The World Financial Order
International Economic Law

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Overview

I. Historical Background
II. IMF and World Bank
III. International Monetary Policy
IV. Responding to the Financial and Economic Crisis
I. Historical Background

1. Treaty of Versailles

- Negotiated at the Paris Peace Conference (opened 18 January 1919)
- Peace treaty at the end of WW I ending the state of war between Germany and the Allied Powers (signed 28 June 1919)
- Terms of peace were mainly determined by the “Big Three” (U.S., U.K., FR)
1. Treaty of Versailles

- Treaty required Germany…
  - …to accept the sole responsibility for causing the war
  - …to disarm and make territorial concessions
  - …to pay reparations in the amount of 132 billion gold marks

- Germany was stripped of its vital industries, territories and transportation systems (“Carthaginian peace”)

- Absence of a stabilizing system in international finance and trade

Covenant of the League of Nations (Part I of the Treaty)

- Intergovernmental organization → forerunner to the UN
- 58 members (the US never joined!)
- Principal organs: Assembly, Council, Secretariat
- Other bodies
  - Permanent Court of International Justice
  - International Labour Organization
  - Health Organization
  - …
1. Treaty of Versailles

“The Allied and Associated Governments affirm and Germany accepts the responsibility of Germany and her allies for causing all the loss and damage to which the Allied and Associated Governments and their nationals have been subjected as a consequence of the war imposed upon them by the aggression of Germany and her allies.”

Article 231 (“War Guilt Clause”)

2. Atlantic Charter and Conference of Bretton Woods

Atlantic Charter (1941)

- The Allies learnt their lesson…
- Economic cooperation is the best way to achieve both peace and prosperity
2. Atlantic Charter and Conference of Bretton Woods

Atlantic Charter (1941)

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<td>Bretton Woods Agreement</td>
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<td>International Trade Organization (ITO)</td>
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The negotiations on an ITO failed in 1948 in La Havana; only the General Agreement on Tariffs and Trade (GATT) was left.

Bretton Woods Conference (1944)

- The UN Monetary and Financial Conference took place in 1944 in Bretton Woods (New Hampshire, USA)
- Aim: Establish a new international monetary and financial order after World War II
  - J. M. Keynes (U.K.): "International clearing union"
  - H. D. White (U.S.): "International stabilization fund"
2. Atlantic Charter and Conference of Bretton Woods

Bretton Woods Conference (1944)

- **Outcome**
  - IMF: to manage the international monetary system
  - IBRD: to provide financing for reconstruction and development
  - Bretton Woods system of exchange rate management
  - GATT (ITO proposal failed): to liberalize trade

“There has never been such a far-reaching proposal on so great a scale to provide employment in the present and increase productivity in the future. We have been working quietly away in the cool woods and mountains of New Hampshire and I doubt if the world yet understands how big a thing we are bringing to birth.”

J. M. Keynes, BBC broadcast (1944)
3. Emerging Legal Concepts

“If we could get a freer flow of trade…freer in the sense of fewer discriminations and obstructions…so that one country would not be deadly jealous of another and the living standards of all countries might rise, thereby eliminating the economic dissatisfaction that breeds war, we might have a reasonable chance of lasting peace.”

The Memoirs of Cordell Hull (1948)

3. Emerging Legal Concepts

- Idea that the fundamental causes of the two World Wars lay in economic discrimination and trade restrictions
- Facilitating international trade by…
  - …maintaining fixed exchange rates between countries
  - …actively reducing protectionist policies (e.g., high tariffs)
3. Emerging Legal Concepts

- International economic cooperation: From bilateral to multilateral approach
- Trade preferences: From reciprocity to most-favored-nation treatment
- Market access: From market barriers to national treatment
1. International Monetary Fund

Purposes (Art. I Articles of Agreement)

- Promote international monetary cooperation
- Facilitate international trade
- Promote exchange stability
- Assist in establishing a multilateral system of payments and in eliminating foreign exchange restrictions
- Provide temporary financial resources to members
- Shorten the duration and lessen the degree of disequilibrium in balances of payments of members

1. International Monetary Fund

Organization

- Ruled by Articles of Agreement

- Near-global membership (currently 188)
1. International Monetary Fund

Obligations of the Members

- Exchange arrangements (Art. IV Articles of Agreement)
  - Originally: Sustaining fixed exchange rates
  - Policies that promote a stable monetary system, prohibition of exchange rate manipulation
- Currency convertibility (Art. VIII para. 2-4 Articles of Agreement)
  - Avoiding restrictions on current payments
  - Avoiding of discriminatory currency practices
  - Convertibility of foreign-held balances
- Furnishing of information (Art. VIII para. 5 Articles of Agreement)

Special Drawing Rights (SDRs)

- International reserve asset created 1969 to support the Bretton Woods fixed exchange rate regime
- Today lessened need for SDRs
- NOT a currency nor a claim on the IMF
1. International Monetary Fund
Special Drawing Rights (SDRs)

- Share in world exports of goods and services
- Share in international reserves

- US Dollar 41.9%
- Euro 37.4%
- Yen 9.4%
- Pound 11.3%

- Allocation to members according to their quotas
- Costless and unconditional international reserve asset (interest is neither earned nor paid)
- Exchange for hard currency
  - Voluntary trading arrangements
  - Backup designation mechanism
1. International Monetary Fund

Special Drawing Rights – Allocations

- General allocations: to meet a long term global need to supplement existing reserve assets
  - 1st allocation: SDR 9.3 billion in 1970–72 (yearly installments)
  - 2nd allocation: SDR 12.1 billion in 1979–81 (yearly installments)
  - 3rd allocation: SDR 161.2 billion on 28 August 2009

- Special allocation: to achieve an equitable participation in the SDRs system
  - SDR 21.5 billion on 9 September 2009

1. International Monetary Fund

Quotas

- Similar to a capital share that members have in the IMF
- A Member’s quota is determined on the basis of a formula relying on its economic position in the world economy
  - Quotas are denominated in SDRs
  - Largest quota: USA with SDR 42.1 billion (≈ USD 65 bn)
  - Smallest quota: Tuvalu with SDR 1.8 million (≈ USD 2.8 million)
  - Total quotas (February 2013): SDR 238.5 billion (≈ USD 368 bn)
1. International Monetary Fund

Quotas – Functions

- Access to financial assistance
  - Up to 200% of quota annually and...
  - up to 600% cumulatively (Stand-by Arrangement)
  - But: access may be higher in exceptional circumstances

- Voting power: each Member has...
  - ...250 basic votes
  - ...plus one additional vote for each SDR 100,000 of quota

Quotas

75% To be paid in the member’s own currency

25% To be paid in SDRs or widely accepted currencies (i.e., USD, euro, yen or pound sterling)
1. International Monetary Fund

Activities – Surveillance

• Country surveillance
  – Article IV Consultations
  – Financial Sector Assessment Program
  – Reports on Observance of Standards and Codes

• Regional and global surveillance
  – Regional and World Economic Outlooks
  – Global Financial Stability Report

Activities – Lending

• A range of lending facilities…
  – …for short- or medium-term balance of payments difficulties
  – …for recovery from natural disasters and conflicts

• Often covers only a fraction of the member’s needs (catalytic function)

• Letter of intent: describes the policy program of the member that requests IMF financing
1. International Monetary Fund

Why conditionality?

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<th>Sovereign debtor</th>
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<td>Collateralized loans</td>
<td>Which collateral?</td>
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<td>Enforcement in court</td>
<td>“Sovereign immunity”</td>
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<td>Contractual pledge to repay the loan</td>
<td>Credibility of pledge by sovereign powers?</td>
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1. International Monetary Fund

Conditionality – what it means…

- Set of binding predefined policy conditions attached to IMF lending
- Lending in installments (tranches) based on performance criteria
- Requires complex monitoring and periodic reviewing
- Ex post and ex ante conditionality