# Shaktikanta Das: India’s relations with the International Monetary Fund

Remarks by Mr Shaktikanta Das, Governor of the Reserve Bank of India, at the Release of Shri V. Srinivas’s book on "India’s Relations with the International Monetary Fund: 25 Years in Perspective 1991-2016", New Delhi, 26 July 2019.

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I am delighted to be part of this event for the launch of Shri V. Srinivas’s book on “India’s Relations with the International Monetary Fund”. A respected civil servant of the 1989 batch, he has drawn extensively on his hands-on stint as Advisor to the Executive Director for India at the IMF during 2003–06, combining it with his scholarship and experience in policy making. The book and the function today will promote readership on an important subject and spur more thoughts and analysis. As you are aware, RBI as an institution is closely involved with the functioning of the IMF both to project our Macro economic interests as well as from the angle of governance of the IMF.

2. Against the backdrop of previous Fund programs with India in 1966 and 1981, the book trains its focus on perhaps the most eventful period of India’s engagement with the Fund, beginning with the balance of payments crisis of 1991 and covering the period up to 2016 that brings to the fore the dramatic transition in India’s status with the IMF from a debtor to a creditor. In the same period, the Indian economy also witnessed a transformation from an inward-looking economy driven by import substitution to an increasingly open and emerging global power in a dynamic world order. This period also witnessed the transformation of the Fund from a stigmatised lender of last resort focused exclusively on exchange rate surveillance towards a more central role in the international monetary system after the global financial crisis. Over this period, the Fund has not only focussed on macroeconomic policies but embraced a wider gamut of issues that covered women’s empowerment, poverty alleviation, sustainable development, fintech and climate change. As Dr Y.V.Reddy has stated in his Foreword to the book : “The book fills a serious gap in the existing literature on the subject….”. I congratulate Srinivas for his scholarly contribution in writing this book.

3. I thought I would take this opportunity to share some of my own thoughts on the Fund and its role in the international monetary system, drawing on my experiences, including as G20 Sherpa and now as Alternate to the Finance Minister in the Board of Governors of the Fund. Speaking on the sidelines of the Fund-Bank spring meeting in April this year, I had alluded to labels such as “currency manipulation” and called for greater understanding all around, to the compulsions of Emerging Market Economies (EMEs) in building up their own buffers. I would like to point out that the origin of the phrase ‘currency manipulation’ itself is of recent vintage, dating to 2015, when the US Treasury started publishing a semi-annual report on the subject. In this backdrop, it has acquired a predominantly bilateral connotation. Currently, the semi-annual Report judges countries as currency manipulators on the basis of three criteria: (i) a bilateral trade surplus with the US of at least US $ 20 billion; (ii) a material current account surplus of at least 2 per cent of GDP; and (iii) persistent one-sided net purchases in 6 out of 12 months adding to at least 2 per cent of an economy’s GDP over a 12-month period. A country is put on the monitoring list even if two out of the three criteria are met. India was recently removed from that list after featuring in it from 2018. In the more recent period, the term has gained greater focus in the heat and dust of trade wars.

4. A question that crops up is why has labelling become a bilateral prerogative when a multilateral institutional architecture exists for the purpose? After all, Article IV, Section 3 (a) of the Articles of Agreement that established the Fund, invests it with the oversight of the international monetary system. Article IV, section 1(iii) enjoins each member country to avoid manipulating exchange rates to gain unfair competitive advantage. Article VIII, Section 3 obligates members and their

fiscal agents not to engage in discriminatory currency arrangements or Multiple Currency Practices (MCPs) unless they are approved by the Fund or maintained under Article XIV, Section 2.3. The application of the MCP concept has been reasonably considered, explained and applied by the Fund with suitable changes carried out when needed.

5. After the collapse of the Bretton Woods system of fixed exchange rates and the eventual floating of currencies from 1973, the second amendment of the Fund's Articles of Agreement in 1978 made its mandate more explicit by fixing its oversight over individual countries' exchange rate policies. The Fund's mandate was updated in 2007 to clarify that exchange rate manipulation was associated with 'fundamental misalignment' that results in external instability. Fears of labelling among the membership led to several reviews culminating in 2012 when an Integrated Surveillance Decision was adopted, which emphasised the connection between domestic and external stability as well as global risks and spillovers.

6. In pursuit of this mandate, the Fund, in its Article IV Consultations every year, undertakes in-depth assessment of members' economic developments and policies, including and especially exchange rate policies. This is backed by rigorous technical evaluation through a suite of models. The Consultations report is published and any case of exchange rate misalignment and/or multiple currency practices is candidly brought to the notice of national authorities for correction. This is mandatory, as the Articles of Agreement constitute an international treaty; and in India, they are underpinned by parliamentary legislation in the form of the International Monetary Fund and Bank Act, 1945. Given this multilateral framework, the overlay of bilateral labelling that I talked about earlier raises questions, including on the role of the Fund itself.

7. Admittedly, like any policy-making institution, the Fund's policies and practices will not always be the right or the best in terms of their efficacy. As its own Independent Evaluation Office (IEO) pointed out in 2005, a major reason for the Fund failing to meet its core responsibility of exchange rate surveillance was a strong sense among some member countries of a lack of even-handedness in surveillance – that somehow, it was tolerant of currency depreciations but not of countries resisting appreciation. This criticism by the IEO persists in its Evaluation Update of 2017. Notwithstanding such criticisms, the IMF is open to learning and deservedly remains a well-respected institution. We, therefore, look forward to engaging with the Fund on its April 2019 proposal for a more integrated framework encompassing the interaction of monetary, exchange rate, macro-prudential and capital flow management policies. I strongly believe that a multilateral framework under the aegis of the IMF is the most appropriate approach to deal with these issues.

8. It is important to appreciate the context in which EMEs operate so as to foster a shared understanding of their challenges. First, the nature of shocks which these countries face has changed from balance of payments strains to full-blown financial crises. Second, in the years following the global financial crisis, EMEs and financial markets have been buffeted by global spillovers which have amplified both sudden surges and sudden stops or reversals of capital flows. The existing state of financial safety nets, regional or multilateral, fall grossly short of providing the necessary buffers against such turbulence. Moreover, access to swaps from systemically important central banks is not available to the EMEs. For many EMEs, high fluctuations in currency movements have pronounced macroeconomic consequences. This is corroborated in a recently articulated view by Mark Carney, Governor, Bank of England that significant improvements in the institutional frameworks of EMEs are being offset by asymmetries in the international monetary system and market-driven finance.[1] Against this backdrop, these countries have accumulated reserves over the past two decades which has significantly reduced the sensitivity of capital flows to push factors. Governor Carney adds that this extra insurance, however, has come at a high cost for EMEs. In this context, I may mention that in spite of the insurance coming at a high cost, there is enough evidence to indicate that costs of financial crises have been very high in relation to costs of insurance. Thus, it is evident that build-up of reserves by EMEs, so far is not so much to prop up their currencies as to self-insure themselves against global contagion.

9. How do we collectively ensure that multilateral principles and frameworks for orderly exchange rate and payment arrangements are not superseded by bilateral hegemony? The best way forward is to strengthen existing institutions like the Fund and make them more relevant and trusted. Through its Articles of Agreement, the Fund is a quota-based organisation, but quotas currently constitute only 49 per cent of its resources. At the height of the global financial crisis and in the years following it, the Fund activated borrowing arrangements such as the New Arrangements to Borrow (NAB) and the bilateral Note Purchase Agreements (NPAs), to which India also contributed. These borrowing arrangements are, however, intended to be temporary bridges. The solution lies in commitments of quota resources by members in order to secure the legitimacy of the Fund as a global lender of the last resort, the overseer of the international monetary system and a trusted policy advisor. This adds urgency to the completion of the 15th General Review of Quotas, delayed for the fourth year now.

10. The global order today faces several challenges that will test the skills of the international organizations as well as those of national monetary and fiscal authorities. International coordination has become somewhat weaker in the very recent years. Many advanced economies (AEs) have been pursuing low interest rate policies for long without perhaps adequate recognition of their adverse impacts. Today at the global level, the total amount of bonds with negative yields has risen to nearly $13 trillion; implying that nearly a third of AE government bonds trade at negative yields. Equity premium has crossed 4 per cent, which is 1 standard deviation higher than its long-term average. Return to lower interest rates in AEs poses challenges as leverage has already built up in the EMEs and the needed deleveraging is not complete in many European economies. Amid low global interest rates, total credit to the non-financial sector in the EMEs went up from 107.2 per cent of GDP at the end of 2008 to 194. 4 per cent of GDP by March 2018, before it dropped to 183.2 per cent at the end of 2018. Net private capital flows to EMEs in the form of direct and portfolio investments also nearly doubled in the post-crisis period. This has posed risks to some EMEs. Some of these risks have surfaced in form of weak bank/ non-bank balance sheets and some remain latent and can surface, especially when the global interest rate cycles turn decisively. The world will be looking to the IMF to suggest dependable solutions. EMEs on their part need to follow policies that promote macroeconomic and financial stability, while focussing on growth.

11. Solutions are turning more difficult to come by as the global economy seems to be moving into a new and unsettling phase in an environment of stressed trade negotiations, rising geopolitical confrontation, and limited policy space and high debt levels in several economies. General government debt of AEs as a group has surpassed 100 per cent of GDP. Fiscal space is also constrained in many of the advanced economies.

12. It is important in the backdrop of slowing global growth that policies of monetary and fiscal authorities are well-calibrated so that they support growth without further build-up of leverage and asset price bubbles. Prudent policies are critical to growth with macro-economic stability. Globally, we need to focus on policy space, judiciously use it and simultaneously undertake structural reforms to improve productivity, innovation and job creation. The coming year will test IMF for its policy advice in these areas. How the IMF and the central banks provide forward guidance will be key to sustaining global economic growth while maintaining financial stability.

13. I have highlighted a few concerns that have caused me to introspect considerably on the future of the global monetary and financial system, especially as we confront these challenges on a day-to-day basis at the RBI. A global search for effective solutions is underway. This quest must be armed with the lessons of history and experience, and in this context, I commend this book for your reading.

Thank you.

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[1] Carney, Mark (2019), "Pull, Push, Pipes: Sustainable Capital Flows for a New World Order", speech at the

Institute of International Finance Spring Membership Meeting, Tokyo, June 6