International Monetary Fund and the Developing Countries with Special Reference to India

Dissertation submitted to the Jawaharlal Nehru University
in partial fulfilment of the requirements
for the award of the Degree of
MASTER OF PHILOSOPHY

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1990

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20th July, 1990.

C E R T I F I C A T E

This is to certify that the dissertation entitled "INTERNATIONAL MONETARY FUND AND THE DEVELOPING COUNTRIES WITH SPECIAL REFERENCE TO INDIA", submitted by ARVIND SINGH, is an original work and has not been previously submitted for any degree at this or any other University.

We recommend that this dissertation be presented before the examiners for consideration of the Degree of Master of Philosophy.

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ACKNOWLEDGEMENT

I express my deep sense of gratitude to Prof. (Mrs.) Sumitra Chishti, for her valuable guidance, constructive suggestions, healthy criticism and sincere supervision throughout the course of this work. Her scholarly suggestions helped me in bringing this dissertation to the present shape.

I am thankful to my friends Ashok Negi, Ram Pratap, Mukesh, Harimohan Sharma, Sudhakar, D.P.S., Rakesh, Parviz Ahmed for their cooperation and encouragement during my work in their own ways.

I am grateful Mr. Devender Kumar, for nice typographical work of my dissertation in rather short time. At last but not the least, I am grateful to my parents and younger brother who constantly boosted my morale while writing the dissertation.

Arvind Singh

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INTRODUCTION

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CHAPTER I

The post war world witnessed the emergence of a large number of developing countries. These countries took a series of steps to initiate developmental programmes in order to achieve higher standards of life for their people. Their programmes led to recurrent balance of payments deficits. In fact, the balance of payment barriers surfaced earlier than the savings barriers. Hence, they were in search of solutions to this endemic problem.

They, therefore, looked at the International Monetary Fund, for the timely and adequate assistance to tackle the balance of payments deficits and enable them to pursue their programmes to achieve sustained development.

The International Monetary Fund which came in the wake of collapse of international trade and payments system consequent to the great depression and the world War II has been entrusted with the task of helping the member nations to tackle their balance of payments problems and restore stability and predictability in the world payments system, By designing priciples, policies and procedures that the member countries are expected to follow.

It is important to recognise at the outset that the IMF has no special mandate to assist the Developing countries.

As will be seen the balance of payments problem of developing countries are treated by IMF at par with the balance of payments problem of advanced countries. The developing countries have special balance of payments problem arising out of the specific factors that cause balance of payments deficits. First, the exports of developing countries consist and comprise even today mainly of primary products. These products have a high degree of price and volume instability leading to volatality in the foreign exchange earnings. Second, the primary product producing and exporting developing countries have experienced continuous deterioration in terms of trade resulting is substantial losses in foreign exchange earnings the exception of period when oil producing and exporting countries which enjoyed a favourable terms of trade. Third, a large number of developing countries have limited number of manufactured products, which have growing international demand. Those products in which they have comparative advantage face stiff tarrif and non-tarrif barriers in there markets. Fourth, due to underdevelopment, the economies are inadaptable and inflexible. They cannot easily adopt to the requirements of international markets. Finally, their balance of payments deficits can be termed as structural and having fundemental disequilibrium.

The IMF, however, steadily shifted its attention to provide icreased of assistance to developing countries. This endeavour of the IMF, began in the sixties and gained momentum in the seventies and eighties.

The purpose of this dissertation is to study the increased role of the IMF in helping developing countries to tackle their balance of payments problem.

A brief description of history and the establishement of the IMF, its objective and lending policies will be made in chapter II. Chapter III will be devoted to the survey of the role of the IMF Vis - a - Vis United Nations , Chapter V will discuss the relationship between the IMF and India during the period(1970 - 83) Chapter IV will focus its attention between IMF and developing countries, which will be followed by the conclusion.

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CHAPTER II

A BRIEF SURVEY OF THE ORIGIN, ORGANISATION, OBJECTIVES AND FUNCTIONAL MECHANISM OF INTERNATIONAL MONETARY FUND.

CHAPTER II

A Brief Survey of the origin, Organisation, objectives and Functional Mechanism of International Monetary Fund.

International transactions of a current and capital nature were financed through certain facilities and arrangements through banks and exchange markets of financial centres like London, New York, etc. upto the second world war. Through these facilities money of one country was available in exchange for that of another for transactions both of current and capital nature. The business of financing international transactions was performed by the gold standard towards the latter part of the nineteenth century.[1] In fact the gold standard performed the functions of the international monetary system upto the outbreak of world war-I.

The international gold standard was closely dependent upon the London money market, which upto world war I was the largest and the most free market for bullion. It was also the centre of commodity dealings and for international payments. It provided both short term and long term credit facilities for the financial markets of the world. The international gold standard provided a mechanism for large payments to be made with a small gold reserve. It kept the cost of internationally traded goods roughly at a certain level in different countries. It

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1.A.I.Blownfield, "Monetary Policy Under the International Gold Standard", 1880-1914, (New York 1959), pp.56-62.

kept exchange rates stable with very small fluctuations, which facilitated the international movement of capital and goods. The standard worked very well upto the outbreak of world war I in 1914, when three important changes produced a great revolution. Firstly, the international link between the gold reserve and money supply by which balance of payments were adjusted between different countries was broken. It was because gold exports and imports did not remain free during the war. This link[2] was resumed between 1925 and 1931, when gold bullion standard was adopted internationally. During this period, the central bank maintained parity between gold and internal paper money by undertaking to provide gold subject to a minimum limit. This link was again broken when England went off the gold standard on September 24, 1931 and in 1936 France the leader of the gold block countries also gave up the gold standard. In between these years, all other gold standard countries had placed restrictions on gold exports. Secondly, in England the limit on the note issue was factually though not legally abandoned. Thirdly, there had been a rapid growth of many forms of liquid assets, many of which were forms of government debt, which did not serve as a means of payment as money did. They could however, be quickly converted into money almost at face value. They constitute potential spending power in the hands of the owner.

Attention should be paid to certain features of the monetary system which came to prevail between 1920 and 1939. To meet the depression of 1929, the monetary authorities of various countries restorted to various measures like exchange depreciation,

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2.K.W.Dam, "The rules of Game, Reform and Evolution in the International Monetary system. (Chicago 1982),p.6.

flectuating exchange rates, multiple currency practices, direct control over imports, etc. Evey country followed devices it thought suitable. It was however, during this period that international currency plans, viz. The White plan, and the Keynes plan[3] etc. Were prepared to reconstruct the monetary system in the post war period.

Firstly, the maintenance of the par value led to a great overvaluation or undervaluation of currency at different times. The corrective action required a great degree of the deflationary or inflationary adjustment, which the system might not be able to withstand. Secondly , some of the major monetary systems were not responsive to changes in reserve positions.

Thirdly, the conflict of monetary policy in the major countries was frequently resolved in ways which were inconsistent with the interests of the gold standard. Fourthly, after world war I, heavy international capital movements produced disequilibriating effects.

The gold standard as a mechanism of adjusting volume of payments disequilibria ceased to exist after 1931. Between 1929 and 1932 prices collapsed and international trade fell to unprecedently low levels. These developments produced different effects on the economics of various countries. The terms of trade moved sharply against the primary commodity producing countries. Secondly, the burden of their foreign obligations

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3. L.B.YEAGER "International Monetary Relations", Theory, History and Policy 2nd. ed.(New Yorks 1976), PP.26-48.

increased due to a decline in their foreign exchange earnings. There were widespread defaults. Thirdly, the primary commodities producing countries had to earn foreign exchange to import essential goods and they had to use foreign resources carefully. The economy of the industrial countries[4] reached a precarious position. There was a sharp rise in unemployment, especially in the United Kingdom. Industrial and developing[4] countries alike suffered from overwhelming deflationary pressures, and almost all the countreis began to seek ways of defending themselves against the undercutting of its pences from abroad-some by competitive exchange depreciation, some by introducing flexible exchange rates or multiple rates; and some by direct control of imports and other international transactions. As countries tried to, "export their unemployment" to others, "begger my neighbour", policies became the rule. Countries sought solutions independently and individually, many of them progressively introducing exchange controls and import licensing schemes,with a view to limiting imports and payments abroad and several resorting to bilateral agreements through which increased imports were exchanged for increased exports. In a nutshell,there was stable international monetary system, gold standard had collapased without giving way to any alternative monetary system with rules and regulations accepted by the

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4.W.A.Brown, Jr."The Gold Standard Reinterpreted", 1914-34, 2 vols. (New York, 1934), pp.105-140.

comity of nations.

Out of the above shortcomings based on the experience of countries in the inter war years emerged the plans for the setting up of new international monetary and financial institutions, which are playing a great role in helping member countries in providing foreign resources for easing their balance of payments difficulties and for providing long term capital for economic growth. A search for such institution began during the concluding years of the war -II. The White plan" developed in the United States and named after Harry Dexter White, Assistant to the Secretary of the Treasury, (U.S.A) had origins dating back to 1940. The "Keynes Plan", developed in the United Kingdom by John Maynard Keynes,[6] origins going back at least to the summer of 1941. Furthermore, the ideas encompassed in both plans had precedents in stabilisation arrangements tried in the 1930s. The Keynes Plan called for an International currency Union (or Clearing Union), which was to keep banking accounts for central banks in exactly the same way as cental banks in each country kept accounts for commercial banks. These accounts were to be denominated in an international currency to be known as "bancor". Bancor was to be defined in terms of gold, but the union could alter its name. Member countries could obtain Bancor in exchange for gold but could not obtain gold in exchange for Bancor. Exchange rates were to be

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5.J.K.Horsefield, "The international Monetary Fund 1945-65 : Twenty Years of International Monetary Cooperation, 3 Vols. (Washington, 1969),pp.37-82.

6.D.Moggridge,"The Collected writings of John Maynard Keynes, Activities 1940-44, (London 1980), pp.21-100.

fixed in terms of bancor and were not be changed without the permission of a governing board. Within limits, member counrties could run direct balances with the union, such balances taking the form of overdrafts rather than specific loans.

The White plan covered what became both the fund and the world bank. A number of purposes for the fund were listed, including stabilizing countries exchange rates, encouraging the flow of productive capital among countries, facilitating the settlement and servicing of international debts, lesseing balance of payments disequilibrium, and reducing exchange control, bilateral arrangements, and trade barriers. Unlike Keynes's clearing Union the institution commissioned by the White plan was a contributory one, with members making subscriptions partly in gold and the remainder in national currencies, totalling "at least 35 billion". Any member might purchase from the fund the currency of any other member within certain predetermined limits. All members of the United Nations could join, provided they were committed both to eliminating controls over foreign exchange transactions (except for those approved by the fund) and to establishing fixed exchange rates; to be altered only with the consent of the fund when essential ot correct a "fundamental disequilibrium". The fund was to be managed by a board of executive directors.

Both the Keynes and White plans went through a number of drafts before they were made public early in 1942. In the year

1943 the plans were debated publicly, especially among economists, bankers and businessmen in the United States. Keynes White and their respective colleagues exchanged views on their own plans, and other plans-including those put forward by the French and the Canadian authorities. The debate in the United States centered on the relative advantages of specific trades of international cooperation. Should there be a highly structured world economy with inter-governmental mechanisms (such as the fund) and rules regulating currencies, investments, and trade, as favoured by Keynesian economists and others sympathetic to governmental management? Or should automatic forces dominate, with limited government interference and no international organizations, as favoured by more traditional economists and by bankers and businessmen?

In the course of 1943, U.S. officials also consulted representatives from a number of countries, many of whom proposed specific changes in the draft plans. From September 15 through October 9, 1943, as part of a broader series of meetings covering also proposals for post war international investment, commodity policy, and commercial policy, nine meetings on the monetary plans were held in Washington between a U.S. group headed by White, and a British delegation headed by Keynes, to discuss some 14 points on which US and U.K. officials differed. The outcome[7] was the "Joint statement by experts. On the establishment of an international monetary fund.

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7. J.K. Horsefield, <u>The International Monetary Fund 1945-65, Twenty Years of International Monetary Cooperation</u>, 3 Vol.(Washington 1969), p.129.

Even this joint statement went through several drafts before the final text was produced in 1944.

Planning for the conference was then intensified to inform the delegates of the intricate technical issues that would dominate the discussions of Brettton Woods background memoranda were circulated on such potentially controversial topics as the allocation of quotas in the fund, gold contributions, access to the funds resources, noting structure, and management. Then, prior to the full scale conference at Brett-on woods, a limited group of countries received invitations to send representatives to a preliminary drafting conference at Atlantic city, New Jersey, U.S.A in the Second half of June 1944. Besides the United States, 16 countries were represented Australia, Belgium, Brazil, Canada, Chile, China, Cuba, Czechoslovakia, France, Greece, India, Mexico, the Netherlands, Norway, the USSR, and the United Kingdom delegates who had been attending the Atlantic city conference boarded a special train from Atlantic city of Friday, June 30, to the remote village of Bretton woods to atland the United Nations Monetary and Financial Conference held 14-22July, 1944) in the white mountains of northern New Hampshire[8]. While the train wound its way through New Jersey and the New England countryside, two lawyers from the U.S. delegation undertook to transform the documents resulting from the Atlantic city conference (where some 70 amendments to the joint statements had been proposed) into the basic material

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8. Ibid, pp.136-182.

for the next stage.

The delegates worked incredibly hard. Commission I on the Fund was headed by White, while Keynes headed Commission II on the World Bank. Since the White plan rather than the Keynes plan was to be the basis of the Funds articles, this division of responsibility seemed best. Commission III on other means of International financial cooperation was headed by Eduardo Sharez,Minister of Finance of Mexico. Planary sessions went on all day as the nature of the provisions be included in the Articles of agreement of the Fund and the Bank were debated. In addition, many-probably the great majority of the controversies that emerged were dealt within informal negotiations. To a large extent, these took place within the various drafting committes but, as at all such conferences, the representatives of the two countries most concerned often thrashed out their differences bilaterally. This was particularly true of negotiations between the representatives of the United States and the United Kingdom.

The delegates were determined to be successful. They viewed their agreement on plans for international economic cooperation after world war II as an essential show of strength necessary to build a better, peaceful, and more prosperous world once world war II had ended.

Despite the successful drafting of Articles for the Fund and the World Bank, the arrangements agreed to at Bretton Woods were consciously viewed as experimental.No one was certain how they would work in practice. The negotiators did not intend to make the Bretton woods system rigid. Rather, the system was intended to give countries more freedom than did the gold standard to pursue their micro economic policies, mainly monetary and fiscal policies, so that they could reach their domestic goals, Particularly the goal of attaining and monetaring domestic full employment.

ORGANISATION OF THE I.M.F.

The structure[9] of the I.M.F.is described in Article XII of the Agreement, and consists of a Board of Governors, executive directors, a managing director and a staff. The Board of Governor is the highest decisions making organ of the I.M.F., endowed with suitable powers and consists of one Governor and one alternate appointed by each member in such a manner as it may deem appropriate.

The Governor and the alternate have the term period of five years, and remain in this capacity subject to the pleasure of the member country appointing them.

Objectives of the IMF

The objectives of the fund stated in Article 1 of the Fund Agreement are as follows:[10]

To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

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 productive resources of all members as primary objective of economic policy.

To promote exchange stability to maintain orderly exchange arrangements among members and to avoid competitive exchange

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9 .J.Keith Horsefield, The IMF 1945-65, (Washington, 1969), p.199.

10. International Monetary Fund, Articles of Agreement of the International Monetary Fund, (Washington)Dec.27, 1945, Article I.

depreciation.

To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

To give confidence to members by making the funds resources temporarily available to them under adequate safeguards, thus providing them with opportunity to correct mal-adjustments in their balance of payments without resorting to measure destructive of national or international prosperity, and

In accordance with the above, to shorten the duration and lesser the degree of disequilibrium in the international balance of payments of members. The fund is guided in all policies and decisions by the purposes setforth in the above article.

In practice, the exercise of the fund's power is generally entrusted to the executive directors, with the exception of those expressly returned to the Governors under Article XII, Section 2(b) of the Fund agreement and other related provisions, these reserved powers are following.[11]

1. Admit new members and determine the conditions of their admission;
2. Approve a revision of quotas;
3. Approve a uniform change in the Par value of the monetary unit of members.

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11. Hans Aufricht, <u>The I.M.F. Legal Basis Structure, Functions</u>, (New York, 1964), p.26.

4. Make arrangements to cooperate with other international organisations (other than informal) arrangements of a temporary or administrative character.)

5.Determine the distribution of the net income of the fund;

6.Require a member to withdraw;

7.Decide to liquidate the I.M.F.

8.Decide appeals from interpretations of the fund agrrement rendered by the executive director under Article XVIII (a) of the Fund Agreement. The Board of Governor holds annual meetings generally in September and are held jointly alongwith International

Bank for Resources and Development and International Finance Corporation International Development Association. The meetings have been usually held consequently twice in Washington D.C., and outside the Unite States in the third year. In between annual meetings, the Governors take decisions wherever necessary and appropriate by so called mail note. There are no special qualifications for the Governor and each member may appoint a Governor or an alternate Governor as it deems fit. Quorum for any meeting of the Board of Governors shall be a majority of the Governors exercising not less than two thirds of the total voting power.

Each Governor shall be entitled to cast the number of votes alloted under Section 5 of this article to the member appointing him. No alternate shall vote but only during the time of the absence of the Principal member.

Executive Directors:

The executive directors are charged with the responsibility of conducting the general operation and to attain this they will exercise all powers delegated to them by the Board of Governors. There shall not be less than twelve[12] directors, which total can be increased with the approval of the Board of Governors, when more and more members, Swell the ranks of the I.M.F. Five of the directors shall be appointed by the five members having the largest quotas (being called appointed directors) and the other shall be elected from the American Republic not entitled to appoint directors, and the best from the other member countries. In addition to the above directors, two members, the holding of whose currencies by the I.M.F. have been, on the average once the preceding two years, reduced below their quota by the largest absolute amounts, shall be granted the right to appoint a director. The election of elective directors shall be conducted at intervals of two years, and if the office of an elected director remains vacant more than ninety days before the end of his term, another director shall be elected for the rest of his term by the members who elected the former director. The executive directors shall function in

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12. J.Keith Horsefield, The I.M.F. 1945-65, (Washington, D.C. 1969), p.300.

continuous sessions at the principal office of the I.M.F. Which according to article XIII of the agreement, shall be located in the territories of the members having the largest quota and should meet whenever the requirements of IMF demand. A Governor for any meeting of the Executive Directors shall be a majority of the directors, representing not less than one half of the voting power. Except in special cases the Chairman shall call a meeting of the Executive directors at least with two days clear notice.

Managing Director

The executive directors shall select a Managing Director who shall not be a Governor or an executive Director. He shall not have a right to vote except in case of a tie. He may participate in the meetings of the Board of Governors but shall not vote at such meetings. The Managing Director shall cease to hold office when the executive director so decide. The Managing Director shall be responsible for the organisation, appointment and dismissal of the staff of the fund subject to the general control of the executive directors. The Managing director is normally to be appointed for five years, but this may be altered by the executive directors. Any qualified person who is younger than 65, shall be selected as managing director and when he reaches the age of 70, he shall resign his office. There are certain conditions which the Managing Director has to take into account while appointing the members of the staff, for instance he has to see that the highest standards of efficiency and of technical competence, are fulfilled, he has to also see that due importance is given to regional representation.

Voting Power

The IMP was to be an international organisation. Unlike many such organisations decisions were to be made by weighted voting rather than by one country-one vote procedures. Both the U.S. and Britain agreed on this point because weighted voting would assure them jointly a dominating voice in decisions. Voting power on the Board of Governors and the Directorate is prorata with the size of the member's quota, each member having 250 votes plus one additional vote for each part of its quota equal to one hundred thousand United States dollar.[13] When voting is required on the waiving of conditions applicable to the granting of an application by a member for use of the fund's resources, the voting formula is more complex, being designed to give more voting power to surplus countries. This formula can be summarised as follows.

a) General Formula - Member's Vote $= 250 + \frac{X}{100,000}$

b) Voting on Article V Sec. 4 or 5 - member's Vote

$$= 250 + \frac{X}{100,000} + \frac{Y}{400,00} - \frac{Z}{400,000}$$

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13. (Article XII, Section 5(a)of the I.M.F. Charter Joseph Gold, Voting and Decisions in the International Monetary Fund (Washington D.C.1972), pp.30-43.

Where X = member's quota in US $

Y = net sales of its currency to date

Z = net purchase of other currencies to date.

subsequent revisions of quotas have altered the absolute number of votes per member but the relative voting strengths of members still favours the large rich countries.

From all of this it will be evident that the management of the fund was to be political rather than technical. That Governors and directors were to regard themselves as a pool of technical knowledge and that the largest contributor to the fund had secured for itself a dominant role in policy and decision making. Such a set up could scarcely fail to undermine the international character of the fund and help to make it a sounding board for divergencies of political (rather than economic) problems."[14] Added to this is the location of the Fund's offices in Washington and it will be clear that Keyne's fears for the future of the fund as an international rallying ground for the best technical option on international monstary matters were well founded?

Changes in the 1970s & 1980s

The first amendment was proposed by Board of governors in May 31,1968. If took place on July 28,1969, and the special drawing account came into being one week later on August 6-1969. The term"reform" Of the Fund used at the time of the first amendment referred to those amendments that went into effect simultaneously

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14.J.K.Horsefield, "IMF (1945-65) (Washington 1973) Vo. I, P.837.

with the amendments incorporating the SDR facility in the articles. Actually the changes involved in this "reform" were few: They introduced the need for a special majority of 85 percent of voting strength before certain decisions could take place.

In mid - 1971 further developments stuck at the heart of the monetary arrangements designed at Brettonwoods. Five European members found it necessary to take exchange rate actions including resort by the federal republic of Germany and the Netherlands to the floating of their currencies. On August 15.1971, impelled by a current account deficit of what at the time was considered an intolerable magnitude the U.S. authorities suspended the convertibility of dollars held by the monetary authorities of other countries into gold. Par values and convertibility into gold were at an end In December 1971 a realignment of currencies was worked out in the Smithsonian agreement by the "Group of Ten, This paved the way for some measure of order in international economic relations . The uncertainty prevailing was lessened to some extent. The disturbances caused due to the dollar inconvertibility gave impetus to bring about reform of the international monetary system. Impelled by this the Board of governous on July 26,1972, adopted a Resolution setting up a committee of the Board of Governors on Reform of the International Monetary System and Relate issues. This came to be known as the Committe of Twenty or (C-20). This had 9 developing country members.

After the Smithsonian agreement of December 1971, Monetary officials hoped that the new currency alignment would provide the basis for a viable regime, and a temporary arrangement was introduced in which central rates could be substituted for par values and in which the permitted margins were widened. The rates of the Smithsonian Agreement was shorlined however. There was an exchange crisis when most of the currencies of the member countries started floating. To bring about a reform of the world monetary system, the committee of twenty worked intensively from September 1972 until June 1974 on the many technical and complex issues involved. Negotiating the provisions of the second Amendment was a complex and protracted process. It began on July 9, 1974, shortly after the committee of Twenty completed its work. The main objectives of the second amendment are to allow members to chose their exchange arrangements; to aim at a gradual reduction in the role of gold in the international monetary system,to make the SDR the principal reserve asset of the system, to modernize the funds options and transactions, to make changes and allow for possible future changes in the fund's organizational structure, and to give the fund the capability to adopt to further development in the international monetary system.

Operations of the I.M.F.

As a financial institution IMF provides 'loan' assistance to the member countries for relatively short period. For this purpose the Fund receives resources from member countries in the form of 'gold and specified quantities of the currencies of the individual member countries known as 'quota'. Quotas constitute subscriptions by member countries to the capital fund of the I.M.F. They define the relative importance of the member-countries in the matter of their rights and obligations. For instance, the higher a country's quota, the larger its capacity to borrow from the I.M.F. Quotas also determine the voting strength of the member countries and the distribution of the internatinal money i.e. SDRs among member countries is also done exactly in proportion to the quotas of members The quotas are fixed on the following criteria :

a) 2 per cent of international income;

b) 5 per cent of gold and dollar balances;

c) 10 per cent of average annual imports;

d) 10 per cent of maximum variation in annual exports;

e) the sum of (a), (b), (c) and (d) increased by the percentage ratios of average annual exports to national income. The years used there 1940 in (a), 1934-38 in (c), (d) and (e) and July 1, 1943, in (4). This came to be known as the Bretton woods formula.[15] According to this, out of a total of $8,800 million for the 44 nations gathered at Bretton woods, the quota for the U.S. was $2,750 million. The quota for India was fixed at $400 million.[16] The sixth largest after the U.S.A., U.K. USSR, China and France. The members had to pay 25 per cent of their quotas in the form of gold and the rest in their own currencies. For the original members, gold subscription were set at either 25% of their quotas of 10 per cent of their net official holdings of gold and US Dollars as on 12th September 1946 whichever was less. This formula has usually been followed for later members. But there is a certain amount of bargaining in the matter. In cases, where the gold subscription is below 25% the members are under an obligation to

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15. Articles of Agreement, Article III, Section 3(b),

16. S.L.M. Simha, "Internationl Monetary Reforms - An Introduction".(Bombay 1973), p.33.

educe their currency subscription, so as to bring it down to 75 per cent through payment of gold or other currencies acceptable to the Fund. The quotas are reviewed every few years and adjusted fromtime to time by the Fund. The significance of the gold subscription is to enable the IMF to acquire those currencies which are needed by members but the holdings of which by the fund have been run down.

The subscriptions (called by quota) were not, however, the only source of fund assets. The fund would draw income from charges on members drawing.[17] These charges were to be imposed on drawings and hence only on deficit countries. In addition to one time service change of 3/4 per cent on each transaction the Articles of Agreement provided for a sliding scale of periodic changes based on the relation of the amount of drawings to the drawing country's quota and on the elapsed time from the date of the drawing. The charges were payable in gold, though members with monetary reserves less than ½ of quotas were permitted to pay a portion of the charges in local currency.

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17. J.K. Horsefield, "The International Monetary Fund 1945-65", Twenty Years of International Monetary Cooperation 3 Vols. (Washington 1969),p.7.

The articles of agreement envisaged two other kinds of transactions designed to increase funds assets : Borrowing and replenishment by sale of gold. Investment of Fund assets was a possible third source not specifically provided from the Articles of agreement. A fourth source of assets was implicit in the maintenance of value provisions. Although the Fund would have large holdings of gold and of member currencies, it was not specifically empowered to increase those holding by investment, on the other hand, no provision prohibited such investments. Now, to take the maintenance of value provisions the fund was conceived as a revaluing fund of constnat gold value and this value was to be maintained. To do this, a member that reduced the value of its currency was required to pay an amount in its own currency equal to the reduction in the gold value of its currency held by the fund.

Exchange Transactions of the I.M.F.

Taking the currencies from the Fund by member countries is called an exchange operation, that is to say, the member gives its currency to the IMF in exchange for other currencies it requires when a member acquires currencies in this manner, it is said to be a 'drawing' from the fund and when it returns to the fund the currencies, it had acquired earlier, it is said to be making a repurchase of its currency.

The Fund had developed a number of outlets for lending. These are known as facilities and are the following :

1. Gold Tranche (SDR TRANCHE)
2. First Credit Tranche
3. Second Credit Tranche
4. Third CreditTranche
5. Fourth Credit Tranche
6. Stand-by Arrangement
7. Compensatory Financing Facility
8. Buffer stock facility
9. Oil facility
10. Extended facility, and
11. Trust Fund loan facility.

The <u>Gold Tranche</u> is the total of a member's gold subscription and the credit, if any, which the member has extended through the fund to other members. For example, if a member has paid 25 per cent of the quota in gold. Then the gold tranche for the member is 25 per cent of the quota. If a member besides paying 25 per cent gold subscription has a creditor position in the fund to the extent of 25 per cent, then its gold tranche is 50 per cent of its quota which if a member has paid 18 per cent gold subscription and 82 per cent in terms of its own currency then the gold tranche is 18 per cent for the member country. Later on gold tranche was abolished when gold sale operations began.

As regards drawings under the credit tranches, the IMF's policy is to treat the drawing in the first credit tranche of 25 per cent of the quota, on a liberal basis, almost automatically. However, the requests for drawings beyond the first credit tranches, require substantial justifications i.e. while approaching the fund for a drawing in the higher amounts, the member would have to give a programme of actions, in the fiscal, monetary and exchange fields, which would have the effect of correcting the disequilibrium in the member's balance of payments; on the effective implementaion of such a programme, the member would be in a position to repay, in relatively short period, the credit which it receives from the IMF. "The Funds attitude to requests for transactions within the first credit tranche - that is, transaction which bring the fund's holdings of a member's currency above 100 per cent but not above 125 per cent of its quotas is a liberal one. Provided that the member itself is making reasonable efforts to solve its problems. Requests for transactions beyond these limits requires a substantial justification. They are likely to be favourably received when the drawings on <u>standby arrangements</u> are included to support a sound programme aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange.[18]

Thus it shows that the assistance provided by IMF is a mixture of unconditionality and conditionality. The chief source of condionality is found in stand by arrangements and it is because of its conduciveness to conditionality that the fund made little or no use of its special authority to impose conditions. The stand by arrangement were initiated in 1952 and they involve the advance arrangements of future needs with the I.M.F.

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18. <u>IMF Annual Report</u>, 1962, p.31.

for such credit facility. Under standby arrangement, a member of ghe IMF is given an assurance that, following a review of the member country's financial and economic policies and its balance of payments position, the member can purchase from the Fund the currencies of other member's, upto an agreed amount and during a stated period.

According to some[19] the facility of standby arrangements is wholly unnecessary and inconsistent with the I.M.F. policy of liberal credit to member countries upto the limits prescribed in the Articles of Agreement. The IMF itself is a source of standby credit and a formal standby arrangement does not appear to be necessary. Besides, undertakings are given (by the member country) all too freely about the pursuit of fiscal and monetary policies at the time of standby arrangements without careful regard to their practicability and the result is that the undertakings are not honoured and requests for relaxation are often made. Besides, there is a certain amount of inherent discrimination among the member countries.[20] In addition, the repayment of standby assis-

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19. S.L.N. Simha, "International Monetary Reforms : An Introduction" (Bombay 1973), p.45.

20. Ibid., p.45.

stance will have to be made within a period of three years.

To meet the growing needs of developmental financing of the less developed countries the IMF adhered to compensatory financing facility. With special rules for countries suffering from a shortfall in export proceeds from primary commodities. This facility was available to all members suffering from this particular balance of payments problem. Specifically they would be able to draw upto 25 per cent of their quota (increased in 1966 to 50 per cent) and if necessary, the fund would waive the normal limit of fund holdings of a member's currency to 200 per cent of quota.[21] The effect of the decision was thus 40 per cent the drawing country to avail the performance commitments involved in a standby arrangement and to permit members to draw even though they had already exhausted their credit trenches by conventional drawings. Moreover, as a result of a floating feature introduced in 1966 liberalisation a drawing under the compensatory financing facility did not affect a member's tranche position. Thus , a member not having drawn

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21. P.R. Brahmanand, "The IMF loan and India's Economic Future " (Bombay 1982), p.1-7.

previously could draw under the facility whole leaving its gold tranche intact and fully available for future drawings.

Besides, the fund had developed a number of other outlets for lending e.g., buffer-stock facility, oil facility, extended facility and trust fund loan facility. Some of these outlets have become possible because of the resources placed at the disposal of the fund by some of the oil exporting countries and others, for example, the Fund has enriched by a loan fromthe Saudi Arabian monetary authority ($8 billion - $4 billion a year for two years interest payable on the basis of weighted average rate of 5 year government securities in the fine component currencies of SDR,which is currently between 14 to 15 per cent.[22] Since some of these loans are re-payable over a longer term, the Fund has the opportunity to extend the length of its lending operations.

The trust fund loans are made by the fund out of the profits it has made by its gold-sale operations.

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22. Ibid, p.3.

The purpose of Buffer stock financing facility[23] is to assist in the financing of member's contributions to international buffer stocks of primary products when members having balance of payments difficulties participate in such arrangements under commodity agreements that meet appropriate criteria, such as the principle laid down by the United Nation's in regard to international commodity agreements. This policy was introduced in 1969. The drawings for buffer stock financing may be made upto 50 per cent of quota. The fund has so far authorised the use of funds ordinary resources to all the members of the fund facing serious payments imbalances that are large in relation to their quotas.

Under the Extended Finance Facility, the fund assist these members whose economics suffer from serious balance of payments difficulties resulting from structural imbalances in production, trade, prices, and an inherently weak balanceof payments position. The funds under this scheme are made available in large amounts. Sequentially for longer periods and the repayment schedule

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23. IMF Survey, September 30, 1980.

can be spread over 7 to 10 years. The drawings under this can be phased over three years and are subject to performance clauses relating to the implementation of key policy measures. The purchases outstanding under this scheme may not exceed 140 per cent of the member's quota. Between 1974 to 1981 only 7.7 billion SDRs had been allotted under this scheme and it has mainly been utilized by non-oil rich developing economies for overcoming their balance of payments crisis. In 1980, the Fund adopted a policy called Enlarged Access.[24] The maximum total amount available to a member from credit tranches, the extended facility and the supplementary financing facility (or successor borrowing arrangements) has now been set at 150 per cent of quota per annum of 450 per cent of quota over three years. A member's cumulative drawings under these arrangements is not to exceed 600 per cent of quota. These limits are subject to review in the light of the availability of borrowed resources to the fund. The table on the next page summarizes the use of fund's resources under various tranche policies.

It is necessary to point out that when a member

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24. IMF Survey, January 26, 1981, p.17.

T a b l e

USE OF FUND RESOURCES IN MILLION S.D.R.s

Fiscal year of the end April 30	Within reserve tranche	Within credit tranche	Compensation financing facility	Buffer stock facility	Extended facility	Oil facility	T o t a l
1966	602.6	2203.4	11.3	-	-	-	2817.3
1967	677.0	322.0	62.3	-	-	-	1061.3
1968	639.0	489.6	219.7	-	-	-	1348.3
1969	902.8	1924.0	12.1	-	-	-	2838.9
1970	689.4	2297.2	9.0	-	-	-	2995.7
1971	810.5	354.5	2.5	-	-	-	1167.4
1972	1576.5	264.9	167.0	20.1	-	-	2028.5
1973	641.0	322.8	206.4	5.3	-	-	1175.4
1974	607.5	238.8	211.6	-	-	-	1057.7
1975	981.5	1603.8	18.0	-	-	2409.3	5102.5
1976	1324.1	461.0	827.8	4.7	7.7	3966.2	6591.4
1977	160.6	2370.0	1752.8	-	90.0	436.9	4910.3
1978	135.7	1936.8	321.8	-	108.0	-	2503.0
1979	2480.4	485.0	464.7	47.6	242.0	-	3719.6
1980	225.5	1105.8	862.9	26.1	216.0	-	2433.3

S o u r c e : Compiled from International Monetary Fund, Annual Report 1966, 1970, 1973, 1976, 1978 and 1980.

draws on the Fund, it uses its own currency to purchase the currencies of other members countries or special drawing rights (SDRs) held by the General Resources Account. Thus a drawing results in an increase in the Fund's holdings of the purchasing member's currency and a corresponding decrease in the Fund'd holding of other currencies or SDRs that are sold. A member incurs an essential obligations to repurchase its currencies from the Fund to the extent that the Fund's holdings of the member's currency are in excess of 100 per cent of the member quota.

Usually, repurchases are required to be made within three to five years after the date of purchase, but under the extended facility. The period of repurchases is within 4-10 years, under the oil facility within 3.7 years, and under the supplementary financing facility within 3½ to 7 years.

<u>S.D.R.s</u>

Prior to World War II, gold constituted over 90 per cent of international liquidity. With the fast increasing volumes of world trade and payments, it was felt that a shortage of international liquidity was likely to arise because of the slow growth of gold reserves and the present internatinal monetary system would not automatically provide the increased liquidity. Therefore, a need was felt for a new type of reserve and a solution of this problem was provided by refund drawing rights which was created in 1968 as a supplement to Gold and dollars.[25] The SDRs is defined variously as a legal tender or paper gold in international payments - almost like creation of paper currency in the national economies substituted regular coins in gold and silver. SDRs supplemented the traditional reserve assets, namely, gold and foreign exchange. The scheme of SDRs was approved in principle in 1967 but came into operation only since January 1970. With the establishment of the facility of SDRs, the accounts of the IMF are divided into two categories, namely, the General account and the Special drawing account. The ordinary transaction of the I.M.F. relating to subsctiption towards quota, drawings, repurdiases and payments of charges are all conducted through the General account. The transactions

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25. S.D. Cohen, "International Monetary Reforms 1964-59" (New York), 1970, p.11.

relating to the SDRs are conducted through the Special drawing account.

Every member of the IMF has a right to be a participant in the SDR facility. But a member of the I.M.F. is not compelled to join the SDR scheme. However, most of the members have become member of the SDR scheme. The allocation of SDRs may be made only to participants but the holding of such rights is not restricted to participants. The und can accept and hold SDRs in and use them through the general account. The Fund by a special majority (85 per cent of voting power) will be able to permit non-members and members that are that participants to engage in operations and transactions involving SDRs. The SDRs themselves are not international money. They are like coupons which can be exchanged for currencies required by the holder of SDRs, for making international payments when SDRs are converted into other currencies, the charges and interest rate has to be paid at the rate of 1½ per cent per annum. The SDRs are not the liability of the IMF. There is no peel of currencies to back the issue of SDRs. The real backing of the SDRs in the undertaking given by the Articles of Agreement and, particularly the undertaking to give convertible currencies in exchange of SDRs.[26]

The allocation of SDRs is made on the basis of the quota of the IMF of the individual member countries. If a country's quota is 25 per cent, then it will receive 25 per cent of the allocation of SDRs. Since the developing countries do not have the major share of the quotas, they also do not have the major share of allocation of SDRs. The decisions to allocate or cancel SDRs may be made only by the Board of Governors on the basis of the proposals from the administration of the fund and only by a special majority. The first allocation of SDRs was made by the IMF on 1st January, 1970. A total of SDRs3,414 million was distributed, each member being entitled allocation for 16.8 per cent of its quota. Second allocation was made on 1st January, 1971, for an amount of 2,944 million, each participant getting 10.7 per cent of its quota. The third allocation of 2952 million units was made on 1st January, 1972.

The SDRs can be used by members in three alternative ways :

1. To obtain US dollars, French Franc or British Pound Sterling from other designated participants to obtain currency in exchange.

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26. C.A. Coombs, The Arena of International Finance, (New York), 1976, pp. 180-200.

2. To use SDRs for obtaining balances of its own currency held by another participant; by agreement with that participant; and

3. To use SDRs to effect repurchases and to pay charges in the Fund's general account. Thus the IMF can held and use SDRs though no allocations are made to it.

CHATPER III

THE I.M.F's RELATIONSHIP WITH U.N.

CHAPTER - III

THE I.M.F.'S RELATIONSHIP WITH U.N.

The I.M.F.'s organisational structure is very much different from the organisational structure of the other specialized agencies in the U.N. system. As a specialized agency of the United Nations, the Fund has always had close relations with that body and a staff member served as special Representative to the United Nations. But an analysis would show that the structural, organisational and political characteristics of the IMF remain none the less quiet distinct.

The agreements which they have concluded with the United Nations are substantially different from these which have been signed by the other specialised agencies.[1] The IMF has safeguarded its autonomy to the point where one finds only a nominal line of authority between it and the U.N.General Assembly. They cooperate with ECOSOC but do not accept the systematic application of Article 62 of the UN charter, The IMF functions independent of the UN. Its administrative and budgetary rules and practices are not the subject of regular reviews by bodies which have been empowered to advise the UN and its related agencies on their procedures and to assess their performance in these areas. But still a nominal relationship has been there as the Managing Director continued to make his annual address to the ECOSOC, presenting the Fund's annual Report. It was

1.Mahdi Elimandgra, "The United Nations System an Analysis", (London 1973), p.102.

usual for a number of Executive Directors and Senior staff to attend Planary sessions of the ECOSOC. The Managing Director participated in meetings of the Administrative Committee on coordination (ACC).

Other staff members represented the fund in preliminary meetings and sub-committee activities of the ACC; at the General Assembly; at the Committee for Development Planning of the ECOSOC; at the first session of the Industrial Development Board, and at the concerning Council of the UNDP, including the special meetings in 1969 to consider the Report by Sir Robert Jackson on the capacity of the development system of the United Nations.

The agency of the United Nations with which the Fund has had a virtually continuous relationship was the UNCTAD. In fact, it was primarily in order to maintain close relations with UNCTAD and with the GATT that an office was set up in Geneva in 1965.[2] Thereafter, the fund, was represented at numerous meetins of the regular committees and of special groups of the UNCTAD, both in Geneva and in New York. Of particular interest to the Fund was the Committee on Invisibles and Financing related to UNCOAD the Expert Group on international Monetary Issues, the Intergovernmental Group on supplementary Financing, the Special Committee on preferences, and the UNCTAD intergovernmental Group on Trade Expansion, Economic

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2.Margaret Garritsen Devries, "The International Monetary Fund 1966-1971", (Washington 1976), P.605.

Cooperation,and Regional Integration among developing countries. By 1971, keeping in touch with the work of the UNCTAD absorbed the full-time services of one staff member of the funds office in Geneva.

The Fund staff continued to attend the meetings of the various regional economic commissions of the United Nations - the Economic Commissions for Africa (ECA); Asia and the far-east (ECAFE), Europe (ECE), and Latin America (ECLA)- and to go to working party and committee meetings of these commissions.

From time to time the staff attended meetings of adhoc groups that were assembled by the United Nations to consider specialized topics. These meetings included, for instance, those of a committee of Experts on Development Planning, an Inter Regional seminar on the Planning of the foreign trade sector, an expert group on the measurement of capital flow, to the developing countries, an Inter Regional Seminar on government accounting and Financial management and Round Table on Export credit. The staff also participated in the fourth session of the Commission on International Trade Law, held in Geneva.

CHAPTER - IV

INTERNATIONAL MONETARY FUND & THE DEVELOPING COUNTRIES

CHAPTER - IV

International Monetary Fund & the Developing Countries

The Bretton Woods conference and the Previous meetings which taken together, resulted in the establishment of the IMA were dominated by a few industrial countries and most significantly by the United State and the United Kingdom. Developing countries exerted only a minimal infludences. However they were not completely excluded from the discussion, there was indeed some debate concerning the problems of development. During the first few years of its existence, the Fund showed relatively little concern with the problems of developing countries. This was partly because it viewed development as lying under the purview of IBRD. During this period most of the Fund's resources were utilized by the European countries as they had come under the Marshall plan aid. The developing countries could utilize only a quarter of the rescouces. Even so, certain policy changes and other innovations that occured in the early 1950s were beneficial to developing countries. Amongst these were the proliferation of technical and advisory missions to developing countries countries and the introduction by the IMF of a limited range of educational courses, also in the early 1950's steps were taken to make drawings on the gold tranche virtually automatic and the drawing on the first credit tranche more easily available. If one goes by the annual reports of the IMF in the early and middle 1950's one finds that Fund had little specific interest in the particular problems countries, they were treated at Par[1] with the developed countries and the Fund policy was necessarily to effect stabilization and free trade. In the late 1950's and 1960's the Fund's attitude towards development changed drastically This drastic change was apparently to alleviate the economic problems faced by the developing countries in certain areas such as the deteriorating terms of trade of primary Product exporting countries, growing awareness of the establlity of the export receipts of developing countries, and the increasing representation of developing countries in International councils.

The first tangible step taken by IMF with regard to the problems of the Developing countries was made in 1963 when the I.M.F. reached a decision to introduce a scheme to compensate members against shortfalls in exports receipts, this scheme though officially open to all the members, it was largely beneficial to all the developing countries. This scheme was known as <u>compensatory Financing Facility</u> of the IMF. Due to the vulnerable world economic environment, the CFF was liberalized in 1975 and again in 1979, in 1981 it was intergrated with a scheme to assist countries facing balance of payments problem as a result of excess cereal imports. At first, compensation was available only on restrictive terms,

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1. GRAHAM BIRD, "<u>The International Monetary System and the Less Developed Countries</u> (London 1978) p.112.

but in 1966, following a substantial degree of pressure by developing countries amendment's were made that made the compensatory financing Facility more attrative to the developing countries. CFF chiefly provides assistance to primary product exporters experiencing payments deficits arising from export shortfall's due to sudden fall in world prices, harvest failure and the other causes. The shortfall must be judged to be temporary and largely beyond the control of the member, and the member must be able to show that it has a payments need for assistance. Access is determined by a formala which measures deviation of exports from an average value and the amount of credit may not exceed 100% of quota. IN May 1981 this facility was extended to cover abnormal incr eases in cereal imports, presumably due to harvest failures. When a member makes use of both export and food short fall provisions, the maximum credit is 125% of quota. IN 1969 the Fund took action to assist members who faced balance of payments difficulties as a result of their participation in Buffer stock schemes[2]. The measures were designed to extend the educational and the advisory activities of the fund which benefitted developing countries. But apart from these beneficial remedies provided by the IMF, there has been several areas where the developing countries found themselves at odds with the IMF. These areas included the deterioration in the terms of trade of the primary commodities producing countries.

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2. I.M.F. Survey, September 30, 1980.

As has already been seen that the announcement by the President of United States on 15 August 1971, that the monitory authorities of his country no longer undertook to convert foreign official holdings of U.S. dollars into gold, added impetus to the great debate about the reforms of the international monetary system in the 1970's may be seen as a period of attempts to write a new monetary constitution for the world by a revision of IMF Articles of agreement, ~~and~~. amendment became effective in April 1978. It is atleast debatable whether those changes in the International monetary system may be regarded as reforms particularly from the view point of developing countries The articles of agreement have been amended only twice once in 1970 to legitimate the creation of SDRs, secondly in 1978 as a culmination to the changed realities of the world economy and the need to redraft monetary constitution of the world. The failure of the Brettonwoods systems led to an attempt to make full assessment of the International monetary system and to think of reforms that would cover all aspects of the system. This discussion took place under the auspices of the Fund in the committee on Reform of the International Monetary System and related issues. (The committee of Twenty or C-20) which had nine developing countries out of twenty. Following a suggestion of C-20, a joint ministerial committee of the Board of governors of the Bank and the Fund on the transfer of the real resources to developing countries was set up. This was in response to some of the criticism which have been made concerning the amount of assistance provided by the IMF to developing countries. The committee has concerned itself with the transfer of real resources to developing countries, paying particular attention to developing countries and those developing countries most seriously have payments difficulties. As a consequence to this C/20 recommendation, a two year oil facility in 1974 was constituted to cater to the needs of the countries which had to cope with the problems due to the escalation of the costs of oil. In the years upto 1973 the oil market became tighter with moderate but steady increases in the oil prices. Late in 1973, at the time of the Yom Kippur war, the OPEC countries took advantage of this market situation by engaging in a joint offensive[3]. to increase the price. Further, price increases took place during 1974, phased in accordance with the policies of the individual countries and the demand in the market, and the official price reached $10.72 a barrel in 1975, almost four times the price two years previously. (see table 1) .

TABLE 1

OIL PRICES, 1973-80

	1973	1974	1975	1976	1977	1978	1979	1980
US$ per barrel (official price for Saudi light)	2.70	9.76	10.72	11.51	12.40	12.70	17.26	28.67

Source: IMF International Financial Statistics.

3. David F.Lomax, "The Developing Countries Debt Crisis" (London 1986) p.p. 28-86.

The oil price increases could be regarded as the culmination of the inflationary a spiral of the end of the post war boom, having followed a sharp increase in commodity prices in the early 1970s. However, the increase in oil prices went well beyond the correction of any lagging of oil behind either the general level of OECD inflation or other commodity prices. Where previously the OPEC ~~inflation~~ countries had enough money from their oil exports to maintain their growth programmes, with overall control of the oil market moving with the major oil companies, in future the OPEC countries obtained a monopoly rent from the oil fields, and could build up their financial strength. Over the succeeding decade, the producing countries would obtain control over production and price in their own countries and use their resources and wealth to obtain a far stronger position in the world market.

As a consequence to this C-20 recommendation, a two year oil facility in 1974 was constituted to cater to the needs of the countries which had to cope with the problems due to the escalation of the costs of oil. Due to this facility concessionary assistance[4] was available to low-income developing countries that had been most seriously affected by the oil crisis.

The partial insulation whith was provided by the IMF under the oil facility and the subsidization of interest rates were significant changes in the relationship between

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4. GRAHAM BIRD, Resources Uses, and the conditionality Debate, quoted in Tony Killick (ed.), "The Quest for Economic stabilization (London 1984) p.148.

the I.M.F. and the developing countries.

Other institutional changes that were effected included the institution of Extended Fund facility (EFF) and the Trust Fund. In principle, the EFF enabled the fund's involvement with the formulation of economic policy in member countries as eariler the funds policy were more narrow confining itself to financial stabilization policies. The Extended Fund FAcilities explicity recognised the inherent structural misallocation of financial resources and came prominently to involve itself with the development policy. In the early 1970's there seemed to be a beginning of a reapprisal of the fund's involvement in economic stabilization. The outcome of this reapprisal, which was made more necessary by events in the 1970's was reflected by changes in policy, as regards both the contents of programmes and the period of repayment, that were made at the end of 1970s.

Previously the I.M.F. had tended to respond to pressures from developing countries by enlarging the range of its facilities rather than by changing its policy conditions. But one finds that in the late 1970s and early 1980s, there were some potentially significant changes in the form of legthening the possible programme period for stand bys of in the form of the 1970 review of the guidelines on conditionality. The lengthening of the programme period offered the countries the chance to pursue rather longer term balance of payments policies, and to supply as opposed to demand management.

The 1979 review of guidelines was an important landmark as regards the phenomen acceptance of the constraints that the developing countries were witnessing. A statement in the review that[5], the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the canks of their balance of payments problems have been frequently quoted as an important step towards the liberalization of the Fund's policy towards the developing countries. The review had also imphasized the need to encourage members to adopt corrective measures at an early stage in their balance of payments difficulties and recognized that in many cases a longer period of adjustment is required than normally associated with a standby arrangement.

However, in practical terms all these amendments were termed out to be merely theoretical underpinnings as the und still showed its preference to the shortrun programmes, with emphasis being placed on short term policies. fact some people analyzed that review , was in the main an attempt to codify and clarify, existing practicies, on conditionality than to break a new ground,

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5. Ibid, p.150.

and the reference to social and political factors had little discernible effect on actual lending policies. The fund retained its option concerning first, the need for countries to adjust irrespective of the origin of their balance of payments problems and second, what policies were generally speaking, most useful in bringing about such adjustment. The logic of a more supply oriented approach to adjustment was largely rejected by the Fund for a series of theoretical and operational reasons and sound demand management remained the central priece of the fund programmes: The general pattern of the use of fund credit by edeveloping countries has shown that the experience of drawing was different between oil exporting and non-oil-developing countries. While some have made frequent and large drawings others have had little or no recourse to the fund. During the mid 1970's, however, the majority of developing countries did draw on the fund, and 1976 was peak year for drawings. These fell in 1977 and 1978 before picking up again in 1979. By 1981 and 1982 total purchases had reached record levels. Prior to 1977 the developing countries of Latin America and Carribean had historically drawn most from the Fund but after 1976[6] drawings from developing countries in the Western hemsphere dropped dramatically By the end of 1979, of the 101 developing countries then belonging to the fund, 87 had made a drawing at some time. Drawings have however been heavily concentrated in a much narrower group of countries. The largest users by end-1979-India, Argentina, the

6. Ibid, p.153.

the P illipines, Chile and Pakistan - alone accounted for 29% of total drawings by due developing countries, the largest ten for 45% and the largest twenty for 62%. However, when drawings are expressed as a percent of quota, Nicaragua, the Phillipines, Jamaica, Sri Lanka, Sudan, Chile and Peru emerge as the largest users.

Developing countries and IMF Decision Making

A country's quota broadly determines its voting strength in the Fund has already been seen and the amount of fund credits for which it is eligible. There have been complaints that while developing countries, together comprise 86% of the total membership they command only 42% of the total votes, although industrial countries can respond by pointing out that it is overwhelmingly their currencies which used in the Fund's lending and that their share in total world trade is even more preponderant than their voting strength.

TABLE

QUOTAS, RATES AND TRADING SHARES OF I.M.F. MEMBERS

	No. of members	Quotas[a] SDR bn	Votes (% of total)	Share of [c] world exports 1981 (%)
Industrial	21	37.79	57.8	66.7
Oil Exporting Developing countries	12	6.65	11.6	14.9
Other developing Countries	113	16.78	30.6	17.2
Total	146	60.60	100.0	100.0

Source : Graham Bird, 'IMF and Least developing countries' (London 1978), p.103.

The quota system has been criticized on the following grounds by the developing countries :

1. The quota system is based on principles which do not take into account some important problems faced by developing countries, e.g. commodity concentrations in trade and instability of export earnings.

2. During the first half of the 1970s the ratio of quotas to imports declined by about 50 percent for the dev-loping countries while the rise in exports was inadequate to cover the large deficits that developing countries experience today. An increase in quota would have helped these countries to mitigate the incidence of deficits.

3. The quota system has failed to protect most of these countries from the severe effects of some exogenous shocks that they experience during the mid 1970s because of a quadrupling of oil prices and the system of repayment of credit to the I.M.F. is strictly related to the short-run objective of stabilizing the balance of payments rather than the long run aim of achieving growth objective.

4. Quotas should reflect the economic need for reserves by the member countries. In practice it reflects to a large degree the relative political bargaining power of the members of the fund. Besides, quotas are biased in favour of developed countries since they have large reserves and more convertible currencies.

5. Lastly, it is also argued that the balance of payments difficulties experienced by the developing countries are the result of domestic policies such as demand management, the IMF's policies for internal adjustments could be appropriate but in many cases these countries suffer from external disturbances e.g. a fall in external demand or a sudden fall in supply of major exports. Deflation under such conditions would increase costs substantially in these countries, but an increased quota will provide time long enough to wokr out the needed adjustments to overcome balance of payments deficits and the costs of deflation.

Uses of the IMF Facilities by Developing Countries:

1. The compensatory Financing Facility

Before its liberalization in 1966 only Brazil, Egypt and Sudan had made use of the C.F.F. following liberalization seven developing countries drew on the C.F.F. in 1967 but during the remainder of the decade the CFF was little used. IN 1976, following a further liberalization, there was a dramatic change, 37 developing countries drew a total of SDR 1863 m, giving an average drawing of SDR 50.1 m. As compared with the previous record year of 1972, the size of the average drawing more than doubled and the number of developing countries using the CFF almost quadrupled.

Following 1976, CFF drawings fell dramatically in 1977, but rose steadily during 1978-81. By April 1982 outstanding purchases for compensatory financing exceeded those under both the funds regular facilities and the unaugmented E.F.F.

2. The Buffer Stock Financing Facility:

Till April 1980 drawings by developing countries totaled a mere SDR 37m, and only ten developing countries had used it.

3. Oil Facility :

By contrast during its short existence, the OF was extensively used by developing countries. By the end of 1976, non-oil developing countries had drawn a total of SDR 3411 m under it.

4. The Extended Fund Facility :

The EFF was initially little used by developing countries. In 1975-79 there was total of only eleven drawings by eight countries, totalling SDR 605 m. However, after 1979 the EFF, augmented by resources from the SFF and EAP, became much more heavily used. From amongst those negotiated between 1975 and 1982 the Indian EFF of November 1981 has attracted most natoriety and generated greatest interest and discussion.

5. The Trust Fund :

Established in 1976 the Trust fund was terminated in 1981

TABLE 3

USE OF FUND RESOURCES BY NON-OIL DEVELOPING COUNTRIES

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Total purchases	475.5	823.7	410.1	1440.5	2474.5	3835.0	1035.2	1210.7	1769.9	3752.7	7081.7
Reserve tranche	98.5	178.2	68.2	329.1	359.1	212.5	30.7	100.6	98.0	359.1	310.4
Comp. Finance export shortfalls	69.5	299.5	113.5	107.2	188.5	1803.1	240.5	479.0	572.0	980.4	1230.5
Comp. finance cereal import excesses	-	-	-	-	-	-	-	-	-	-	-
Buffer Stock	1.8	6.4	-	-	4.7	-	-	36.1	13.9	-	-
Oil Facility	-	-	-	939.7	1579.4	891.8	-	-	-	-	-
Credit Tranche ordinary resources	295.8	339.6	228.5	564.6	335.2	777.6	553.3	421.0	647.7	855.5	1662.2
Credit Tranche SFF	-	-	-	-	-	-	-	-	205.4	443.1	1468.9
Credit Tranche EAF	-	-	-	-	-	-	-	-	-	-	305.5
Extended facility ordinary resources	-	-	-	-	7.7	90.0	208.8	174.0	131.5	339.3	1040.8
Extended facility SFF	-	-	-	-	-	-	-	-	101.5	275.2	570.8
Extended facility EAR	-	-	-	-	-	-	-	-	-	-	480.6
Gold distribution	-	-	-	-	-	-	97.5	55.4	60.3	4.0	-
Total repurchases	432.1	502.5	488.3	449.0	515.9	871.9	1293.1	1997.8	1710.6	1906.4	1611.7
Repurchases of purchases	426.8	4984.6	475.0	433.7	399.5	865.8	1290.6	1989.4	1612.5	1860.0	1592.5

Source : IMF (International Financial Statistics), Supplement 1982.

having provided grants totalling $ 1.3 billion to 104 developing countries and concessioned balance of payments loans totalling $ 3.7 billion to 55 eligible developing countries.

DEVELOPING COUNTRIES & COMMERCIAL BANKS AND THE IMF.

A major issue facing the I.M.F. was the conditions under which assistance should be given to developing countries. Throughout most of the 1970s it was the IMF view that the main objective[7] should be to help in the financing of the OPEC countries, surpluses. It was a persistent theme of the committee of twenty four and the development committee of the world bank that I.M.F. conditionality should be eased. Nevertheless, a change of emphasis occured, reported after the interim committee meeting of the I.M.F. held in Gabon in May 1981, when more traditional views of conditionality were re-adopted by the I.M.F. The IMF has since then maintained remarkably firmly its views that economic programmes should include adjustment, despite the emotional and political pressures at the peak of the world debt crisis that the objective should be to assist the developing countries with easy terms, rather than to insist upon full adjustment. Critics of fund programmes of conditionality offer several arguments. A major one is that by expecting developing countries to deflate, the IMF is creating a deflationary bias in the world economy, and making the adjustment process cumulatively worse. A second criticism is that deflationary adjustment programmes put great political pressure on the governments, of developing countries. Third, it is argued that by exhorting full adjustment, the IMF is curtailing the growth of the developing

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7. David F. Lomax, "The Developing countries debt Crisis" (London 1986), p.239.

countries and damaging impact upon the welfare of their people.

The relationship between the I.M.F. and the private sector[8] has attracted much attention in the period since 1973-74 6il crisis as the commercial banks have become heavily involved in providing balance of payments finance to developing countries. By the end of 1981, the IMF and private banks were essentially involved in different countries with the fund doing most of its lending to countries deemed as credit worthy by the banks. In 1982-83 the situation further changed as a number of the larger developing countries particularly Mexico, Argentina and Brazil which had previously been reliant on private capital encountered debt problems which forced them to turn to the Fund, an option that they had util often stoutily resisted.The developing countries have not favoured going to the I.M.F. to avoid the conditionality,[9] but they have encountered problems as they have been facing the debt burden and the commercial banks have refused to fund them in the absence of any guaranteed mechanism, wherein they could be sure of the country's credit worthiness. During the oil crisis many non-oil developing countries went heavily in favour of commercial lending, as it was easily in favour of commercial lending, because it was easily negotiable and the benefits which accured to them in the form of adjustment costs were thereby avoided. Commercial borrowing performed

8. Graham Bird, "The International Monetary System and the Less Developed Countries", (London 1978), p.210.

9. Ibid, p.218.

a useful function in unabling growth to be maintained even in the face of large payments deficits. The commercial borrowing has had its problems, for instance only high and middle-income developing countries have been able to get these credits, the low. income developing countries have not received loans as their creditworthiness was not sound.

The expansion in the Fund's financial operations has been matched by the much greater emphasis on conditional financing. In other words, the resources of the fund are now to be utilized for objectives which increase production and help in earning foreign exchange so that borrowing members have to follow appropriate adjustment policies. The ultimate aim of the fund[10] programme is to set the right framework or restoring viable external payments positions and sustainable growth.

ASSESSMENT OF THE I.M.F.'s ROLE IN ASSISTING THE DEVELOPING COUNTRIES

The task of assessing the impact of the fund programmes is by no means straight forward. There seems to be agreement between the Fund's critics and defenders that its programmes have major effects on the economics of developing countries concerned, the disagreemtn being about whether the net sum of these effects is harmful or beneficial. The biggest source of dispute between the I.M.F. and the developing countries

10. K.K. Sharma, "The International Monetary System" (New Delhi, 1983), p.113.

has been the issue of conditionality. The chief components of conditionality attached to a fund stabilisation programme can be broken down into : (a) Precondition, (b) Performance criteria, (c) Other measures written into the letter of intent. There are good reasons why conditionality is attached to some forms of I.M.F. financial[11] assistance to member countries. One such reason is derived from the traditional requirements of sound banking practice according to which lenders of the Fund generally ensure that borrowers are in a position to repay loans. Until the mid 1970s the IMF tended to respond to pressures from developing countries by enlarging the range of its facilities rather than by changing its policy conditions. In the late 1970s and early 1980s, however, potentially significant changes have taken place in the form of lengthening the possible period of repayment for both stand bys and extended facility drawings, and in the form of 1979 Review guidelines on conditionality. The lengthening of the repayment period may enable countries to pursue a long term balance of payments policies and this may allow the Fund to put greater emphasis on structurally oriented policies,and on supply, as opposed to demand management. While the 1979 review of guidelines on conditionality endorses the Fund's belief in conditionality, it includes changes from the previous position. First the Review encourages countries to turn to the Fund at an early stage of their balance of payments difficulties as a precaution against the emergence of such difficulties.

11, Wilfred L. David, "The I.M.F. Policy Paradigm" (New York 1985), p. 19.

"Conditionality" is the term given to the conditions generally relating to macro-economic policies-which countries have to meet to qualify for international[12] loans. During late 1970s and early 1980's conditionality has become very much important for economic policy making in the developing countries, being a critical and often dominant factor in about two thirds of countries in sub-SAHARAN Africa and Latin America; and indirectly infulencing policies in many other countries. Since conditionality has so much influence on international financial loans and third world policy making, it is vital to assess whether this influence hasbeen exerted in the best interest of the individual countries, and also of the world economy. IN the early 1970s the use of the low conditionality played more preponderant role but in the early eighties and later on most of the developing countries have resorted to the high conditionality resources. Before the 1979 Review guidelines on conditionality, middle and higher developing countries approached the Fund only when their economic situation deteriorated considerably to crisis proportions,[13] and when their credit worthiness was seriously threatened here the fund came to play a crucial role as the lender of the first and last resort by supporting the private sector. Some of the important criticism relating to the conditionality guideline is that it has put too much emphasis on internal adjustment in a

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12. Frances, Stewart, "Should conditionality Change?" quoted in Kjell & Havnevik (ed.), "The IMF and the World Bank in Africa" (Sweden 1987) p.30.

13. Granambird, "Relationshiops and resources used " quoted in Tony, Killick(ed.), The Quest for economic stabilisation (London, 1984) p.170.

demand deflation[14] as a means of obtaining balance of payments equilibrium, and too little on development. The experts from the developing countries contend that severe payments difficulties have been caused primarily by external factors rather by domestic mismanagement. The developing countries also contend thatthe Fund's policies show little appreciation of the structural inflexibilities which exists in many developing countries and of the political and social consequences of the policies advocated. They also argue that the Fund should be broader in outlook than only to confine itself to overseeing the repayment of the I.M.F. loan.

The high conditionality credits are typically provided under short term standby arrangements, with an average repayment period of 12-18 months, but sometimes with extensions upto three years. Borrowing under the standby arrangement guarantees that borrowing member an assured line of credit for a certain period of time. Drawings take the form of a series of installments, with their release dependent on the observance of certain "performance criteria", These performance criteria tend to be quiet harsh and are based on both qualitative and quantitative, indicators.

The quantitative performance criteria are usually implemented through agreements with borrowing member countries. In this case the borrowing member must agree: (1) to eliminate budget

14. Ibid., p.170.

deficits by reducing government expenditure, eliminating government subsidies, and or by increasing taxes and (2) to reduce government borrowing from the central bank, place ceiling on external borrowing increase interest rates, and adjust the exchange rate. The qualitative criteria are designed to measure the extent to which the adjustment and stabilization programmes are being satisfactorily implemented. A qualitative criterion is that the countries should avoid exchange rate restrictions as a means of solving balance of payments problems.

In addition the developing countries claim that their balance of payments problem are more structural ordained than a cause of the economic mismanagement, they see inflation as a recurrent cycle which is induced due to the short term bottlenecks. If developing countries export goods with low price and income elasticities; but import goods for which their own income elasticities are high, then economic growth is liable to be inconsistent with balance of payments equilibrium. Dependence on markets in industrial countries makes variations in the level of economic activity in these countries a potentially important source of short run price and income instability in developing countries. The focus of their exports are[15] primary commodities which are prone to unceasing price fluctuations in the world market. The critics of the Fund also say that the liberalization which is generally emphasized by the Fund

15. Graham Bird, "International Monetary System and the Less Developing Countries, (London 1977), p.65.

might impede the growth of indigenous manufacturing which may have difficulty in competing with foreign producers who because of their larger scale, have lower unit costs. Similary, they contend that exhortation for abandoning multiple exchange rate regimes does not enable them to avail the gains by discriminating between various imports and exports. Critics maintain that wherever multiple exchange practices have been abandoned under the insistence of the Fund, the alternative measures designed to achieve the same ends have been inferior. According to some observers trade liberalization and demand deflation have generated other undesirable consequences. These include a takeover of domestic production by foreign owned multinationals, a simultaneously cost inflationary and demand deflationary situation steeming from an attempt to balance the budget by raising the price of public utility goods and services: an increase in debt service payments arising from the foreign borrowing undertaken to fill the foreign-exchange gap created by liberalization; and the increased importation of non-essentials. It is claimed that the developing countries lost more than they have gained. Even when the governments have accepted the Fund's conditionality, their enthusiasm, to pursue the stated objectives of the conditionality have not been encouraging, since they are very unpopular in their countries.

for instance the cut in the food subsidies often clearly exhorted by the Fund to the governments can not but cause the overthrow of the government. Similarly the pruning of the welfare programmes in the villages, where the government has been spending unceasingly cannot but cause resentment among the masses. Some other criticisms which have been levelled against the Fund is that it has been used as an instrument by the developed nations to impose their own interests under the garb of conditionality. Sometimes, tensions have arisen between the Fund and some developing countries who claim that the Fund has launched an orchestrated campaign to deflect these countries from the path of socialism.[16]

Criticis of the Fund also maintain that the Fund's Programme s have been characterized as a means by which western capitalist economics endeavour to bring about the downfall of developing governments to which they are opposed. Despite all these criticisms the Fund has made a significant contribution towards helping countries to correct balance of payments deficits efficiently by providing temporary financial assistance, policy adivse and incentives. Fund's assistance of crucial points have avoided the impending crisis faced by the developing countries in the

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16. Graham Bird, "Relations and Resources uses" quoted in Tony Killick (ed.),"The Quest for economic stabilisation (London 1984),p.173.

economic front. Fund is not a development institution and that it should not, therefore, provide soft aid. ON a semi-permanent basis. Development is the principal concern of the Fund's sister institution, the world bank and its affiliates. Fund has helped the developing countries in its range of specialized facilites[17] which have often been primarily of relevance to developing countries as well as through ecouraging the growth of world trade. Defenders of the fund also claim that fund is a flexible, Edectic and rather openminded instititurion.

The criticism that the Fund opts for overly tough measures often results, so defenders claim, from the fact that countries only turn to the Fund at a late stage in their difficulties when the situation has reached crisis propertions. Further more given, that in such circumstances quick results are required, it is easier to produce these by reducing demand then by increasing supply.

The recapturatebriefly, changes are needed in conditionality because in recent years conditionality has been accompanised by falling per capita incomes, rising unemployment and impoverishment, falling welfare of vulnerable groups, including especially the children of the poorest 40 percentage of the population, and reduced growth prospects, as growth in physical and human capital has been slowed or reversed.

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17. Ibid., p.125.

The conditionality guidelines have pushed the African economy into a further dependency[18] of the primary commodities. The conditionality guidelines must be restructed and suitably oriented in a manner wherein they are instrumental in reducing the imbalances, while maintaining the incomes of the poorest, protecting social welfare, and promoting the conditions for medium term growth.

Conditionality cannot be defined independently of the international environment. The conditonality guidelines have to takeinto account the country specific problems, relating to the economic, political and social realities. The tendency of homogenization and the principle of uniformity[19] of treatment may prove to be counter productive for the developing countries.

It is claimed by the IMF in helping members to design adjustment programmes, the Fund will pay regard to the domestic social and political objectives, the economic priorities, and circumstances of members, including the cuases of their balance of payments problems"[20]. However, while there is a recognition of the need to the strike a delicate belance between uniformity of treatment and flexibility, the evidence suggests that, in the majority of cases, the uniformity principle is more closely adhered to. As a result, they has been standing criticism of the Fund for 'policy homogenization'

18. Wilfred L. David, "The IMF Policy Baradigm?" (New York 1985), p.25.

19. IMF, Annual Report, 1979.

20. Ibid., p.45.

across countries, irrespective of the their individual economic circumstances.

Thus it becomes pertinent that to make the guidelines on conditionality more effective in promoting the cause of the vulnerable countries, it should adhere to the following principles.

There is a need for the IMF, to be more open and less dogmatic about its views regarding the underlying philosophy of the workings of the economy, causal mechanisms and consequently the desirability of particular policy instruments and institutions.[21] The IMF should incorporate the social and political realities into the design of programes. Then the timing of adjustment programme should be more gradual, when also requires more medium term finance. For instence, sub-Sahran Africa the present conditionality is more focussed on agriculture, and is broadly deindustrializing Here one has to take note that the industrial sector has to play an important role in providing simple consumption and investment goods for domestic use, the prolonged dependence on agriculture, might lead to stagnation in the economic front in the long run.

Modalities of arriving at conditionality:

Smaller countries often have problem due to the confrontationists attitudes of the Fund in imposing the conditionality clauses. Since these countries lack skilled and trained staff which can be handy while negotiating with the Fund's officials, these countries have most of the times been on the receiving end. The government officials from these countries are unable to provide the much needed

21. Frances Stewart, "Should conditionality change?" quotedin KGELL G. HAVNEVIK (ed.) "The IMF and the World Bank in Africa", (Sweden, 1987) p.36.

intellectual muscle. These countries also lack political bargaining power, Therefore they have to settle down for the undesirable conditionality guidelines. Therefore, to obviate the dire consequences of undesirable guidelines there should be some changes, e.g. the government should be allowed to devise their own adjustment package. Some collective discussion[22] among recipient governments should be initiated, where experiences and ideas can be exchanged and joint positions considered. The other major defect of present negotiations is that they are almost entirely confined to officials from the central bank and finance ministry, on the part of governments, and to the Fund on the part of the international community, Naturaly, then, economic growth and social welfare tends to be neglected, and financial stability to be given precedences. This will persist unless representatives of social welfare and others interests are incorporated into design and negotiation of programmes. On the side of governments this requires that ministeries of planning and develppment and representatives fo ministries econcerned with education, health and nutrition are involved, with a similar widening on the international side. So long as program design, negotiations and monitoring are confined to the financial institutions, the present type of conditonality is unlikely to change.

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22. Ibid., p.43

Conclusion:

Conditionality has two elements. One is the desire of creditors to ensure repayment, which is an unavoidable aspect of any lending. Second element in the conditionality is the desire by creditor countries to impose their own vision of the world on recipients. As we have seen, the I.M.F. style conditionality, which has influence well beyond the actual flows of finance that go directly through the I.M.F., largely reflects the industrialized capitalist country's vision of the world.

This vision essentially rests on the belief that market forces alone, with major impetus ~~coming~~ from the private sector are sufficient to bring about adjustment and ensure the generation of foreign exchange to meet repayment obligations. An analytical study does reveal that the Fund without doubt favours market related solutions as the more efficient means of correcting deficits, and is not narrowly against the fund has been dominated by the powerful developed countries. This domination has not prevented significant modifications from being made over the years that have been of direct benefit to least developing countries, e.g. The review of guidelines on conditionality in 1979.

CHAPTER - V

INDIA AND THE INTERNATIONAL MONETARY FUND(1970-1983)

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India had been one of the few countries among the colonies which participated in the Brettonwoods conference. India took active participation and sought to direct the Funds objective to provide for special attention to the development problems of developing countries. For instance, in drafting the Articles of Agreement of the IMF, India, in particular, pushed hard for some appropriate[1] reference to developing countries. To some extent the final version of Article 1, section (ii), was a compromise between the United States, which was particularly opposed to any direct reference to Developing, countries, and India. The Articles of Agreement did not make any distinction between develop and less developed countries, but there was a direct reference to development. India was an important country in the decision making position, being fifth largest quota holder. However, she lost her position when the quotas were revised.

India's dealings with the I.M.F. came to the forefront during the mid Sixties when she brougt loans from the I.M.F. The International Monetary Fund and the World Bank insisted upon devaluation as a prerequisite for the restoration of foreign capital inflow into India which had been interrupted by the outbreak of the Indio-Pakistani conflict in 1965.

1. GRAHAM BIRD, "The International Monetary System and the Less Developed Countries" (London 1978) P.17

The devaluation was announced on June 6, 1966. The ext-tent of devaluation was 36.5 percent on the existing parity. The incidence of foreign debts in terms of the Rupee went up as a Consequence. The rise in import price gave a boost to inflationary forces working inside the country. The devaluation was, infact, rendered partly ineffective by the post devaluation price increase. This loan had created considerable amount of controversies, firstly, because the devaluation was undetaken at the suggestion of the IMF and second it was argued that the devaluation would be ineffective because of inadequate elasticities of exports and imports of India.

India began borrowing from the I.M.F. in the early 70's. India withdrew Rs 485 crores from the IMF under the gold tranche, first credit tranche and drawing under the 1974 oil facility. This was due to the pressure on the reserves as a result of large outlays for imports of food, fuel and fertilizers. The pressure continued in the early years of 1975-76. India, therefore had to draw from the Fund in August 1975 an amount equivalent to Rs. 207 crores under the 1975 oil facility.[2] The impending oil crisis after Yom kippur war, when most of the gulf countries increased the prices of the oil manifold, caused adverse balance of payments problem for the developing countries like India.

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2. I.M.F. Survey, IMF 10 August, 1975, p.86

India's balance of payments position improved. This is reflected in the rise of exchange reserves at the end of June 1976 when they stood at Rs. 1751 Crores. At this level there was a rise of Rs.259 crores in the first quarter of 1976-77, despite the payment of Rs.65 crores in April 1976 towards the repurchase of the drawing made in February 1974 under the compensatory financing facility. The rise in the exchange reserves to Rs.2863 crores at the end of March 1977 represented an unprecedented rise of about Rs. 1371 crores from the Rs.1492 crores at the end of March 1976.

The following Table I shows India's borrowings from the I.M.F. repurcheases, outstanding debts:

TABLE I

Items	1970-71	71-72	72-73	73-74	74-75	75-76	76-77	77-78	78-79	79-80	80-81
1. India's borrowing from I.M.F. (i) Drawing	-	-	-	62	485	207	-	-	-	-	272+537= 809 Trust Fund
(ii). Repurchases	154	-	-	-	-	-	303	244	207	55	-
(iii). Outstanding debts	-	-	-	62	547	754	451	207	-	-	-
2. Share of non Oil developing countries in fund credit	206	53.5	90.1	98.1	61.1	55.6	54.8	80.6	60.07	9.2	100.00

Sources:- Government of India, Economics Survey 1981-82, p.45.

This improvement did not last long. The India's Balance of payments position during the 1977-78 -1980 - 81 worsened due to the import liberalisation polices introduced by the Government.

It was further aggravated in 1970-80 and 1981-81 when oil prices were further hiked by the OPEC countries. Coupled with this the problem of agitation in the state of Assam for a long period also had impacts on domestic production of petroleum. Between 1977-78 and 1978-79 domestic production of Petroleum (crude) increased from 10.7 million tonnes to 11.6 million tonnes (i.e. an increase of 8.4 percent) but in the following year 1979-80, it just rose to 11.8 million tonnes.- a rise or 1.7 percent and in 1980-81, it suffered a decline by 11.1 percent and was around 10.5., as shown in the table II given below.

Table II

PRODUCTION OF CRUDE PETROLEUM IN INDIA

Year	Production (Mnt.)	Percent increase over the previous year
1977-78	10.7	-
1978-79	11.6	8.4
1979-80	11.8	1.4
1980-81	10.5	-11.1

Source: Government of India, Economic Survey, 1981-82.p.53

The price of Imillion tonne of crude production is around Rs.1,000 crores. and the Assam crisis has further increased the petroleum imports to Rs.51386 crores in 1980-81. This caused the exchange crisis which emerged as a major constraint on India's Economic growth.

The Table III lists the foreing exchange reserves of India They were rising from 1976-79 mainly as a result of increased remmitances from Indian's working overseas in response to the oil price induced investment and construction boom in the gulf countries, which increased exports from India and suspension of food imports into India following the green revolution. But the trend has reversed after 1979.

TABLE III

FOREIGN EXCHANGE RESERVES OF INDIA

Year	Rs.in crores	U.S.Dollars (Million)
31.March 1971	438	548
31.March1972	480	600
31.March 1973	479	599
31.March 1974	581	726
31.March 1975	610	762
31.March 1976	1432	1865
31.March 1977	2868	3579
31.March 1978	4800	1625
31.March 1979	5220	6526
31.March 1980	5164	6455
31.March 1981	4822	6028
31.August1981	3763	4704

Source : Government of India Economic Survey 1981-82.p.63

If the drawings of $1 billion from IMF in 1980 are excluded then the drop in reserves is even sharper The reserves as on 31 August 1981 , including the IMF drawings represent about three months import requirements, which although more comfortable than those of nineteen sixties, is potentially, not far from the anxiety zone.

EXTENDED FINANCIAL FACILITY (EFF) OF THE IMF AND INDIA

The sharp decline in the foreign exchange reserves made the government of India to consider the borrowing of a huge loan from the IMF under EFF scheme. This decision of the government of India has been one of the most controversial policies of the government of India.

When India approached the Fund, the USA was not in agreement with other members of the Fund to grant this loan, for it was feared by the U.S. as argued by the Wall street journal[3] that the bulk of these Funds will be spent on buying French Mirage. However when the decision was considered by the IMF the US requested to have abstained and later agreed with other members to grant this facility. The loan was sanctioned. Of the total loan of SDR 5 billion, SDR 0.9 billion is to be made available in the first year. SDR 1.8 billion in the second year, and SDR 2.3 billion in the third

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3. R.B.SAXENA, "IMF Loan to India, A study in Economic Diplomacy",(New Delhi, 1984) P.180

limiting the option of commercial borrowing and leanes India "tied clients".

x) The other binding clauses relates to the limit place on the contracting or guaranteeing of medium loans of maturity of less than 12 years in the Euro-market to 1.4 billion SDR. This restriction is for the first year and may continue every year. This excludes the Provisions for the two large projects in steel and electric power sectors, paradeep and Kudremukh. There will be further performance clauses for the period between July 1982, and June 1983 before the contracting of the second instalment and for the period from 1 July 1983 onwards for the contracting of the third instanment.

xi) Besides this loan also required continous consultation with the Fund on General economic policies, no imposition or intensification of restrictions on imports, for balance of payments reasons, no multiple currency practices and no new bilateral payment arrangements.

The loan came under severe criticism at home for two major reasons. First, it was considered that loan was not required for it was argued that the government of India had exaggerated the balance of payments crisis and infact wanted to increase imports, second, the loan under the EFF has conditionality which subjected economic policies of India to be monitored and directed by the I.M.F.

(iv) The upward revision of prices in agricultural and Key industrial fields.

v) Subsidies on Public foodgrains distribution and other items will be contained.

vi) A tight fiscal policy (which will have at least three components) will be followed namely.

a) Indirect taxes and price of Public goods and services will be raised.

b) Direct taxes will not be raised, to promote savings and encourage investment.

c) Public expenditure will be reduced.

vii) The pursuit of a realistic policy in regard to exchange rates will be ensured. This by implication means devaluation even though not immideately.

viii) A tight monetory policy will be pursued, which includes ceiling on total domestic credit and sub-ceiling on the net credit to the government. The ceiling is placed at 19.4 percent growth in 1981-82, for total domestic credit expansion by 26 march 1982, the total domestic credit should not exceed Rs.74,181 crores and the net credit to government Rs.30,981 crores. Togther, the total credit should not go up beyond 15.7 percent of the level in 1981-82 as compared to 1980-81 The IMF has specified that there will be a ceiling on non-concessional foreign loans, This tantaamounts to IMF's year. These years run from 1st July to 30th June. About 48 percent of the loan is to be provided from the ordinary resources of the IMF and the remaning 52 percent is to come from borrowed resources. The average interest chargeable on the entire three years loan package worked out at around 10.4 percent. The text of both the Indian governemnts, letters of intent requesting the loan and the IMF's confidential memorandum supporting that request have indicated the conditionality. These documents mere "leaked" by an executives director of the IMF from an unnamed third world country to a journalist N.Ram of the[4] Hindu who was capable of understanding their significance and he published large portion of the text, with his analysis in his newspaper.

The IMF has imposed the following conditionalities.

(i) Measures will be taken to encourage investments and production in the Private sector which encoppasses." steps excessive regulations and restrictions"

(ii) An export orientation will be given to international trade which would reverse the "direction of economic development and policies which made the domestic market more attractive than exports.

(iii) Import will be liberalized.

N.Ram's despatches are contained in <u>The Hindu,</u> 15-19 Oct, 1981.

The balance of payments crisis that India confronted during the Period 1979-81 was exaggerated as claimed by by some. Infact, the world Bank was of the opinion that India entered this adjustment Programme from much stronger position. Reserves were at record levels and there was a significant flow of concessional assistance in the pipeline. The debt service burden had fallen to its lowest level. Further the oil crisis was of short nature. However, the government of India had played up this deficit in the balance of payments. In fact the, IMF in its confidential memorandum had [5] acknowledged that oil import problems were transitory. It added that with the end in the agitation in Assam, the oil imports in volume terms would decline "By contrast there will be a step up in the growth of non-oil imports to 28 percent (17 percent in volume terms) from 14 percent in 1980/81. The principal factor contributing to this acceleration is the continuing, effect of import liberalization measures taken in earlier years, the more liberal import regime has made possible higher imports of steel , chemicals, and equipment to support economic expansion.

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5. Cheryl Payer, "The IMF and India", quoted in KJELL J. Havnevik(ed)," The IMF and the World Bank in Africa, (Sweden 1987) p.73.

One of the most important critics of the loan was the West Bengal Government which had arranged a conference of twenty three chosen economists in Calcutta who subjected the loan to numerous of criticisms and warned of the danger s of having this loan. The West Bengal government in its white paper titled,[6] The IMF Loan Facts and Issues, which contained an introduction by Dr.Ashok Mitra, then West Bengal Finance Minister, who appealed to the people and the parliament to annul the loan agreement. The white paper contained a number of commissioned articles by a group of economists supporting this stand point.

The various points of criticism that were levelled by these economists are as follows. Firstly,they asserted that before the loan was sanctioned, the Indian Public including the Indian Parliament had not been taken into confidence about the negotiations. They also voiced their apprehension that India's freedom in formulating its own independent fiscal and monetary policies would be seriously jeoparadized. Secondly they held that India's monetary and fiscal policies during the period of loan would be formulated not in New Delhi, but in Washington. They noted that acceptance of the loan would force the Indian government to give special priveleges to the private sector, including foreign investors, the imports substitution policies, so earnestly undertaken would have to be

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6. IMF Loan - Facts and issues," White paper, West Bengal Government 1981)

reversed. Thirdly the bilateral agreements with the socialist countries could not be undertaken without the prior clearance from the Fund. Fourthly the Fund would force the government to curtail food subsidies and the public distribution system. Finally they also asserted that liberal conditions for the use of foreign exchange would lead to a greater access to the multinational corporations in the Indian economy which would seriously jeoparadise the attempts made by indegenous entrepreneurs for the development of technology. They offered a remedy to the balance of payments deficits by saying that India could save Rs1000 crores annually by a substantial reduction in the consumption of petrolum and products and by other economies in the import bill.

There was also criticism levelled against the monetary and fiscal policy as stressed by IMF for India which will effect the poor by cutting down various welfare programmes, food subsidy etc. It is also feared that the ceiling on the bank credit would affect adversely the interests of the poor. The argument seems to be given the need to increase output and given also IMF's concern that the private sector should not be denied funds unduly, it may happen that the credit squeeze will affect the poorer borrowers from banks more than the richer ones.

In the non-plan expenditure containing , defence expenditure seems to be difficult. Therefore the axe might fall on food subsidies alone affecting the low income urran consumers because the Fund being anxious to promote exports may turn a blind eye to export subsidies.[7] Examining the arguments of the proponents and the critics of the I.M.F loan one comes to the conclusion that the major reason for the present ills has been the Financial indiscipline. It is most desirable that government should impose self discipline. But since it has never done so, take it as a second best choice that discipline should be enforced by the I.M.F.

Supporters of this loan which included Brahmananda[8] argued that conditionality clauses holds for all loans from the Fund other than tranche loans and the conditionality requirement is non-discriminatory. According to him conditionality requirement is natural because it is a safeguard against default in repayment of loan in stipulated period of time, ceiling on credit against possible expansion of money in large scale.

The governemnt's defence of the loan was embedded in the Finance minister's statement in Parliament where he

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7 .IMF Loan, Conditionality and Economics Sovereignty, Economic Times , 23 September, 1981.

8. P.R. Brahmanand, "IMF hoan and India's Economic Future (Bombay 1982) pp.18 - 64)

referred to Article IV which stated that India would have consultations with the IMF on all matters relating to the programme which the governemnt intended to follow.[9] However, India would adopt only such of the measures and policies and programmes as more consistent with its own policies approved by the Parliament. For example, he pointed out that the steep fall in the foreign exchange reserve accompanied by cutting down of imports of POL products would put the economy in distress. He also pointed out that the borrowings in the Euro currency market would be 8 percentage points more expensive than the fund loan. He ruled out the sale of gold from reserves.[10] The performance criteria according to him was no condition, considering the domestic fiscal situation. He pointed out that India was neither prevented from borrowing from the Euro-market on higher than 12 year terms and from IDA loans, nor was it prevented from bilateral agreements with socialist countries. He stated categorically that adjustment programme is fully in conformity with India's economic priorities, social and political objectives and its plan-frame. He is of the view that the consultation process in general was part of the obligation of every member of the IMF weather he was a borrower or not. The consulation referred to all economic matters but it did not bind the government in regard to policies

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9. FINANCIAL EXPRESS, 24 November 1981.

10. Ibid.

and programmes. The Finance Minister also ruled out any prospect of devaluation of rupee. Thus he argued that no compromise has been made on the sovereignty of the country by accepting loan from the I.M.F.

Proponents of the loan, seems to put a very optimistic picture. They not only welcomed the loan as a timely step to overcome balance of payments problem, but also conditionality clause as a very natural and normal phenomenon for a member country of the Fund. They were also of the view that the so called structural adjustment programme is in conformity with economic. Priorities, social and political objective and sixth plan frame and hence no compromise has been made while taking the loan from the I.M.F.

Accoridng to the critics of the loan if one analyzed the conditionality clauses closely then it can be reduced to the opening of the economy to imports and foreign investments and technological exploitation, which in a sophisticated language is called as collaboration. This is more favourable to the material interests of the countries which control the Fund. The ultimate beneficiaries of this liberalization programme exhorted by the Fund would actually be the wealtheir classes of India wo have become accustomed to imported consumer goods just as many of the industry/ies are dependent

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11. Financial ExPress, 24 Nov. 1981.

on imported consumer imputs and technology. Until there is a miraculous breakthrough in the exports, the government will have to face the ultimate burden of this loan and will have no room to maneuvre.

Implications of the loan to India:

The loan that India had taken from IMF have several implications. Firstly, the loan involved the repayment of the principal amount of the loan and the interest and amortisation payments. Against the gross amount of Rs. 5200 crores borrowed the net inflow available to India over the three years (after allowing for interest payments within this period) would amount to only Rs. 4810.92 crores. India would have to repay a total debt service amount of Rs.9261.58 crores in servicing the debt over the 12 year period beginning from 1982-83. Over the period the total interest liability on account of the I.M.F. loan amounted to Rs.4061.58 crores which worked out nearly to 78 percent of the originally contracted amount.

The debt service implications of the I.M.F. loan is as follows:

Total loan	:Rs.5200 crores
Interest charges	:Rs4061.58 crores
Total repayment	:Rs9261.58 crores

The dept service cost of this loan is very heavy and according to one estimate it is expected to go well beyond the danger level of 20 percent if the country drawn it fully.

The Indian Government did not avail of the last tranche of the loan, This was the result of excessive political pressure built at home while the IMF was pressurizing India to follow its prescriptions more rigorously. The government under Mrs. Indira Gandhi was unable to take this risk. Hence it did not draw the last tranche and gave the explanation that India had done so to enable developing countries to get more assistance from the IMF and India could tackle her balance of payment deficits from her own resources.

The loan undoubtedly created a burden on India's Payment without any enduring solution to its balance of payments problem.

CHAPTER - VI

CONCLUSION

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CONCLUSIONS

As we have seen that IMF was founded to maintain International Monetary Order and stability after the Second World War. The architects of this Institution wanted to avoid the pitfalls of the last experiments in the International Monetary Order e.g. the failure of the International Gold Standard and the experiences of the Great Depression in the 1930s.

The Pre-war world situation when the efforts to establish International Monetary Fund were on, U.S.A and Britain were successfull in pushing through certain provisions which safeguarded the predominance of these powers' interest in the IMF's decision making. The structure and organisation of the IMF, ensured that the developed nations by virtue of their quotas will be ruling the roost in determining the future course of the International Monetary Order.

In the initial years of its operations IMF, did not participate actively in helping the developing countries need for International Finance, rather it was pre-occupied with the task of helping the war torn economies of the European countries who came under the Marshall Plan.

It was during the 1970's that IMF increased its assistance to the developing couutries facing balance of payments problem. It introduced various lending facilities under which the developing countries could be provided assistance. This included the compensatory finance facility, which had special rules for countries suffering from a shortfall in export proceeds from primary commodities. This facility was available to all members suffering from this particular balance of payments problem besides the fund introduced a number of other outlets for lending in the eighties, e.g. buffer-stock facility, oil facility, extended facility and trust fund loan facility. Some of these outlets have become possible because of the resources placed at the disposal of the fund by some of the oil exporting countries. Since some of these loans are repayable over a longer term, the fund has the opportunity to extend the fund length of its lending operations which has been beneficial to the developing countries. In 1969, the first amendment was made by which SDRs were created to increase the International liquidity. The creation of SDRs was necessitated because it was felt that shortage of international liquidity was likely to arise because of the slow growth of gold reserves and the present international monetary system would not automatically provide the increased liquidity. Therefore, a need was felt for a new type of reserve and a solution of this problem was provided by refund drawing rights which was created in 1968 as a supplement to Gold and dollars.

Extended fund facility was one of the outlets which was introduced by the IMF in the 1980's under this facility the fund assists those members whose economies suffer from serious balance of payments difficulties resulting from strucrual imbalances in production trade. Prices and an inherently week balance of payments position. The Funds under this scheme are made available in large amounts, sequentially for longer periods and the repayment schedule can be spread over 7 to 10 years. India went for a loan of SDR 5 billion in 1981 with an average interest chargeable at 10.4 percent, The loan came under lot of criticism. One of the critics of this loan was, the West Bengal Govt, which had arranged a conference of twenty three economists at Calcutta, who subjected the loan to a lot of criticism. In the white paper titled IMF loan: facts and issues, they enumerates several points wherein they argued that India's balance of payments was not serious enough to warrant the resorting to such a big loan. Firstly, they argued that the acceptance of the loan would seriously jeopardize India's freedom in formulating its own independent fiscal and monetary policies. Secondly, they held that acceptance of the loan would force the Indian Government to give special privileges to the Private Sector, including foreign investors, the import substitution policies, so earnestly undertaken would have to be reversed. Third, the bilateral agreements with the Socialist countries could not be undertaken wityout the prior clearance from the Fund. Fourth, the Fund would force the government to curtail food subsidies and the public distribution system. Finally, they also asserted that liberal conditions for the use of foreign exchange would lead to a greater access to the multinational corporations in the Indian Economy which would seriously jeopardize the attempts made by indigenous entrepreneurs for the development of technology they offered a remedy for the balance of payments deficits by savying that India could save 1000 crores annually by a substantial reduction in the consumption of petroleum products and by other economics.

Proponnents argued that loan was timely step to overcome balance of payments problem, but also conditionality clauses as a very natural and normal phenomenon, for a member country of the Fund. They also propounded that the so-called structural adjustment programme is in conformity with economic priorities, social and political objectives, of the Sixth Plan frame and hence no compromise has been made while taking the loan. Due to the intense public pressure at home the government annuled the borrowing of the last tranche of the loan. The loan created a burden on India's payments without bringing any enduring solution to the problem.

The relationship between IMF and the Developing countries has rather been more hostile than cooperative. This hostility arises due to their grievances relating to the conditionality clauses. The IMF's prescriptions relating to conditionality clauses have not been appreciated by the developing countries. They have complained that IMF has shown little concern to their specific problems while arriving at the conditionality. They also harbour the opinion that the Fund's programmes have been characterised as a means by which Western Capitalist economics endeavour to bring about the down fall of developing countries governments, to which they are opposed. They also say that IMF has become a willing-tool in the hands of the Developed nations through which they are trying to impose their capitalistic vision on the economics of the developing countries.

Despite all these criticisms the Fund has made a significant contribution towards helping countries to correct balance of payment deficits efficiently by providing temporary financial assistance, policy advice and incentives. Fund's assistance at crucial points have avoided the impending crisis faced by the developing countries in the economic front.

As regarding the issue of conditionality, it becomes pertinent that the conditionality guidelines should be made more effective, by making it more flexible and also the conditionality guidelines which are imposed, should take into account the country specific problems of the developing countries. The timing of adjustment programme should be more gradual, which also requires more medium term finance to the developing country members.

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