INTERNATIONAL MONETARY SYSTEM AND RELATIONS

LESSON VII

SILESIAN UNIVERSITY
SCHOOL OF BUSINESS ADMINISTRATION IN KARVINA

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EVS/XXX

Outline of the lecture

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1. Evolution of the International Monetary System
2. Bretton Wood System
3. Flexible Exchange Rate Regime
4. Financial Crisis
5. International Monetary Relations (IMF, WB)

EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

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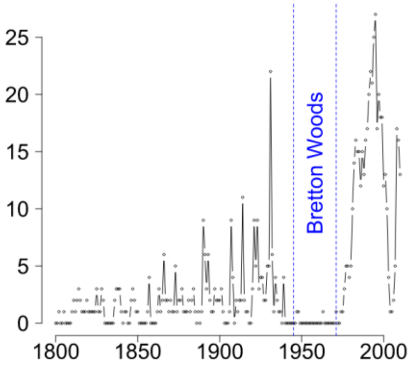
- Bimetallism: Before 1875
- Classical Gold Standard: 1875-1914
- Interwar Period: 1915-1944
- Bretton Woods System: 1945-1972
- The Flexible Exchange Rate Regime: 1973-Present



EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

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- Bimetallism: Before 1875
- A "double standard" in the sense that both gold and silver were used as money.
- Both gold and silver were used as international means of payment and the exchange rates among currencies were determined by either their gold or silver contents.
- A major problem in the international use of bimetallism was that, with each nation independently setting its own rate of exchange between the two metals, the resulting rates often differed widely from country to country.
  - during the period from 1792 to 1834 the United States maintained an exchange ratio between silver and gold of 15:1, while ratios in Europe ranged from 15.5:1 to 16.06:1. This made it profitable for owners of gold to sell their gold in the European market and take their silver to the United States mint. The effect was that gold was withdrawn from domestic American circulation; the "inferior" money had driven it out.

EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

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- Classical Gold Standard: 1875-1914
- During this period in most major countries:
  - Gold alone was assured of unrestricted coinage
  - There was two-way convertibility between gold and national currencies at a stable ratio.
  - Gold could be freely exported or imported.
- The exchange rate between two country's currencies would be determined by their relative gold contents.

EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

- Classical Gold Standard: 1875-1914
- Highly stable exchange rates under the classical gold standard provided an environment that was favorable to international trade and investment.
- Misalignment of exchange rates and international imbalances of payment were automatically corrected by the price-specie-flow mechanism.
  - Suppose Great Britain exported more to France than France imported from Great Britain.
  - This cannot persist under a gold standard.
  - Net export of goods from Great Britain to France will be accompanied by a net flow of gold from France to Great Britain.
  - This flow of gold will lead to a lower price level in France and, at the same time, a higher price level in Britain.
  - The resultant change in relative price levels will slow exports from Great Britain and encourage exports from France.

EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

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- Classical Gold Standard: 1875-1914
- There are shortcomings:
- The supply of newly minted gold is so restricted that the growth of world trade and investment can be hampered for the lack of sufficient monetary reserves.
- Even if the world returned to a gold standard, any national government could abandon the standard.

EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

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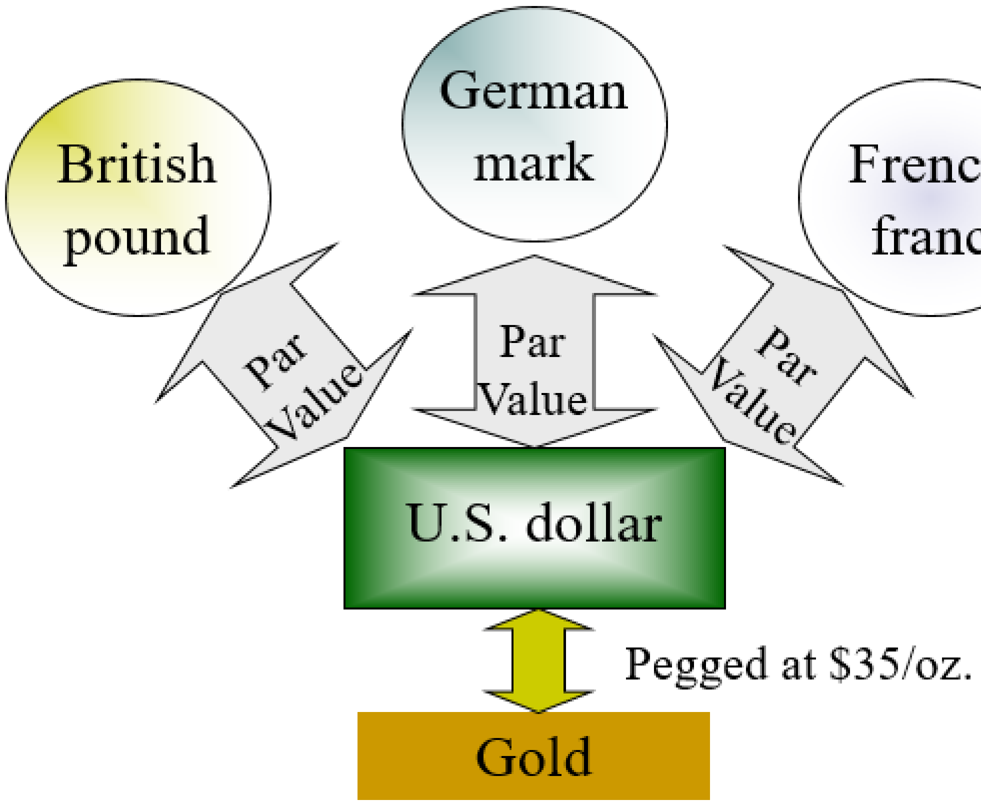
- Interwar Period: 1915-1944
- Exchange rates fluctuated as countries widely used "predatory" depreciations of their currencies as a means of gaining advantage in the world export market.
- Attempts were made to restore the gold standard, but participants lacked the political will to "follow the rules of the game".
- The result for international trade and investment was profoundly detrimental.

EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

- Bretton Woods System: 1945-1972
- Named for a 1944 meeting of 44 nations at Bretton Woods, New Hampshire.
- The purpose was to design a postwar international monetary system.
- The goal was exchange rate stability without the gold standard.
- The result was the creation of the IMF and the World Bank.
- Under the Bretton Woods system, the U.S. dollar was pegged to gold at $35 per ounce and other currencies were pegged to the U.S. dollar.
- Each country was responsible for maintaining its exchange rate within 1% of the adopted par value by buying or selling foreign reserves as necessary.
- The Bretton Woods system was a dollar-based gold exchange standard.

Bretton Woods System: 1945-1972



EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

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- The Flexible Exchange Rate Regime: 1973-Present
- Current Exchange Rate Arrangements
- Free Float
  - The largest number of countries, about 48, allow market forces to determine their currency's value.
- Managed Float
  - About 25 countries combine government intervention with market forces to set exchange rates.
- Pegged to another currency
  - Such as the U.S. dollar or euro (through franc or mark).
- No national currency
  - Some countries do not bother printing their own currency. For example, Ecuador, Panama, and El Salvador have dollarized. Montenegro and San Marino use the euro.

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- The Mexican Peso Crisis
- On 20 December, 1994, the Mexican government announced a plan to devalue the peso against the dollar by 14 percent.
- This decision changed currency trader's expectations about the future value of the peso.
- They stampeded for the exits.
- In their rush to get out the peso fell by as much as 40 percent.

- The Mexican Peso crisis is unique in that it represents the first serious international financial crisis touched off by cross-border flight of portfolio capital.

- The Mexican Peso Crisis
- Two lessons emerge:
  - It is essential to have a multinational safety net in place to safeguard the world financial system from such crises.
  - An influx of foreign capital can lead to an overvaluation in the first place.
- 2004
- TEN years ago Mexico suffered its “tequila crisis”. Its current-account deficit was a dangerous 7% of GDP and its foreign-exchange reserves dwindled: as a result, the peso's fixed exchange rate against the dollar snapped. The currency plunged by around 50% within six months.

FINANCIAL CRISIS

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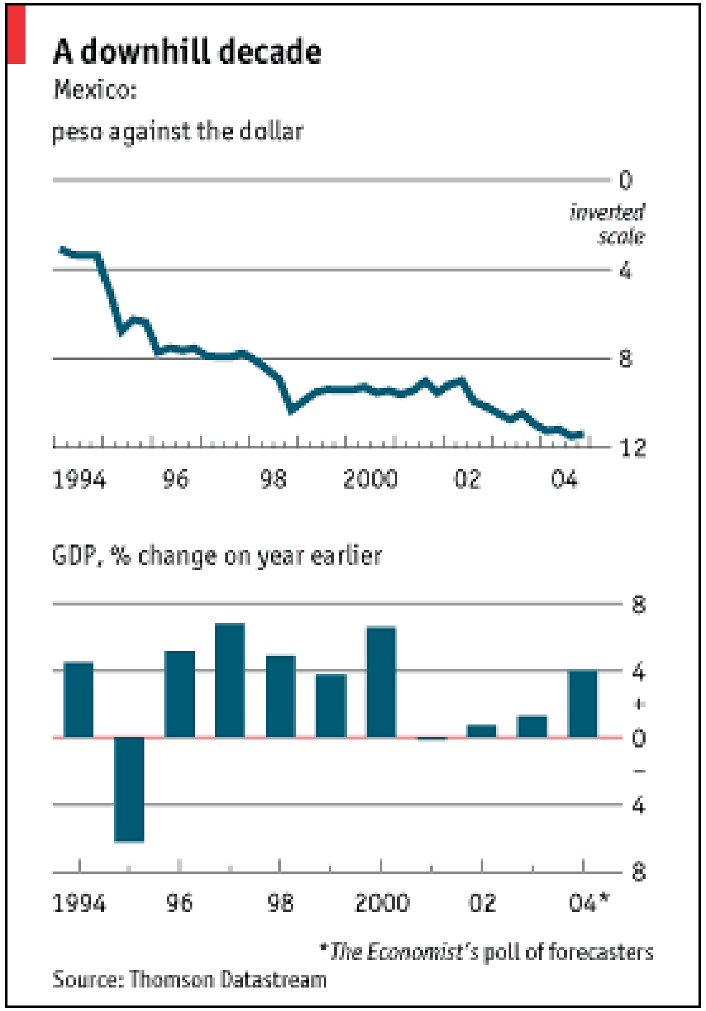

FINANCIAL CRISIS

- The Asian Currency Crisis
- 1997-1998
- The Asian currency crisis turned out to be far more serious than the Mexican peso crisis in terms of the extent of the contagion and the severity of the resultant economic and social costs.
- Many firms with foreign currency bonds were forced into bankruptcy.
- The region experienced a deep, widespread recession.

FINANCIAL CRISIS

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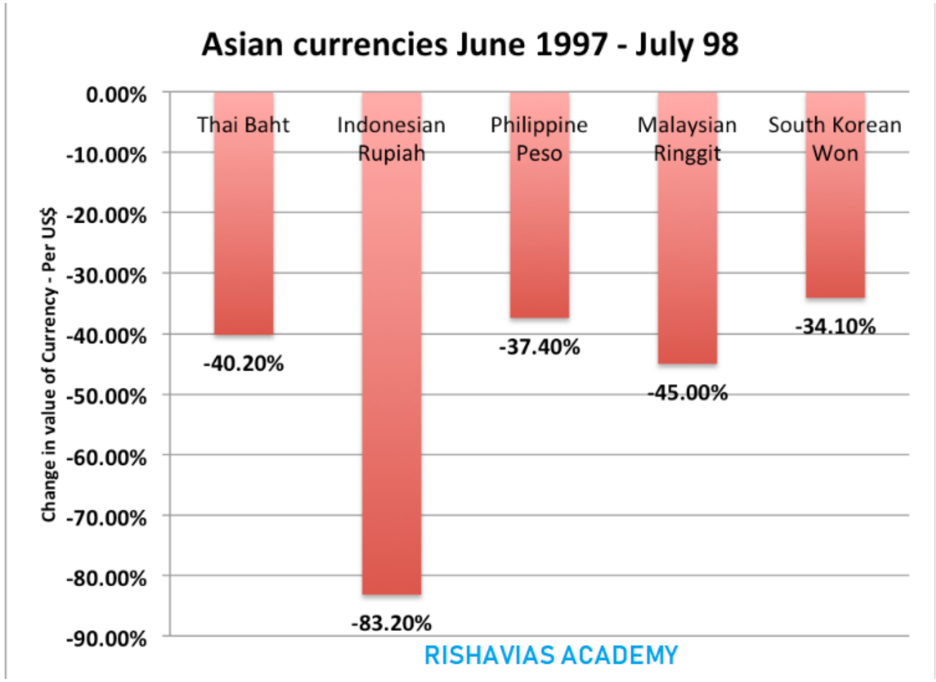
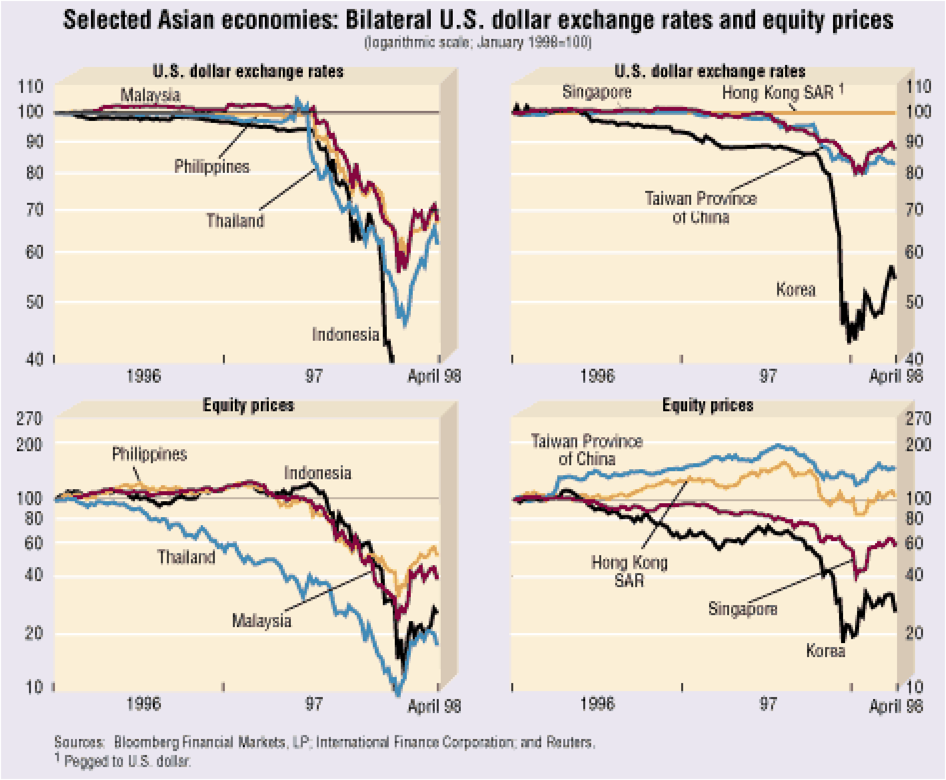
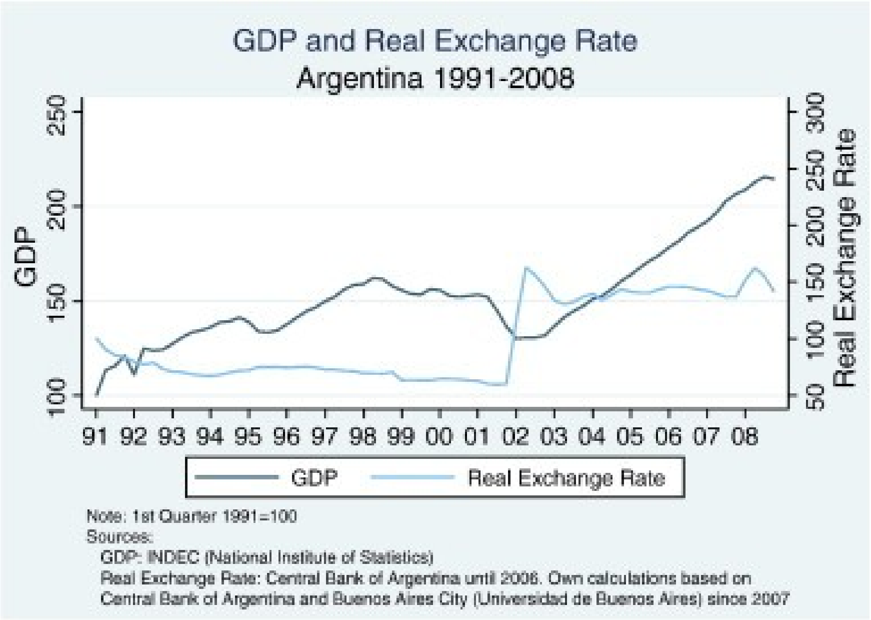




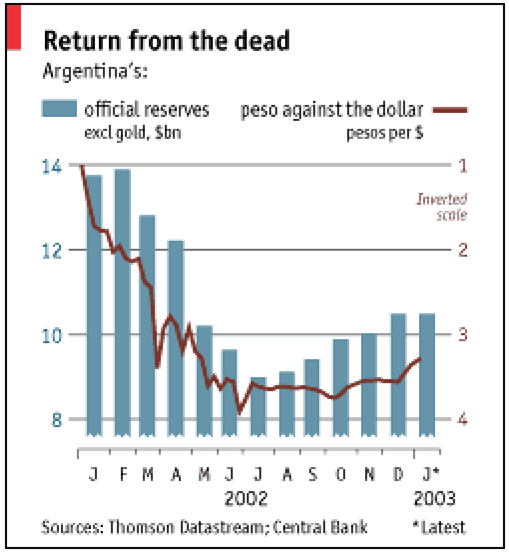
FINANCIAL CRISIS

- The Argentinean Peso Crisis
- In 1991 the Argentine government passed a convertibility law that linked the peso to the U.S. dollar at parity.
- The initial economic effects were positive:
  - Argentina's chronic inflation was curtailed
  - Foreign investment poured in
- As the U.S. dollar appreciated on the world market the Argentine peso became stronger as well.



FINANCIAL CRISIS

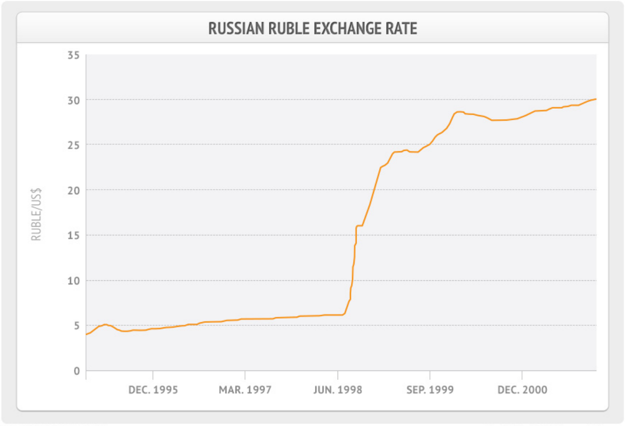
- The Argentinean Peso Crisis
- The strong peso hurt exports from Argentina and caused a protracted economic downturn that led to the abandonment of peso–dollar parity in January 2002.
  - The unemployment rate rose above 20 percent
  - The inflation rate reached a monthly rate of 20 percent



FINANCIAL CRISIS

- The Argentinean Peso Crisis
- There are at least three factors that are related to the collapse of the currency board arrangement and the ensuing economic crisis:
  - Lack of fiscal discipline
  - Labor market inflexibility
  - Contagion from the financial crises in Brazil and Russia

Economist.com



FINANCIAL CRISIS

- The Argentinean Peso Crisis – to be continued?

- International Monetary Fund
- The IMF was conceived in July 1944 at the United Nations Bretton Woods Conference in New Hampshire, United States.
- The 44 countries in attendance sought to build a framework for international economic cooperation and avoid repeating the competitive currency devaluations that contributed to the Great Depression of the 1930s.
- The IMF's primary mission is to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries and their citizens to transact with each other.

- International Monetary Fund

Fast Facts
About the IMF

1944	Year the IMF was established	$1 trillion	Total amount the IMF is able to lend to its member countries
189	Member countries	36	Current lending arrangements
147	Nationalities represented by staff	0%	Interest rate on loans to low-income countries
24	Executive Directors representing 189 member countries	$303 million	For hands-on technical advice, policy-oriented training, and peer learning

- International Monetary Fund
- **Surveillance -** the IMF monitors member country policies as well as national, regional, and global economic and financial developments through a formal system.
- **Financial assistance -** Providing loans to member countries that are experiencing actual or potential balance-of-payments problems is a core responsibility of the IMF.
- **Capacity development -** The IMF provides technical assistance and training to help member countries build better economic institutions and strengthen related human capacities.

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- International Monetary Fund
- **SDRs -** The IMF issues an international reserve asset known as Special Drawing Rights, or SDRs, that can supplement the official reserves of member countries. Total global allocations are currently about SDR 204 billion (some $283 billion).
- **Resources -** Member quotas are the primary source of IMF financial resources. A member's quota broadly reflects its size and position in the world economy.
- **Governance and organization -** at the top of its organizational structure is the Board of Governors, consisting of one governor and one alternate governor from each member country, usually the top officials from the central bank or finance ministry. The Board of Governors meets once a year at the IMF–World Bank Annual Meetings. Twenty-four of the governors serve on the International Monetary and Financial Committee, or IMFC, which advises the IMF's Executive Board on the supervision and management of the international monetary and financial system.

INTERNATIONAL MONETARY RELATIONS

- International Monetary Fund

Fast Facts

- **Membership:** 189 countries
- **Headquarters:** Washington, D.C.
- **Executive Board:** 24 Directors each representing a single country or groups of countries
- **Staff:** Approximately 2,700 from 150 countries
- **Total quotas:** SDR 477 billion (US$661 billion)
- **Borrowed resources envelope:** SDR 500 billion (US$693 billion)
- **Committed amounts under current lending arrangements:** SDR 152 billion (US$210 billion), of which SDR 96 billion (US$133 billion) has not been drawn.
- **The largest borrowers:** Argentina, Ukraine, Greece, Egypt
- **The largest precautionary loans:** Mexico, Colombia, Morocco
- **Surveillance consultations:** 132 consultations in 2014, 124 in 2015 and 132 in 2016.
- **Capacity development spending:** US$332 million in FY2016, over a quarter of the IMF's total budget
- **Primary aims:**
    - Promote international monetary cooperation;
    - Facilitate the expansion and balanced growth of international trade;
    - Promote exchange stability;
    - Assist in the establishment of a multilateral system of payments; and
    - Make resources available (with adequate safeguards) to members experiencing balance-of-payments difficulties.

- World Bank
- The World Bank is like a cooperative, made up of 189 member countries. These member countries, or shareholders, are represented by a Board of Governors, who are the ultimate policymakers at the World Bank. Generally, the governors are member countries' ministers of finance or ministers of development. They meet once a year at the Annual Meetings of the Boards of Governors of the World Bank Group and the International Monetary Fund.
- The governors delegate specific duties to 25 Executive Directors, who work on-site at the Bank. The five largest shareholders appoint an executive director, while other member countries are represented by elected executive directors.

- World Bank

The World Bank Group is one of the world's largest sources of funding and knowledge for developing countries. Its five institutions share a commitment to reducing poverty, increasing shared prosperity, and promoting sustainable development.

WORLD BANK GROUP
Five Institutions, One Group

IBRD	IDA	IFC	MIGA	ICSID
The International Bank for Reconstruction and Development	The International Development Association	The International Finance Corporation	The Multilateral Investment Guarantee Agency	The International Centre for Settlement of Investment Disputes

- World Bank - IBRD

- **The International Bank for Reconstruction and Development (IBRD)** is a global development cooperative owned by 189 member countries. As the largest development bank in the world, it supports the World Bank Group's mission by providing loans, guarantees, risk management products, and advisory services to middle-income and creditworthy low-income countries, as well as by coordinating responses to regional and global challenges.

- **International Development Association (IDA)** helps countries create strong institutions that facilitate private sector growth, reduce poverty, deliver valuable services and earn the confidence of their citizens.

- World Bank - IBRD
- **The International Finance Corporation (IFC)** is the largest global development institution focused on the private sector in developing countries. The Bank Group has set two goals for the world to achieve by 2030: end extreme poverty and promote shared prosperity in every country.
- **The Multilateral Investment Guarantee Agency (MIGA) -** its goal is to promote foreign direct investment into developing countries to support economic growth and more.
- **The International Centre for Settlement of Investment Disputes (ISCID)** was established in 1966 and is the world's leading institution devoted to international investment dispute settlement. It has extensive experience in this field, having administered the majority of all international investment cases.

Thank you for your Attention!