INDIA'S BORROWING FROM IMF: A CRITICAL STUDY

DISSERTATION

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Certificate

Certified that Mr. Jamil Ahmad has worked under my supervision for preparing his dissertation on "India's Borrowing from IMF: A Critical Study" in partial fulfilment of the requirement for the award of M.Phil degree in Economics by the Aligarh Muslim University, Aligarh.

To the best of my knowledge the study is candidate's original work.

(Dr. Abdul Wahab)
Supervisor
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Jamil Ahmad
(Jamil Ahmad)
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CHAPTER - 1

INTRODUCTION

1.1 The Problem:

Following the bitter experience of the 1930's and the Second World War, the International Monetary Fund (IMF) came into existence in 1944 to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

In the inter-war period exchange restrictions and competitive devaluations had been widely used in pursuit of trade and employment objectives; and inevitably, resort to the use of such national policy instruments led to retaliatory measures on the part of the trading partners. At the same time, inadequate international liquidity had contributed substantially to the economic difficulties of the 1930s. The World trade and investment suffered badly. Under such a situation, there developed the need for increased international co-operation in money, finance and trade. "The leading industrial nations especially wanted to avoid reoccurrence of the
competitive exchange rate depreciations, "beggar-my-neighbour" trade restrictions, and deflationary measures that had been adopted in the 1930s to meet balance-of-payment problems. Pledged to undertake full-employment policies after the war, the countries now wanted to be free to pursue domestic expansion, unconstrained by the balance of payments."^1 To achieve this goal, a conference of financial experts and delegates from 44 countries of the world was held on July 1, 1944 in Bretton Woods, New Hampshire, USA. This conference proposed the establishment of the IMF, the World Bank and an International Trade Organisation (ITO). The ITO, however, could not be established while the IMF and the World Bank took birth. The IMF became operational in 1947 with the objectives of providing 'machinery for consultation and collaboration on international monetary problems', promotion of stable and orderly exchange rate through its par value system and the provision of short-term finance to discourage resort to measures destructive of national or international prosperity (e.g. inappropriate resort to deflation and devaluation or protection) in response to payments imbalances.

Developing countries faced with the wide foreign exchange gap have sought financial assistance from the
fund to bridge the gap and speed up the tempo of the development programmes. The IMF has also developed a number of facilities for lending over the years. However, the fund's resources are made available to borrowing nations on fulfilment of certain policy conditions only. These conditions broadly include conditions on the utilisation of the loan and conditions for change in the macroeconomic policies of the government of the borrowing country concerned. The later category relate to deregulation, privatisation and freedom for market forces to operate in respect of production, prices and investment.

The policy conditions are known as "conditionality" and has been a topic of animated discussion among economists and political leaders. Some has regarded it as the unique and distinctive feature of the Fund's assistance in view of the revolving nature of its resources while others consider them as an act of interference by the Fund in the internal economic affairs of the borrowing nation. In India, too, the borrowings from IMF have been subjected to criticism on grounds such as the country's erosion of independence in the formulation of economic policies, accentuation of the payments difficulties, reversal of the direction of past policies etc.
1.2 Objectives of the Study:

In view of the above, our main objective in this study is to critically evaluate India's borrowings from the IMF over the period 1947-48 to 1996-97. Within the framework of this broad objective, the specific objectives set out for the study are as follows:

i. To give an account of the circumstances and the level of India's borrowings from the IMF during the period 1947-48 to 1996-97;

ii. To assess the contribution of these borrowings in financing India's balance of payments deficit; and

iii. To examine the validity of various criticisms that have been generally levelled against India's borrowings from the IMF.

1.3 Data Base and Methodology:

The study is based mainly on secondary sources of data, which include publications of government, IMF as well as the publications of various authors. These sources have been duly acknowledged at appropriate places.

The study covers the period 1947-48 to 1996-97 for which comparable data are readily available. The methodology used is largely analytical.
1.4 Plan of the Study:

The Plan of the study is as follows: *Chapter -II* briefly reviews the origin, objectives, functioning and evolution of the IMF since its inception. The relationship between India and the IMF is discussed in *Chapter-III*. India's borrowings from the IMF during the period 1947-48 to 1996-97 are analysed in *Chapter-IV*. The analysis includes aspects such as the extent of India's recourse to IMF borrowing to overcome the BOPs deficits, and their implications for Indian economy in general. Finally *Chapter-V* presents the main conclusions of our study.

Reference:

CHAPTER - 2
INTERNATIONAL MONETARY FUND: ORIGIN FUNCTIONING AND EVOLUTION

2.1 Introduction:

The aim of this chapter is to discuss the origin, objectives and functioning of the International Monetary Fund (IMF) focussing on how the Fund has evolved over the years. The chapter is divided into eight sections and these covers: 2.2 Origin of the IMF . 2.3 Objectives and Functions. 2.4 Organisation. 2.5 Membership and Quotas. 2.6 Lending operations. 2.7 Evolution of the Fund. and 2.8 Concluding remarks.

2.2 Origin of the IMF:

As it is well known, the World War I brought the demise of the gold standard and the interwar period was characterised by chaotic conditions in international trade and finance. The Great Depression forced the monetary authority of the various countries to resort to various measures like exchange depreciation, fluctuating exchange rate, multiple currency practices, direct control over imports etc. to export their unemployment (beggar thy neighbour policies). Consequently, the volume of world trade was affected severely. In fact between 1929
and 1932 price collapsed and international trade fell to unprecidently low levels. These developments produced different effects on the economy of the various countries. The important ones may be listed as follows:

(i) The terms of trade moved sharply against the primary commodities producing countries

(ii) The burden of their foreign obligations increased due to a decline in their foreign exchange earnings leading to widespread defaults

(iii) The primary product producing countries had to earn foreign exchange to import essential goods and they had to use foreign resources carefully. The economies of the industrial countries reached a precarious position. There was a sharp rise in unemployment, specially in the United Kingdom.

Countries sought solution independently and individually many of them progressively introducing exchange controls and limiting imports through tariffs and quotas. In complete change of course, the United States was faced with two obstacles. one being the direct control over the trade and other being the instability of the exchange rates. "More than anything else the United States required stable exchange rates
in order to secure widespread acceptance of its own policies as the leader in the world economy”¹

The restrictions on multilateral trade and payments increased during the world war II. The enlightened public opinion and world statesmen feared that these restrictive trade and payment practices would continue after the War unless concerted international efforts were made to create some effective international machinery which could restore stability of exchange rate, prevent competitive currency depreciations and remove restrictions on trade and capital movement etc. This fear led the British economist John Maynard Keynes during the War to prepare a comprehensive plan of international monetary co-operation for implementation after the war. This plan came to be known as the “Keynes Plan” The other plan was prepared by the American expert Harry D. White and Called the “White Plan”. The basic features of these plans were taken together and merged into a common plan which was evolved at the United Nations Monetary and Financial Conference of 44 nations held at Bretton Woods, New Hampshire in the USA in July 1944. The conference proposed the establishment of the International
Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD) and the International Trade Organisation (ITO). Of these, the IMF and the IBRD were established while the ITO could not be set up and a partial substitute the General Agreement on Tariffs and Trade (GATT) was established as an interim arrangement.

The Articles of the Fund were agreed upon in 1944, it came into being in Dec. 1945 and started functioning in April 1947. The Fund aimed to provide exchange rate stability, temporary assistance to member countries falling short of foreign exchange and international sponsoring of measures for curbing fundamental disequilibrium or causes of fundamental disequilibrium in the balance of payments of countries.

2.3 Objectives and Functions:

The objectives of the Fund² are to provide exchange rate stability, to maintain orderly exchange management among members and to avoid competitive exchange rate changes. These objectives have been well set out in Article I of the Fund Agreement as under³:

(i) To promote international monetary cooperation through a permanent institution which provide
the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade and to contribute thereby the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transaction between member and in the elimination of foreign exchange restriction which hamper the growth of the world trade.

(v) To give confidence to members by making the Fund resources temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustment
in their balance of payments (BoPs) without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

In joining the Fund, each country agrees to cooperate with the above objectives. The IMF operates in such a way as to fulfill its objectives as laid down in Bretton Woods Article of Agreements.

IMF performs three major functions which are discussed below:

1. It serves as a short-term credit institution. If the member country is in need of getting assistance for improving its balance of payments the Fund helps such country. It does not supply all the foreign exchange requirements of countries but only partially. The country can borrow from the Fund for the specific purpose and have to reverse the transactions with interest on net withdrawals.

2. It provides a mechanism for improving long term balance of payments position. The rules of the
Fund provide orderly adjustment of exchange rates
No country can involve in competitive devaluation
The Fund imposes conditions on the international monetary system. Whenever a country feels that its exchange rate is out of line, it can consult the Fund before effecting a change in the exchange rate.

3. It provides a mechanism for international consultations. It brings together the representatives of the members of the Fund and provides an excellent opportunity for reconciling conflicting claims. These measures of international co-operations are bound to have not only stabilizing influence on the world economy but also lead to the expansion of trade and output in the member countries. This is how it contributes to promotion and maintenance of high level of employment and real income.

2.4 Organisation:

The organisation of the IMF is described in Article XII of the Agreement and consists of Board of Governors, Executive Directors, a Managing director and staffs.
The highest authority of the Fund is exercised by the Board of Governors, on which each member country is represented by a Governor and an alternative Governor. The Board of Governors meets once a year, but the Governor may take votes by mail or other means between annual meetings. The Board of Governors has delegated many of its powers to the 24 Executive Directors in Washington, who are appointed or elected by individual member countries or group of countries. Each appointed Director has voting power proportionate to the quota of the government he or she represents, while each elected Director casts all the votes of the countries he/she represents.

The Managing Director is selected by Executive Directors and serve as the Chairman of the Executive Board, but may not vote except in case of a tie. The term of office is for 5 years but may be extended or terminated at the discretion of the Executive Directors. The Managing Director is responsible for the ordinary business of the IMF, under the direction of Executive Directors. Managing Director shall also be responsible for the organization, appointment and the dismissal of the staff of IMF.
2.5 Membership and Quotas:

The IMF consists of its original members and others. The originals are those countries which participated in the Bretton woods conference. The other members are those countries which latter became members in accordance with the terms prescribed by the IMF. The actual procedure is for such countries to request participation and present their request to the Board of Governors and for the Executive Directors then to decide upon the conditions (such as quotas and method of payments) which are then to be approved by the Board of Governors. If a member wishes to withdraw from the Fund, it is always possible for it to do so by advising the IMF authorities. At present the total membership of the Fund is 185.

Quota:

Each member joining the Fund was allotted a quota, that is a quantity of Funds to be paid into the IMF. The size of each member's quota was determined by a formula that took into account such factors as the country's national income, the variability of its exports, the ratio of its exports to national income. As a result, the more economically powerful countries enjoyed the
larger quotas. The sum of all quotas was $8.8 billion in 1944 including the Soviet quota of $1.2 billion. But the USSR never, in fact, joined the Fund. The US has the dominant position in the Fund.

At the time of its establishment, each member country was required to pay 25 per cent of its quota in terms of gold or US dollars and the balance in its national currency. But this practice of the gold reserves by the member countries was discontinued from April 1978 and the IMF has been delinked from gold since then. Now the reserve asset portion of 25 percent is paid in special Drawing Right (SDR) or usable reserve currency.

A country quota in the Fund determines her (i) subscription to the Fund, (ii) drawing rights on the Fund under both regular and special facilities, (iii) Voting power, and (iv) share of any allocation of the SDR. Quotas of all members are revised at intervals not longer than five years and take into account the adequacy of the Fund resources in fulfilling its responsibilities and reflect factors such as the growth of the world economy and changes in the relative size of the member countries. However any revision become effective only if it is
approved by a four fifths majority of the total voting power. The Articles of Agreement do not indicate how a member's quota is to be determined. The quota increases are normally divided into two portions equi-proportional and selective. The former is based on the shares of members in actual quotas while the later is based on the member's shares in calculated quotas. The calculated quotas are derived on the basis of quota formulas which have been revised over time as shown below.

Quota Formulas

**Original Bretton Woods Formula**

\[
Q = (0.02Y + 0.05R + 0.10M + 0.10V)(1 + X/Y)
\]

Where.

- \(Q\) = calculated quotas
- \(Y\) = national income.
- \(M\) = gold and foreign exchange reserves
- \(X\) = average annual exports (five year average)
- \(M\) = average annual imports (five year average)
- \(V\) = maximum fluctuation in exports defined as the difference between highest and the lowest value of exports during a five year period.
Formulas for the Fourth through Seventh General Reviews:

Several important changes were introduced in the quota formulas at the time of the Fourth Review:

a) the weights in the Bretton Woods formula were each reduced by 50 per cent.

b) in addition to the Bretton Woods formula, four derivative formulas were introduced.

c) all five formulas were calculated on the basis of two sets of data. Set I data uses exports, imports and variability of exports and Set II data uses current payments, current receipts and variability of current receipts.

Revised Bretton Woods Formula

\[ Q_1 = (0.01 Y + 0.025 R + 0.05 M + 0.2276 V) (1 + X/Y) \]
\[ Q_1' = (0.01 Y + 0.025 R + 0.05 P + 0.2276 VC) (1 + C/Y) \]

Derivative Formulas:

Scheme III:

\[ Q_2 = (0.0065 Y + 0.078 M + 0.5065 V) (1 + X/Y) \]
\[ Q_2' = (0.0065 Y + 0.078 P + 0.5065 VC) (1 + C/Y) \]

Scheme IV:

\[ Q_3 = (0.0045 Y + 0.070 M + 0.9622 V) (1 + X/Y) \]
Q3' = (0.0045Y + 0.070 P + 0.9622 VC) (1 + C/Y)

Scheme M4:
Q4 = (0.005 Y + 0.044 M + 0.044 X + 1.044 V)
Q4' = (0.005 Y + 0.044 P + 0.044 C + 1.044 VC)

Scheme M7:
Q5 = (0.0045 Y + 0.039 M + 0.039 X + 1.304 V)
Q5' = (0.0045 Y + 0.039 P + 0.039 C + 1.304 VC)

where,
Qi = Quota calculated with Set I data,
Qi' = Quota calculated with Set II data,
P = Current payments,
C = Current receipts,
M = Imports,
X = Exports,
V = Variability of exports,
VC = Variability of current receipts.

Formulas for the Eighth and Ninth General Reviews:

At the time of the Eighth Review, the following changes were made:

A) GDP replaced national income,

b) foreign reserves was included in all of the derivative formulas, and measure of reserves was broadened to include SDRs and ECUS and redefined as a twelve month average rather than a year end level.
c) Set I calculations were dropped, and
d) the co-efficient of variability was reduced by 20 per cent in the four derivative formulas.

**Bretton Woods reduced formula:**

\[
Q_1 = (0.01 Y + 0.025 R + 0.05 P + 0.2276 \text{vc}) (1 + c/y)
\]

Scheme III:

\[
Q_2 = \frac{(0.0065 Y + 0.0205125 R + 0.078 P + 0.4052 \text{VC})}{(1 + C/Y)}
\]

Scheme IV

\[
Q_3 = \frac{(0.0045 Y + 0.03896768 R + 0.07 P + 0.76976 \text{VC})}{(1+C/Y)}
\]

Scheme M4:

\[
Q_4 = (0.005 Y+0.042280464 R + 0.044 (P+C) + 0.8352 \text{ VC})
\]

Scheme M7:

\[
Q_5 = (0.0045 Y + 0.5281008 R + 0.039 (P+C) + 1.0432 \text{ VC})
\]

An adjustment factor is applied to each of the derivative formulas so that the totals derived under each formula at the time of a quota review equal that derived under the Bretton Woods formula. From the formulas, the calculated quota is derived as the higher of the result of Bretton Woods formula and the result obtained by averaging the two lowest results of the derivative formulas.
The quota formulas for the Eleventh Review (which is not yet concluded) have been kept the same as those used in the Ninth Review.


Table-2.1 gives a comparative picture of the total increase in quotas under successive and General Reviews.
### Table - 2.1
Distribution of IMF Quotas in General Reviews

<table>
<thead>
<tr>
<th>Review of Quotas</th>
<th>Date of Adoption of Resolution</th>
<th>Increase in Quota (% of Fund Size)</th>
<th>Equi-proportional Increase in Quota (% of Fund Size)</th>
<th>Total Quota* (SDR million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Quinquennial</td>
<td>No increase proposal</td>
<td>--</td>
<td>--</td>
<td>8036.50</td>
</tr>
<tr>
<td>Second Quinquennial</td>
<td>No increase proposal</td>
<td>--</td>
<td>--</td>
<td>8750.50</td>
</tr>
<tr>
<td>1958/59</td>
<td>Feb. 2, 1959 &amp; April 6,1959</td>
<td>60.7</td>
<td>50.0</td>
<td>14640.25</td>
</tr>
<tr>
<td>Third Quinquennial</td>
<td>No increase proposal</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Fourth Quinquennial</td>
<td>March 31, 1965</td>
<td>30.7</td>
<td>25.00</td>
<td>20932.00</td>
</tr>
<tr>
<td>Fifth General</td>
<td>Feb. 9, 1970</td>
<td>35.4</td>
<td>increases varied for different groups of countries</td>
<td>28776.00</td>
</tr>
<tr>
<td>Sixth General</td>
<td>March 4, 1975</td>
<td>33.6</td>
<td></td>
<td>38976.40</td>
</tr>
<tr>
<td></td>
<td>March 22, 1976</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Seventh General</td>
<td>Dec 11, 1978</td>
<td>50.9</td>
<td>50.0</td>
<td>59605.50</td>
</tr>
<tr>
<td>Eighth General</td>
<td>March 31, 1983</td>
<td>47.5</td>
<td>19.00</td>
<td>89236.30</td>
</tr>
<tr>
<td>Ninth General</td>
<td>June 28, 1990</td>
<td>50.0</td>
<td>30.00</td>
<td>141404.30</td>
</tr>
<tr>
<td>Tenth General</td>
<td>No increase proposal</td>
<td>--</td>
<td>--</td>
<td>144737.80</td>
</tr>
</tbody>
</table>

a = Total quotas include increase in Fund Quotas on account of addition to membership and ad-hoc increases, if any.

It can be seen from Table 2.1 that in the first two Reviews concluded in 1951 and 1958 respectively, no increase in the quotas was suggested. In a special Review done in 1958-59 all round increase of 50 per cent in quotas was agreed due to the heavy drawings made on the Fund. The Fourth (1965) and the Fifth (1970) Reviews led to lower increases in quotas 25 per cent each. Thereafter the quotas were raised by 32.5 per cent, 50 per cent, 47.5 per cent and 50 per cent in the Sixth (1976), Seventh (1978), Eighth (1983) and Ninth (1990) Reviews respectively. No increase was however proposed in the Tenth Review. The total size of the quotas grew steadily over these years from a little over SDR 8 billion to more than SDR 144 billion.

Apart from the periodic revision of quotas, the IMF is authorised, under its Articles of Agreement, to supplement its ordinary resources by borrowing. The first such attempt was made in January 1962 when quotas were supplemented by the Decision on 'General Arrangements to Borrow (GAB)'. Under it ten leading countries (Belgium, Canada, France, Germany, Italy, Japan, The Netherlands, Sweden, Great Britain and the United States of America) agreed to stand ready to lend upto $6 billion of their currencies for the use of the
Fund. The GAB has been revised and reformed over the years. The IMF can also enter into medium term and short-term borrowing arrangements to supplement its resources.

2.6 Lending Operations of the IMF:

The Fund has a variety of facilities for lending its resources to the member countries. The rules governing access to the resources of the IMF are uniform for all the members. The amount of facility available to a member, depends mainly on the quota of the member, the strength of members adjustment policies and its BoPs needs. However, there also exists special facilities for developing countries. Broadly, members of the Fund may draw on its resources under the following heads:

(1) Regular Facilities

(2) Special Facilities

(3) Emergency Assistance.

(1) Regular Facilities:

These facilities comprise: (1) Tranche facilities and (ii) Extended Fund Facility

Tranche facilities are further divided into (a) gold/reserve Tranche and (b) four credit tranche.
(a) Reserve tranche originally called the gold tranche is equal to the difference between the country's quota and the Fund's holdings of that country's currency. A member country is permitted to draw from the IMF at any time without scrutiny to meet the requirement of its balance of payment need. Reserve tranche purchase is not regarded as the use of Fund credit as the country merely uses the liquidity it deposited with the Fund as a part of its membership subscription.

(b) In addition to the reserve tranche, credit is made available to members in four tranches or segments each equal to 25 per cent of a member's quota. The first credit tranche purchase is defined as one that raises the Funds holdings of a member's currency in the Fund to not more than 25 per cent of quota. For drawings under first credit tranche members must demonstrate reasonable efforts to overcome BoP problems. In this case no performance criteria are insisted upon. Subsequent purchases are made in three successive trenches, each equal to 25 percent of quota, to a level of not more than 100 per cent of quota. Purchases in these three trenches are referred to as "upper
credit tranche purchases”. Upper credit tranche drawings are made in installments and are released on the implementation of the agreed programme in full. Policy conditions become more stringent as drawings rise under these trenches.

(ii) Extended Fund Facility (EFF)

The use of credit in the form of credit trenches was criticized mainly by the developing countries for their short term duration. The IMF provided loan under stringent condition through “stand lay arrangement” for a period of 12 months. This period was considered too short for any effective monetary and economic plans.

Hence, a medium term facility called as Extended Fund Facility (EFF) was introduced by the IMF in September 1974 to give assistance to its members having a BoP difficulty caused by structural economic changes.

Under the EFF the Fund may provide assistance to its members to overcome their BoP problems over a longer period and in amounts larger than their quotas than under their credit tranche policies. If a member’s BoP problem has risen because of structural distortions such as production pattern has changed or its trading
pattern has changed, then the assistance will be extended from EFF because it helps in overcoming such difficulties on the one hand and at the same time it will minimize the loss in output and employment which takes a longer time for recovery or improvement. The problem does require much longer amount of financing than available under the credit tranche. The EFF thus provides finance as well as time to permit them to implement policies.

(2) Special Facilities:

(i) Systematic Transformation Facility (STF):

This was a temporary facility created in response to the needs of the economies in transition from centrally planned to market based-system. It's provide financial assistance to members experiencing BoPs needs resulting from severe disruptions in their traditional trade and payments arrangements. It was created in April 1993 and was in effect though April 1995. Access to the facility was limited to not more than 50% of quota and could be in addition to financing obtained under other Fund facilities, and the purchase period was the same as that for the extended Fund facilities.
(ii) Compensatory and Contingency financing facilities (CCFF)

The compensatory financing facility started in 1963 for compensatory financing of developing countries. The purpose of this facility is twofold. The compensatory element provide resources to members to cover shortfalls in export earnings and services receipts and excess in cereal import costs that are temporary and arise from events beyond the members control.

(iii) Buffer Stock Financing Facility:

The Buffer stock financing facility was established in 1969. Under this facility the Fund provides resources to help finance member’s contributions to approved buffer stocks. Repurchase are made in three and one fourth to five years.

(3) Emergency Assistance

In addition to the balance of payments support under its regular and special facilities, the Fund provides emergency assistance in the form of purchases to help members meet balance of payments problems arising from sudden and unforeseeable natural disorders. These include:
(i) **Structural Adjustment Facility (SAF)**

The structural adjustment facility was approved by the Board of the IMF in March, 1986. This was set up to provide concessional assistance to low income countries. The plus points are that it has long term prospective, related intently with structural problems, away from the performance indicators or benchmark based on time bound policy actions upon which the continuation of disbursements will not automatically depend, and the greater collaboration with the world Bank within this framework. Detail yearly policy programs are formulated and are supported by SAF or ESAF arrangements. ESAF arrangement is differ from SAF arrangements in the scope and strength of structural policies. and in terms of access levels monitoring procedure, and source of funding. The rate of interest on SAF and ESAF loans is 0.5 per cent. and repayments are made in five and one half to ten years.

The lending operations of the IMF technically take the form of sale of currency. Any member nation running short of foreign currency may buy the required currency from the Fund in exchange of its own currency. But the buying member is under an obligation to
repurchase its currency from the Fund within the stipulated time period.

Similarly the availability of Fund from the IMF is subject to policy conditions. These conditions become more stringent with the rising level of borrowing and relate to:

(a) The appropriateness of the exchange rate.
(b) The elimination or reduction of exchange restrictions of complexities,
(c) effectiveness of monetary and fiscal policies in containing or reducing inflation.
(d) restriction on govt. deficits by reducing expenditures especially subsidies.
(e) Financial liberalisation.
(f) encouragement of the private sector etc.

These policy conditions are known as “conditionality” and are the control element in Fund policy on use of its resources. But it has also led to the severe criticism of the IMF on the ground that it limits the independence of the country concerned not only in managing the balance of payments, but also in the area of trade and industrial policies. Accepting IMF
conditions loan may be available but the problem of poverty and unemployment may not be solved the country may go deeper into the moras of dependence on external support.

2.7 Evolution of The IMF:

As discussed in the preceding section the IMF came into existence as an organisation of countries seeking promotion of international monetary cooperation and expansion of trade with a view to contribute to increased employment and improvement in economic conditions among all member countries. It has worked consistently towards the attainment of this goal and evolved in several important direction in response to changing conditions. In this section we discuss some of the important changes that have taken place in the Bretton woods systems since its inception.

(a) Creation of Special Drawing Rights (SDRs)

The special drawing rights (SDRs), also known as paper gold was created by the IMF in 1969 as international reserves assets to meet the long term global needs to supplement existing international reserves. They were created through the first amendment to the Fund as unconditional reserves assets to influence
the level of world reserves in order to solve the problem
of international liquidity. They were allocated to the
participant member in proportion to the Fund's quota.
For this purpose the Fund has established the special
drawing accounts.

The feature, the creation and use of SDRs as they
stood originally, were as under.12

(i) A unit of SDRs was declared to be equivalent to
0.888671 gram of fine gold which was equivalent
to the value of one US dollar.

(ii) Participation in the SDR managements is open only
to the members of the IMF. However membership
in the SDR system is not obligatory.

(iii) SDRs can only be held by official agencies say
central bank. The SDRs are not issued in the form
of certificates. The initial allocations and the
transactions are recorded in the books of the IMF.

(iv) While SDRs are an asset to the holders, they do
not represent the liability of the IMF or any other
agency. There is no "backing" for SDRs in the
form of assets, except the undertaking of member
countries to abide by the regulations concerning the
SDRs.
(v) The heart of the SDRs system is unconditional right of a holder to receive from other holders designated by the Fund, convertible currencies in exchange for SDRs. This right is matched by an even larger obligation on the part of member countries, namely, to accept SDRs, up to a maximum of 200 per cent of the allocation.

(vi) Although a member can use up all the SDRs allocated to it, it is required to maintain an average holding of 30 per cent of the initial allocation during a five-year period. This is to restrain member countries from rushing into using up SDRs without drawing upon other reserves. This restriction was removed in 1981.

(vii) The issue of the SDR to member countries strictly in proportion to their quotas in the IMF.

(viii) Those who make use of SDRs to acquire other currencies (debtors) have to pay interest rates and those who receive SDRs from other (creditors) would receive the same rate of interest, originally both being 1.5% per annum.

(ix) There is a complex procedure for the issue of SDRs, so that it represents a near unanimous
decision of the participating members. A proposal for issuing SDRs requires 85% majority of votes of the Board of Governors.

(x) In order to provide some long range planning, the managing director is expected to propose the allocation of SDRs for a basic period of five years generally. The aggregate amount being issued in installments. But this period like some other features, including the rate of interest, can be varied. So far as the first allocation was concerned, the basic period was conceived in terms of three years.

In order to further widen the use of SDRs, the second Amendment (1973) empowered the Fund to lay down uses of SDRs in transaction with the other participants. These 'prescribed holders' of SDRs have the same degree of freedom as Fund members to buy and sell SDRs and receive or use them in loans, pledges, swaps, donations or settlement of financial obligations. In 1994/95 there were 15 'prescribed holder's':

3. The Andean Reserve Fund.
4. The Arb Monetary Fund, Abu Dhabi.
6. BIS-Basle.
8. The Central Bank of Western African Countries, Dakar.
13. The International Bank for Agricultural Development.

The Fund has also adopted a series of decisions allowing the following additional use of SDRs¹⁴:

(i) in Swap arrangements

(ii) in forward operations.

(iii) in loans to other member.
(iv) in settlement of financial obligations

(v) As security for performance for financial obligations

(vi) in donation.

The third major change came in the reconstitution clause of the SDRs. Reconstitution provision was the feature of the SDRs as safeguard to its conversion into another assets from the time of its inception. The participant was required to maintain a minimum average holdings of SDRs of 30% of its net cumulative allocation over successive 5 years. By late 1970s when the Fund realized that the usability of SDR has increased under basket technique of valuation the SDR is valued as the sum of fixed amount of several currencies. To ensure maximum stability for the exchange value of SDR, the criterion for the selection of a currency was that it should be most widely used in international trade and payments. The weight given to a currency indicated importance of the currency in trade as well as in financial markets. To reflect the changing importance of different currencies in world trade periodic reviews and changes in the composition of basket was necessary. After the introduction of 5 currency basket the weights were changed in 1986 and then in 1991. The matter
of increasing the SDRs by another 36 billion in a near future in under consideration of the Board Governors of the Fund (June, 1995).\textsuperscript{15}

(b) \textit{The Role of Gold}

The use and place of gold in the international monetary system were most drastic feature of the 2nd amendment. The broader objective of the second amendment was to reduce the role of gold in the international monetary system. This objective was pursued by immediate and radical changes in the role of the gold, prohibition of any function as a denominator of exchange rate arrangements and the elimination of the obligation of the Fund as well as members to transfer or receive gold under articles of the Fund and a disposition of a part of gold held by the Fund were radical innovations. As far as the member is concerned they were left free to buy gold on a particular price.

(c) \textit{The Exchange rate Arrangements}

The most important aspect of the second amendment regarding exchange rate is that it legalized to choose exchange rate arrangements by member countries including floating. Only a few country did that. The amendment completely departed from the articles of the
the Agreement of the Fund (1944). The par value system was abolished, the new objective regarding exchange rate was "a stable system of exchange rates". The emphasis in these provisions shifted stable exchange rate to orderly economic and financial conditions that will promote a stable system of exchange rates. In order to achieve the stability in the system member became subject to certain obligations in relation to their external and domestic policies and the IMF was required to maintain a surveilance.

(d) Freely Usable Currency

Before the second amendment there were some currencies (US $ & £ sterling) which were used for purchase and repurchase of other currencies by member. The 2nd Amendment provided that Fund shall have policies of its own to select currencies for use. The following currencies were declared as usable: French Franc, German Duetch Mark, Japanese Yen, US Dollar & Sterling.

2.8 Concluding Remarks:

Concluding we may say that the IMF come into existence as a balance of payments institution and provided resources for relatively short-run. With the
passage of time the Fund has given greater emphasis on longer term balance of payments problems. Its focus of attention since the 1950 has been the developing countries in general and the least developed member countries in particular. It has introduced special concessional lending facilities to assist low income members developing countries with protected balance of payment problems. The IMF has also responded to the needs of a market dominated world economy.
Reference


10. Singh R.S. *IMF Policies Towards LDCs with Special Reference to India*. VELAYUDHA PERUMAL S. "Fund conditionality and structural Adjustment in developing countries" Deep and Deep Publication. New Delhi P-130.


15. Ibid.
CHAPTER-III

INTERNATIONAL MONETARY FUND AND INDIA

3.1 Introduction

This chapter attempts to focus on India's relations with the International Monetary Fund. India is a founder member of the IMF and has played an important role in the formulation of its policies. Similarly, India has taken recourse to financial assistance from the IMF on various occasions to meet out her balance of payments difficulties. Accordingly India's relations with the IMF is analysed under two heads, namely India's role in decision making in the IMF (section 3.2) and the financial transaction between the IMF and India (Section 3.3). The main conclusions of the chapter are presented in the final section (3.4)

3.2 India's role in the IMF

As discussed in the preceding chapter, the IMF was established in 1944 following the painful experience of the thirties. Its broad objectives included regulation of the volume of the International liquidity, ensuring the stability of exchange rate, promotion of free trade and capital movement, coordination of economic policy of the member countries and assisting them in resolving their BoPs difficulties. It was also stated that the creation of IMF was
in reality, a substitute for the gold standard and an alternative to the system of free exchange.

Hence, it was considered necessary for India to acquire the membership of the Fund and share the international prosperity by increasing her tempo of industrialization and, at the same time, to contribute towards the achievements of broader economic ends. Because, there was urgent need for the rehabilitation of the Indian economy, its expansion and modernization. The maintenance of high level of employment and real incomes within the country needed the best of our attention and vigilance.

Moreover, the membership of the Fund was expected to bring the following potential benefits to India:

(i) To delink rupees with the sterling as a consequence of the linking of the World currencies with gold. The rupee was also to be linked to the currencies of the world.

(ii) Possibility of obtaining short-term loan from the Fund for correcting temporary disequilibrium in her current payment positions.

(iii) Facility to devalue the rupee in case of permanent disequilibrium without retaliation from other member countries.

(iv) Participation in the future formulation of International
Monetary policies.

(v) Facility of obtaining expert opinion on various monetary problems as the International Monetary Fund was to be the body of experts.

(vi) Possibility of multilateralism in trade, which the Fund sought to establish, and which was of great advantage to India for it could enable her to utilize her foreign exchange earnings at competitive prices, and lastly

(vii) Cooperation and active collaboration in monetary matters with other member countries.

Against these considerations along with 44 other representative countries India joined the Fund at the time of its establishment and since then has played an important role in the decision making process in the Fund. On a number of crucial points which have a bearing on the developing countries, India has supported views protecting their interest. Most of India’s views have found expression through India’s work with the group of 24 (the international group on Monetary Affairs) and her stated position in the interim committee and in the annual meetings of the International Monetary Fund and the World Bank group. In this context, the following areas could be particularly identified in which India’s contribution may be considered as important:
a. Quota Calculations

The quotas being the capital base of the Fund assume significance as they decide a country's:

i. Financial and organisational relations with the Fund;

ii. Voting power in the Fund's decision making;

iii. Access to the Funds financial facilities; and

iv. Share in SDR allocation.

Accordingly the quota issues have been most difficult to resolve. When initial quotas for the founder members were fixed a number of countries including India had objected to the proposals for quotas and votes. An adhoc committee for the determination of quotas of the individual member was formed and India was a member of the said committee. The committee placed India's quota at US$ 400million in July 1944. This formed 5 percent of total Fund Quota's.

b. SDR Allocation

Another important issue on which India has made its views felt is the allocation of SDRs. SDRs were last allocated in 1980-81 which was 681.17 million. Although initially it was intended that SDRs be created as and when global needs for liquidity arises, no SDRS were allocated
subsequent to 1980-81, as there was no consensus among member of the Fund on the presence of a global needs. India and other developing countries which have been pressing for a general allocation of SDRs have indicated their willingness to go along with one time special allocation of SDRs on grounds of equity.

c. Access Limits

The member of the IMF can make use of Fund resources up to the access limits which are fixed from time to time for various facilities of the IMF. The Fund's credit tranche Policies limit the use of ordinary resources to 100 per cent of quota. However, it does not imply a prohibition of purchases beyond 100 per cent. Historically, maximum access to the various Funds policies and facilities has varied in keeping with the flexibility of the policies on use of Fund resources. In 1981, the IMF approved enlarge access policy with the broad objective of providing stand by or extended arrangement assistance to members which are facing balance of payments problem that are large compared to their quotas.

3.3 Financial Transaction between India and IMF:

Broadly, India's Financial transaction with the Fund could be divided into three categories:
a) Those relating to quota subscription

b) SDR allocations

c) Borrowing from the IMF

In this section, we analyse India's subscription quota in the Fund as well as the allocation of SDRs while the country's borrowing from the Fund will be discussed in detail in the following chapter.

**a. Quota Subscription:**

As mentioned in the preceding section, India's initial quota in the Fund was fixed at $400 million which formed 5 per cent of the total Fund Quota. What is perhaps of more important is the fact that India also enjoyed fifth place in the Fund on the basis of her quota.

As per the original agreement reached at Bretton woods, member countries having the largest number of share in the Fund’s capital were the US, the UK, the former USSR, China, France and India in that order. As the USSR failed to ratify the agreement, India moved on to the fifth place which assumes significance as each of the five members having the largest shares were entitled to have a ‘Permanent’ Chair in the Executive Board and to appoint its own executive directions. India thus enjoyed a permanent seat in the IMF at the time of its inception.
Till 1970 India's quota in the Fund was the fifth and it had the power to appoint a permanent Executive Director. With the increase in the Fund quota after May 1970, the quota of Japan, Canada and Italy increased more than that of India. Accordingly, India ceased to hold a permanent position as Executive Director of the Fund.

Table 3.1 gives a comparative picture of the total increase in the Fund's quota's under successive Quinnquennial and general reviews with the relative figures for India.
### Table 3.1 Distribution of IMF Quota to India in General Review

<table>
<thead>
<tr>
<th>Review of Quotas</th>
<th>IMF's Total Quotas (SDRmillion)</th>
<th>India's Quota (SDRmillion)</th>
<th>India's Share in total quotas (%)</th>
<th>India's Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>First quinquennial</td>
<td>8036.50</td>
<td>400.00</td>
<td>4.98</td>
<td>5</td>
</tr>
<tr>
<td>Second</td>
<td>8750.50</td>
<td>400.00</td>
<td>4.57</td>
<td>5</td>
</tr>
<tr>
<td>1958/59</td>
<td>14640.25</td>
<td>600.00</td>
<td>4.10</td>
<td>5</td>
</tr>
<tr>
<td>Third</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fourth</td>
<td>20932.00</td>
<td>750.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fifth General</td>
<td>28776.00</td>
<td>940.00</td>
<td>3.58</td>
<td>5</td>
</tr>
<tr>
<td>Sixth General</td>
<td>38976.40</td>
<td>1145.00</td>
<td>3.27</td>
<td>8</td>
</tr>
<tr>
<td>Seventh General</td>
<td>59605.50</td>
<td>1717.50</td>
<td>2.87</td>
<td>8</td>
</tr>
<tr>
<td>Eighth</td>
<td>89236.30</td>
<td>2207.70</td>
<td>2.47</td>
<td>11</td>
</tr>
<tr>
<td>Ninth</td>
<td>141404.30</td>
<td>3055.50</td>
<td>2.16</td>
<td>13</td>
</tr>
<tr>
<td>Tenth</td>
<td>144737.80'</td>
<td>3055.50</td>
<td>2.11</td>
<td>13</td>
</tr>
</tbody>
</table>

**Source:** RBI Occasional Paper Vol. 18, No. 2 & 3 (June & Sept. 1997).

#: Fund quotas at Present.
It can be seen from the table 3.1 that India’s place in the Fund has been going down in relative terms. In March 1983, India’s quota in the Fund after the eighth revision stood at 2207.70 million SDR, i.e. 2.47 per cent of the total Fund quota and India has relegated to the eleventh position. Once the ninth and Tenth revision is formalised, India will come down to 13th position with 2.11 per cent quota of 3055.5 million SDR.

Thus, India has been steadily going down in the IMF dispensation since its early years. There was a time when India was one of the top five nations which meant that it was assured of in executive directorship without having to stand for election. As India slipped further, it reached 12th and now 13th in the totem pole. the Indian Executive director is now elected with the votes of Srilanka and Bangladesh in addition to its own.2

India’s falling share in total quotas reflect India’s falling share in world trade, relatively low growth of GDP and low level of foreign reserves over certain periods. It may, however, be noted that a decline in India’s share in calculated quota does not necessarily reflect depressed economic performance by India in absolute terms as changing share in quotas reflect relative performance of economic including industrial economies.3
b. Allocation of SDRs

SDR was created by the IMF in 1969 as an International reserves asset to meet the long term global need to supplement existing International reserves. The creation of SDR reflected the international community's dissatisfaction with the monetary system in which the main source of liquidity expansion was the balance of payments of the US SDRs are allocated to members participating in the SDR department. A total of SDR 21.4 billion was allocated during the first basic period (1970-72) and a part of the third basic period (1979-81). The allocation of SDRs to India and the holdings of SDRs at different periods of time are given in Table 3.2.
Table 3.2 Allocations of SDRs to India (SDRs million)

<table>
<thead>
<tr>
<th>Year</th>
<th>Allocation</th>
<th>Cumulative allocation</th>
<th>Amount</th>
<th>Percent of allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>126 00</td>
<td>126 00</td>
<td>126 00</td>
<td>100 00</td>
</tr>
<tr>
<td>1971</td>
<td>158 58</td>
<td>226 58</td>
<td>179 76</td>
<td>79 34</td>
</tr>
<tr>
<td>1972</td>
<td>99 64</td>
<td>326 22</td>
<td>247 69</td>
<td>76 00</td>
</tr>
<tr>
<td>1979</td>
<td>119 08</td>
<td>445 30</td>
<td>344 89</td>
<td>77 45</td>
</tr>
<tr>
<td>1980</td>
<td>119 08</td>
<td>564 38</td>
<td>490 05</td>
<td>86 83</td>
</tr>
<tr>
<td>1981</td>
<td>116 79</td>
<td>681 17</td>
<td>493 46</td>
<td>72 44</td>
</tr>
<tr>
<td>1985</td>
<td>———</td>
<td>681 17</td>
<td>221 17</td>
<td>32 00</td>
</tr>
<tr>
<td>1990</td>
<td>———</td>
<td>681 17</td>
<td>82 47</td>
<td>12 00</td>
</tr>
<tr>
<td>1991</td>
<td>———</td>
<td>681 17</td>
<td>134 51</td>
<td>20 00</td>
</tr>
<tr>
<td>1992</td>
<td>———</td>
<td>681 17</td>
<td>91 68</td>
<td>13 00</td>
</tr>
<tr>
<td>1993</td>
<td>———</td>
<td>681 17</td>
<td>68 88</td>
<td>10 00</td>
</tr>
<tr>
<td>1994</td>
<td>———</td>
<td>681 17</td>
<td>127 18</td>
<td>19 00</td>
</tr>
<tr>
<td>1995</td>
<td>———</td>
<td>681 17</td>
<td>50 41</td>
<td>7 00</td>
</tr>
</tbody>
</table>

As it is clear from the table, the total cumulative SDRs allocation to India in 1970 was to SDRs 126.00 million. This cumulative allocation of SDR to India is now amounts to SDR 681.17 million in 1995.

3.4 Concluding Remarks

Summarizing, the birth of the International Monetary Fund was a landmark in the International monetary cooperation. India has used this organization to influence its macro economy as well as individual sectors. It has also worked for safeguarding the interest of other developing countries by influencing the decision making process in the Fund.

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1. Kapuria R.S., Indian Rupee. Publisher, Vohra and 1967. p. 120


CHAPTER-4

INIDA'S BORROWING FROM IMF:

4.1 Introduction

In this chapter an attempt is made to critically review India's borrowing experience with the IMF ever since its inception. The chapter is divided into five sections. Section 4.2 gives a brief historical overview of India's balance of payments position under plans and focuses on how the Fund's resources have been used to overcome the pressure on external front. Section 4.3 deals with the IMF conditionality and also examines its implications for the Indian economy in general. This is followed by a critical evaluation of India's borrowing from the Fund in section 4.4. Finally, section 4.5 summerises the main conclusions of this chapter.

4.2 Role of IMF's Financial Assistance in Financing India's BoP deficit.

The balance of payment is one of the oldest and most important statistical statement for any country, especially the more open one. It is "a systematic record of all economic transactions between the residents of given country and of the residents of the rest of the world in an accounting period viz. a year." The balance of payments statement is devided into two
major accounts viz, current account and capital account. Transaction relating to goods services and income constitute the current account, while those relating to claims and liabilities of a financial nature, which go to finance the deficit on current account or to absorb its surplus, form the capital account. The sum of these current and capital account transactions together constitutes the basic balance on the balance of payment.

Since balance of payments accounts are prepared on the double-entry systems of accounting, sum of all debits equals the sum of all credits and the account are always in balance. However, the deficit or surplus is measured by summarizing all items in the balance of payment except those in the nation's official reserve account. When the debits (payments) exceed the credit (receipts) in the current and capital accounts, BoP said to be in 'deficit'. In the opposite case we have a 'surplus' in the BoPs. A 'deficit' in the BoP is considered as negative or unfavourable or adverse BoP situation for the reporting country; and a 'surplus' in the balance of payments is considered as positive, favourable or active BoP situation of the country.
Thus, balance of payment is an important index which reflects the true economic position of a country, whether the country is a creditor or debtor county and whether its currency is rising or falling in its external value. Actually, the disequilibrium in the balance of payments is undesirable and bad for the country concerned and it is the ultimate responsibility of the govt. to maintain the balance of payments equilibrium. The govt and the Central Bank must have adequate reserves or appropriate borrowing arrangements to bridge the gap in BoPs problems.

When India became independent, it had a 'sterling balance' worth Rs. 1,733 crores. This was the result of a sizeable surplus on balance of trade with the U K acquired during the second world war period when U K had made large scale purchasing from India to meet its war requirements. During the First Plan the balance of payment position remained satisfactory. The net deficit on current account was only of the order of Rs. 151 crores as against Rs. 667-727 crores expected in the plan. There was a net cash outflow of Rs. 22 crores of private capital and net inflows of Rs. 36 crores of official capital. The total depletion in reserves was of the order of Rs. 127 crores. The overall deficit in BoP was negligible at Rs. 42 crore.
This was because the First plan put emphasis on agriculture and did not require large imports of machinery and capital goods.

India did not avail of any facility from the IMF; instead India repurchased (repaid) the amount borrowed earlier. India withdraw SDR 28 million in 1947-48 and SDR 71.98 million in 1948-49.

The development strategy adopted in the Second Plan gave primary importance to the establishment and development of basic and capital goods industries. This necessitated large scale imports of capital equipments, machinery and technical know-how. Throughout the second plan period, export remained stagnant while the value of imports almost doubled the value of exports. As a result the deficit in the balance of payments during the second plan increased to Rs.1644 crore\(^5\).

This resulted in the significance loss of reserves. Infact, by the middle of the second plan, the balance of payment problem became so acute that to cope with the situation, India pursued restrictive import policy and borrowed an amount equivalent to SDR 200 m from the IMF.
The balance of payment position remained tight during the Third Plan and the deficit rose further to Rs. 1,972 crore. The main reasons were rise in the import of industrial raw materials, machinery, maintenance and defence equipment due to the Chinese aggression of 1962 and Indo-Pak war of 1965 and fall in the export of traditional items like cotton textile and jute goods.

As a result India borrowed a relatively large amount of SDR 375 million from the IMF during the third plan period.

The period of Three Annual plans following the third plan also witnessed a substantial deficit of more than Rs. 2000 crore.

India, besides devaluing her currency, sought the assistance from the IMF to the tune of SDR 415 million including SDR 90 million under the compensatory financing facilities (CFF) to tide over the deficit.

During the Fourth Plan period, some natural disturbances occurred. The monsoon rain did not arrive as expected in the Indian subcontinent in 1972. A severe drought hit large part of Africa and Asia. These developments resulted in heavy price increases and an inflationary impetus was given to the world
economy. The prices of the basics increased by 100 per cent and the fertilizer prices increased by 170 per cent.\textsuperscript{6}

The most spectacular and the most important disturbance was however, manmade. Following the Arab-Israeli war which started in Oct 1973, the Organisation of Petroleum Exporting Countries (OPEC) decided to increase the price of the oil drastically. The oil price was increased by almost 300 per cent. Many countries, including India ran very heavy deficit in their BoPs in 1974. The deficit in India's balance of trade came to be Rs 1563.9 crores.

To finance the deficit between 1973-74 and 1974-75 India borrowed from the IMF a sum of SDR 775 million including SDR 200 million under the oil facility.

The pressure on BoP continued in the early years of 1975-76. India therefore drew from the Fund in Aug.1975 an amount SDR 201.34 million, under the oil facilities.\textsuperscript{7}

During the Fifth Plan (except the first year 1974-75) the overall balance of payments position turned out to be very satisfactory. This relatively short period (76-79 and 79-80) was a golden period as far as the balance of payments is concerned. India had a small
current account surpluses of 0.6 per cent of GDP during this period and also poses foreign exchange reserves equivalent to about seven months import.* The relatively comfortable position on the balance of payments front was due to the following factors:

i) First and foremost was the rapid increase in private remittance from oil exporting countries. A large number of Indian workers temporarily migrated to the oil-rich middle east countries and started remitting their net earnings to their families in India.

2) There was a strong growth in exports of nearly 31% in 1975-76 over 1974-75 and 23% in 1976-77 over 1975-76 (in rupee terms).

3) As a result of the conservation measures adopted domestically and increase in oil production, the country was able to arrest the growth in oil import. Only after 1977-78 when the country attained a comfortable position in its balance of payments and foreign exchange reserves did the import of crude oil pick up.

4) There was a substantial expansion in the activities of Indian firms in the oil exporting middle east countries. Indian firms were
building roads, airport, housing, estates, power station, steel mills etc. in a number of middle east countries. These export of construction services as well as of some materials contributed substantially to India's foreign exchange earnings.

As a result of these factors, the Indian economy adjusted to the first oil shock rather quickly. In fact, during two years of fifth plan- 1976-77 and 1977-78 there was a surplus on current account. Taking the fifth plan as a whole, there was a deficit of only Rs. 1,146 crore on current account. Table 4.1 gives an account of India's transactions with the IMF during the period 1945-46 to 1979-80.
<table>
<thead>
<tr>
<th>Year (Apr.-Mar.)</th>
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(Table 41 Contd)

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<th>Repurchases</th>
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<td>SB</td>
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CCFF: Compensatory and Contingency Financing Facility

CFF: Compensatory Financing Facility

FCTSB: First Credit Tranche Stand-by

SB: Upper Credit Tranche Stand by Arrangement

The IMF set up a Trust Fund in 1976 mainly from the resources that came from profit of selling a portion of its gold holding at market prices. The Trust Fund resources were used for providing balance of payment assistance to eligible low income developing member countries of the Fund on highly concessional terms, over two prescribed periods. The Fund laid down conditions that governed the receipt of assistance from the trust Fund and broadly referred to the ability of country to demonstrate the need for balance of payments assistance and also that it was making a reasonable effort to strengthen its balance of payments position. Sixty one developing member countries were listed in the first basic period as eligible for Trust Fund assistance and India was among them. In fact India's entitlement on total quotas of eligible members was the highest at 25 per cent. However, due to the inherent strength in external payments and reserves position, India was unable to demonstrate the need for using the Trust Fund loan and consequently could not draw on her entitlement which was then redistributed to others in need.

In the second period (July 1978 through 1980) however India made use of Trust Fund loans amounting to SDR 529.01 million. And the total amount was repaid by the year 1990-91. This can be seen from the data presented in Table 4.2.
Table - 4.2

India's Transaction with IMF (Trust Fund Loan)

<table>
<thead>
<tr>
<th>Year (Apr-Mar)</th>
<th>Trust Fund (SDR million)</th>
<th>Loans</th>
<th>Repayments</th>
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<td>1980-81</td>
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<tr>
<td>1990-91</td>
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<td>56.10</td>
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Source: Reserve Bank of India Occasional Papers vol 18 No. 2 & 3 special issue (June & Sept.) 1997
The second oil shock came in 1979-80 as the oil prices were hiked by the OPEC. This had a serious negative impact on the Indian economy and the government of India in order to finance huge current account deficit in the early eighties, entered into a three year extended Arrangement with the IMF for SDR 5.0 billion in November 1981. This was the largest amount that any member country had borrowed under any facility from the Fund till then. Of the total loan SDR 900 million were to be made available in the first year, SDR 1.8 billion in the second year and SDR 2.3 billion in the third year. In terms of relative share the year wise distribution was 18 percent 36 per cent and 46 per cent respectively.

The First part SDR 600 million was drawn at the end of 1982. In the second year of agreement India brought SDR 1800 million at the end of 1983. A further SDR 1300 million was drawn in 1983-84. Thus in all India could draw SDR 3.9 b within the three years of agreement. In January 1984, nearly 10 month ahead of the end of the arrangement period India on its own informed the Fund that the last tranche of SDR 1.1 billion was not needed.
The balance of payment performance during the Sixth Plan turned out to be much better than initially anticipated. The current account deficit was Rs. 6,400 crore as against estimated amount of Rs. 9,100 crore. The improvement in the balance of payment was the result of several factors. First, there was a considerable saving in the imports of crude oil as a result of increase in its domestic production. The domestic production of crude oil increased from 11.8 million tonnes in 1979-80 to 29 million tonnes in 1984-85. Second, the growth in import was checked considerably by significant improvement in the functioning of infrastructure, import substitution in steel, cement, non-ferous metals and improvement in food grain production. Third, there were net SDR 3.9b drawals from the IMF and other borrowings to fill the balance of payments gap. Lastly, there were large capital inflows from non-resident Indians helping the country in improvement in the balance of payments position during the sixth plan.

The happy situation on the balance of payment front however, did not continue during the Seventh Plan. Trade deficit in the first three years of the plan exceeded Rs 9000 crore per annum and in the fourth and fifth years (1988-89) and (1989-90) exceeded Rs.
Following the adoption of the liberalisation policy by the govt. imports increased considerably while exports largely lagged behind.

India did not take any recourse to the IMF borrowing till December 1990. During 1988-89 and 1989-90 the Indian economy became heavily dependent on short term commercial borrowing from abroad. This was due to the increasing fiscal deficit of the govt. of India and also due to the programme of import liberalization.

The Gulf crisis during the year 1990-91 created a critical BoP situation in India. In addition to the massive trade deficit of Rs. 16,934 crore, there was a deterioration in the invisible account as well because of lower remittance and higher interest payments. The current account deficit soared to Rs. 17,369 crore. The govt. had to impose a strict import squeeze. As a result, the value of imports declined by 19.4 per cent in 1991-92 in dollar terms as compared with 1990-91 while exports were almost stagnant. The foreign exchange reserve was equal to three and a half months' import. Around the same time credit rating of the country was lowered restricting the country's access to commercial borrowings. Foreign exchange reserves kept
on falling and on the expectations of impending depreciation of the rupee, there was a temporary loss of confidence leading to a flight of NRI deposits. The import cover of foreign exchange declined to just one month of imports at the end of 1990-91 and dipped further to less than half a month by July 1991.

In such an adverse situation India had to look for a deal with IMF/ World Bank for improving the situation. It was in January 1991 that the govt. of India received first credit tranche of SDR 552 million and CCFF loan during January September 1991 of SDR 1352 million. It also borrowed under stand by credit to the tune of SDR 270 million between Nov. 1991 to January 1992. The gross drawing from the Fund during this period amounted to SDR 2.2 billion. Table 4.3 gives the details of India's recourse to IMF's Funds during the eighties and the nineties. It shows that to overcome the BoP difficulties India borrowed from the IMF SDR 231.00 million in 1993-94 under the stand-by arrangement. Thereafter, it has not taken any financial assistance from the Fund.
Table - 4.3
India’s Transactions with IMF (Purchases, Repurchase and Loans)
During Eighties and Ninties

| Year (Apr-Mar) | Purchases | | | | | Repurchases | | | |
|---------------|-----------|-----------------|---|---|---|---|---|---|---|---|---|---|---|
|               | EFF | FCTSB | CFF/CCFF | SB | Oil Facility | Total | EFF | FCTSB | CFF/CCFF | SB | Oil Facility | Total |
| 1980-81       |     |     | 266.00    |   |   | 266.00 |     |     |     |   |   |     |
| 1981-82       | 600.00 |     |   |   |   | 600.00 |     |     |     |   |   |     |
| 1982-83       | 1800.00 |     |   |   |   | 1800.00 |     |     |     |   |   |     |
| 1983-84       | 1300.00 |     |   |   |   | 1300.00 |     | 66.50 |   |   |   | 66.50 |
| 1984-85       | 200.00 |     |   |   |   | 200.00 |     | 133.00 |   |   |   | 133.00 |
| 1985-86       |     |     |     |   |   |     | 131.25 | 66.50 |   |   |   | 197.75 |
| 1986-87       |     |     |     |   |   |     | 431.25 |   |   |   |   | 431.25 |
| 1987-88       |     |     |     |   |   |     | 704.17 |   |   |   |   | 74.17 |
| 1988-89       |     |     |     |   |   |     | 804.17 |   |   |   |   | 804.17 |

(Contd .......)
<table>
<thead>
<tr>
<th>Year (Apr-Mar)</th>
<th>Purchases</th>
<th>Repurchases</th>
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<tr>
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<td>551 93</td>
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</table>

CCFF: Compensatory and Contingency Financing Facility
CFF: Compensatory Financing Facility
FCTSB: First Credit Tranche Stand by
SB: Upper Credit Tranche Stand by Arrangement

Source: RBI Occasional Paper Vol 18 No 2 & 3 Special Issue (June & Sept) 1997 IMF Annual Reportes
4.3 IMF Conditionality and its Implications:

The IMF does not provide financial assistance to its member countries without any conditions. In fact as discussed in chapter 2, the availability of financial assistance from the Fund is subject to policy conditions which become more stringent as drawings rise through different tranche. These policy conditions are known as "conditionality" and in general term refers to the terms and conditions of loans. The conditions can be broadly divided into two categories as the conditions on the utilisation of the loan viz., utilisation and promptness in the execution of projects and the conditions for the change in the macro-economic policies of the Government., i.e., the introduction of supply management measures and structural reforms. The later broadly include:

i. The integration of the economy into the world economy.

ii. Curbing the role played by the govt. in the economy.

iii. Allowing the market forces to play a greater role.

Thus the IMF Policy package is a programme for opening up of the economy to the entry of foreign goods and foreign capital. This is required to be
achieved through the reduction of tariffs on entry foreign goods and services and by the elimination of any quantitative restriction on them. Integration of the economy into the world economy is assumed to follow since capital and goods can freely come in. This means the removal of controls, delicensing, provision of a hospitable climate for multinational goods via import liberalisation and for multinational capital. But such conditions imposed by the IMF while granting loans to borrowing countries have been generally criticised by the politicians and academicians of developing countries on various grounds: Firstly, they are means for strengthening the monopoly sector, accelerating concentration of output and capital, destroying indigenous skills and technology, and increasing dependence on technology imports and foreign capital.

Secondly, the IMF package is not only inequitious; it is ineffective as well in curbing the balance for payments deficits. Payments deficit in developing countries is not a temporary phenomenon or accidental phenomenon, but one which recurs in every period as they cannot earn as much foreign exchange as are needed. Their export volume does not increase both on account of element and supply factors while significantly has an everincreasing tendency to meet
the development requirements. The terms of trade have also moved against the developing countries.

Thirdly, a devaluation of the currency to shift the international terms of trade in favour of the advanced capitalist countries is a part of the package. This is done even when it is not justified by the relative rates of inflation in the country and the world economy. Devaluation of the domestic currency makes imports expensive, raises the cost of servicing the foreign debt and in inflationary in character. Thus the net effect of devaluation is generally higher inflation, worsening of fiscal problems, greater recessions, or a combination of these.

Fourthly, the most important implications of the IMF loan involve the repayment of the principle amount of the loan and the payment of interest. For example, during 1981-84 India borrowed the gross amount of Rs. 5200 cr, but the net inflow into India over these years was Rs. 4810.92 cr only. The total interest payment obligation was Rs. 4061.58 crores and the total debt servicing was to the extent of Rs. 9261.58 crore which worked out nearly to 78% of the original contracted amount.

The implication of the India's borrowing from the IMF in 1981 is shown in Table 4.4.
Table - 4.4
IMF Borrowing : Debt Servicing Implications for India

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<th>Period</th>
<th>IMF Loan</th>
<th>Loan Out</th>
<th>Loan Standing</th>
<th>Interest</th>
<th>Loan Repay</th>
<th>Debt Servicing</th>
<th>Net Inflow</th>
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<th>Interest</th>
<th>Loan Repay</th>
<th>Debt Servicing</th>
<th>Net Inflow</th>
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</tr>
<tr>
<td>1989-90</td>
<td>—</td>
<td>2971.03</td>
<td>376.07</td>
<td>742.86</td>
<td>1118.93</td>
<td>-1118.93</td>
<td></td>
</tr>
<tr>
<td>1990-91</td>
<td>—</td>
<td>2228.57</td>
<td>300.86</td>
<td>742.86</td>
<td>1043.72</td>
<td>-1043.72</td>
<td></td>
</tr>
<tr>
<td>1991-92</td>
<td>—</td>
<td>1489.71</td>
<td>222.64</td>
<td>742.86</td>
<td>965.5</td>
<td>-965.5</td>
<td></td>
</tr>
<tr>
<td>1992-93</td>
<td>—</td>
<td>742.86</td>
<td>150.33</td>
<td>742.86</td>
<td>893.29</td>
<td>-893.29</td>
<td></td>
</tr>
<tr>
<td>1993-94</td>
<td>—</td>
<td>—</td>
<td>75.20</td>
<td>742.86</td>
<td>818.05</td>
<td>-818.05</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>5200</td>
<td>—</td>
<td>4061.58</td>
<td>5200.00</td>
<td>9261.58</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Singh, R.S. IMF Policies Towards Less Developed Countries (LDCs) with Special Reference to India. Deep & Deep Publication. New Delhi. p 179.
Again during the year 1990-91 the balance of payments problem became grave, thereby necessitating the Indian Govt. to obtain a loan from IMF to augment foreign exchange reserves position. India's borrowing from IMF and its debts implication can be seen with the help of Table 4.5.
Table - 4.5
IMF Borrowing : Implications of 1991 Loan for India

<table>
<thead>
<tr>
<th>Year (Apr.-Mar.)</th>
<th>IMF Loan</th>
<th>Out Loan Standing</th>
<th>Interest</th>
<th>Loan Repay</th>
<th>Debt Servicing</th>
<th>Net Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>1700</td>
<td>1700</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>1700</td>
</tr>
<tr>
<td>1991-92</td>
<td>1300</td>
<td>3000</td>
<td>187.5</td>
<td>—</td>
<td>187.5</td>
<td>1112.50</td>
</tr>
<tr>
<td>1992-93</td>
<td>300</td>
<td>3300</td>
<td>206.25</td>
<td>—</td>
<td>206.25</td>
<td>93.75</td>
</tr>
<tr>
<td>1993-94</td>
<td>—</td>
<td>3300</td>
<td>206.25</td>
<td>—</td>
<td>206.25</td>
<td>-206.25</td>
</tr>
<tr>
<td>1994-95</td>
<td>—</td>
<td>3300</td>
<td>206.25</td>
<td>825</td>
<td>1031.25</td>
<td>-1031.25</td>
</tr>
<tr>
<td>1995-96</td>
<td>—</td>
<td>2475</td>
<td>154.94</td>
<td>825</td>
<td>979.94</td>
<td>-979.94</td>
</tr>
</tbody>
</table>

(Contd )
(Table-4.5 Contd.)

<table>
<thead>
<tr>
<th>Year (Apr.-Mar.)</th>
<th>IMF Loan Out</th>
<th>Loan Outstanding</th>
<th>Interest</th>
<th>Loan Repay</th>
<th>Debt Servicing</th>
<th>Net Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-97</td>
<td>—</td>
<td>1650</td>
<td>103.38</td>
<td>825</td>
<td>928.38</td>
<td>-928.38</td>
</tr>
<tr>
<td>1997-98</td>
<td>—</td>
<td>825</td>
<td>51.56</td>
<td>825</td>
<td>876.56</td>
<td>-876.56</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3300</strong></td>
<td><strong>1116.13</strong></td>
<td><strong>3300</strong></td>
<td><strong>4416.13</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source:* Singh, R.S., IMF Policies Towards Less Developed Countries (LDCs) with Special Reference to India, Deep & Deep Publication, New Delhi, p. 178.
It is clear from the table that against the IMF Loan of Rs. 3399 crore the total interest payment amounted to Rs. 1116.13 crore while total debt servicing worked out to be Rs. 4416.3 crore.

Fifthly, the IMF policy package is a programme for several curtailments in the living standards of the working people. It forces the govt. of the borrowing country to cut back on expenditures in the social sector like health, and education or in employment generation in the name of achieving fiscal balance. Many of these areas become available for the private sector. Import liberalization means the eliminating the domestic producers in a number of industries and consequently unemployment. Tight monetary policy has the similar effect.

The logic of the IMF package therefore is such that its net result must be an "inflation" and "recession" and unemployment, a squeeze on money wages and salaries and cut in public expenditure on welfare relief and subsidies on essential consumption items. Each of these measures adversely affects the low and middle income groups; together their impact can be disastrous. And if a devaluation is additionally thrown in, the impact is even greater via its inflationary consequences.
Last but not the least the IMF is criticised on the ground that it is guide by U.S.A and other developed countries while disbursing loans. And these countries try to impose their philosophy on member countries.

The Fund has been conservative from the very beginning. It has laid down stringent conditions for lending to member countries. It charges high interest rate. For instance, if a loan is financed from the ordinary resources of the Fund, the interest rate charge is 6.5 percent. On the other hand, if the loan is financed from the borrowed resources by the Fund, the interest rate as high as 15 per cent. During 1950s and 1960s, a member country was required to repay the loan within 3 to 5 years. Now the repayment period of loans under the EFF is between four and ten years from the Funds own resources and 3.5 to 7 years for borrowed Funds.

4.4 Critical Evaluation of India's Borrowing from IMF:

In India too the borrowing from the IMF has not been welcomed by all sections of the society. For example, when India borrowed from the IMF in 1981, it was bitterly criticised among others, by the government of West Bengal which had arranged a
conference under the economist finance minister Dr. Ashok Mitra on this issue. Twenty three economists, specially invited by the W.B. govt., drew attention to the economic danger of the loan and, in particular, according to them, to the loss of economic sovereignty implied in the conditions. The W. Bengal govt. came out with a white paper on the IMF loan titled, "IMF loan-Facts and Issue". Some of the important criticisms made by these economist may be summarise as follows.\(^\text{13}\)

i. The nations prerogative to formulate its economic policies and preservations to cure its economic problems is going to be seriously circumscribed by the acceptance of the conditions laid down by the Fund. India's monetary and fiscal policies during the period of loan would be formulated not in New Delhi, but in Washington.

ii. The conditions of the loan whittle down seriously the broad tenor of economic policy in India sofar accepted.

iii. The loan would force the Indian govt. to give special privileges to the private sector, including foreign investors; import substitution policies will be reversed; New bilateral trade agreements with
socialist and other countries can not be accepted without prior clearance from the Fund; other external borrowing would be subjected to ceiling.

iv. The Fund would also force the Indian govt. to curtailment of food subsidy and public distribution system (PDS); we might drift to a regime of perpetual inflation and perpetual balance of payment difficulties.

v. Some of the policy measures like reduction in deficits and contraction in credit would effect the activities of the state govt. and of the small scale sector.

vi. Liberal conditions for the use of foreign exchange would lead to greater access to the multinational co-operations in the Indian economy which would seriously jeopardies the attempts made by endogenous entrepreneurs for the development of technology.

Similarly the latest borrowing by India from the IMF has been criticised mostly on the above noted grounds. But most of these criticism seems to be a little unjustified or highly exaggerated. Our analysis of IMF assistance to India has revealed that India's balance of payments difficulties on several occasions would have
intensified, had the Fund not come to her assistance in time of difficulties. The Fund does interfere but it cannot be called as the country's "sellout" to the Fund. Likewise the Fund insistence on adherence to fiscal discipline, reduction in unnecessary expenditure, cut in defence budget etc. cannot be regarded as 'humiliating'.

4.5 Concluding Remarks:

To conclude, the rational behind India's borrowing from IMF has been to put Indian economy back on its track and the Fund has been helpful to India towards the realisation of this goal.
CHAPTER-5

CONCLUSIONS

The IMF came into existence in 1944 to safeguard the global economy against the type of devastating break down that had occurred in the 1930s. Since then it has worked consistently towards the attainment of this goal and evolved in several important directions in response to changing conditions.

During the first quarter century of its existence, the IMF oversaw the "par value system". served as a forum for consultation and collaboration and helped member countries correct short term balance of payment problems by lending them the foreign currencies they needed. But when in the early 1970s. the system of fixed but adjustable exchange rates was abandoned the IMF assumed "surveillance" role. To-day it is authorised not only to monitor the exchange rate policies of members but also their economic policies affecting exchange rates.

In the 1960s, the IMF made two important changes in its operational policies namely the introduction of the General Arrangements to Borrow (GAB) to
supplement its financial resources in order to have enough cash on hand to meet the members' borrowing needs and the creation of the Special Drawing Right (SDRs). The SDR was created to meet out the threat of a shortage of international liquidity.

During the 1960s, the IMF also increased its attention to developing countries by introducing two new lending mechanism - the compensatory financing facility and the buffer stock facility.

For decades, the Fund provided assistance to its member countries on a short term basis which was considered not sufficient enough for a borrowing nation to implement any effective monetary and economic plans. Hence the IMF introduced a new lending instrument, the Extended Fund Facility, in September 1974, tailored to the medium term needs of the developing countries.

In the 1980s and 1990s, the IMF's lending activities continued to expand. It established the structural Adjustment Facility in 1986 and the Entranced Structural Adjustment Facility in 1988.
Thus over the years, the IMF has made noticeable moves to respond to the needs of member countries in general and the developing countries in particular. It has paid greater attention to the least developed member countries since the second half of 1980s.

India is a founder member of the IMF and has played an important role in the formulation of its policies. Its initial quota in the Fund was fixed at $400 million which formed 5 per cent of the Fund's total quota. India enjoyed fifth place in the Fund and was entitled to have a 'permanent' chair in the Executive Board and appoint its own Executive Director. But over the years India's position in the Fund has gone down reflecting its falling share in world rate, relatively low growth in GDP and low levels of foreign exchange.

India has borrowed Funds from the IMF on several occasions under different facilities during the period 1947-48 to 1996-97. These have been used to overcome the pressure on balance of payments position of the country.

But the "conditionality" attached by the Fund has led to the criticism of India's borrowings from the IMF.
Our study indicates that in the absence of such assistance by the IMF, India's difficulties on the balance of payments front would have intensified and affected the country's growth adversely. Similarly the Fund's insistence on fiscal discipline, cut in defence and other unnecessary expenditures are essential for intrinsic wealth of the economy and cannot be regarded as 'humiliating'.
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