Syllabus subtopic: Important International institutions, agencies and fora, their structure, mandate.

Prelims and Mains focus: about the IMF report and its significance; about IMF and terms associated to it

News: The International Monetary Fund (IMF) on Monday slashed India’s growth forecast by 1.3 percentage points to 4.8% for 2019-20, prompting the agency to also trim its global growth estimates as a result.

Why?
Growth in India slowed sharply owing to stress in the non-bank financial sector and weak rural income growth.

Background
Finance minister Nirmala Sitharaman, scheduled to present her second budget on 1 February, is expected to increase infrastructure spending and boost rural expenditure to revive growth, which slowed to a six-and-a-half-year low of 4.5% in the quarter ended 30 September.

Contrasting figures
While the Indian government’s statistics department and the Reserve Bank of India (RBI) have estimated growth in 2019-20 at 5%, rating agency Moody’s Investors Service has projected growth at 4.9% for the fiscal.

What did the IMF recommend earlier?
- IMF in its Article IV consultation report on India released last month said the Indian government should avoid a fiscal stimulus to boost the economy and, instead, opt for an easier monetary policy.
- However, retail inflation has picked up since and RBI has paused its
monetary easing cycle. Retail inflation touched a five-and-a-half-year high of 7.35% in December, breaching the central bank’s tolerance limit of 6%. This may constrain RBI from not only further monetary easing in its policy review on 6 February, but may also force it to rethink its accommodative policy stance. The IMF growth projection for India shows economic downturn is quite entrenched.

**IMF’s ‘World Economic Outlook’ report highlights**

- It projected global growth to increase modestly from 2.9% in 2019 to 3.3% in 2020 and 3.4% in 2021. The slight downward revision of 0.1 percentage point for 2019 and 2020, and 0.2 percentage point for 2021, is owed largely to downward revisions for India.

- The IMF report, however, projected India’s growth to revive in 2020-21 to 5.8%, 30 basis points below its October estimate, supported by monetary and fiscal stimulus as well as subdued oil prices.

- IMF raised China’s growth estimate by 20 basis points to 6% for 2020, reflecting the signing of the phase I trade deal with the US.

- Despite several headwinds, IMF said some indications have emerged towards the year-end that global growth may be bottoming out. The report, however, warned that downside risks remain prominent, including rising geopolitical tensions, notably between the US and Iran, intensifying social unrest, further worsening of relations between the US and its trading partners and deepening economic friction between other countries.

- The pickup in global growth for 2020 remains highly uncertain as it relies on improved growth outcomes for stressed economies like Argentina, Iran, and Turkey and for underperforming emerging and developing economies such as Brazil, India, and Mexico. A materialization of these risks could lead to rapidly deteriorating sentiment, causing global growth to fall below the projected baseline.
Way ahead

- The economic slowdown seems to be sharper than estimated. This is a wake-up call for the government ahead of its 1 February budget, which is likely to address the economy’s structural weaknesses and recalibrate spending within the available fiscal space. With inflation crossing the central bank’s tolerance limit, the ball is now in the government's court to revive growth.

- Monetary policy having run its course, the government should spend wisely to support economic recovery.

International Monetary Fund (IMF)

Bretton Woods

- Bretton Woods is a place in New Hampshire State of USA.
- In 1944, US President Roosevelt hosted a conference here, to rebuild the world economy, after Second World War.
- Delegates of 44 allied nations came to participate (India was represented by Sir D. Deshmukh, the first Indian Governor of RBI)
- Officially known as United Nations Monetary and Financial Conference, commonly known as Bretton Woods because of the place where it was held.

This conference resulted into creation of four important organizations viz.

1. IMF (International monetary fund)
2. World Bank
3. GATT (General Agreement on Trade and Tariff) – later becomes WTO in 1995
4. Fixed Exchange Rate system (Discarded in 1970s)

IMF

- HQ – Washington
- Official language – Chinese, English, French, Russian, Spanish, Arabic
- Formally created in 1945 by 29 member countries
- Stated goal was to assist in the reconstruction of world’s international payment system post World War II
- Countries contribute funds to a pool through a quota system from which countries with payment imbalances temporarily can borrow money and other
IMF Quota & Voting Rights

- Quotas were assigned to member countries reflecting their relative economic power & credit deposit to IMF.
- Subscription was to be paid 25% in gold or currency convertible into gold (effectively the dollar, which was the only currency then, still directly gold convertible for central banks) and 75% in the member’s own currency.
- Members were provided voting rights in proportion to their quota, hence member countries with higher quota have a higher say at IMF.

Special Drawing Rights

- Special drawing rights (SDRs) are supplementary foreign exchange reserve assets defined and maintained by the International Monetary Fund (IMF).
- SDR is not a currency, instead represents a claim to currency held by IMF member countries for which they may be exchanged.
- The value of an SDR is defined by a weighted currency basket of five major currencies: the US dollar, the euro, the British pound, the Chinese Yuan and the Japanese yen.
- Central bank of member countries held SDR with IMF which can be used by them to access funds from IMF in case of financial crises in their domestic market.

Reserve Tranche

- A certain proportion of a member country’s quota is specified as its reserve tranche.
- The member country can access its reserve tranche funds at its discretion, and is not under an immediate obligation to repay those funds to the IMF.
- Member nation reserve tranches are typically 25% of the member’s quota.

Given its unequal voting power mechanism, IMF doesn’t always serve the interests of poor & developing countries, hence requires two set of reforms

1. IMF reform in quota
- IMF Executive board decides the Quota of each member based on various
parameters including GDP & tariff barriers.
• Higher quota gives higher voting rights and borrowing permissions, But formula is designed in such way US has ~18% quota, G7 collectively own >40% while India and Russia have barely ~2.5% each.
• BRICS, G20 and emerging market economies are against this scheme especially after Subprime crisis and declined economic strength of USA & G7
• 2010: Board decided to increases quota of developing countries albeit mainly by decreasing the quota of poor countries.

**Problem:** 70% votes required to implement this reform, not 70 nations, & the nations who collectively own 70% quota- USA, Germany, Japan etc. Hence quota reform is pending.

2. **IMF reform in governance**

• Currently in Executive board, 5 out 24 directors are permanently decided by five largest quota holders.
• 2010: new reforms proposed: Board composition will be reviewed every 8 years + all directors to be elected, no permanent chairs.

**Problem:** Requires 85% votes in favour, hence governance reform is pending as well.