, and compatible with the uniform, voluntary and cooperative nature of the ROSC exercise;

© Assessment should be followed up with technical assistance at the request of the jurisdictions concerned; and

(d) Assessments should be conducted in accordance with comprehensive and integrated methodology.

Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) assessment is now standard components of Financial Sector Assessment Programme (FSAP) and Offshore Financial Centres Assessment (OFC).

4.II Sovereign Debt Restructuring Mechanism (SDRM)

The IMF as part of its on-going work on crisis prevention and resolution,

has begun discussions on how to assist countries with unsustainable debts resolve such issues in an orderly manner. To avoid crisis, the Fund as part of its obligation is considering two complementary approaches to creating a more orderly and predictable process for sovereign debt restructuring:

(a) A contractual approach in which debt restructuring would be facilitated by enhanced use of certain contractual provisions in sovereign debt contracts; and

(b) The establishment of a Universal Statutory Framework, which would create a legal framework for collective decision making by debtors and a super majority of creditors. With the above in mind, the Executive Board had had discussions that provided a preliminary discussion on two central issues in the design of SDRM. They are the scope of the debt that SDRM will cover and claims involved.

4. II.I Rationale for the SDRM

Often, countries experience severe financial difficulties as a result of major portfolio imbalances or through balance sheet difficulties, extending beyond the sovereign. A resolution of such financial crisis and a return to sustainable growth will require adjustments to sovereign debt burden, complemented by other policies. In this wise, it is recognised that SDRM would constitute a central element of a broader crisis resolution strategy.

Country experiences had tended to support the need for SDRM review. A default or a restructuring in the shadow of default may involve declining real incomes and curtailed private investment, financial sector difficulties and a drain on external reserves of the country, in its attempt to stem pressures from capital outflows. Also, efforts to resolve collective action difficulties equally provide the motivation for contractual approaches to improving sovereign debt restructuring mechanisms. The current process of sovereign debt sustainability imposes undue costs on both the debtor country and creditors because it is prolonged and unpredictable. It may also risk contributing to contagion, with associate costs and risks for the stability of the international financial system.

Against this background, there is an increasing recognition in both the official sector and private markets for the current process of restructuring the debt of a sovereign, to be improved. Therefore, the objective of the sovereign debt restructuring mechanism is to provide a framework that strengthens incentives for a sovereign and its creditors to reach a rapid and collaborative agreement on a restructuring of unsustainable debt in a manner that preserves the economic values of assets and facilitates a return to medium-term viability. For such a mechanism to achieve its objective, it must not only address collective action problems amongst creditors but also bring an early and effective dialogue between the debtor and its creditors.

4. II.II Principles Guiding the Design of the Mechanism

The design of a mechanism that would achieve the above objectives invariably requires and raises a wide range of complex issues of a legal and financial nature. With a view to ensuring that these issues are resolved and the objectives achieved, the following principles should guide the design:

- The mechanism should only be used to restructure debt that is judged to be unsustainable. It should neither increase the likelihood of restructuring nor encourage defaults.

- In circumstances where a member's debt is unsustainable, the mechanism should be designed to catalyze a rapid restructuring. One of the reasons why the cost of restructuring is so high is that it is usually subjected to undue delays, both in terms of when the restructuring process is initiated and its duration. For this reason, the mechanism should create incentives for an early and collaborative engagement between the debtor and its creditors and should establish a procedure that enables the restructuring process to be completed within a reasonable time frame.

- Any interference with contractual relations should be limited to those measures that are needed to resolve the most important collective action problems. The principal feature of the mechanism is that it would allow a sovereign and qualified majority of creditors to reach an agreement that would then be made binding on all creditors that are subject to the restructuring, paying due regard to seniority among claims. The merits of including any other measure that would interfere with contractual relations must be assessed in terms of: (i) whether it resolves a critical collective action problem; (ii) whether it does so in a manner that minimizes interference with contractual rights and obligations.

- The framework should be designed in a manner that promotes greater transparency in the restructuring process. Accordingly, the mechanism should establish procedures that enable creditors to have adequate access to information regarding the debtor's general situation, including its all overall debt (and its treatment of creditors that may not be subject to the mechanism), economic prospects and policies, and the proposed financing plan.

• The mechanism should encourage early and active creditor participation during the restructuring process. In addition to providing for a creditor vote on the terms of a restructuring, the framework should enable creditors to play an active role at earlier stages in the process, including through the formation of creditors' committees.

• The mechanism should not interfere with the sovereignty of debtors. The mechanism should not be activated without the sovereign's request. Accordingly, the sovereign would only seek to activate the mechanism when it had formed a judgement that the features of the SDRM would enhance its capacity to restructure its debt rapidly and in a manner that limits economic dislocation.

• The framework should establish incentives for a negotiation. The process of restructuring sovereign debt is relatively complex, requiring the resolution of a number of difficult substantive and procedural questions. To the extent possible, these issues should be resolved through the give-and-take of negotiations and, therefore, the mechanism should not be designed in a manner that presumes a particular outcome.

• The framework needs to be sufficiently flexible-and simple- to accommodate the operation and evolution of capital markets. The provisions of the SDRM must be sufficiently clear for the process to be predictable. At the same time, however, it should avoid relying on overly detailed and narrow rules and definitions that will only invite future circumvention through financial engineering.

• Since the framework is intended to fill a gap within the existing financial architecture, it should not be used to restructure the claims of public entities that are already subject to domestic insolvency systems.

• The integrity of the decision making process under the mechanism should be safeguarded by an efficient and impartial dispute resolution process. Since the mechanism will aggregate diverse claims for voting and restructuring purposes, disputes are likely to arise as to the validity and value of these claims. Resolving these disputes in a fair, impartial and expeditious manner is critical to the success of the restructuring exercise.

• Finally, the formal role of the Fund under the SDRM should be limited. Although the SDRM would be established through an amendment of the Fund's Articles of Agreement, the SDRM should not give the existing organs of the Fund any new significant legal powers. In the final analysis, however, the framework should be designed to catalyze early and effective dialogue between the debtor and creditors-it should not increase the role of the Fund in this dialogue.

4. II.III Scope of Claims to Be Covered

While the mechanisms would identify the scope of claims that could potentially be subject to a restructuring ("eligible claims"), whether all or some of these claims would be restructured in a particular case would depend on the negotiations between the debtor and its creditors. As a general rule, eligible claims would include all rights to receive payments relating to the commercial activities of the sovereign. The central government would have the option to include its own debt and, subject to the consent of the debtor in question, claims on: (i) the central bank and (ii) public entities or sub-national governments that are not subject to a domestic insolvency framework.

Specific exclusions from "eligible claims" would include:

v Claims that are governed by domestic law and subject to the exclusive jurisdiction of the domestic courts. Although such claims would be restructured outside the SDRM, the transparency requirements of the SDRM would ensure that the holders of external claims were aware of the terms being offered to the holders of domestic claims when they vote on a proposed restructuring agreement under the SDRM.

v Claims that benefit from privileges, such as secured claims, which could not be restructured absent the individual consent of the creditor in question. However, to the extent that the value of the claim exceeds the value of the privilege, the "under secured" portion would be subject to restructuring under the SDRM.

v Claims held by international organisations, reflecting the unique role these institutions play in the existing international financial system.

5.0 CONCLUSION

The paper set out to explore the origin and role of IMF in the World Economy. The study traces the origin of International Monetary Fund (IMF), which with the International Bank for Reconstruction and Development (IBRD) – the World Bank, formed the Bretton wood Institutions, established in July 1944 in New Hampshire, USA.

In the decades since World War II, apart from rising prosperity, the World Economy and Monetary System have undergone other major changes. Its surveillance activities have been expanded and so has the role the bank plays to member countries and verse versa.

Rapid advances in technology and communication have

contributed to the increasing international integration of markets and closer linkages among National Economies. This has resulted in easy spread of financial crises among and between countries, when they erupt.

Administratively, the IMF has a weighted voting system. The larger a country's quota in the Fund, the more votes the country will have. Also Board decisions are based on consensus among members and are often supported unanimously.

The IMF medium of Exchange is the Special Drawing Right (SDR). The SDR is an international reserve asset, introduced in 1969. SDR is therefore a Unit of Account. Its value is set daily using a basket of four major currencies, and reviewed every five years.

REFERENCES

Andrews D. (1999). Debt Relief for Law-Income Countries: The Enhanced et al (1999). HIPC Initiative, IMF Pamphlet Series No.51, November.

Guitian M. (1992). The Unique Nature of the Responsibilities of the International Monetary Fund, IMF Pamphlet Series No.46, September.

IMF (1995). Unproductive Public Expenditures: A pragmatic Approach to Policy Analysis, Pamphlet Series No.48. Fiscal Affairs Department, May.

IMF (1998). Financial Organization and Operations of the IMF, Pamphlet Series No.45 Fifth Edition, Treasurer's Department, March.

IMF (1998). The IMF and the Poor, Pamphlet Series No.52, March.

Masson P. R. and Mussa M. (1995). The Role of the IMF: Financing and Its Interactions with Adjustment and Surveillance, IMF Pamphlet Series No. 50, March.