What is the IMF?

- IMF is a multilateral financial institution having its genesis in the **Bretton Wood Conference** during 1944.
- Works to achieve sustainable growth and prosperity for all its **190 member countries.** It does so by supporting economic policies that promote financial stability and monetary cooperation, which are essential to increase productivity, job creation, and economic well-being.
- It's role since 1970 onwards was to provide loans to economies battling on their respective balance of payments front arising out of the collapse of the fixed exchange rates system, oil shocks & also to those economies opening up as a part of global integration but having structural problems on their trade front.
- The IMF has three critical missions:
    1. Furthering international monetary cooperation
    2. Encouraging the expansion of trade and economic growth
    3. Discouraging policies that would harm prosperity.
- IMF also plays an important role along with the World Bank Group for eradication of absolute poverty especially in Asian & African countries through its programmes like poverty reduction growth fund (PRGF).

What does IMF Do?

The IMF fosters international financial stability by offering:

1. Policy Advice

- A core responsibility of the IMF is monitoring the economic and financial policies of member countries and providing them with policy advice, an activity known as **surveillance.**
- As part of this process, which also takes place at the global and regional levels, the IMF identifies potential risks and recommends appropriate policy adjustments to sustain economic growth and promote financial stability.

2. Financial Assistance

- IMF does not lend for specific projects, unlike development banks.
- IMF provides financial support to countries hit by crises to create breathing room as they implement policies that restore economic stability and growth.
- It also provides precautionary financing to help prevent **crises**. IMF lending is continuously refined to meet countries' changing needs.

Why does Crises occur?

The causes of crises are varied and complex. They can be domestic, external, or both.

Domestic factors

- Includes inappropriate fiscal and monetary policies, which can lead to large current account and fiscal deficits and high public debt levels.
- An exchange rate fixed at an inappropriate level, which can erode competitiveness and result in the loss of official reserves.
- A weak financial system, which can create economic booms and busts.
- Political instability and weak institutions also can trigger crises.

External factors

- Shocks ranging from natural disasters to large swings in commodity prices. Both are common causes of crises, especially for low-income countries.
- With globalization, sudden changes in market sentiment can result in capital flow volatility. Even countries with sound fundamentals can be severely affected by economic crises and policies elsewhere.
- The **COVID-19 pandemic** was an example of external shock affecting countries across the globe. The IMF responded with unprecedented financial assistance to help countries protect the most vulnerable and set the stage for economic recovery.

IMF lending in action

1. First, a member **country in need** of financial support makes a request to the IMF.
2. Then, the country's government and IMF staff **discuss** the economic and financial situation and financing needs.
3. Typically, a country's government and the IMF agree on a program of economic policies before the IMF lends to the country. In most cases, a country's commitments to undertake certain policy actions, known as policy conditionality, are an integral part of IMF lending.
4. Once the terms are agreed upon, the **policy program underlying an arrangement** is presented to the IMF's Executive Board in a "Letter of Intent" and detailed in a "Memorandum of Understanding." The IMF staff makes **a recommendation** to the Executive Board to endorse the country's policy intentions and offer financing. This process can be expedited under the IMF's Emergency Financing Mechanism.
5. After its Executive Board approves a loan, the IMF **monitors how members implement** the policy actions underpinning it. A country's return to economic and financial health ensures that IMF funds are repaid so that they can be made available to other member countries.

3. Capacity development

- The IMF provides technical assistance and training – known as capacity development as one of its core functions.
- The IMF provides capacity development in various ways. Staff from the IMF's headquarters may meet with country officials in person or remotely, or work in the country as a resident adviser.
- The IMF also offers a global network of regional capacity development centres, and classroom and online training for officials in member countries.
- Capacity development accounts for around a **third of the IMF's annual spending.** It is available to all members upon their request and is tailored to a country's specific needs.

- Capacity development can help countries to improve tax collection and bolster public finances. It can help countries to modernize their monetary and exchange rate policies, develop legal systems, or strengthen governance.
- Capacity development also can help countries collect and disseminate data to inform decision-making.
- In response to the **COVID-19 pandemic** and resulting economic upheaval, the IMF helped more than 160 member countries with urgent issues such as cash management, financial supervision, and cybersecurity.
- It worked with tax and budget administrators to help member countries support businesses and individuals. The IMF issued nearly **100 technical notes** on policy issues, and it expanded its online courses, launching an IMF Institute Learning Channel on YouTube. The channel offers on-demand microlearning videos for government officials and the public.

IMF'S Quota

- Availing loan facilities from the IMF requires membership by **buying a Quota** usually in relation to the output of the economies & their stature in the world.
- The quota in turn **determines voting rights** for various policy decisions including loans to be provided to the affected economies by the IMF.
- Quota is bought by paying **25% in any Widely Accepted Currency** (WAC) comprising of the USD, Euro, Pound Sterling & Japanese Yen denominated in **Special Drawing Rights** (SDR's).
- Effective from October 2016, the IMF added the Chinese Renminbi to the basket of currencies that make up the Special Drawing Rights (SDR).
- The **remaining 75%** can be bought in home currency & maintained with the central bank of that country but cannot be withdrawn without authorisation of IMF.
- Quotas are reviewed at least after every 5 years.
- Currently, the formula used to derive quota of a member country is the weighted average of:
  - **Member country's GDP,** with assigned weight of 50%.
  - Its economic openness, weighing 30%.
  - Its economic variability, weighing 15%.
  - International Reserves, weighing 5%.
- **Role of Quota** – Quota determines.
  - Subscriptions to IMF
  - Voting Power
  - Access to IMF funding

Present IMF Quota and vote share of some member countries

Member country	Quota (%)	Vote Share (%)
US	17.44 (Highest)	16.51 (Highest)
China	6.41	6.08
UK	4.24	4.03
India	**2.76**	**2.63**

In terms of quota and vote share, the largest member is the **United States** and the smallest member is **Tuvalu.**

Special Drawing Rights

- SDR is not intrinsically a currency but is a unit of account maintained by IMF.
- It is an international reserve asset created by the IMF in 1969 to supplement its member countries official reserves.
- It is neither a proper currency nor a claim on IMF.
- Its value is based on the basket of following five major currencies.

Currency	**Which determined in the 2022 review**	**Fixed number of units of currency for a 5 year. Starting 1st August 2022**
U.S. dollar	43.38	0.57813
Euro	29.31	0.37379
Chinese Yuan	12.28	1.00 993
Japanese Yen	7.59	13.452
Pound Sterling	7.44	0.0 80870

- This basket is reviewed after every 5 years.
- The value of SDR's keep changing due to continuous fluctuations in exchange rates.
- Unlike other currencies SDR is not traded in forex market.

- Criterion for inclusion of a currency in the SDR basket
  - **Export Criterion**
    - Issuer the currency must be an A IMF member slash monetary union which has IMF members.
    - It should also be among the largest exporters of the world.
  - **Currency to be freely used**
    - Currency must be widely used in international transactions for making payment and should be widely traded in principal exchange markets.

Financial Resources of IMF

1. **Quotas –** IMF's main source is the funds provided by the member countries to IMF as per assigned quota.
2. **Multilateral borrowings through NAB** - it's an additional source of funding for IMF. These borrowings are made by IMF presently through NAB (till 2018 - through both GAB and NAB)

   GAB and NAB are credit arrangements between IMF and group of member countries and institutions to provide supplementary resources to IMF to get additional funds required to meet exceptional situations of financial crisis.

   - **General Arrangements to Borrow (GAB)** - Existing since 1962 but lapsed in December 2017.
   - **New Arrangements to Borrow (NAB)** - Has 40 participant member countries with total fund size of us to US $ 250 billion , India gave 12 million U.S. dollars loan to IMF under NAB to meet sovereign debt crisis of Europe.
3. **Bilateral Borrowing Arrangements** - After quotas & NAB, in order to meet financial needs of members, IMF also goes for **Bilateral Borrowing Agreements (BBA)** . BBA also has 40 participants with total commitment of 440 billion U.S. dollars.

Organizational Structure of International Monetary Fund (IMF)

The United Nations is the parent organization that handles the proper functioning and administration of the IMF. The **IMF is headed by a Managing Director** who is elected by the Executive Board for a 5-year term of office. The International Monetary Fund (IMF) consists of the Board of Governors, Ministerial Committees, and the Executive Board.

Structure of the International Monetary Fund (IMF)	
Governing Bodies of IMF	**Roles and Responsibilities**
Board of Governors	• Each governor of the Board of Governors is appointed by his/her respective member country. • Elects or appoints executive directors to the Executive Board. • Board of Governors is advised by the International Monetary and Financial Committee (IMFC) and the Development Committee. • An annual meet up between the Board of Governors and the World Bank Group is conducted during the IMF–World Bank Annual Meetings to discuss the work of their respective institutions.
Ministerial Committees 1. International Monetary and Financial Committee (IMFC) 2. Development Committee	• It manages the international monetary and financial system. • Amendment of the Articles of Agreement. • To solve the issues in the developing countries that are related to economic development.
Executive Board	• It is a 24-member board that discusses all the aspects of the Funds. • The Board normally makes decisions based on consensus, but sometimes formal votes are taken.

Criticism of IMF

- IMF's governance is an area of contention. For decades, Europe and the United States have guaranteed the **helm** of the IMF to a European and that of the World Bank to an American**.**
- Conditions placed on loans are too intrusive and compromise the economic and political sovereignty of the receiving countries. 'Conditionality' refers to more forceful conditions, ones that often turn the loan into a policy tool.
- IMF imposed the policies on countries without understanding the distinct characteristics of the countries that made those policies difficult to carry out, unnecessary, or even counterproductive.

- Policies were imposed all at once, rather than in an appropriate sequence. IMF demands that countries it lends to privatize government services rapidly. It results in a blind faith in the free market that ignores the fact that the ground must be prepared for privatization.
- Failure in predictions of Global Recession of 2008-09, let alone its prevention.
- Veto Power of the US – US can easily veto any decision of IMF as it holds more than 16 % of the voting power & total 85 % votes are required to pass any major reform.

Reforms undertaken by IMF

- More than 6% transfer of voting rights from the US & European countries to emerging member nations.
- Increase in voting rights of India from 2.3% to 2..63% & China's from 3.8% to 6.08%
- 2010 Quota Reforms approved by Board of Governors were implemented in 2016 with delay because of reluctance from US Congress as it was affecting its share.

India and IMF

- India is a **founder member** of the IMF.
- **Post-partition period,** India had serious balance of payments deficits, particularly with the dollar and other hard currency countries. It was the IMF that came to the rescue.
- The Fund granted India loans to meet the financial difficulties arising out of the Indo–Pak conflict of 1965 and 1971.
- In 1981, India was given a massive loan of about Rs. 5,000 crores to overcome foreign exchange crisis resulting from persistent deficit in balance of payments on current account.
- India has availed of the **services of specialists of the IMF** for the purpose of assessing the state of the Indian economy. In this way India has had the benefit of independent scrutiny and advice.

- **Early 1990s** when **foreign exchange reserves – for two weeks' imports** as against the generally accepted **'safe minimum reserves'** of **three-month equivalent** — position were terribly unsatisfactory.
    - Government of India's immediate response was to secure an emergency loan of $2.2 billion from the International Monetary Fund by pledging 67 tons of India's gold reserves as collateral security.
    - India promised IMF to launch several structural reforms (like devaluation of Indian currency, reduction in budgetary and fiscal deficit, cut in government expenditure and subsidy, import liberalisation, industrial policy reforms, trade policy reforms, banking reforms, financial sector reforms, privatization of public sector enterprises, etc.) in the coming years.
- The foreign reserves started picking up with the onset of the liberalisation policies.
- India has occupied a special place in the **Board of Directors** of the Fund. Thus, India had played a **creditable role in determining the policies of the Fund**. This has **increased the India's prestige** in the international circles.
- India has **not taken any financial assistance from the IMF since 1993**.
- Repayments of all the loans taken from the International Monetary Fund were completed on 31 May 2000.
- **The Finance Minister** of India is the **ex-officio Governor on the Board of Governors** of the IMF & **RBI Governor is the Alternate Governor at the IMF.**
- In, 2022 India was the 13th largest IMF quota – holding member country (2.75%)
- India's voting rights have increased from 2.3 % to 2.63 %.
- India has subscribed to IMF's Special Data Dissemination Standard (i.e. committed to observe Global Accounting Standards in Gov't finances, along with providing info on data dissemination practices.)