GANESAR COLLEGE OF ARTS AND SCIENCE

MELAISIVAPURI

FOREIGN EXCHANGE MANAGEMENT

UNIT V

International Financial Institution

IFI is a financial institution that has been established by more than one country, and hence is subject to international law. Its owners or shareholders are generally national governments, although other international institutions and other organization occasionally figure as shareholders. The most prominent IFIs are creations of multiple nations, although some bilateral financial institutions exist and are technically IFIs.

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International Monetary Fund

They worked with the objectives of finding a system which would (a) help in removing the restrictions on trade, (b) ensure free converti-bility of currencies (which was suspended during the inter-war period due to multitude of exchange controls) and maintain stability in exchange rates among the currencies. In these efforts the USA and the UK had a greater role to play.

In June 1944, representatives of 44 Allied powers met at Bretton Woods, New Hampshire, USA, to given concrete shape to their ideas. The agreement reached at this meeting provided for establishing two institutions which came to be known as the 'Bretton woods'. The institutions set up were the International monetary Fund (IMF) and the International Bank for Reconstruction and Development (world bank).

OBJECTIVES :

1. To promote international monetary co-operation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

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

3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

4. 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.

5. To given confidence to members by making the general resources of the fund temporarily available to them under adequate safeguards thus providing them with opportunit to correct maladjustments in their balance of payments without resorting to measures destructive to national or international prosperit

6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments deficits.

FUNCTIONS

1. Reviewing and monitoring national and global economic and financial developments and advising members on their economic policies.

2. Lending them hard currencies to support adjustment and reform policies designed to correct balance of payments and promote sustainable growth.

3. Offering a wide range of technical assistance, as well as training for government and central bank officials, its areas of expertise.

4. working with its member governments, and with other international organisations, regulatory bodies, and the private sector, to strengthen the international monetary and financial system.

5. Along with IBRD make assessments of member countries financial sectors to help identify actual and potential weaknesse

6. working with the Basel committee on Banking supervision to improve regulatory standards

7. preparation of country reports on their observance of standards and codes focussing mainly on areas of direct concern to IMF.

8. publishing information on its own activities and policies and on those of its member countries

RESOURCES

Quotas: The main resource for IMF is the member's quotas. quota represents the subscription by a member country to the capital fund of the IMF. quotas are fixed for each country based broadly on its economic size. Apart from representing the subscription of a country to the IMF, the quota also forms the basis for determining its drawing right from the IMF, its voting power and share in allocation of SDRS. All these rights are available to a member in proportion to the quota allotted to it.

Initially, it was stipulated that 25% of a country's quota should be paid in the form of gold or US dollars and the other 75% in the country's own currency. At present instead of contribution in gold, the 25%

of the quota is to be contributed in the form of SDRs or widely accepted foreign currency, such as US Dollar, Euro, yen or pound sterling.

Borrowings.

If necessary IMF can borrow to supplement the resources available from the quota subscription of its members.

General Arrangements to Borrow:

IMF can supplement its resources by borrowing. IMF entered into 'General Arrangement to Borrow' (GAB) in 1962. Under this agreement ten industrialised countries agreed to lend to IMF their own currencies up to the limit agreed. The ten countries, known as the Group of Ten, include Belgium, Canada, France, West Germany, Italy, Japan, Netherlands, Sweden, UK and USA.

New Arrangement to Borrow:

Similar to GAB, IMF entered into a new arrangement to borrow (NAB) in 1998, under which 25 countries have agreed to lend SDR 34 billion. The stipulation for IMF is that the borrowing under NAB cannot exceed SDR 34 billion

Trust Funds:

The IMF provides financial assistance to low-income countries through concessional lending under the poverty Reduction and Growth Facility (PRGF), and debt-relief under the Heavily Indebted poor countries (HIPC) Initiative. These resources are financed through bilateral contributions and by the IMF itself. They are separated from the quota subscriptions and are administered under the PRGF and PRGF-HIPC Trusts, for which the IMF acts as Trustee.

SPECIAL DRAWING RIGHTS.

During the late sixties the growth in world monetary reserves in the form of gold and US dollars international trade. During 1963-68, the monetary reserves in the form of gold and US dollars increased by about 16% while for the same period the growth in the international trade was of the order of 70%. The slackness in the growth of resources was mainly due to dependence on the accretion of gold to monetary reserves.

Allocation:

Allocation of SDRs is made to member-countries in proportion to their quotas. The decision to allocate SDR is taken period-ically by the Board of Governors taking into account the requirements of internati-onal liquidity. A majority of 85% of the voting power is required for decisions involving allocation or cancelling of SDR. starting from 1970, when SDR were first allocated, the quantum of SDRS allocated has increased over the period and as at the end of April 1990 the total amount of SDRs allocated stood at SDR.

Valuation and Interest.

It may be remembered that SDR was introduced before the dollar crisis OF August 1971. Keeping with the monetary environment prevalent at the time of its introduction, initially the value of one SDR was equal to a specific quantity of gold and was provided with an absolute gold value guarantee.

WORLD BANK GROUP

1. IBRD - International Bank for Reconstruction and Development.

That aims to reduce poverty in middle-income and credit worthy poorer countries by promoting sustainable development through loans, guarantees and advisory services.

2. IDA - International Development Association

That provides highly concessional financing to the word's poorest countries in the form of interest free credit and grants.

3. IFC - International Financial corporation

That aims to promote economic development through the private sector.

4. MIGA - Multilateral Investment Guarantee Agency

That helps encourage foreign promote foreign direct investment in developing countries by providing guarantees to investors against non-investment in developing countries by

6. ICSID - International Centre for Settlement of Investment Disputes

That helps encourage foreign investment by providing international facilities for conciliation and arbitration of investment disputes.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

IBRD is an offshoot of the Bretton Woods conference of 1944. It is the original institution of the World Bank Group and for many still it is the World Bank. IBRD was established mainly to provide long-term capital assistance to its member countries for their reconstruction and development. In the initial days the World Bank concentrated on reconstruction and aid of the war shattered European economies. Later the bank shifted its focus and development of the backward countries began to receive prime importance. Today it plays an important role in poverty reduction in middle-income and creditworthy poorer countries.

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OBJECTIVES

1. To assist in reconstruction and development of the territories of its member-governments by faciliating investment of capital for productive purposes.

2. To promote foreign private investment by guarantees of or through participation in loans and other investments of capital for productive purposes.

3. Where private capital is not available on reasonable terms, to make loans for productive purpose out of its own resources or out of the funds borrowed by it,

4. To promote the long-term range growth of international trade and the maintenance of equibrium in the balance of payment of members by encouraging international investment for the development of the productive resources of members.