International Business
Prof. J. K. Nayak
Department of Management Studies
Indian Institute of Technology, Roorkee

Lecture – 43
Bretton Woods Agreement, IMF, Its Role and Functions

Welcome friends. Welcome to the course of International Business. In the last lecture, we had discussed about the export promotional measures. And for example, we talked about the export promotion schemes right, how the government tries to undertake various schemes, like the duty drawback scheme, export finance scheme.

And then we talked about you know the various organizations involved in the export promotion in the India. For example, the IIFT for example, the (Refer Time: 01:00), and then the DGFT right. So, we talked about the various organizations and various schemes in the last lecture.

Today we will talk about the different institutions the economic institutions in the international scenario which are involved in international trade; not only in trade, but also they have a large influence on the monetary and economic condition of a country right. So, they are not exactly a part of the international business scene, but they have a importance on the economy as a whole.

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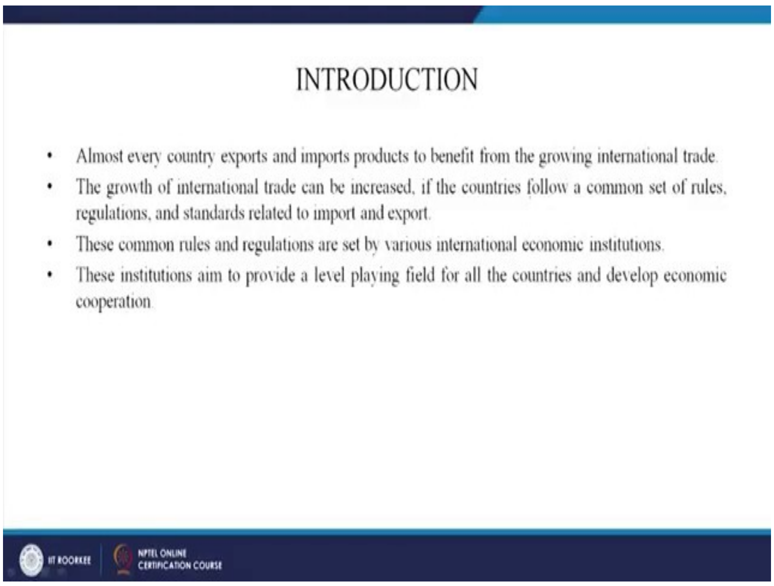

For example, let us talk start with the first one as it says almost every country exports and imports products to benefit from the growing international trade. The growth of trade can be increased, if the countries follow some common rules right, regulations, and standards related to the imports and exports, so that is the reason why the World Trade Organization tries to talk more about globalization. So, that you know and liberization, so that the economies open up more and then they would all be benefited.

So, in order to have those growth in trade and business, some rules and regulations are specified. These rules and regulations are set by various international economic institutions right.

This institutions aim to provide a level playing field, so that nobody takes advantage of it neither strong countries take at exploit the weaker ones which is generally the fear for against globalization right that large strong countries will take more advantage, and the weaker countries will get exploited that is the fear right, and develop economic cooperation right.

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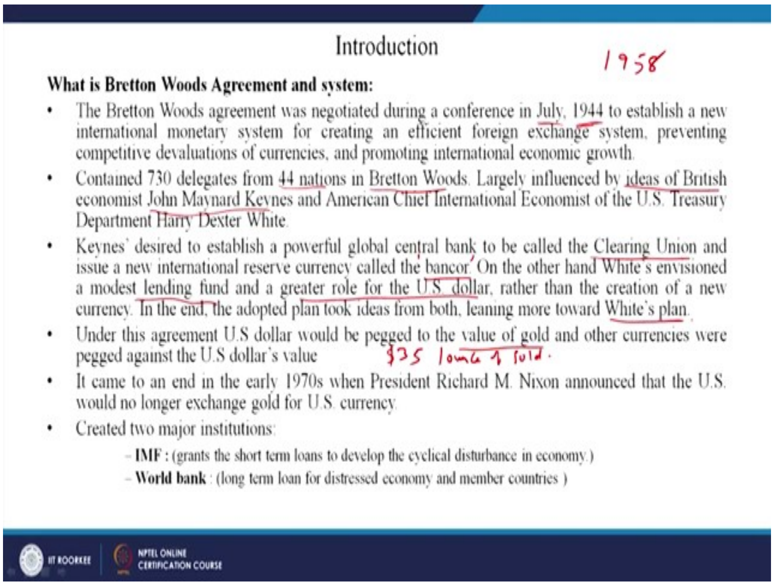

So, among when we talk about this economic institutions, so the major international economic institutions, we will start today when we talk about it we will first talk about before we get into any you know institution for that, we will talk about the Bretton's Wood agreement and system right. What is this Bretton Woods agreement, and why it we are discussing today?

This is an agreement which was negotiated during the World War II time right as you can see during the World War II. And it was established as a new international monetary system for creating an efficient foreign exchange system right, preventing competitive devaluations of currencies, and promoting international economic growth. So, after the World War what happened was many economies had got affected.

So, some of the elide you know countries they wanted to come together, and there were 44 nations in together as you can see here also. So, 44 nations who came together to set up a monetary system right, and they felt this monetary system would help in smooth transaction of business and trade.

So, it was held in Bretton Woods right, and 730 delegates came here which is also called as Bretton Woods conference right. Largely influenced by this Bretton Woods agreement was largely influenced by two people right, the ideas of one was John Maynard Keynes – his idea, and the other was the chief international economist of the US treasury department Harry Dexter White right. These two people had a significant influence in making this Bretton Woods agreement system.

What was Keynes you know thought? Keynes had desire to establish a powerful global central bank which would be called as the Clearing Union, and it would issue a new international reserve currency called the banker. This is what Keynes had wanted. On the other hand, why it is envisioned a modest lending fund and a greater role for the US dollar right? So, instead of creating a new currency and all that like the banker which Keynes was thinking, so White thought, we will be more of a creator lending fund right.

In the end, what happened, the adopted plan took ideas from both, and but it was more leaning towards White's plan, that means, a new currency was not adopted, but more of a funding approach was made right. Under this agreement, the US dollar would be pegged to the value of gold right.

What was the condition? The US dollar and that is at that time if I am not wrong 35 dollars right was were pegged against 1 ounce of gold, 1 ounce of gold right during the start. And then the other currencies would be pegged against the US dollars value right. So, this is how it went. So, the gold, the gold was pegged you know the dollars was pegged against the gold, and the other currencies were pegged against the US dollar right.

But this came to effectively if you know this systems started you know although in 44 you know in 1944 they joined. It effectively started working in you know in 1958 right. But in the early 70s when Nixon came into power and was the President of America, Richard Nixon, very famous for the water you know get scandal right announced that the US would no longer exchange gold for US currency right, so that is where the Bretton Woods agreement came to a stop.

But this great you know agreement or you can say this you know initiative which was taken had a wonderful influence because they created two institutions out of it one as you know very popularly called the IMF – International Monetary Fund which grants short term loans to develop the cyclical disturbance and economy, we will deal with it later on. And then the World Bank which gives long term loans for distressed economy right. So, this is how the whole things started.

So, now, let us move to the first one the two bodies after the Bretton Woods agreement was over in 70s. So, when the IMF was built, what is this IMF and how what is its major rules.

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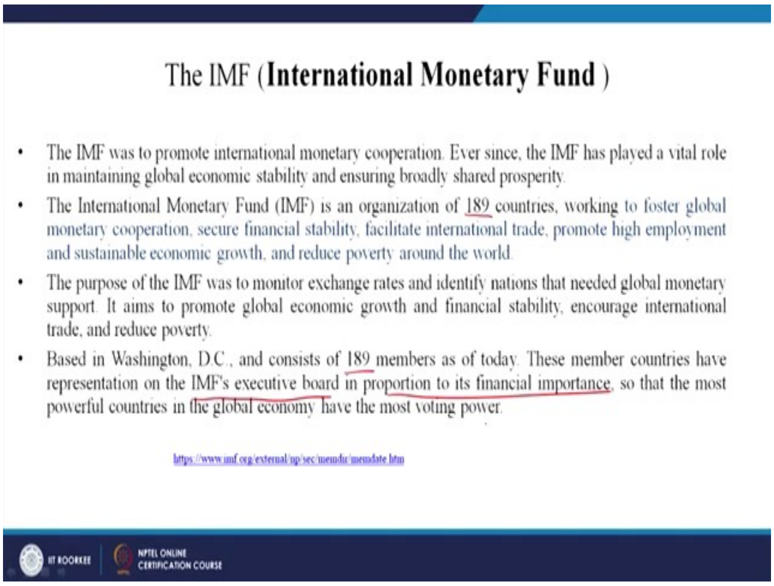

The IMF was to promote international monetary cooperation right, the whole idea was to promote international monetary cooperation. And it has played a vital role in maintaining global economic stability and ensuring broadly shared prosperity. So, it talks about prosperity as a shared principal, so everybody grows.

It is an organization as of today with 189 countries working to foster, so these are some of the you know major in objectives of the IMF to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment, and sustainable economic growth, and reduce poverty around the world. So, these are some of the objectives of the IMF right.

The IMF's another the purpose was to monitor exchange rates, and identify nations that needed global monetary support. So, suppose some country was in a monetary distress or a fiscal problem. So, it was IMF, it is IMF who goes into the as a savior right. It aims to promote the global economic growth and financial stability, encourage international trade, and reduce poverty as I have written already.

It is based in Washington DC, and 189 members are there. So, these member countries have representation on the IMFs executive board in proportion, this is very important. The member countries, so there are 189. These member countries have representation on the IMFs executive board in proportion to its financial importance in the global trade or something right, so that the most powerful countries in the global economy have the most voting power right ok.

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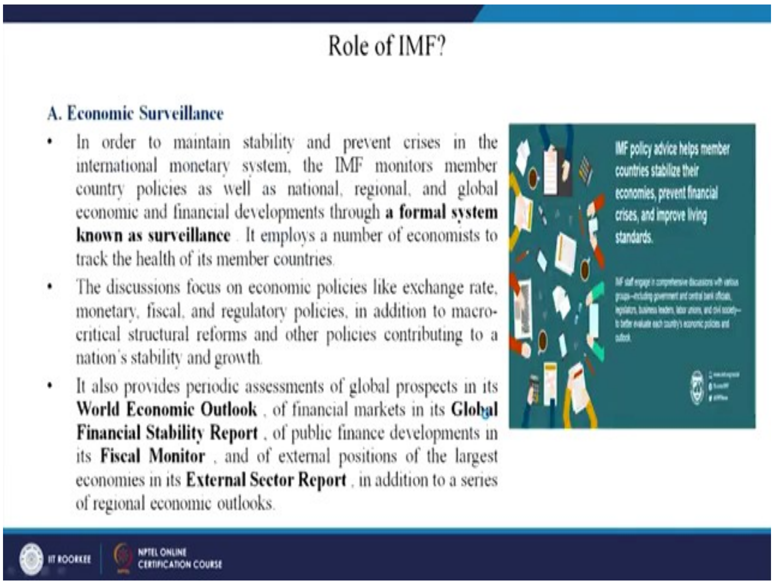

Now, let us deal with the role of IMF. So, let us discuss in detail. So, the first prominent I know role is that it plays the role of economic surveillance. Now, what is it mean? In order to maintain stability and prevent crisis in the international monetary system, so you must have heard of several crises which have happened in the past for example 29 there was a great depression, 2008 there was a you know the subprime crisis.

So, in 29, IMF was not there obviously, but the point is whenever there was a crisis an economic crisis around, the world 1980-99 Southeast Asian crisis was there. So, whenever such crises have occurred, the IMF immediately comes to the rescue of these nations right.

So, in order to maintain stability and prevent crisis in the international monetary system, the IMF monitors member countries policies as well as national, regional, and global economy, and financial developments through a formal system known as surveillance.

What its saying it creates a formal system to keep in check the policies of the various countries, the regions and the global economy as a whole.

It employs a number of economists right to track the health of its member countries. So, there are 189 member countries. So, it employs a large number of economists to take you know to keep track of the health economic health of these countries right. The discussions focus on economic policies like exchange rate, monetary policies, fiscal policy, regulatory policies, in addition to the macroeconomic structural reforms.

Now, what do you mean by structural reforms? Structural reforms are basically the you know the let us say the banking reforms, or you know the kind of policies which are have a structural effect right, or makes a structural change. So, for example, what are the BFC policy, what are the bank policies, how do govern banks, so these are things, and other policies contributing to a nation’s stability and growth.

It also provides periodic assessments of the global prospects in its World Economic Outlook, of financial markets in its Global Financial Stability Report, of public finance developments in Fiscal Monitor, and of external positions of the largest economies in its External Sector Report, in addition to a series of regional economic outlooks right. So, this is the first role of the IMF.

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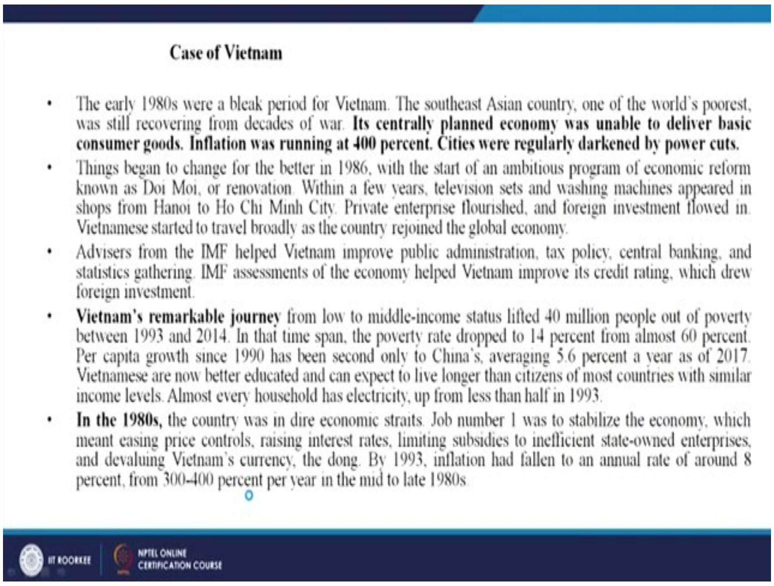

So, let us look at a case which I have brought. So, how Vietnam is a classic case which in the 1980s or early 80s, it went through a very difficult time right this country, one of the world's poorest was still recovering from the decades of war Vietnam, US-Vietnam war. I think it is very popular.

So, most of the people might have heard the Vietnam War right. So, it was still recovering from the war. Its centrally planned economy was unable to deliver basic consumer goods. So, the country was in a bad state. Inflation was running at 400 percent. The cities were regularly darkened by power cuts. So, these were very bad scene.

Things began to change around 1986, with the start of an ambitious program known as Doi Moi, or renovation in their language. Within a few years, Vietnam people had television sets, washing machines, consumer goods right which develop, and people you know there were lot number of businesses springing up, the private enterprise flourished, and forest foreign investment flowed in.

Vietnam is started to travel abroad, and you know joined the global economy. How it happened? Advisers from the IMF helped Vietnam improve public administration, tax policy, central banking, and statistics gathering. IMF assessments of the economy helped Vietnam improve its credit rating also which drew foreign investment.

And one of the you know the in this remarkable journey, it from a low to middle income status 40 million people were lifted out of poverty right. So, Vietnam's remarkable journey it says from low to middle income status lifted 40 million people right out of poverty between 93 and 2014 right, almost in a span of 21 years.

In this time span, the poverty rate dropped to 14 percent from 60 percent almost. Vietnam is are now better educated and expect to live longer, these are all indicators of a good economy also. So, almost every household has electricity, up from less than half in 1993 right.

In 1980s, the country was in dire economic states as I said. Job number, job number 1 was to stabilize you know what the IMF had to do was to stabilize the economy which meant easing price controls, raising interest rates, limiting subsidies to inefficient state owned enterprises, and devaluing the Vietnam currency. So, these are some of the problems.

So, the IMF had to take care of these problems, stabilize the economy, may ease the price controls right, raise the interest rates were rising, so that had to be controlled; subsidies where too much so that has to be again, and the Vietnam currency was devaluating, so the dong is basically right. All these things have to be taken care of right.

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So, the country transformed with the help of the support of you know the organizations like the Asian Development Bank, the World Bank and the IMF right. Finally, Vietnams went through a very good time and it was able to attract companies like South Korea's, Samsung and all these kind of good companies, and in fact the local companies in Vietnam also are doing pretty well today right. So, you can see a sea change that happened just because of a good you know intervention of the IMF in case of Vietnam right.

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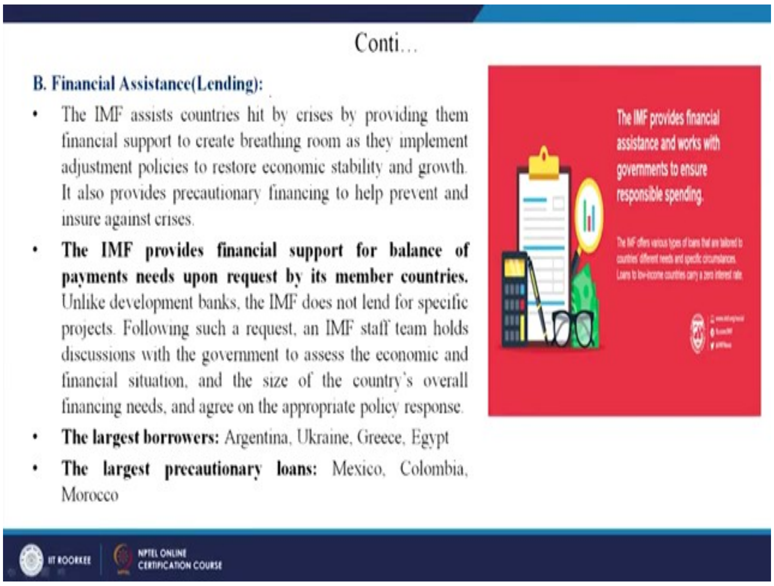

Second you know role of the IMF is to assist in financial assistance or lending, now what does it mean. The IMF assists countries hit by crisis, so if there is a country hit by crisis it provides financial support; to create breathing room as the implement adjustment policies to restore economic stability and growth. It also provides precautionary financing to help prevent and ensure against crisis.

So, it provides finance against when in different kind of situations, suppose there is a serious you know balance of payment crisis or sometimes due to some trade reforms; the country is going through some trade reforms and in and therefore, it is you know it has been because of some certain reasons, it has lost you know its ability to earn currency or revenue. So, all these time in this such situations the IMF comes and supports it for a time period right.

The IMF provides financial support for balance of payment needs upon request by its member countries. Unlike the development banks, the IMF does not lend; this is the difference what you can understand for specific projects.

So, IMF and the suppose for the example the World Bank, the difference is that the IMF does not lend for specific projects right. Following such a request, an IMF staff team holds discussion with the government to assess the economic and financial situations, and size and the size of the country’s, overall financing needs and agree upon the appropriate policy response right.

So, it is basically what it tries it is strike; it works like a elder brother, who tries to understand the countries problem and tries to correct its problem with the help of its you know economists who have the knowledge about the particular country x, y or z right. So, the largest borrowers has been like Argentina, Ukraine, Greece, Egypt and just some of the precautionary loans which have been given to Mexico, Colombia, Morocco.

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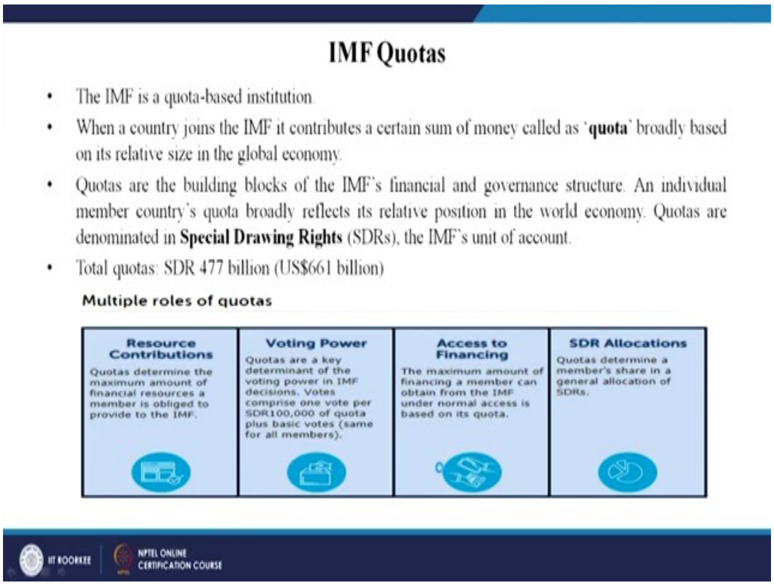

Now, what how does the IMF give loan basically right. So, the IMF is basically quota-based institution. Now, what is this quota? So, when a country joins to the IMF it becomes a member country, it contributes a certain sum of money right which is called as a quota right. So, and this quota is broadly based on its relative size in the global economy; so it is not same for everybody, it depends on the on your international size basically trade size, right.

Quotas are the building blocks of the IMFs financial and governance structure. An individual member country, member countries quota broadly reflects its relative position in the world economy as I said. And quotas are determined denominated sorry, in SDRs basically Special Drawing Rights which is the IMFs unit of account. As of today, the combined total quotas value is 477 billion or in terms of SDR or US 661 billion which you can take right.

Now, these are some of the multiple roles of quotas which have been shown in the diagrammatic form you can see for example, quotas determine the maximum amount of financial resources, a member is obliged to provide to the IMF right. Quotas are a key determinant of the voting power right, the maximum amount of financing a member can obtain from the IMF is based on its quota. Quotas determine a members share in a general allocation of the SDRs – Special Drawing Rights, right.

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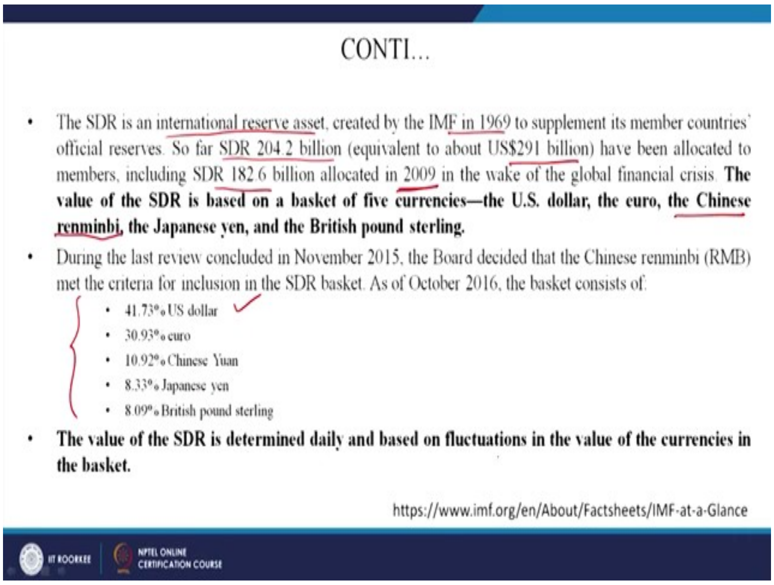

What is this SDR? It is an international reserve asset, the special drawing right is an international reserve asset created by the IMF in 69. To supplement its member countries official reserves right. So, far SDR 204.2 billion equivalent to 291 billion US dollars have been allocated to its members including 182.6 million allocated only in 2009 during the global financial crisis which is largely called as the subprime crisis also.

The value of the SDR is based on a basket of five currencies, it was earlier 4, the fifth one has been recently is recently going to be added; the US dollar, the euro, the Chinese; this one is the recent one the Chinese renminbi right, the Japanese yen, and the British pound sterling right.

So, this is how the percentage of the SDR count goes right in the SDR basket, the basket consists of so this 5; so US dollar 41.73, euro 30, the Chinese one or renminbi 10.92, Japanese 8.33, British pound 8.09. The value of the SDR is determined daily and based on fluctuations in the value of the currencies in the basket.

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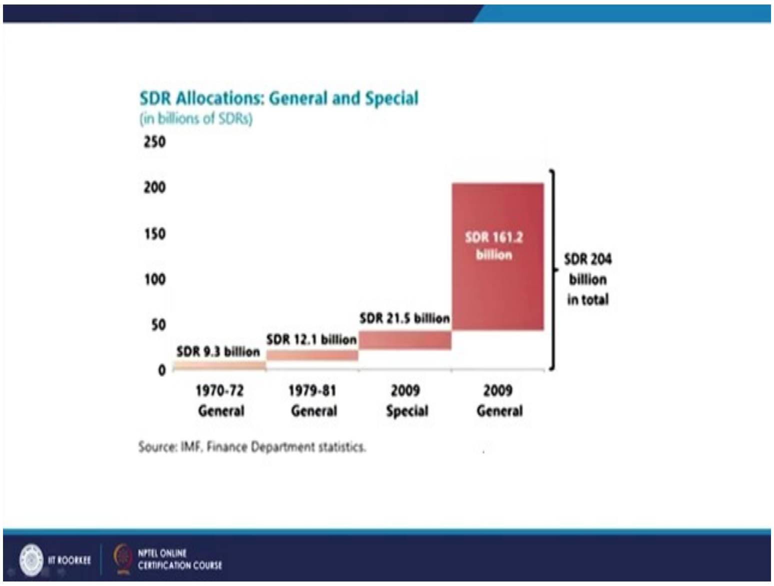

So, this is how it has been used till now allocated till now right that you can see later on also.

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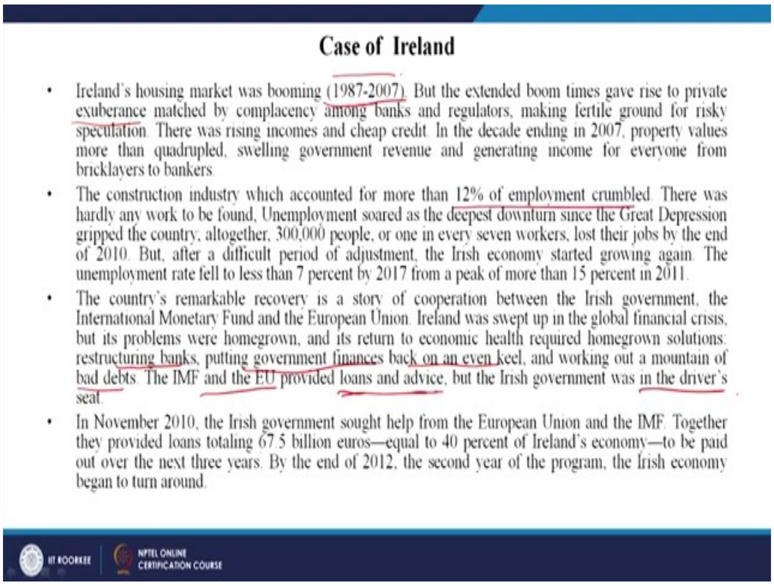

Another case we will talk about. So, this was a case which happened in Ireland. So, Ireland is economy is largely you know employment is largely driven by construction industry. Its housing market was booming in 1987 to 2007, so you can understand this is the same period we were talking about the great the severe financial crisis which happened in 2000 around 8.

So, but the extended boom times when you know during this time 87-2007, the country was doing pretty good right. It was one of the very good economies, but when you are in a good time you know the things tend to go wrong from there. So, what happened with the extended boom times gave rise to private exuberance.

So, people started spending money matched by complacency among banks, banks were complacent and they were not working efficiently and regulators. Making fertile ground for risky speculation, now they started making risky speculations which they were thinking nothing would go wrong, because in good times people are people generally think that nothing will go wrong; this is something like a you know we say, this is an you know psychological effect that we have that nothing would happen to me or nothing would go wrong with me right, so this is what happens.

So, there was rising incomes and cheap credit, but in the Decade ending in 2007 when property values more than quadrupled right, swelling government revenue and generating income for everyone from bricklayers to bankers, but that is where that time came and now the economy started going in the other side the on the bad side. The construction industry which accounted for more than 12 percent of the employee employment crumbled.

Hardly any work was to be found in Ireland, unemployment soared and since the great depression gripped the country in 2000, uh 1929, since then this was the now the second the biggest you know thing that had affected them.

Almost 300000 people or one in every seven workers lost their jobs by the end of 2010. After a difficult period of adjustment the Irish economy started growing again, the employment rate fell to less than 7 percent by 2017 from a peak 15 percent in 2011, so that is not a small size it is a huge size right.

The countries remarkable recovery story of cooperation between the Irish government and the IMF and the European Union. Ireland was swept in the global financial crisis right as we have seen, but its problems actually were home grown that means, the problems came from their own country right.

So, what was the problem. So, for example what did the IMF do and its returned to economic health required homegrown solutions. So, what did they do, restructuring of banks was done; putting government finances back on an even keel and working out at a mountain of bad debts, so all these things had to be corrected first.

So, the IMF and the EU provided loans and advice; so loans is only one thing which people thing there is the loan, but more than the loan the advice is equally important right; but the Irish government took up you know was in the driver seat and took the charge right.

In November 2010, Irish government sought help from the European Union and the IMF. Together they provided loans totaling 67.5 billion Euros equal to 40 percent of Ireland's economy, to be paid out over the next 3 years right. And by the end of 2012, the second year of the program right the Irish economy began to turn around. So, it was a again somewhat dark time to a positive side they moved right.

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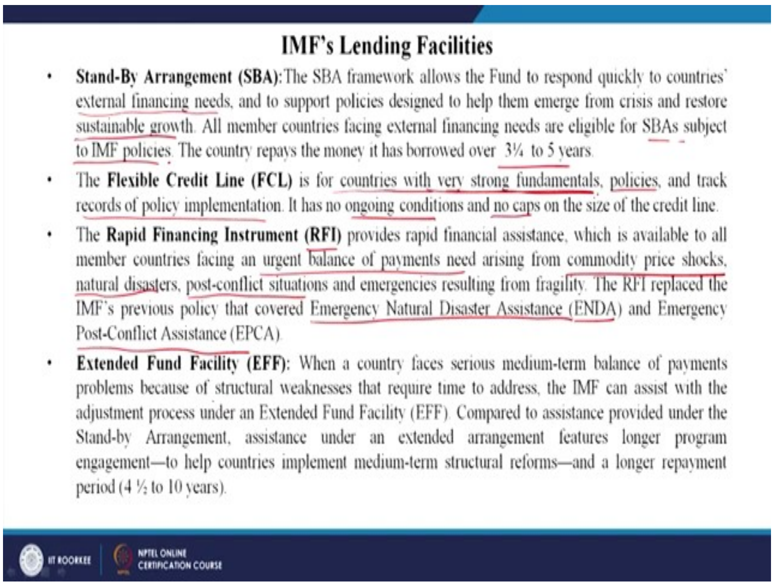

Now, what are the IMF lending facilities some of the we will discuss some of the lending facilities right. So, the first one we will start by is called the Stand-By Arrangement – SBA, what does it mean; The SBA framework allows the fund to respond quickly to countries external financing needs, and to support policies designed to help them emerge from crisis and restore sustainable growth.

All member countries facing external financing problem needs are eligible for SBAs subject to the IMF policies, and then the country repays the money over such some time period right. So, this is generally given this is a kind when it is given when the country is going through some kind of financial crisis.

The second is flexible credit line; this is for countries with very strong fundamentals, this is this has this was started very recently. So, of policies and track records of policy implementation, it has no ongoing conditions and no caps; there is no restriction on the size of the credit line, so that is why it becomes very important that this flexible credit line is given flexible and there is another called precautionary also credit line which is given just as an invest insurance, basically kind of insurance right; to countries with very strong fundamentals and policies.

Then comes the RFI which says, the rapid financing instrument. It provides rapid financial assistance which is available to all the member countries facing an urgent balance of payment problem, so this is also in all these things most of the points it is the balance of payment crisis right.

Now, this is arising from commodity price shocks, natural disasters may be, post-conflict situations some warlike situations, and emerging emergencies resulting from fragility. So, the RFI replaced the IMFs previous policy that covered Emergency Natural Disaster Assistance – ENDA, and Emergency Post Conflict Assistance – EPCA; so this was you know replaced with the rapid financing instrument, ok.

The next one is called EFF – Extended Fund Facility. When a country faces serious midterm balance of payment problem because of structural weaknesses, so structural are home grown problems. Generally the problems which because of some policy wrong policies, so you know banking crisis are happening, financial institutions are not doing well, you know everything is going wrong right.

One bank after the other is falling that request time to address, now this problem will require time to address structural problems cannot be corrected very soon. So, the IMF can assist with the adjustment process under an extended fund facility compared to assistance provided under the stand-by arrangement right, this one.

Assistance under an extended arrangement features longer program engagement, to help countries implement mid-term structural reforms. So, since these are structural reforms and it would take time, it would not be cannot be done easily. So, these loans are given these facilities are given keeping that in mind generally for a long-term period. And a longer repayment period up to 4 and a half to 10 years is kept in mind right by the IMF.

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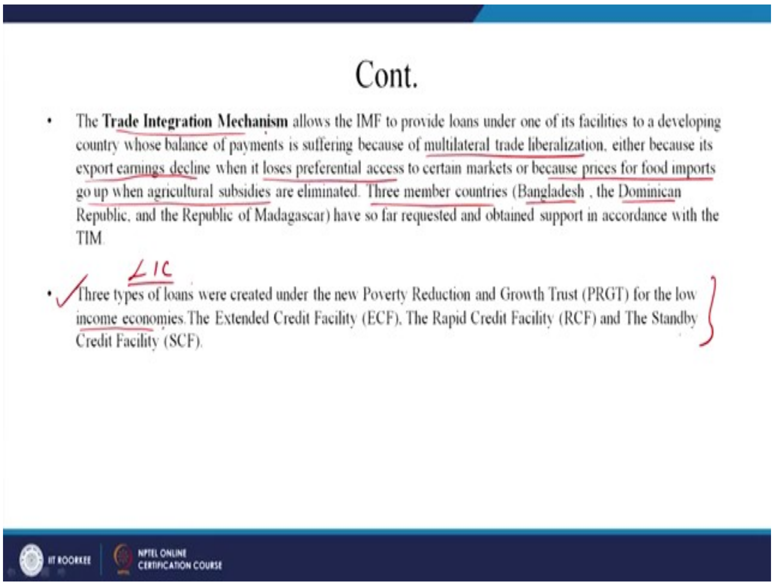

Another one is a trade integration mechanism which allows the IMF to provide loans under one of its facilities to a developing country, whose balance of payment is suffering because of multilateral trade liberalization.

Now, you must have heard about trade liberalization; so either because of its export earnings decline when it loses preferential access right, so some countries have lost the preferential access. There was a for example, the multi fiber agreement; so some countries were getting preferential access, then it was stopped right at one point of time.

So, when you lose such kind of sudden advantages, so you get do not get an advantage or other preferential access to certain markets or in sometimes, because the prices of food imports go up when agriculture subsidies are completely eliminated; so now the WTO pressurizes to eliminate the subsidies. So, in such conditions this to support the countries which have suddenly come to a shock because of such kind of changes in the in the mechanism, so the IMF also gives loan right or money.

Three member countries such as Bangladesh, the Dominican Republic, and the Republic of Madagascar have so far requested and obtained support in accordance with the TIM(trade integration mechanism), ok. There are three other types of loans also given by the you know this is for generally for the low income nations, these three as you these three for the low income countries, this is generally given.

This was created under the new Poverty Reduction in Growth Trust – PRGT for the low I have written, low economic economies low income economies. The extended credit facility, the rapid credit facility, and the standby credit facility. So, these are some new kind of loans which have been made by the IMF to take care of the low economic countries right.

So, we will stop it here today because of the paucity of time. So, we will continue from here in the next section right, right then.

So, thank you very much.