INTERNATIONAL FINANCE

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Topics Covered Today

- International Monetary System (IMS)
- Evolution of IMS

International Monetary System (IMS)

- IMS is a system by which countries settle their debts with each other.
- IMS is a set of agreements, rules, institutions, mechanisms and policies regarding exchange rates, international payments and the flow of capital.
- It is the financial arrangements that exist to ensure that international business is carried on smoothly.

Evolution of IMS

- Early days prior to the evolution of IMS, trade payments were settled through barter.
- Later to overcome the inconvenience of barter system, traders began using metal like gold or silver for settling payments.
- IMS developed through the following stages:

Stages of IMS

Stages	Explanation
Bimetallism: Before 1875	Prior to 1875 countries had bimetallism. In that period gold and silver were used for settling payments
Gold Standard: 1880-1916	Bimetallic standard was replaced by the gold standard. The gold standard lasted until the outbreak of world war 1 in 1914. The central feature of gold standard was that exchange rates of different countries were fixed and the values were set in relation to gold. Thus gold served as the common basis for the determination of individual currency values. Each country following the gold standard specified that one unit of its currency would be equal to a certain amount of gold.

Stages of IMS

Stages	Explanation
Interwar Period: 1914-1944	Most of the countries abandoned the gold standard in 1914 when first world war broke out. The first world war, great depression in 1929, failure of banks in USA, decline in the value of Franc and Pound, hyperinflation due to first world war and depression forced the countries to shift from gold standard to paper standard. Paper standard refers to a monetary standard in which inconvertible paper money circulates as unlimited legal tender. Under paper money standard, although the standard money is made of paper , both currency and coins serve as standard money for purpose of payment. No gold reserves are required either to back domestic paper currency or to facilitate foreign payments. Here quantity of money in circulation is controlled and managed by the monetary authority with a view to maintain stability in prices and incomes within the country

Stages of IMS

Stages	Explanation
Bretton woods System: 1944-1972	By the end of 2nd world war many countries' financial system were in a chaos. To overcome this 44 nations gathered at Bretton Woods, USA to find out a solution to overcome this chaos situation. In the meeting they decided to establish an international institution to ensure good functioning of the system and thus IMF and World Bank formed. These are also called Bretton Wood Twins. IMF agreement was the basis for international monetary system from 1945 until 1971. Under Bretton Woods system, each country established a par value in relation to the US Dollar which was pegged to gold at $35 per ounce of gold. Each country was responsible for maintaining its exchange rate within ± 1% system Under Bretton Wood System, US $ was the only currency that was fully convertible to gold and other currencies were convertible to gold only through US Dollar. Because of this arrangement Bretton Wood System can be described as 'dollar based gold exchange standard.' Devaluation or revaluation of more than 5% had to be done with the permission of IMF. This measure was to avoid chain devaluations like the ones which occurred before 2nd world war.

Stages of IMS

Stages	Explanation
Fixed Exchange Rates: 1945-1973	It is the regime in which all member countries are required to maintain a fixed exchange rate for monetary discipline. But most countries found it difficult to maintain a fixed exchange rate, due to post war conditions existing in their countries. The fixed exchange rate system collapsed in 1971 when US Government declared that its currency was no more convertible into gold and that its currency would float against other currencies.
Floating Exchange Rate System	Floating exchange rate system exists since the collapse of the fixed exchange rate regime. Under this system the exchange rates are allowed to seek their own levels in the foreign exchange markets without Government interventions. However to smoothen out exchange rate fluctuations, many countries' central banks have been intervening quite frequently. Therefore, the present international monetary system is called as Managed Floating System or Dirty Float.

THANK YOU