



Redrawing of International Financial Structure

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1 Need for Redrawing

- Need for the creation of new banks was felt because of the discriminatory attitude of the West towards the developing countries.
 - The BRICS member countries accounting for almost half of the world's population and about one-fifth of global economic output have only 11 per cent of the votes at international financial institutions like the IMF.
 - Both the WB and the IMF are based on weighted voting system, which provide the rich countries a big say in the management.
 - There are informal arrangements whereby an American is always at the top in the WB; while an European is in top position in IMF. In those monetary institutions, the developing countries don't have enough voting rights.
 - There have been instances of violation of their Articles of Agreement as per which political issues should not influence the lending policies. Eg- World Bank denied India fresh loans after India tested nuclear weapons in 1998.
 - The demand of investment in infrastructure in the emerging markets and developing countries is likely to increase to \$1.8-2.3 trillion per year by 2020. While IMF's funding is heavily conditioned, ADB has at its disposal only \$10 billion to lend for investment in infrastructure sector. India alone needs \$1 trillion to finance in infrastructure sector.

2 Proposed and Pending Reforms in Bretton Wood Twins

The emerging economies are fighting for a package of reforms that would

- Double the IMF's quota to \$720 billion

Shift six percentage points of total quota to developing countries.

- China would become the third largest quota-holder at the Fund (second only to the U.S. and Japan)
- Brazil, Russia, and India would become top-ten quota-holders as well
- Decrease USA voting power slightly but would still maintain its veto
- Move two of the 24 IMF directorships from European to developing countries

3 Creation of New Banks

3.1 New Development Bank (NDB)

- Opened by Brazil-Russia-India-China-South Africa (BRICS) as a channel of alternate finance to the emerging economies and the Global South.
- It will help signatory countries to raise and avail resources for their infrastructure and sustainable development projects.
- It is a landmark event in fiscal cooperation among the five emerging economies.
- It will be headquartered in Shanghai; First President is K V Kamath
- Unlike the World Bank, which assigns votes based on capital share, in the New Development Bank each participant country will be assigned one vote and none of the countries will have veto power.
- The BRICS countries have stressed that the NDB would not rival but complement the western backed International Monetary Fund (IMF) and the World Bank.

3.2 Asian Infrastructure Investment Bank (AIIB)

- Proposed by China, its purpose is to provide finance to infrastructure projects in the Asia-Pacific region.
- The authorised capital of AIIB will be \$100 billion; Headquarter is to be located in Beijing.
- China, India and Russia are the three largest shareholders.

- This is the first time that three out of five permanent members of the UN Security Council (China, UK and France) and four out of seven G7 members (UK, France, Germany and Italy) have defied the US in the setting up a new multilateral development bank.
- The voting shares are based on the size of each member country's economy and not contribution to the bank's authorised capital.
- The bank is likely to lend anywhere between \$10-15 billion a year during the first five-six years of its existence.
- The bank would target investments in "high-quality, low-cost" projects.
- The AIIB is expected to open a new channel of funding for the Global South, which was so far dependent on the western backed International Monetary Fund (IMF), the World Bank and the Asian Development Bank (ADB), in which Japan plays a pre-eminent role.
- It will focus on infrastructure development in Asia—a move that is likely to support the Eurasian connectivity initiative under the China-led Belt and Road framework.
- India will likely to be in the beneficiary of lending from the AIIB, especially in the power sector.
- Bridging the digital divide between the regional and global economies would be the bank's top priority in the future.
- Despite U.S. objections, European countries including Britain, France and Germany joined the AIIB. Australia and South Korea — top U.S. allies in the Asia-Pacific — also decided to participate in the development bank as its founding members.

4 Turning Point in International Financial Structure

- The establishment of the NDB and AIIB should serve as a wake-up call for the Western economic powers. The international financial architecture is at a turning point.
- The emergence of the NDB and the Asian Infrastructure Investment Bank (AIIB) was fastened by the reluctance by the West, especially the United States, since 2010 to grant emerging economies a greater say within the IMF.
- The primary issue for the US is decreased dominance of the IMF, World Bank and ADB if the AIIB and NDB grow in size over time.
- The **World Bank** and the **ADB** have flourished so long because they targeted their lending initially to larger creditworthy borrowers such as India and subsequently China. The poorest countries have mostly received concessional loans which are funded out of grants from developed countries.
- The World Bank and ADB now seem to be too driven by the sensibilities of **NGOs** in developed countries on sustainable development issues. Such considerations are not completely ignored by developing nations. However, they need avenues to fund projects in the hydroelectricity-irrigation, thermal and nuclear power sectors for their developmental growth. These fundings are unilaterally refused by existing multilateral development banks.
- The World Bank has moved far away from when it used to proactively fund long gestation infrastructure projects. Consequently, AIIB would try to step into that role.
- The AIIB & NDB will complement and reinforce each other. They would jointly contribute to infrastructure building of the developing countries and play their different role in this regard.
It is being called as a very positive development in the sense that it opens up more borrowing opportunities.
- However, like the insufficiency of funds with the ADB, the NDB and the AIIB may also suffer from resource crunch as they have too little capital to tackle infrastructure deficits and halt short-term liquidity pressures.
- Fears linger that China, second largest economy in the world could try to assert greater influence over the NDB and AIIB. China has larger percentage of share in total capital of NDB and 50 per cent share in AIIB.
- It is needed that no one country controls the lending and other operational activities of NDB and AIIB. It is only then that these financial institutions could have some role in improving global financial governance system.

5. India and latest quota reforms at IMF

- India's voting rights in IMF increase to 2.6 per cent from the current 2.3 per cent, and China's, to six per cent from 3.8, as per the new division.
- The reforms bring India and Brazil into the list of the top 10 members of IMF, along with the U.S, Japan, France, Germany, Italy, the United Kingdom, China and Russia.

5.1 Suggestions by India

- Mr Rajan, RBI Governor added his voice to the calls for an increase in the \$253 bn capital of the *International Bank for Reconstruction and Development*, the main arm of the World Bank, to fund the burgeoning infrastructure needs of emerging economies such as India.
- Mr Rajan also called for a “*global safety net*” backed by the IMF to provide support to economies that might experience liquidity crises in the future.
- Mr Rajan said one possibility was a *multilateral swap arrangement* among central banks — of the sort that already exists between the emerging Brics economies and in the \$50bn Japanese credit line for India, for example — guaranteed by the IMF.

Only time will tell how NDB and AIIB emerge as alternative source of funding in the international financial market. But it has almost become certain that the era of West's control over the international financial resources has started eroding.

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