Imf -role for developing countries

Countries

Introduction

International Monetary Fund (IMF), is a specialized agency of the United Nations, established in 1945. It was planned at the Bretton Woods Conference (1944), and its headquarters are in Washington, D. C. There is close collaboration between it and the International Bank forReconstructionand Development. Its primary mission is to ensure stability in the international monetary system. The IMF provides policy advice and financing to member countries with economic problems.

The organization, using a fund subscribed by the member nations, purchases foreign currencies on application from its members so as to discharge international indebtedness and stabilize exchange rates. The IMF currency reserve units are called Special Drawing Rights (SDRs); from 1974 to 1980 the value of SDRs was based on the currencies of 16 leading trading nations. Since 1980 it has been reevaluated every five years and based on the relative international economic importance of the British pound sterling, the European Union euro (formerly the French franc and German mark), the Japanese yen, and the U. S. dollar. To facilitate international trade and reduce inequities in exchange, the fund has limited power to set the par value of currencies. Members are provided with technical assistance in making monetary transactions. In 1995 the fund moved to increase disclosure requirements of countries borrowingmoneyand at the same time created an emergency bailout fund for countries in financial crisis. IMF was criticized in 1998 for exacerbating the Asian financial crisis, through the fund's decision to require Asian nations to raise their interest rates to record levels.

During the international financial crisis of the early 21st century the IMF provided loans and access to credit of more than $100 billion to developing countries that were affected by falling demand for their exports and other financial problems. Instead of increasing government expenditure and boosting domestic demand, local employment and economic activity to overcome the recession, the IMF is cutting spending and increasing tariffs and taxes in already contracting economies for the express purpose of maintaining low inflation and fiscal deficit rates, flexible exchange rates, and trade and financial liberalization.

In this paper we try to analyze effect of reduced government expenditure for developing countries that sought aid on dealing with currency crisis. We also analyze the reasons behind strict monetary policy prescribed by IMF. Our analysis provides a framework that would help improve IMF's approach in future. Reasons behind strict monetary policy: IMF claims upon maintaining transparency in setting up operation, but it is actually extremely secretive. In recent years, as criticism about this policy has grown, IMF has made certain parameters of structural adjustment of various developing countries public.

Although IMF assumes a dominating role in structuring policies for affected nations, it imposes its policies on them rather than involving them in the decision making process. Key structural adjustment measures include:

- Privatizing government-owned enterprises and government-provided services;
- Slashing government spending;
- Orienting economies to promote exports;
- Trade and investment liberalization;

- Higher interest rates, eliminating subsidies on consumer items such as foods, fuel and medicines and tax increases.

The basic idea of these policies is to shrink the size and role of government, rely on market forces to distribute resources and services and integrate poor countries into the global economy. Also, despite pledges to address the crisis in flexible and innovative ways, the IMF's key objective in crisis loans remained 'macroeconomic stability' through the 'tightening of monetary and fiscal policies' with below objectives:

- Lowering fiscal deficits and inflation levels;
- Buffering international reserves;
- Reducing or restraining public spending;
- Increasing official interest rates or restraining the growth of the money supply.

Preventing currency depreciation Structural Adjustments in IMF policy: Structural adjustments have been successful at its intended efforts to diminish the scope of government and to integrate developing countries into the global economy. But they have failed by many other measures. By and large, countries undergoing structural adjustment have not experienced economic growth, even in the medium term. Main Reasons include:

- The IMF caters to wealthy countries and Wall Street: Dominating decision power and voting power has made US a largest shareholder of IMF of rich countries. Disproportional amount of power held by wealthy countries translates into decisions that benefit wealthy bankers,

investors and corporations from industrialized countries at the expense of sustainable development;

- The IMF is imposing a fundamentally flawed development model IMF forces countries from the Global South to prioritize export production over the development of a diversified domestic economy. i. e. hift fromfoodproduction for local consumption to the production of crops for export to the industrialized countries. Small businesses and farmers can't compete with large multinational corporations. Thus the cycle ofpovertyis perpetuated, not eliminated;
- IMF Policies hurt theenvironmentThe IMF does not consider environmental impacts of lending policies; and environmental ministries and groups are not included in policy making. The focus on export growth to earn hard currency to pay back loans means unsustainable liquidation of natural resources.

This happened with the bailouts of Brazil, Indonesia, and Russia--countries that are renowned for their great biodiversity The IMF bails out rich bankers, creating a moral hazard and greater instability in the global economy The IMF pushes countries to dismantle trade and investment rules, as well as raise interest rates in order to lower inflation. The removal of regulations that might limit speculation has greatly increased capital investment in developing country financial markets. More than $1. 5 trillion crosses borders every day.

This capital is short-term, unstable, and puts countries at the whim of financial speculators. TheMexican1995 peso crisis was partly a result of these IMF policies. Impact of Structural reforms on developing countries and

its evaluation: Those developing countries that have experienced the greatest economic successes in recent decades have violated many of the central precepts of structural adjustment. They have protected certain parts of their economy, and they have maintained an active governmental role in economic planning.

A review of policies sponsored by the IMF illustrated the basicfailureof structural adjustment. Countries undergoing such structural adjustment experienced stagnating growth rates and saw their foreign debt nearly double-dramatic evidence of failure, since reducing foreign debt is one of ESAF's ostensible purposes. As per reports, the two regions with the most structural adjustment experience, per capital income has stagnated (Latin America) or collapsed (Africa, where per capita income dropped more than 20 percent between 1980 and 1997). The emphasis on exports tends to be socially disruptive, especially in rural areas.

Poor subsistence farmers frequently find their economic activity described as nonproductive, and experience land pressures from expanding agribusinesses, timber companies and mines. Pushed off their land, they frequently join the ranks of the urban unemployed, or move onto previously unsettled, and frequently environmentally fragile, lands. Structural adjustment has generally contributed to rising income and wealth inequality in the developing countries, a fact tacitly acknowledged by both recently retired IMF Managing Director Michel Camdessus and World Bank President James Wolfensohn.

Consider the Asian meltdown caused in large part by South Korea, Thailand, the Philippines, Malaysia and Indonesia, which was caused by heavy reliance

on short-term foreign loans. When it became apparent that private enterprises in those nations would not be able to meet their payment obligations, international currency markets panicked. Currency traders sought to convert their Asian money into dollars, and the Asian currencies plummeted. That made it harder for the Asian countries to pay their loans, and it made imports suddenly very expensive.

The IMF’s usual policy of countries not meeting their balance of payments due to increased value imports and reduced exports was reapplied here. Treating the Asian Financial crisis like other situations, IMF made arrangements for loans to enable these countries to payoff their debts. But IMF placed the condition that the countries would adopt the structural adjustment policies. But they failed to understand that the Asian crisis condition differed from this situation.

Like, even though Asian countries did not run budget deficits, they were compelled to restrict government spending which further deepened their slowdown. The Fund failed to manage an orderly roll over of short-term loans to long-term loans, which was most needed; and it forced governments, including in South Korea and Indonesia to guarantee private debts owed to foreign creditors. In retrospect, even the IMF would admit that it made things worse in Asia. Malaysia stood out as a country that refused IMF assistance and advice.

Instead of further opening its economy, Malaysia imposed capital controls, in an effort to eliminate speculative trading in its currency While the IMF mocked this approach when adopted, the Fund later admitted that it succeeded. Malaysia generally suffered less severe economic problems than

the other countries embroiled in the Asian financial crisis. Considering example of Pakistan, Pakistan is among the most frequent users of IMF loans, having borrowed IMF money 12 times since 1980.

However, 10 of these programmes were abandoned midway due to Pakistan's failure to fully adopt the IMF's policy recommendations. Undue US interference, inadequate political analysis capacities within the IMF, inappropriate sequencing and over-ambitious agendas given the short loan durations were the main reasons . For example, Pakistan was advised to reduce import duties before it developed alternative taxation measures to cover the ensuing tax revenue shortfalls.

This increased Pakistan's public debt significantly as it had to borrow to cover the resulting fiscal deficits. However, Pakistan must partly share the blame since it accepted the loan conditions. Same happened with for some African countries, which lack both the technical capacities to analyse the IMF conditions and alternative financing options The IMF's structural adjustment prescriptions for countries suffering through the Asian financial crisis were roundly denounced, including by many conservative and mainstream economists and opinion makers.

The widespread criticism of the Fund undermined its political credibility. The IMF response has been to make some minor concessions in making its documents more publicly available, limiting its demands that countries liberalize their capital markets (including by allowing unlimited trade in their currency, and permitting foreign investors to invest in domestic stocks and bonds without restriction), and increasing its rhetorical commitment to paying attention to poverty in its structural adjustment programs.

But the financial crisis, aggravated due to IMF'sstructural policy, had alreadyled to massive human suffering. " IMF suicides" became common among workers who lost their jobs and dignity. In Indonesia, the worst hit country, poverty rates rose from an official level of 11 percent before the crisis to 40 to 60 percent in varying estimates. GDP declined by 15 percent m one year. IMF policies exacerbated the economic meltdown in countries hit by the Asian financial crisis.

Mandated reductions in government spending worsened the Asian nation's recessions and depressions. And the forced elimination of price controls and subsidies for the poor imposed enormous costs of the lowest income strata's. In Indonesia, food and gasoline prices rose 25 to 75 percent overnight or in the course of a few days. Although most developing countries are in need of fundamental reform along the general economic principles advocated by the IMF, the problem lies with the specifics of the IMF reform agenda.

Thus as per the latest records, most successful East Asian countries have adopted IMF's principles but have utilized very different specific tools which preserve long-term development, unlike IMF-recommended tools. Instead of widespread immediate privatization, China initially introduced managerial incentive systems in agriculture and industry. This boosted Chinese productivity without the massive economic ruin that the IMF-advised mass-scale privatization caused in Russia in the 1990s.

In fact, no developing country sticking entirely to the IMF approaches has achieved the type of success achieved by East Asian countries. Towards growth- and development-oriented fiscal and monetary policies: A more development-oriented macroeconomic policy stance is necessary in order to

generate the quantum leap in resources that LICs need tofinancelarge-scale new investments in economic and social infrastructure, which includes the specific MDG (Millennium DevelopmentGoals) goals in thehealthandeducationsectors, and job creation.

Progress on poverty reduction and basic human development has historically required, and continues to require, such a critical degree of spending and investment in the domestic economy. In order to support the achievement of the MDGs, IMF policies need to change:

- Support of active use of fiscal policy to for public investments and public spending to build essential economic and social infrastructures.

Future revenues expected from the investment should pay off the debt that the government initially incurred. The IMF should encourage more expansionary monetary options that better enable domestic firms and consumers to access affordable credit for expanding production, employment, and increased contributions to the domestic tax base. Monetary policy should thus maintain low real interest rates, rather than ineffectively trying to keep inflation low with high interest rates which dampen aggregate demand and growth prospects. The IMF should permit the regulation of the capital account to confront the continuous inflow, as well as outflow, of private capital from national economies, i. e. 'capital flight'. Now the question lies, whether the IMF is actually concerned about sustainable development? If yes, then the emphasis should not be on IMF pushing the countries to adopt its structural policies in exchange of the debt funds. Instead, IMF's influence and power needs to be reduced so it has less say over developing country policies.