INTERNATIONAL MONETARY FUND (1991)

BACKGROUND GUIDE

DPSNMUN’14

Letter from the Executive Board

Greetings Delegates,

We feel honoured to be presiding over the meeting of International Monetary Fund, hosted by Delhi Public School, Noida Model United Nations 2014. We welcome to the same, and hope this simulation is a great learning experience for you.

The agenda for this **Historic** meeting of the International Monetary Fund shall be **Economic Reforms and Structural Adjustments in India in 1991**, while this meeting will be taking place on (the freeze date) **1st July, 1991**.

This meeting requires comprehensive understanding of the events not only in India, but in other related and relevant countries as well. Please bear in mind at all times that this is a meeting of the IMF, and not the Indian Government body, hence our focus ought to be more 'international'. This shall be requiring analysis and evaluation, which are they key skills required for the committee.

Also, please note that, at no point in time will this background be provided as evidence in the committee. Neither does this background guide intend to substitute your research. We recommend you to research further.

If you have any questions or queries, please feel free to contact us.

We wish you luck for the conference.

Regards,

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Agenda: **Economic Reforms and Structural Adjustments in India in 1991**

Freeze Date: **1st July, 1991**

Background

The entry of the international community into the final decade of the last millennium was tumultuous to say the least. With most of the modern system of economic being in play for not more than 60 years, the level of economic uncertainty in the international arena at the time was also very high. There were two very significant events that took place just at the beginning of the 1990s that set the tone not only for the entire decade, but also for a new international world order.

- **Break-up of the Soviet Bloc**
    - The break-up of the largest section of communist countries left a significant power vacuum. With no counter balance to the Western powers' ideologies, this event has been the most significant in shaping the new international world order, which includes the current security and economic apparatus.
    - The creation of a large number of sovereign nations, with significant military cast offs from the cold war, along with exceedingly lax regulation and enforcement, ensured volatility in eastern Europe for most of the 1990s. The IMF itself saw a large increase in demand for financial assistance due to the presence of a host of newly emerged developing countries.
    - The break-up also became responsible for the increase in smuggling activities through and from Eastern Europe.
- **Iraq-Kuwait War**
    - Admittedly not as significant as the above listed event, however the effects of the Iraq-Kuwait war reverberated throughout the 1990s, contributing significantly to the economic woes of many countries.
    - The Gulf crisis began with the invasion of Kuwait by Iraq at the beginning of August 1990. Crude oil prices rose rapidly thereafter. Thus the price of Brent Chicago was 56% higher at the end of August 1990 (over the price a year ago), 91% at the end of September 1990 and 140% higher at the end of November[1].

The above two events highlight the generally heightened sense of volatility that marked the beginning of the 1990s.

Committee Description

The IMF has a management team and 17 departments that carry out its country, policy, analytical, and technical work. One department is charged with managing the IMF's resources.

The IMF's fundamental mission is to help ensure stability in the international system. It does so in three ways: keeping track of the global economy and the economies of member countries; lending to countries with balance of payments difficulties; and giving practical help to members

[1] http://www.planningcommission.gov.in/reports/wrkpapers/wp_cris9091.pdf

The IMF is led by a Managing Director, who is head of the staff and Chairman of the Executive Board. The Managing Director is assisted by a First Deputy Managing Director and three other Deputy Managing Directors. The Management team oversees the work of the staff and maintains high-level contacts with member governments, the media, non-governmental organizations, think tanks, and other institutions[2].

According to the IMF's Articles of Agreement, the Managing Director "shall be chief of the operating staff of the Fund and shall conduct, under the direction of the Executive Board, the ordinary business of the Fund. Subject to the general control of the Executive Board, he shall be responsible for the organization, appointment, and dismissal of the staff of the Fund."

The IMF currently employs about 2,400 staff, half of whom are economists. Most of them work at the IMF's Washington, D.C., headquarters but a few serve in member countries around the world in small IMF overseas offices or as resident representatives.

The IMF has nine functional departments that carry out its policy, analytical, and technical work and manage its financial resources:

- Communications Department
- Finance Department
- Fiscal Affairs Department
- Institute for Capacity Development
- Legal Department
- Monetary and Capital Markets Department
- Statistics Department
- Strategy, Policy and Review Department

Five area or regional departments which are responsible for advising member countries on macroeconomic policies and the financial sector, and for putting together, when needed, financial arrangements to support economic reform programs:

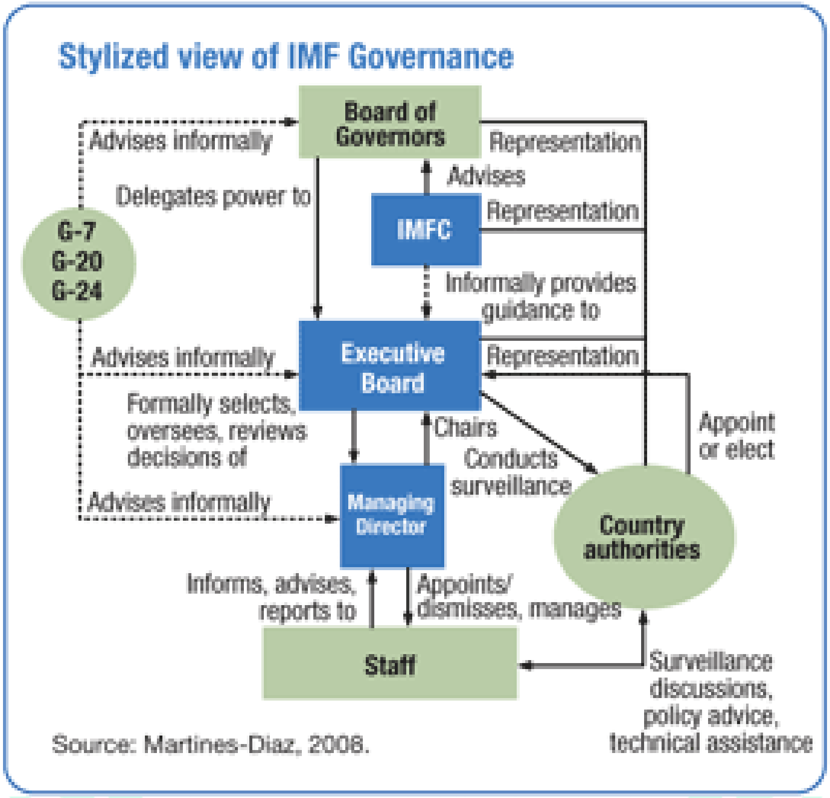
- African Department
- Asia and Pacific Department
- European Department
- Middle East and Central Asia Department
- Western Hemisphere Department

Three support departments:

- Human Resourced Department
- Secretary's Department
- Technological and General Services Department

[2] http://www.imf.org/external/about/mgmt.htm

Governance Structure:



- **Board of Governors:**
  - 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, compulsory withdrawal of members, and amendments to the Articles of Agreement and By-Laws.
  - The Board of Governors also elects or appoints executive directors and is the ultimate arbiter on issues related to the interpretation of the IMF's Articles of Agreement[3]
- **Ministerial Committees**
  - The IMF Board of Governors is advised by two ministerial committees, the International Monetary and Financial Committee (IMFC) and the Development Committee.
  - The IMFC has 24 members, drawn from the pool of 187 governors. Its structure mirrors that of the Executive Board and its 24 constituencies.

[3] http://www.imf.org/external/about/govstruct.htm

- 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. At the end of the Meetings, the Committee issues a joint communiqué summarizing its views. These communiqués provide guidance for the IMF's work program during the six months leading up to the next spring or Annual Meetings. There is no formal voting at the IMFC, which operates by consensus.
- The Development Committee is a joint committee, 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. The committee has 24 members (usually ministers of finance or development). It represents the full membership of the IMF and the World Bank and mainly serves as a forum for building intergovernmental consensus on critical development issues[4].

- **The Executive Board:**
  - The IMF's 24-member Executive Board takes care of the daily business of the IMF. Together, these 24 board members represent all 188 countries. Large economies, such as the United States and China, have their own seat at the table but most countries are grouped in constituencies representing 4 or more countries. The largest constituency includes 24 countries.
  - The Board discusses everything from the IMF staff's annual health checks of member countries' economies to economic policy issues relevant to the global economy. The board normally makes decisions based on consensus but sometimes formal votes are taken. At the end of most formal discussions, the Board issues what is known as a summing up, which summarizes its views. Informal discussions may be held to discuss complex policy issues still at a preliminary stage[5].

Agenda Abstract

- **A plunge in credit worthiness:**
  - The oil shock resulting from developments in the Persian Gulf precipitated an economic crisis in India. The shock itself was not as severe as those of1973-74 or 1979-80, but it came after years of fiscal and balance of payments deficits that had greatly weakened the economy and eroded foreign confidence. Moreover, it was compounded by prolonged political uncertainty, internal conflicts and other domestic problems which delayed corrective action and added to its effects. **As a result, India's credit worthiness has declined to the point where international sources of commercial credit have been cut off and, despite borrowing from the IMF, the external liquidity position is extremely tight. India, therefore, has to take strong measures to adjust the economy. The only real options are whether the adjustment is made in the context of an orderly, growth-oriented adjustment program with external financial support, or through a disorderly and painful**

[4] http://www.imf.org/external/about/govstruct.htm
[5] http://www.imf.org/external/about/govstruct.htm

process that will leave the country cut off from international capital markets for years to come and significantly reduce its growth[6].

- **<u>India's apparent high growth path</u>**:
  - **India's real GDP growth rose from under 3.5% p.a**. in the 1960s and 1970s to **over 5% p.a. in the 1980s**. Although still below the growth rates of some East Asian countries, growth was very good by international standards and in comparison to India's past performance. **Real per capita income rose by 40% in the 1980s**, compared to less than 30% over the previous two decades combined, helping to make inroads into India's massive poverty. **Manufacturing growth in the 1980s accelerated to 7% p.a.** after years of disappointing performance; **productivity growth rose by 2.9% p.a.** following a long period of stagnation; and most significantly, the **volume of exports began to grow at over 10% per year after the middle of the decade**. All of these developments raised hopes that India had achieved a breakthrough onto a higher long-term growth path[7]
- **<u>Developments in 1990/91:</u>**
  - By the end of 1989/90 the need to reduce the unsustainable fiscal and current account deficits was widely recognized. The Government introduced a budget for 1990/91 designed to cut the central government fiscal deficit by 0.8% of GDP and also introduced a new Export-Import Policy, which contained some improvements in the trade regime. But in spite of these new initiatives, the balance of payments came under increasing strain even before the Gulf crisis because of a slowdown in export growth to hard currency areas and growing difficulties in arranging commercial borrowing. Foreign exchange reserves had fallen to 7 weeks of imports by end-July 1990, and major foreign rating agencies were already reviewing India's credit rating, which was subsequently downgraded. Higher oil prices thus hit the Indian economy when it was already on the verge of a foreign exchange liquidity crisis. The additional import costs of higher oil prices for 1990/91, based on the previous year's volume of imports, was about $1050 million, equal to 0.4% of GDP and 4.6% of exports of goods and services. India's overall terms of trade declined by 4% in 1990/91, equivalent to a loss of 0.7% of GDP. Loss of remittances and other factors added about $870 million to foreign exchange costs.
  - Adverse domestic developments added to India's economic problems. Disturbances in Assam and other factors led to a shortfall in domestic oil production and the need for some $800 million worth of additional oil imports. The cost of the scheme to waive repayments on small loans to farmers and artisans grew to at least Rs 55 billion (1.0% of GDP) based on government estimates, which would make it as costly to the budget as the international. Oil price increase, though these costs were shared with the states and were temporarily financed by the banks which now hold

[6] http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1991/08/23/000009265_3960930195417/Rendered/PDF/multi0page.pdf

[7] http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1991/08/23/000009265_3960930195417/Rendered/PDF/multi0page.pdf

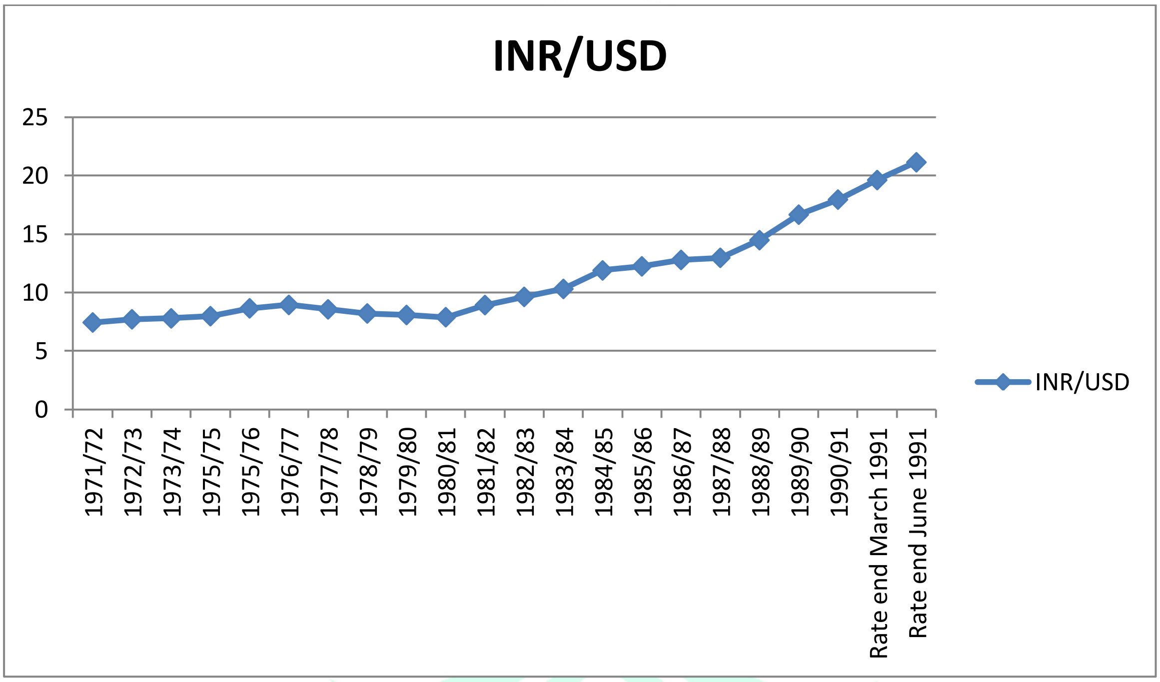
claims against the government. Finally, intensified separatist conflicts, widespread civil disturbances and the fall of two governments raised expenditures, disrupted production, adversely affected budgetary revenue, and diverted the attention of the government from economic policy issues.

- The authorities nevertheless took several measures to counter the adverse effects of the oil crisis and other events. The National Front government imposed a 25% surcharge on petroleum products i n October1 990 and in December the Janata Dal (S)government introduced additional fiscal measures and announced the government's intention to reduce the fiscal deficit to 6.5% of GDP in 1991/92 and to 3-4% within a few years. The October and December actions were unprecedented in magnitude for a set of fiscal measures taken outside the annual budget; together they were expected to mobilize additional revenue qual to 1.5% of GDP on a full-year basis. On the balance of payments front, the authorities also took several steps. In September 1990 they began to make more active use of exchange rate policy, after several months of relative inactivity. They also introduced cash margin requirements for imports and restricted the use of commercial credit for capital goods imports. In January 1991 India secured IMF financing of $1.8 billion in the form of a drawing from the Compensatory and Contingency F0nancing Facility and the first tranche of a Standby. However, the Janata Dal (S) government decided to present only an interim 1991/92 budget and then resigned in March 1991, thereby precluding any further major initiatives until after elections. Elections were delayed following the assassination of Rajiv Gandhi in May, so that a new government was formed only at the end of June 1991. For a period of several critical months, therefore, major policy initiatives could not be taken.
- Despite all the tribulations of 1990/91 overall GDP, sustained partly by a third successive good monsoon, grew by 5%. But inflation reached double digits, the central government fiscal deficit remained at 8.8% of GDP, and the balance of payments position deteriorated. Export growth also fell. In dollar terms exports grew by only 9.1%, down from an average of 19.5% p.a. in the preceding three years, while customs based imports grew by 13.2%. Much of the fall in export growth was due to the poor performance of gems and jewellery, but other important export sectors (engineering and chemicals) also slowed, and in April-May1 991 the dollar value of exports actually fell by an alarming 7 .7% over the same period last year. The dollar value of imports fell even more (22.8%), perhaps indicating that the severe import curbs of the past few months have been affecting both sides of the ledger. Import growth in 1990/91 was mostly due to higher oil imports. Other imports grew by only 4.8% in nominal U.S. dollars. The current account deficit reached an all-time high of $9.9 billion (3.5% of GDP), up from $8.3 billion (3.1% of GDP) in 1989/90. New commercial credit completely dried up, non-resident Indian (NRI) deposits began to be withdrawn, and external reserves (excluding gold) fell below one month of imports, notwithstanding drawings of $1.8 billion on the IMF.

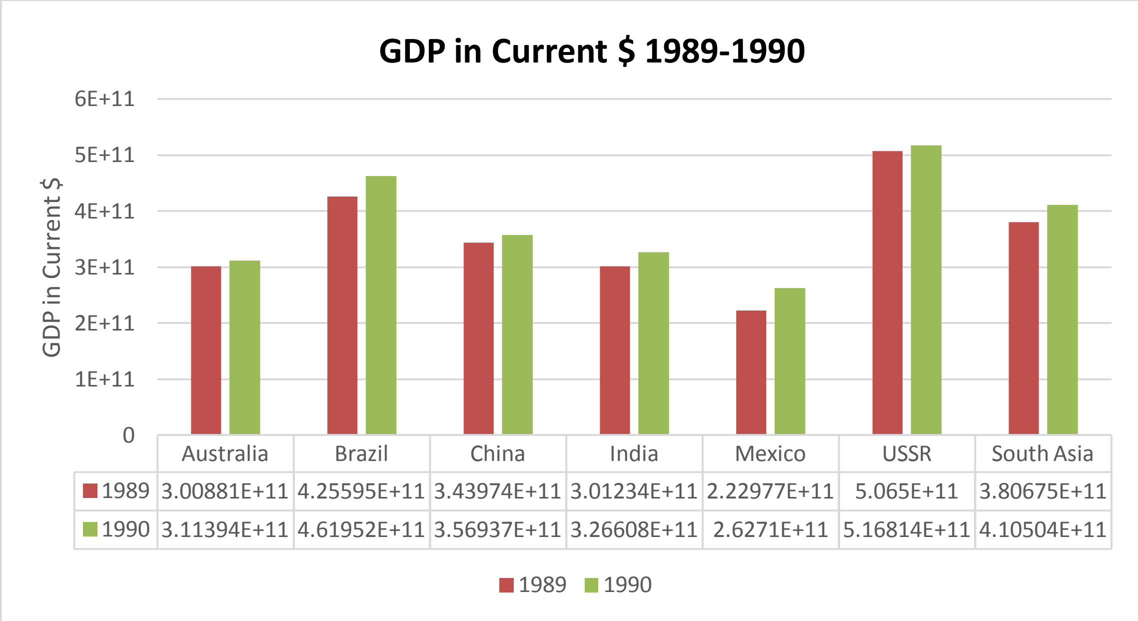
Charts for analysis

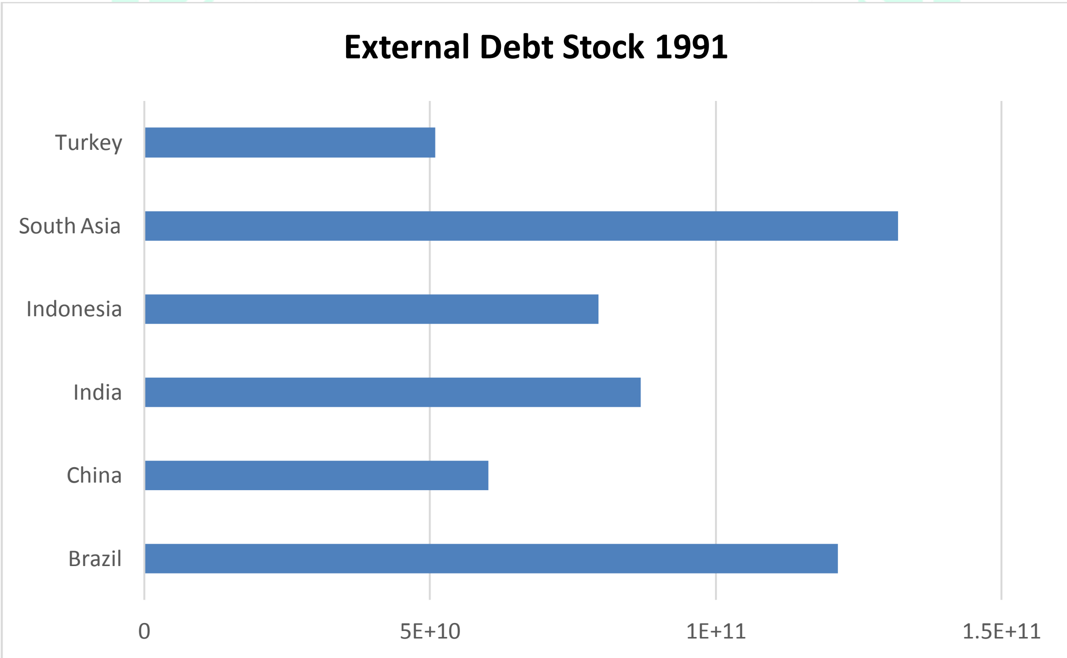
Movement of INR/USD exchange rate

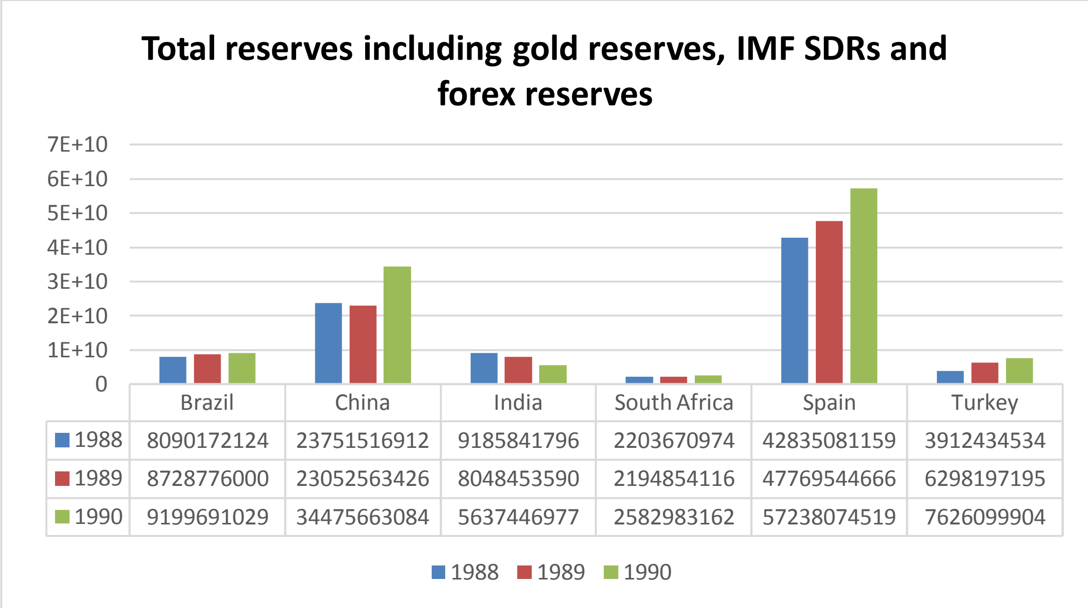
Imports can be seen to becoming costlier further exacerbating higher import costs in 1990/91



Comparisons of economies with similar GDPs can be made.


GDP in Current $ 1989-1990
GDP in Current $
6E+11
5E+11
4E+11
3E+11
2E+11
1E+11
0
Australia
Brazil
China
India
Mexico
USSR
South Asia
1989 3.00881E+11 4.25595E+11 3.43974E+11 3.01234E+11 2.22977E+11 5.065E+11 3.80675E+11
1990 3.11394E+11 4.61952E+11 3.56937E+11 3.26608E+11 2.6271E+11 5.16814E+11 4.10504E+11
1989 1990


External Debt Stock 1991
Turkey
South Asia
Indonesia
India
China
Brazil
0
5E+10
1E+11
1.5E+11



	Brazil	China	India	South Africa	Spain	Turkey
1988	8090172124	23751516912	9185841796	2203670974	42835081159	3912434534
1989	8728776000	23052563426	8048453590	2194854116	47769544666	6298197195
1990	9199691029	34475663084	5637446977	2582983162	57238074519	7626099904

Expectations

Delegates are expected to represent their countries and behave as responsible stewards of the International economic system. In essence, keeping on mind the importance of foreign policy a slightly greater emphasis will be given to originality of arguments and solutions and the depth of knowledge portrayed with regards to the world economic system. Delegates should be ready to engage in negotiations with regards to the format of aid of provided and the caveats attached with IMF aid. Some key points to highlight are:

- Key deficiencies in developing economies
- Inherent gaps in the current economic system that lead to such crises and methods to plug in the said gaps
- Ramifications of the Indian BOP crises and solutions to the same
- Format of support provided by the IMF
- Key growth drivers for the Indian economy

Delegates should note, that since this is a historic committee, the outcome can be different from what originally took place