SRIRAM'S IAS

INTERNATIONAL MONETARY FUND

The United Nations Monetary and Financial Conference, commonly known as Bretton Woods conference, was held in Bretton Woods, New Hampshire, USA in 1944 to regulate the international monetary and financial order after the conclusion of World War II. The conference resulted in the agreements to set up the International Bank for Reconstruction and Development (IBRD) - popularly known as World Bank; and the International Monetary Fund (IMF). The IMF was set up to foster monetary stability at global level. The IBRD was created to speed up post-war reconstruction. The two institutions are known as the Bretton Woods twins. They are specialized agencies of the United Nations.

IMF

The International Monetary Fund, a UN specialised agency, was established under the Bretton Woods Agreement in 1944 along with the World Bank. It has 189 members (2017). Nauru joined as the 189^{th} member in 2016. Nauru is the second smallest member of the Fund, after Tuvalu. Nauru is a tiny island country in Micronesia, northeast of Australia.

It is headquartered in Washington and its Managing Director is Christine Lagarde. Christine Lagarde was asked to serve as IMF Managing Director for a second five-year term starting on from 2016.

IMF started functioning in 1947. India is a founding member.

IMF Objectives

IMF objectives are:

- To promote international monetary cooperation
- To facilitate balanced growth of international trade for the economic growth of all member countries
- To promote exchange rate stability ; maintain orderly exchange rate arrangements; and to advise against competitive exchange rate revaluation
- To help members in times of balance of payments crisis.

Governance Structure

The Board of Governors is the highest decision-making body of the IMF. It consists of one governor and one alternate governor for each member country. The governor is appointed by the member country and is usually the minister of finance or the head of the central bank. While the Board of Governors has delegated most of its powers to the IMF's Executive Board, it retains the right to approve quota increases, special drawing right (SDR) allocations, the admittance of new members and amendments to the Articles of Agreement and By-Laws. The Board of Governors also elects or appoints executive directors.

The IMF Board of Governors is advised by two ministerial committees, the International Monetary and Financial Committee (IMFC) and theDevelopment Committee. The IMFC meets twice a year, during the Spring and Annual Meetings. The Committee discusses matters of common concern affecting the global economy and also advises the IMF on the direction its work.

The Development Committee is tasked with advising the Boards of Governors of the IMF and the World Bank on issues related to economic development in emerging and developing countries.

What the IMF Does
In order to achieve the above objectives, the IMF monitors the world's economies, lends to members in economic difficulty and provides technical assistance.

To elaborate, the work of the IMF is of three main types:

- Surveillance which involves the monitoring of economic and financial developments of every member country and the provision of policy advice, aimed especially at crisis-prevention. Also, appraisal of the exchange rate policies of member countries. In the absence of surveillance, the financial volatility in the world today can become worse.
- Lends to countries with balance of payments difficulties.
- Provides countries with technical assistance and training in its areas of expertise.

The IMF also plays an important role in the fight against money-laundering and terrorism.

Benefits to member countries of the IMF are many. They have access to information on the economic policies of all member countries, the opportunity to influence other members' economic policies, technical assistance in banking, fiscal affairs, and exchange matters, financial support in times of payment difficulties, and increased opportunities for trade and investment

Special Drawing Rights (SDRs)
IMF lends in its own artificial currency unit called the SDR. The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is based on a basket of five key international currencies: dollar, euro, yen, pound and chinese Yuan which was included in 2016. The basket now consists of the following five currencies with their respective weights: U.S. dollar 41.73%, Euro 30.93%, Renminbi (Chinese yuan) 10.92%, Japanese yen 8.33%, British pound 8.09%. The basket composition is reviewed every five years to ensure that it reflects the relative importance of currencies in the world's trading and financial systems. The weights assigned to each currency in the SDR basket are adjusted to take into account their current prominence in terms of international trade and national foreign exchange reserves.
The SDR value in USD terms in November 2017 is $1.403.

SDRs can be exchanged for national currencies. SDRs are not traded in the forex market like other national currencies but can be exchanged between countries. Private parties do not hold or use them.

SDR is neither a currency, nor a claim on the IMF. It is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs.

Renminbi in SDR Basket
China's currency, the renminbi was added to the "Special Drawing Rights" (SDR) basket of currencies from October 2016. Its inclusion is an important milestone in China's global financial integration and reflects growing international use and trading of renminbi. This is the first time in over 15 years that the list of currencies comprising the SDR has been altered. Since 1999, when the euro replaced the Deutsche mark and French franc, its value has been based on a basket of four

currencies: the U.S. dollar, the euro, the Japanese yen, and the British pound, that met the IMF's inclusion criteria.

Some criteria for inclusion in the basket: that the issuing country is among the largest exporters in the world and that its currency is "freely usable."

A currency is determined to be freely usable when it is widely used to make payments for international transactions and widely traded in the principal exchange markets.

Inclusion in the SDR will deepen the expectations that China will let market forces decide the yuan's exchange rate. China will also make its currency convertible. Renminbi will enjoy greater confidence in international markets and pick up as a reserve currency. That may bolster the value of renminbi but market forces will eventually decide valuations. If renminbi appreciates, it will help India's exports and also cut imports. Global trade also may be favourable relatively to India. India need not stock so many dollars and can diversify thus derisking its external account relatively.

IMF Quota

Upon joining, each member of the IMF is assigned a quota- the amount that the country has to pay to the IMF. It is based broadly on its relative size in the world economy. A member's quota guides:

- subscriptions: the amount the member is obliged to provide to the IMF.
- voting power
- the amount of financing a member can obtain from the IMF

Upon joining the IMF, a country normally pays up to one-quarter of its quota in the form of widely accepted foreign currencies (such as the U.S. dollar, euro, yen, or pound sterling) or Special Drawing Rights (SDRs). The remaining three-quarters are paid in the country's own currency.Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account. The largest member of the IMF is the United States, with a current quota (2017) of SDR82.99 billion (about US$118 billion). The IMF reviews members' quotas once in five years.

The International Monetary Fund (IMF) in 2016 announced implementation of its long-pending quota reforms, which will give more voting rights to emerging economies such as India in the functioning of the organisation.

With these reforms, India's quota in IMF would rise to 2.7 per cent, from the existing 2.44 per cent. Also, the voting share of India in IMF would increase to 2.6 per cent from 2.34 per cent. It makes India the eighth-largest shareholder.

The reforms also increase the financial strength of IMF, by doubling its permanent capital resources to 477 billion special drawing rights ($659 billion). For the first time, four emerging market countries — BRIC will be among the 10 largest members of the IMF. Other top 10 members include the US, Japan, and the four largest European countries (France, Germany, Italy, and the UK)

The IMF reviews members' quotas once in five years and the last such review took place in December, 2010.

IMF Borrowing Arrangements

While quota subscriptions of member countries are its main source of financing, the IMF can supplement its resources through borrowing if it believes that resources might fall short of members' needs. Through the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB), a number of member countries and institutions lend additional funds to the IMF.The GAB and NAB are credit arrangements between the IMF and a group of members and institutions to provide supplementary resources to the IMF to prevent or cope with problems of the international monetary system or to deal with an exceptional situation that poses a threat to international monetary stability.

India and NAB

India funded IMF for bailouts in financially-stricken Europe, marking a dramatic role reversal from 1991 when it had to borrow International Monetary Fund (IMF) to avert a balance of payments crisis.

GOI provided loans to the multilateral agency's New Arrangements to Borrow (NAB), a fund whose corpus was raised when the debt crisis in Europe showed no signs of abating after the Greek sovereign debt crisis.

India gave $10b in 2012 during the Mexico summit of the G-20 for the Eurozone crisis firewall.

How the IMF lends

A core responsibility of the IMF is to provide loans to member countries experiencing balance of payments problems. This financial assistance enables countries to rebuild their international reserves; stabilize their currencies; continue paying for debt servicing and imports; and restore conditions for strong economic growth while undertaking policies to correct the underlying problems. Unlike development banks, the IMF does not lend for specific projects.

The changing nature of IMF lending

The volume of loans provided by the IMF has fluctuated significantly over time. The oil shock of the 1970s and the debt crisis of the 1980s were both followed by sharp increases in IMF lending. In the 1990s, the transition process in Central and Eastern Europe and the crises in emerging market economies led to further surges of demand for IMF resources. Deep crises in Latin America kept demand for IMF resources high in the early 2000s. IMF lending rose again in late 2008 in the wake of the global financial crisis.

IMF Facilities

Over the years, the IMF developed various loan instruments, or facilities, that are tailored to address the specific circumstances of its diverse membership.

Low-income countries may borrow at a concessional interest rate through the Poverty Reduction and Growth Facility (PRGF).

The Exogenous Shocks Facility (ESF) provides policy support and financial assistance to low-income countries facing global shocks. For example, due to commodity prices falling etc.

Non-concessional loans are provided mainly through Stand-By Arrangements (SBA) for members who are in a BOP crisis. When a member takes SBA , he may opt for a long term Extended Fund Facility(EFF) which requires basic changes in the economic policy orientation to open up the economy; or he may not opt out of such EFF having used the SBA funds well and not needing any further assistance. The IMF also provides emergency assistance to support recovery from natural disasters and conflicts, in some cases at concessional interest rates.

Except for the PRGF and the ESF, all facilities are subject to the IMF's market-related interest rate. The amount that a country can borrow from the Fund—its access limit—varies depending on the type of loan, but is typically a multiple of the country's IMF quota. This limit may be exceeded in exceptional circumstances.

The IMF's analysis of global economic developments, contained in its World Economic Outlook, provide finance ministers and central bank governors with a common framework for discussing the global economy. Twice a year, it publishes the Global Financial Stability Report. The IMF's performance is assessed on a regular basis by an Independent Evaluation Office.

IMF and social protection

To incorporate social protection considerations into IMF operational work, it works with relevant partner institutions. The relevant institutions include: the World Bank, in the areas of poverty assessment, provision of social safety nets and basic social services, and improving the effectiveness and pro-poor orientation of public expenditures; the International Labour Organization (ILO), in the area of labor market and related social policy reforms; United Nations Children's Fund (UNICEF); the Organization for Economic Cooperation and Development (OECD); regional development banks; and bilateral aid agencies etc.

Social protection refers to policies designed to ensure income security and support to all—paying particular attention to the poor and the vulnerable. Anyone who needs social protection should be able to access it. Universal social protection includes: adequate cash transfers for all who need them, especially children; benefits and support for people of working age in case of maternity, disability, work injury or for those without jobs; and pensions for all older persons. This protection can be provided through social insurance, tax-funded social benefits, social assistance services, public works programs and other schemes guaranteeing basic income security.

IMF and Conditionalities

IMF conditionality is a set of policies or conditions that the IMF requires in exchange for financial resources. The IMF does require collateral from countries for loans but also requires the government seeking assistance to correct its macroeconomic imbalances in the form of policy reform. If the conditions are not met, the funds are withheld. Funds are given in installments linked to policy changes. Some conditionalities enforce structural adjustment wherein the economy is opened up to globalization and privatization. Some are of short term significance like expenditure cuts.

Some of the conditions can include:

- Cutting expenditures, also known as austerity.
- Devaluation of currencies,
- Trade liberalisation, or lifting import and export restrictions,
- open upto foreign direct investment and expand domestic stock markets
- Balancing budgets and not overspending,
- Removing price controls and state subsidies,
- Privatization
- deregulate the exchange rate
- currency convertibility
- downsize the government
- enact flexible labour sector reforms

- Enhancing the rights of foreign investors vis-a-vis national laws
- Improving governance and fighting corruption.

These conditions are known as the Washington Consensus.

These loan conditions ensure that the borrowing country will be able to repay the IMF and that the country will solve their balance-of-payment problems complementary to the global growth.

It is clear that most countries can not follow these policies with popular support. At the same time it must be understood that these policies should be selectively followed for the best results by avoiding populism and adhering to genuine welfarism.The Fund admitted that too many conditions were imposed on borrowers; it overstepped its mandate and expertise.Another criticism about the conditionalities is that the reforms suggested are the same for all countries irrespective of the causes of the crisis. India suggested that the IMF conditionalities must be more sensitive to the domestic realities of the member countries.

IMF and the global financial crisis

As the world economy had become engulfed in in 2008 in the worst crisis since the Great Depression, the IMF mobilized on many fronts to support its member countries, increasing its lending, using its cross-country experience to advise on policy solutions and introducing reforms to become more responsive to member countries' needs.It stepped up crisis lending, including a sharp increase in concessional lending to the world's poorest nations and provided analysis and targeted advice. The IMF overhauled its general lending framework to make it better suited to country needs.

The IMF created a broad financial safety net to limit the spread of the crisis.

Since 2010 the I.M.F. focused largely on Europe after the outbreak of the sovereign debt crisis that has threatened the euro.

Reforming the IMF

Role of IMF was criticized for the following reasons

- One size fits all policy under which it gives the same recipe for all ills
- Conditionalities that go with the loans that it disburses demand that spending on social sector be curtailed
- IMF Managing Director is invariably from a European country (the current MD, Chritine Lagarde is from France) and India and other emerging markets are demanding that it should not be geographically confined and be merit – based
- India wants that its economic power ,as it is emerging, should be recognized and so is given greater voting rights
- IMF failed to predict the global recession in 2008-09, let alone prevent it with its surveillance role

Reforms have taken place after the global crisis in some of these matters.

India and the IMF

India and the IMF have had a friendly relationship, which has been beneficial for both. The IMF provided India with loans over the years and this has helped the country in times of BOP pressure.

- India joined the IMF in 1945, as one of the IMF's original members.
- India accepted the obligations of Article VIII of the IMF Articles of Agreement on current account convertibility in 1994.
- India subscribes to the IMF's Special Data Dissemination Standard. Countries belonging to this group make a commitment to observe the standard and to provide information about their data and data dissemination practices.

While India has not been a frequent user of IMF resources, IMF credit has been instrumental in helping India respond to emerging balance of payments problems on two occasions. In 1981-82, India borrowed SDR 3.9 billion. In 1991-93, India borrowed a total of SDR 2.2 billion under two stand-by arrangements (SBA), and in 1991 it borrowed SDR 1.4 billion under the Contingency Compensatory Financing Facility (CCFF).

The relationship between the IMF and India has grown strong over the years. In fact, the country has turned into a creditor to the IMF and has stopped taking loans from it. We lent $10b in 2012(Mexico G20 Summit) to the IMF to bail out the Eurozone countries. India needs IMF as its globalizing economy carries risks like any other; it also needs IMF for technical training and capacity building; it needs to contribute to global monetary stability for its own enlightened self interest; it needs the SDR to diversify its forex holdings for greater safety.

SDRs as an alternative to the US dollar as global reserve currency
The international monetary system needs reform as was made evident by the 2008 global financial crisis. Dollar as a global reserve currency is neither viable nor desirable to the same degree as before Global imbalances- counties like China make and export goods and have current account surpluses and USA imports them and depends on them with huge and unmanageable CADs.

John Maynard Keynes once proposed a global currency, the Bancor, to be placed at the centre of the international monetary system. The idea never caught on. Instead, we now have a system dominated by holdings of US dollars. This has disadvantages. It creates tension due to the use of a national currency, the dollar, as the global currency. This can lead to global volatility as a result of growing US twin deficits. These deficits generate excessive indebtedness, both external and internal. US monetary policy impacts the whole world though it is made with the US interests in mind.

Some experts argue that the global role of SDRs should be increased as it would avoid help diversify the risk from forex holdings; lessen chances of global financial volatility; make US policies relatively less important for the world etc. Global stability enhances as dollar worries recede. However, SDRs can only supplement the dollar and other global reserve currencies and gold as the SDR is the creation of US and the west within the IMF. If SDR becomes a rival to dollar and yen, it may not receive the support of these countries. Nor are the SDRs created in such huge numbers as is warranted to play the larger role that some are recommending.

Chiang Mai Initiative

The **Chiang Mai Initiative** (CMI) is a multilateral currency pooling arrangement among the ten members of theAssociation of Southeast Asian Nations (ASEAN), the People's Republic of China (including Hong Kong), Japan, and South Korea. It draws from a foreign exchange reserves pool worth US$240 billion that was launched in 2010.

After 1997 Asian Financial Crisis, member countries started this initiative to manage regional short-term liquidity problems and to facilitate the work of other international financial arrangements and organisations like International Monetary Fund. It has never been used as there has not been a crisis since 1997 asian financial crisis.

BRICS CRA

The **BRICS Contingent Reserve Arrangement** (CRA) is a pool of foreign currency reserves for the member countries to draw from when they face any balance of paymemnts crisis- actually or potentially. Each member contributes to the pool which is a safety net. It was established in 2015 by the BRICS countries Brazil, Russia, India, China and South Africa. The legal basis is formed by the Treaty for the Establishment of a BRICS Contingent Reserve Arrangement, signed at Fortaleza, Brazil in 2014. It entered into force upon ratification by all BRICS statesin 2015. It became operational in 2016.

The objective of this reserve is to provide protection against global liquidity pressures when members' national currencies are adversely affected by global financial pressures. It is an example of south-south cooperation- that is cooperation among developing countries. It and implies a commitment from each member that it will support the other during crisis. It plays a role similar to the IMF but the BRICS nations say that it is compelemtary to the IMF. Some see CRA as a competitor to the International Monetary Fund (IMF). That is debatable though.

CRA has a capital of $100 billion which is distributed as follows:.

Country	Capital contribution (billion USD)	Access to Funds (billion USD)	Voting Rights
Brazil	18	18	18.10
China	41	21	39.95
India	18	18	18.10
Russia	18	18	18.10
South Africa	5	10	5.75
Total	100	85	100.00

Can CRA be a rival of IMF?

Russian President Vladimir Putin opined that the new BRICS contingent reserve arrangement (CRA) could be a substitute for the IMF, saying that it "creates the foundation for an effective protection of our national economies from a crisis in financial markets."

However, CRA is said to be complementary to IMF as IMF is steeped in assisting the crisis ridden Eurozone countries. Also, with globalization and huge private flows, the need for safety nets is much more than earlier. CRA does not have such funds.

Under the terms of the arrangement, each country can only borrow a part of its contribution before going to the IMF for a stand by arrangement with the IMF. It works out to a very small amount which is grossly inadequate when compared to Russia and Brazil's crisis-borrowing from the IMF over the past twenty years. The IMF approved lending to Russia of $38 billion (SDR 24.786 billion) in the 1990s. In 2002 alone, the IMF approved a 15-month stand-by credit arrangement of about $30 billion for Brazil. Net private financial flows to emerging markets today are about 10 times what they were in 2002, meaning that the size of the loans necessary to address balance of payments financing problems would be even larger now.The BRICS countries are intensely aware of it as revealed in vast pools of foreign exchange reserves that they maintain. The small amont from the BRICS CRA would make only a symbolic difference in a genuine financial crisis. Thus, CRA is only complementary to IMF as of now.