The Role of the International Monetary Fund in the Global Financial System as an International Lender of Last Resort

Hossein Kazemi[1], Vahid Rafiei[2] (Corresponding author)

[1.] Assistant professor and faculty of Raja University, Qazvin, Iran
[2.] Master of Accounting Raja University, Qazvin, Iran/ PGD in International Accounting and Finance University of East London

Abstract: International monetary fund (IMF) manages and supervises the global financial system. Its purpose is to facilitate development and stabilize international exchange rates. The present study has been conducted to examine the role of the International monetary fund (IMF) in the global financial system as an International lender of last resort. In this, we have determined the importance of IMF as well as its current status, function and objectives were discussed.The analysis showed that IMF plays a vital role in the global financial assistance. It is called as the lender of the last resort so financial crisis.

[Hossein kazemi, Vahid rafiei. **The Role of the International Monetary Fund in Global Financial System as an International Lender of Last Resort**. *Life Sci J* 2012;9(4):2891-2894] (ISSN:1097-8135). http://www.lifesciencesite.com. 424

Key words: International Monetary Fund (IMF)

Introduction:

An international financial organization which manages and supervises the global financial system is known as The International Monetary Fund (IMF). IMF came into existence in 1944, during the United Nations Monetary and Financial Conference. In the United States IMF's head office is in Washington, D.C. (Teunissen and Akkerman, 2005, pp. 78 - 96).

The purpose of existence of IMF is to facilitate development and to stabilize international exchange rates. By keeping track of its member countries' macroeconomic policies, balance of payments and exchange rates, IMF administers global financial system. Currently IMF has 186 members. Other then North Korea, Monaco, Cuba, Taiwan, Tuvalu, Andorra, Nauru, and Liechtenstein all member of United Nations are direct participants in IMF. (Dreher, 2004, pp. 445 – 464).

Especially to poor and underdeveloped countries, IMF provides long-term high leveraged loans. The global influence of IMF is consistently increasing. In order to ensure that IMF's member counties' perspective financial requirements are fulfilled during the current global credit crunch, recently it was decided that additional financial resources would be provided to IMF. Therefore, International Monetary Fund plays a vital role of the in the Global Financial System and often works as an international lender of last resort. (Teunissen and Akkerman, 2005, pp. 78 – 96).

In this essay we will critically evaluate the role of International Monetary Fund in the global financial system as an international lender of the last resort. Moreover, we will determine the importance and significance of IMF as well as its current status, functions and objectives will be discussed.

The Role of the International Monetary Fund in the Global Financial System

IMF's Purpose of Existence and Functions

Great depression of 1930's cased an extraordinary fall down in the global financial activates. It is also considered as one of the reasons which triggered the disastrous World War II. In order to prevent such disaster from happening again, in 1944, world famous leaders met in Bretton Woods to develop financial and economic cooperation amongst counties. As a result of this conference IMF came into existence. IMF was based on macroeconomic, multilateral and global financial cooperation. (Barnett, Finnemore, 2004, pp. 134 – 170).

The prime purpose of its existence was to look after global financial system and to be a lender of the last resort. Therefore, it provides loans even in the global financial crisis and credit crunch situations. Besides providing loans and financial assistance IMF provides early warnings regarding potential finical crisis of a county as well as global ones. It helps countries in formulation of financial policy by giving expert advices according to each individual country's situation and socio-political-economic conditions. (McLeod, 1983, pp. 44 – 61)

One of the prime purposes of IMF is to provide timely loans to countries when their balance of payment is imbalanced due to trade deficits. To ensure that their loans are repaid to them by their creditors (countries obtaining loans) IMF intervene and give advices regarding country's financial and economic policies. Since IMF is created the rate of international financial integration and globalization has increased and constantly increasing. (Calomiris, 1998, pp. 12 – 28).

At the time of creation there were only 45 members of IMF. They all had common goals toward reformation of international payment system, stabilization of exchange rates globally. The most importantly purpose of IMF creation was to stabilize economic system worldwide. The International Monetary Fund is a financial reserve or pool created as a result of investments or contributions made by all member counties. Member counties can borrow money from this pool when their balance of payment for a year does not balance. (Rapkin, and Jonathan R, 2005, pp. 26 - 39).

Presently 186 counties are present members of IMF striving towards achieving global financial stability, international trade enhancement, higher employment generation, poverty reduction, economic growth stability and international monetary cooperation. (Sakbani, 2005, pp. 11 – 25).

IMF as a Lender of the Last Resort

In a situation of financial crisis where availability of credit becomes extinct, financial institutions do not want to provide credit due to fair of creditor's bankruptcy. In such a situation, a financial institution which is willing to provide credit is called as lender of the last resort. As IMF was created with the intention of creating global financial cooperation and harmony therefore, it provides credit and long-term loans to needy countries even during global financial crisis and economic instable situations such as recession and depression. (Calomiris, 1998, pp. 12 – 28).

When most borrowers and lenders become insolvent as a result of fractional reserve banking panic withdrawal of deposited money in the bank can occur. In such a situation IMF prevent panic withdrawal from speeding and hence protect depositors from closing their accounts (Niskanen, 1998, pp. 6-7). So in this way IMF saves entire economy and prevents numerous businesses and financial institutions from collapsing. In severe financial crisis situation State Banks and other institutions can also borrow money from IMF. IMF is considered as a lender of the last resort because it also provides loans even when the borrowers' financial conditions are poor and there is a possibility of their collapse. (Dreher, 2004, pp. 445 - 464).

Importance and Significance of IMF

IMF consistently concentrates and works to improve its member countries' economies. IMF funds are used to providing financial assistance to countries facing severe financial crisis or whose balance of trade shows deficit. Moreover, when stoppage occurs in global market liquidity and capital inflows, IMF provide assistance so that economies can survive. When banking sector of a country reaches bankruptcy for instance due to recession or severe economic crisis then in such situations IMF provides support to the banking sector by supplying required financial support. (Arthur, Sheffrin, 2003, pp. 478 – 488).

Low-income countries especially under developed ones already facing problems due to food, energy and fuel price increase. It is causing decline in remittances, industrial activities and trade. Moreover, due to this social unrest and political instability will increase further. According to World Bank report, this year approximately fifty million further people will be poverty. Till 2015, three million children may further die if the required financial assistance is not provided to such poor countries. Therefore, to give financial assistance to low-income countries additional six billion dollars were announced to be provided by IMF. (Barnett, Finnemore, 2004, pp. 134 – 170).

IMF when provide loans and requisite financial assistance in return it levies certain reforms on the borrowing country. Those reforms are known as Washington Consensus. These reforms or conditions can result in strict price control, fixed exchange rate policies and under or over-valuation of currency. Therefore, financial crisis prevention is merely the intended objective of IMF rather than providing funds carelessly. So by levying conditions over borrowing country's monetary, fiscal, trade, exchange rate and tax collection policies IMF ensures the economic stability of the country as well as return over its investment. (Griffith-Jones, Bhattacharya, 2001, pp. 49 - 109).

Some times when a country consistently suffers trade deficit and financial instability it becomes difficult to repay the borrowed money in the allocated time duration, therefore in such situation IMF reschedule old loans and grant additional time to the country to repay the debt.

Current Status of IMF

IMF still working towards achieving global economic stability as it was working the time it was created. The increased number of IMF member has strengthened IMF and purpose of its existence. In 2008, the recession even affected the liquidity of IMF. Therefore, in order to meet credit shortfall, part of IMF's gold reserves were sold according to the agreed of International Monetary Fund's executive board. (Sakbani, 2005, pp. 11 – 25).

At G-20 London summit, in 2009, it was stated that to meet its member counties' prospective financial needs so that they can sustain current global financial crunch, additional financial resources will be required by IMF. During the London summit, the G-20 leaders promised that IMF's supplementary cash will be increase to $500 billion. Moreover, they granted member countries special drawing rights, which allowed them to draw further $250 billion. (Griffith-Jones, Bhattacharya, 2001, pp. 49 - 109).

Critical Analysis of IMF and its Functions

Economists often make two criticisms on IMF aid. First of all along with financial support, IMF's conditionalities come also which includes Structural Adjustment Programs (SAP). Main objective of levying conditions is to ensure protection of investment by achieving target performance therefore conditionalities results in social unrest and instability. On the other hand, poverty further increases in the borrowing country due to the SAP. (Williamson, 1982, pp. 11 - 25).

IMF is a financial reserves fund in which world most rich and developed countries, people, institutions and organizations invest and earn return over their investment in the form of interest. Some people critics that rather than making suggestions and providing advices, IMF start instructing and dictating borrowing country's economic policies and financial matters to ensure safety of their investment. Moreover, they use their power and influence for gaining non-financial benefits. It is also said that the purpose of creation of IMF was to ensure solidarity and power of certain dominant countries by offering loans so that they can control and suppress needy countries economically and politically. (Dreher, Axel, 2004, pp. 53 - 75).

Although, it provide timely loans and financial stability but at the same time it exploits its creditor countries. IMF is not like a charitable trust, who just gives money without any interest. IMF is a specialized financial institution and even though it provides timely and flexible loans it does not mean that they are not interested in earning interest or non financial benefits. (Dreher, 2003, pp. 101 - 120).

IMF conditionality may result in rising direct and indirect taxes so that budget deficit can be balanced and government revenues can be generated. But when such condition is imposed in a country it further weakens its economy. So in this way rather than making economic conditions better it actually works other way around. As in the case of Pakistan, even though Pakistan was facing hyper inflation but still IMF's conditionality resulted in utility, electric and fuel prices increase. As a result prices of commodities further increased and industrial production declined. (DeRosa, 2001, pp. 17 – 28).

IMF conditionality has great impact on public health of borrowing country. According to a research made in 2008 by two analysts of Cambridge and Yale universities, thousands of deaths in Eastern Europe has caused due to tuberculosis as a result of strict conditions imposed by IMF on international loans borrowers (Chomsky, 2009). It was an indirect effect of IMF conditionality because fewer funds were allocated to public health care due to which tuberculosis cases increased which ultimately lead to thousands of deaths. The countries which have obtained loans from IMF, the deaths caused by tuberculosis have increased to 16.6%. (Teunissen and Akkerman, 2005, pp. 78 - 96).

Conclusion

After analyzing the whole essay it is clear that IMF plays a vital role in the global financial assistance. IMF is called as the lender of the last resort because it lends money to countries facing financial crisis in such a situation when there is no one to give them loans. By providing timely loans to countries facing financial crisis IMF saves them from destabilizing.

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9/29/2012