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MONETARY MANAGEMENT AND THE CURRENT ROLE OF BRETTON WOODS INSTITUTIONS

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Abstract

The purpose of this paper is to discuss the role of the Bretton Woods Institutions (The World Bank Group and International Monetary Fund, IMF) in global monetary management with particular emphasis on the Fund's relationship with Nigeria. The Bretton Woods Institutions have statutory responsibility to interact with member countries. However, this relationship has been misunderstood probably because of their perceived "intrusive" nature. The paper concluded that the Institutions have had important role to play in global monetary management and expected that this role will continue in the future to the extent that it is to the best interest of the world economy. This axiom is also applicable in the case of Nigeria.

I. INTRODUCTION

The involvement of the Bretton Woods Institutions, namely, the World Bank Group and the International Monetary Fund in monetary management in recent years has largely been misunderstood, at times very controversial, and often invokes hostilities. The reason for the confusion appears to be related to the perceived "intrusion" of these institutions in the sovereign affairs of independent states. The reality, however, is that the Bank and the Fund have the statutory rights to interact with their member

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countries, including those in economic and financial crises.

Because of the tendency of the Institutions to prescribe corrective but harsh fiscal and monetary policy regimes to countries experiencing economic problems, they seem to personify the source of the hardship of those countries, thereby making the institutions quite unpopular. It is quite educative to note, however, that many governments implement these policies in tacit agreement with the World Bank and IMF. Most of the time, they take the credit if the programmes succeed, but blame the Bank and the Fund for the hardship associated with implementing the programmes to protect themselves from the expected political fall out. The relationship between the Bretton Woods Institutions and nations in economic and financial crises is likened to that of a doctor and a patient. The doctor prescribes pills to a patient to heal the patient's illness. Thus, it is either the patient purchases and swallows the pills to recover or abandons them at the patient's detriment.

The purpose of this paper is to discuss the current role of the Bretton Woods Institutions in monetary management with particular reference to the Fund's relationship with Nigeria. The overview of the origins of the international financial architecture, centred around the Bretton Woods Institutions is presented in Section II. The IMF's role in monetary management in Nigeria and the implications of the CBN autonomy under the relationship are discussed in Section III. The paper is concluded in Section IV where the future role of the Bretton Woods Institutions in monetary management is also discussed.

II. ORIGINS OF THE BRETTON WOODS INSTITUTIONS

The Bretton Woods Institutions, comprising the World Bank Group and the International Monetary Fund (IMF), were established in 1944 at a conference held in the town of Bretton Woods in the State of New Hampshire, United States of America. The IMF was set up to mid-wife the fixed but adjustable par values of exchange rate system. Under the system, according to Ahluwalia (1999), countries agreed to (i) maintain their exchange rates within a very narrow range of declared par values, which would only be changed with the prior approval of the IMF; and (ii) avoid current account payment restrictions. The idea was to stem past unilateral exchange rate policy measures such as devaluations. The Fund was also expected to provide short-term finance to cover temporary balance of payments disequilibrium on the agreement that such a country will implement certain policy measures. These policies constitute the "conditionality" which the Fund expects, if properly implemented, would return the country's external account position to a balance. The types of IMF financial facilities, purpose, conditions and characteristics are shown in Table I.

The World Bank, on the other hand, was set up to finance the reconstruction of countries devastated by the Second World War as well as develop poor countries. The financing of the reconstruction work was taken over by the Marshall Plan instituted later by the United States, which left the Bank mainly with the responsibility of development financing. During the early years, the Bank concentrated on long-term, structural and sectoral related lending, while the Fund focussed on short-term macroeconomic and balance of payment policy activities.

Table I: IMF FINANCIAL FACILITIES

Credit Facility	Purpose	Conditions	Phasing and Monitoring
Credit Tranches and Extended Fund Facility			
Stand-by Arrangements (1952)	Short-term assistance for countries with balance of payments difficulties of a short-term character	Adopt policies that provide confidence that the member's balance of payments difficulties will be resolved within a reasonable period.	Quarterly purchases(disbursements) contingent on observance of performance criteria and other conditions
Extended Fund Facility (1974)	Longer-term assistance to support members structural reforms to address balance of payments difficulties of a longterm character	Adopt 3-year program, with structural agenda, with annual detailed statement of policies for the next 12 months	Quarterly or semiannual purchases (disbursements) contingent on observance of performance criteria and other conditions
Special Facilities			
Supplemental Reserve Facility (1997)	Short-term assistance for balance of payments difficulties related to crises of market confidence	Available only in context of regular arrangements with associated program and with strengthened policies to address loss of market confidence	Facility available for one year; frontloaded access with two or more purchases (disbursements)
Contingent Credit line (1999)	Precautionary line of defense that would be made readily available against balance of payments difficulties arising from contagion	Eligibility Criteria: (1) absence of balance of payments need from the outset, (2) positive assessment of policies by the IMF, (3) constructive relations with private creditors and satisfactory progress in limiting external vulnerability, (4) satisfactory economic program.	Resources approved for up to one year Small amount (5%-25% of quota) available on approval but not expected to be drawn. Presumption that one-third of resources are released on activation, with the phasing of the remainder determined by a postactivation review.
Compensatory Financing Facility	Medium term assistance for temporary export shortfalls or cereal import excesses. (A provision for use in cases of other contingencies was eliminated in 2000)	Available only when a member has an arrangement with upper credit tranche conditionality, or when its balance of payments position is otherwise satisfactory	Typically disbursed over a minimum of 6 months in accordance with the phasing provisions of the arrangement
Emergency Assistance	Quick, medium-term assistance for Balance of payments difficulties related to:		None, although postconflict assistance can be segmented into two or more purchases made available in exceptional cases
(1) Natural disasters (1962)	(1) To help finance recovery efforts and support economic adjustment programs after natural disasters	(1) Reasonable efforts to overcome balance of payments difficulties	
(2) Postconflict (1995)	(2) To help establish macroeconomic stability in the aftermath of civil unrest, political turmoil, or international armed conflict	(2) Focus on institutional and administrative capacity building to pave the way toward an upper credit tranche arrangment or PRGF	
Facility for Low-Income Members			
Poverty Reduction and Growth Facility (1999) (Replaced the Enhanced Structural Adjustment Facility)	Longer-term assistance for deep-seated balance of payments difficulties of structural nature; aims at sustained poverty-reducing growth	PRGF-supported programs are based on a Poverty Reduction Strategy Paper (PRSP) prepared by the country in a participatory process, and integrating macroeconomic, strucutral, and poverty reduction policies	Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews

The IMF's lending is financed from the capital subscribed by member countries; each country is assigned a quota that represents its financial commitment. A member provides a portion of its quota in foreign currencies acceptable to the IMF-or the IMF-or in SDRs-and the remainder in its own currency. An IMF loan is disbursed or drawn by the borrower purchasing foreign currency assets from the IMF with its own currency. Repayment of the loan is achieved by the borrower repurchasing its currency from the IMF with foreign currency. The table is adapted from Table 4.1 of the IMF 2002 Annual Report.

The collapse of the par value system in 1973 and the subsequent floating of major industrial countries currencies as well as the reduced use of Fund's resources by industrial countries' increased the Fund's exposure to developing countries. In the same vein, in realizing that developing countries' balance of payments difficulties were related to structural problems, the Bank started to advance structural adjustment loans intended to improve macroeconomic performance which could have led to the balance of payment problem in the first instance. Thus, over the years, the changing world economy influenced the institutional arrangements for global monetary management, drawing the policy frameworks of the World Bank and IMF quite closer, while their policy prescriptions influenced the thrust of international monetary management.

III. IMF AND MONETARY MANAGEMENT IN NIGERIA

Nigeria became a member of the IMF on March 30, 1961 shortly after independence on October 1, 1960. Up till the early 1980s, Nigeria enjoyed respectful relationship with the IMF. After Nigeria assumed responsibility for the huge Paris Club debt and Nigerian economic performance declined, the Fund increased its surveillance over Nigeria while also acting as agent for the Paris Club group of countries. Specifically, it was the initiation of the Structural Adjustment Programme in 1986 by Nigeria to correct macroeconomic and structural imbalances in the economy that drew the country and the Fund closer.

Between 1986 and 1992, the Fund established three standby arrangements (SBA), amounting to SDR 1.44 billion for financial support to the SAP. While Nigeria was involved in the design and implementation of the SAP, it however, refused to draw down the financial facility

established to support the adjustment projects and programmes which could have ameliorated some of the social problems associated with the SAP because of political considerations.

The first SBA (January 1987-January 1988) under the SAP involved among other measures, financial sector reforms and liberalization. The key policy thrust was to realign the naira exchange rate to make it more market determined under the framework of the Second-tier Foreign Exchange Market (SFEM). An official rate for some limited transactions requiring Presidential approval was, however, retained. The second SBA programme (February 1989 - April 1990), targeted fiscal sector adjustment as well as banking system reforms and liberalization. During the period, entry of new banks and other financial institutions were encouraged to enhance competition and improved financial intermediation. In addition, the Federal Government and parastatal accounts with commercial and merchant banks were transferred to the CBN to control excess reserves in the banking system, thereby curbing the ability of retail banks to create credit. As a result, banking system liquidity was substantially reduced, leading to a sharp drop in the growth of monetary aggregates while the naira exchange rate attained relative stability. Furthermore, the number of banks in Nigeria increased substantially from 41 in 1986 to 107 in 1990. The third Standby Arrangement covered January 9, 1991 to April 8, 1992 but was derailed by unanticipated excess liquidity unleashed by extra-budgetary expenditure arising from the political transition experiment at that time.

Again, on February 22, 1999, Nigeria entered into an informal arrangement with the IMF under a Staff-Monitored Programme (SMP). A Staff-Monitored Programme is the Fund's instrument for dialogue with member countries without the support of the Fund's financial resources nor

the approval of its Executive Board. Under the programme, Nigeria planned to maintain tight monetary stance by limiting CBN's credit to both the public and private sectors of the economy; maintain stable exchange rate of the naira; and ensure sound and healthy financial system with a firm policy of not bailing out distressed banks. It was envisaged that the restoration of the CBN's instrument autonomy in December, 1998 would enhance the realization of the above goals. By end 1999, the gains of the SMP was limited by existing structural rigidities and fiscal dominance. However, the inflation rate was brought under control from 10.0 per cent in 1998 to 16.6 per cent as at end-1999.

Nigeria's fourth SBA with the Fund was programmed to last from 4th August, 2000 to 31st October, 2001. The monetary programme component of the Arrangement included:

(i) Reducing the growth of money supply;
(ii) Increasing net international reserves;
(iii) Maintaining stable and market determined exchange rate; and
(iv) Strengthening supervisory and regulatory activities over the financial sector to improve system soundness and enhance the effectiveness and efficiency of monetary policy.

The Federal Government further agreed to improve liquidity management by reducing government balances with commercial banks. Specific policy targets expected to be realised under the forth Arrangement included sale of treasury bills and CBN certificates worth N40 billion and up to N100 billion, respectively; unification of inter-bank foreign exchange market rates; reduction of foreign exchange premium between the official and parallel market exchange rates to not more than 10 per cent; and reduction of net foreign assets, net domestic assets, net claims on

government and reserve money to agreed optimal levels.

The rationale behind the Fund's policy prescriptions can be explained by observing that money supply (M2), broadly defined, equals net domestic credit (NDC), net foreign assets (NFA) and other assets (net), OAN. In other words,

$$M2 = NDC + NFA + OAN \quad \ldots\ldots (1)$$

NDC is the sum of net credit to government and private sectors. In the simplest and short terms, NDC is expected to be sensitive largely to interest rate changes, while NFA is influenced mainly by exchange rate movements. Thus, theoretically by raising the treasury bill issue rate, which also has influence on other interest rates in the economy, and devaluing the naira exchange rate, the NDC and NFA are expected to decline and rise, respectively, thereby influencing the growth of the money supply in the desired direction, all other things being equal. Thus,

$$M2 = NDC(r) + NFA(e) + OAN \quad \ldots\ldots (2)$$

where, r and e are interest and exchange rates which are the monetary policy instruments and

$NDC/\ r<0, \quad NFA/\ e>0$

In practice, however, the net effect of the upward review of interest rate and devaluation of the naira exchange rate on money supply, M2, a good measure of liquidity in the banking system, actually depends on the relative impacts of the changes in interest rates and exchange rate which generally also affect each other dynamically. Furthermore, the expected positive impact of the increase in interest rate in reducing the growth of money supply is dampened by the interest rate insensitivity of government borrowing from the banking system.

Before proceeding to discuss the implementation and outcome of the programme, it is pertinent at this point to address the issue of the autonomy of the CBN in monetary management in Nigeria, especially, the often mistaken role of the IMF. The CBN has instrument autonomy in the conduct of monetary policy. What this means is that the Bank can use legal instruments and measures it deems fit to achieve the goal of maintaining price stability. However, in performing this function, the Bank has to take its stakeholders, namely, private sector operators, the executive and the legislative arms of government as well as the international financial community along in the process. In other words, the Central Bank Governor must be able to implement the instruments of the autonomy with tact to ensure harmony with other policies of government and overall interest of the Nigerian economy.

It is in this regard that the implementation of the 2001 SBA and its performance can be evaluated. For instance, while the Fund preferred higher treasury bill issue rate as a mechanism to control excess liquidity, the CBN considered other factors, including negative effects of high interest rates on the real sector in taking action it deemed fit in the best interest of the overall economy. Similarly, the thorny issue of merging the rates in all segments of the foreign exchange market was another area the CBN took a critical look before taking policy action, considering the fact that many non-monetary factors influence the existence of the segmented exchange rates of the naira. Besides, the adoption of the Dutch Auction System in July 2002 which lays greater emphasis on market mechanisms in determining the naira exchange rate, without the prompting of the IMF, demonstrated the CBN's autonomy in making appropriate policies for the domestic economy.

The performance of the fourth SBA after one year implementation

was mixed. The growth of monetary aggregates exceeded targets, while the inflation rate increased from 6.9 per cent in 2000 to 18.9 per cent in 2001. Buoyed by strong demand for oil, the external sector performed above target. Overall, while the fourth SBA ended without completely achieving its goals, subsequent informal efforts were made by the Fund and Nigeria in 2002 to continue with the policy dialogue and to monitor economic developments in the country. However, these latest efforts were truncated in March, 2002 because of the Fund's fear that the country could not successfully implement a Staff-Monitored Programme owing to the perceived unrealistic provisions of the 2002 Federal Government Budget. Nevertheless, IMF missions arrived in Nigeria in June and October, 2002 for the regular Article IV consultations on economic matters, re-emphasizing the fact that the door is never closed on the Bretton Woods Institutions.

IV. FUTURE ROLE OF THE BRETTON WOODS INSTITUTIONS IN MONETARY MANAGEMENT

From the foregoing, it is clear that the Bretton Woods Institutions influence monetary management globally, and in Nigeria in particular to the extent that the policies are consistent with other policies of government. It is expected that they will continue their supervisory roles over international financial markets in the future. However, the form of their intervention will be shaped by evolving global financial and economic developments.

In retrospect, the lessons learnt from the experiences of Asia, the Russian Federation, Brazil and more recently Argentina have already influenced the focus of global monetary management on capital account flow management. The main tenets of the new financial architecture[3] being

put in place to contain contagion arising from capital account flow problems include:

(i) strengthening the financial sector in developing countries;
(ii) improving bilateral and multilateral surveillance;
(iii) making the IMF a genuine lender of last resort;
(iv) introducing mechanisms for orderly negotiations with private creditors;
(v) managing the social consequences of crisis; and
(vi) creating an internationally agreed regime for restrictions on capital account flows.

In addition, emphasis is being placed on designing home grown policies which individual countries could claim ownership as a substitute for the "one policy fits all" past policy prescriptions of the Bretton Woods Institutions.

The CBN, on its part, will continue to interact with the World Bank and the Fund as a member of the Bretton Woods Institution and judiciously use policy instruments available to it to regulate and supervise the Nigerian economy efficiently and effectively.

In conclusion, the paper is of the opinion that the Bretton Woods Institutions have pervasive influence and important role to play currently and in the future in domestic and global monetary management.

For detailed discussion, see Ahluwalia (1999) "The IMF and the World Bank in the New Financial Architecture:

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