Bretton Woods Institutions & Others

The United Nations Monetary and Financial Conference, commonly known as Bretton Woods conference, was held in Bretton Woods, New Hampshire , USA 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.

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 188 members (2014). It is headquartered in Washington and its Managing Director is Christine Lagarde. It started functioning in 1947.

Upon joining, each member of the IMF is assigned a quota, 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
- Access to financing: 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.

India's current quota in the IMF is SDR (Special Drawing Rights) 5821.50 million, giving it a shareholding of 2.44 %. Based on voting share, India (together with its constituency countries viz. Bangladesh, Bhutan and Sri Lanka) is ranked 17th in the list of 24 constituencies.

The IMF reviews members' quotas once in five years and the last such review took place in December, 2010. India has already consented to its quota increase under the 2010 review and after the 2010 quota review comes into effect, our quota share will increase from the current 2.44% to 2.75%, making India the eight largest quota holding country at the IMF up from its previous position of being the 11th largest. In absolute terms, India's quota will increase to SDR 13,114.4 million from SDR 5,821.5 million (an increase of approximately US$ 11.5 billion or INR 56,000 crore).

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 avoid competitive exchange rate revaluation
- To help members in times of balance of payments crisis.

What the IMF Does

In order to achieve the above objectives, the following functions are performed:
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 involves the monitoring of economic and financial developments, and the provision of policy advice, aimed especially at crisis-prevention.

The IMF also lends to countries with balance of payments difficulties, to provide temporary financing and to support policies aimed at correcting the underlying problems; loans to low-income countries are also aimed especially at poverty reduction.

Third, the IMF 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

Surveillance is the process of appraisal of the exchange rate policies of member countries. In the absence of surveillance, the financial volatility in the world today can become worse.

Special Drawing Rights (SDRs)

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 four key international currencies- dollar, euro,yen and pound. SDRs can be exchanged for national currencies.

SDR is neither a currency, nor a claim on the IMF. Rather, 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.

The value of the SDR is set dynamically against a basket of currencies consisting of the euro, Japanese yen, pound sterling, and U.S. dollar. 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. China wants Yuan included.

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 bailouts in financially-stricken Europe, marking a dramatic role reversal from 20 years ago when it went knocking on the doors of the International Monetary Fund (IMF) to avert a balance of payments crisis.

The government took parliamentary approval to provide loans to the multilateral agency's New Arrangements to Borrow (NAB), a fund whose corpus was raised to $580 billion when the debt crisis in Europe showed no signs of abating after the Greek sovereign debt crisis.

India participates in the Financial Transactions Plan of the International Monetary Fund since 2002.FTP is the mechanism through which the Fund finances its lending and repayment operations to its members.

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 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.

IMF Facilities

Over the years, the IMF has 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) and the Exogenous Shocks Facility (ESF). 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 with very strong policies and policy frameworks, and the Extended Fund Facility (which is useful primarily for low-income members).

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.

Extended Fund Facility (EFF) is to help countries address longer-term balance of payments problems requiring fundamental economic reforms. Arrangements under the EFF are thus longer than SBAs.

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 the global financial crisis

As the world economy has become engulfed in the worst crisis since the Great Depression before the second world war, the IMF has 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.

Stepping up crisis lending, including a sharp increase in concessional lending to the world's poorest nations.

Providing analysis and targeted advice.

Becoming more flexible. The IMF has overhauled its general lending framework to make it better suited to country needs.

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

Drawing lessons from the crisis. The IMF is contributing to the ongoing effort to draw lessons from the crisis for policy, regulation, and reform of the global financial architecture.

The financial crisis of 2008 called the fund into action, as it brokered rescue packages for countries like Pakistan, Iceland, Hungary and Ukraine that were swamped by the collapse.

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

It was drawn into the crisis when France and Germany were unable to agree on a purely European solution to Greece's short-term debt needs. The fund pledged to provide up to 15 billion euros as part of a 45 billion euro aid package. But as the crisis deepened for

Greece and threatened to spread to Spain and Portugal, the fund promised to put up a share of a package that could total 120 billion euros, or $160 billion, over three years.

Christine Lagarde made herself into a blunt voice of dissent, criticizing Europe's handling of the debt crisis for an over-emphasis on austerity. She warned repeatedly that the bailout fund created by the European Union was inadequate to stop the spread of the crisis to larger countries like Spain and Italy, and called for measures to restore growth.

In April 2012, the I.M.F. announced that it had raised at least $430 billion in extra lending capacity to be used if the euro zone crisis worsens or global financial conditions deteriorate.

In June, Ms. Lagarde made her most forceful intervention in the European crisis, as the fund called for the euro area to move swiftly toward a fiscal union including issuance of joint euro zone debt and said the viability of the currency was being questioned.

The fund also said it would like euro zone bailout funds to be lent directly to struggling banks – rather than through national governments – and appealed to the European Central Bank to take more aggressive measures to quell volatile financial markets, such as increasing the money supply or resuming the purchase of the bonds of stressed sovereigns such as Spain.

IMF and Brics

In the wake of the ongoing Eurozone crisis, the IMF has proposed a new bilateral borrowing programme to augment its resources for crisis prevention and resolution and to meet the potential financing needs of all IMF members. At the Los Cabos Summit of the G20 held 2012, BRICS countries have announced their contributions, including US$ 10 billion by each of India, Brazil and Russia and US $ 43 billion by China.

The IMF has committed that these new resources will be drawn only if they are needed as a second line of defense after resources already available from quota and existing borrowing arrangements are substantially used. If drawn, they would be repaid with interest. It has been clarified that quota resources would remain the basic source of fund financing and that the role of borrowing is to temporarily supplement the quota resources.

IMF and Conditionalities

There has been a controversy about the IMF loans that the debtor countries are suggested economic reforms that are socially and in human terms damaging in return.. The conditionalities as they are called are justified by the IMF on grounds that they are the genuine reforms necessary for economic health to be restored. IMF further believes that if the recipient country follows the reforms it will be in a position to repay the loan. Debtor countries however hold that the reforms suggested are anti-poor and anti-development-like cutting subsidies; scrapping priority sector lending; opening up the country at a fast pace etc.

Some of the conditionalities are

/reduce fiscal deficit

/follow privatisation

/deregulate the rupee in external transactions
/downsize the government
/enact flexible labour sector reforms
/reduce subsidies etc.

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.

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 poor be curtailed
- The private international flows are huge and in comparison, the IMF resource base is small and so is rendered ineffective
- 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 has 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, and in 1991 it borrowed SDR 1.4 billion under the Compensatory Financing Facility.

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.(See India and NAB above)

The Importance of IMF in the post-Lehman period

The IMF saw its international standing strengthened with the global financial crisis of 2008.The global financial crisis, which originated in the U.S. housing market, sparked a growing discussion among policy makers and academics that the world should no longer rely on a single, dominant currency, such as the dollar. Nobel Prize-winning economist Joseph Stiglitz even called for a new global reserve system based on the SDR's.

With the financial crisis intensifying and private capital drying up for credit, more and more countries are coming to the IMF for funds. Recently IMF bailed out Greece.

G20 has agreed that the IMF should triple its borrowing, to ensure that it has enough money to offer loans.

The money is pledged by other IMF countries.

The IMF wants to use this money to offer a new kind of loan that would be preventive. Rather than waiting for countries to get into financial difficulties, it would offer them a line of credit to help them defend their currencies in advance. – NAB- an additional $250bn. This would be done by creating more of its own currency, the SDR or special drawing right.

The IMF is also set to have a bigger role in preventing future crises, by developing an early warning system for financial problems, and taking a larger role in looking at the problems of the financial sector as a whole, in conjunction with a new global regulator, the Financial Stability Board.

But the biggest changes in the IMF involve giving greater voice to the developing countries.(Read ahead).

Another reform:It has already been agreed that in future, the convention that the World Bank and IMF must be headed by an American and a European respectively will be abandoned.

The changes to the resources and the role of the IMF are historic and perhaps the most important development in international monetary system that reflects changing realities.

But it is a move towards a more balanced global system of international finance.
Quotas, GAB and NAB

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SDRs as an alternative to the US dollar as global reserve currency

The international monetary system needs fundamental reform. Dollar as a global reserve currency is neither viable nor desirable to the same degree as before. It has led to problems like the huge current account deficit and fiscal deficit of the USA. Global imbalances- counties like China make and export goods and have current account surpluses and USA import them and depend on them and thus have 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 current account deficits. These deficits generate excessive indebtedness, both external and internal. So if the US were to shrink its deficit too quickly, a deficiency of supply of the global reserve currency could result.

Responses to global financial instability create the other problem, where developing countries have accumulated large reserves as "self-insurance" against a future balance of payments crisis. These protect them during crises, but also add to global imbalances.
In the late 1960s a more limited global currency was created: the SDRs, issued by the IMF when enough member countries agree. The largest such issue – equivalent to $250bn, and suggested by the G20 in April 2009 – was a response to the dramatic collapse in international private lending after the global financial crisis. It helped soften the negative impact of the crisis on growth.

Some experts argue that the global role of SDRs should be increased as it would avoid the need for countries like India and China to build reserves of dollars. US deficits can also be resolved. Global stability enhances as dollar worries recede. However, SDRs can only supplement the dolar 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.