

INTERNATIONAL MONETARY FUND

WORLD BANK GROUP

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL FINANCE CORPORATION

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Press Release No. 23

October 6 - 8, 1998

Statement by the Hon. **LESZEK BALCEROWICZ**,
Governor of the Fund for **POLAND**,
at the Joint Annual Discussion

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**Leszek Balcerowicz,
Deputy Prime Minister
Minister of Finance,
Poland**

Mr. Chairman, Ladies and Gentlemen,

Both, my own country, and the world economy have changed since I first spoke here at the outset of Poland's transformation in 1989. While I am proud to report to you that Poland remains firmly on the path of market-oriented reforms, macroeconomic stability and sustainable growth, the recent developments in the world economy present a more complex picture.

Economic turmoils often lead to intellectual confusion and false diagnoses, while they demand especially clear thinking.

Let me begin, therefore, with some clarifications:

- Lacking or insufficient controls on capital movements were not the primary reason for the present crisis in the affected countries. A simple comparison of these countries with those which have been resilient to the crisis reveals that the main reason for the differing performance is the quality of their macroeconomic, structural and institutional frameworks for decision making. Not increased controls but improvements of these frameworks through genuine reforms constitute therefore an appropriate response.
- Sudden outflows of short-term capital follow the periods of excessive inflows resulting from both imprudent lending and imprudent borrowing. The former points to the problems of decision making in large financial institutions, the latter reveals the deficiencies in countries' economic policy making.

I would thus be totally wrong if the present crisis was to weaken the commitment to the basic virtues of openness, prudence, and arm-length relationships between politics and the financial and corporate sectors. These virtues have been vindicated by the recent developments. No effort should be spared to prevent the reversal of the generally beneficial trend toward open market economy and orderly liberalization of factor movements.

Globalization should not be the whipping boy in the debate about the current crisis. Globalization rewards those with responsible economic policies but carries risks for countries which avoid or delay reforms and disregard basic requirements of macroeconomic discipline.

After these diagnostic observations let me move to the therapy. Two preliminary remarks are in order:

- First: one should distinguish between steps which are necessary to contain the present crisis, and measures aiming at prevention and containment of the future ones. These two sets of measures overlap to some extent but generally have very different time dimensions, with the former being obviously much more urgent. Also, while working on the containment of the present problems, one should not weaken and complicate the defenses against the future ones, e.g. through unconditional bail-outs of creditors or debtors.

- Second, factors which are given should be distinguished from those which can be treated as policy variables. The former include technological developments responsible for the speed of the short-term capital and the sheer side of these movements. There is no point in trying to control what is beyond anybody's control. In addition, these factors are not the primary reason for the present developments. It is not the mere speed and size of short-term capital but the policies of borrowers and lenders which are really relevant and should be changed, if necessary.

For the sake of brevity let me focus on the issue of how to reduce the probability of future crises. The required strategy includes steps which are also necessary to deal with the present problems. I have here in mind, first of all, the economic policies of major industrial countries. Large countries have large responsibilities not only for themselves but also for the world economy.

In thinking how to prevent the future financial crises I would mention two interacting mechanisms:

- First: better early warning systems that should be put at the disposal of governments, financial institutions and the public at large, and

- Second: measures to improve the quality of decisions made by the major players, e.g. national governments, private financial institutions and international financial organizations. The point here is how to ensure that sound policies are pursued and early warnings are not ignored.

Speaking about the first mechanism, I fully support efforts to enhance surveillance, increase transparency, improve data collection, elaborate and disseminate various standard and make broader use of precautionary arrangements. I am glad to observe that basically all of this is already the work in progress in the IMF. While improving the early warning systems we should know whether the present crisis in the affected countries resulted from the absence of early warnings or from early warnings which were sent but disregarded. It appears to me that the truth is closer to the second alternative. Whatever the exact response, the basic question for the future remains how to strengthen the foundations of policies which lead to sustained development and not to economic crises. It is basically a political question as behind policies is politics, and financial crises have, in most cases, political roots. A major lesson from the

present problems in the crisis stricken countries is that intimate links between politics, financial institutions and the corporate sector ultimately result in the mountains of bad debts and, as a result, in huge social costs. Also, one should think about constitutional arrangements which would limit fiscal deficits and the public debt. I am glad to inform you that such clauses already exist in the Polish Constitution which was adopted last year. Finally, strong prudential regulations and strong supervision in the financial sector are of utmost importance. This is the main response to the complexity of modern financial markets.

I have focused so far on how to make the domestic policies more responsible and efficient. But I also agree with those who see a potential problem in the behavior of private financial institutions on the lending side. Responsible decision making requires an adequate evaluation of potential risks, which, in turn, is inseparable from the penalties for the past mistakes.

Before concluding, I would like to make an official announcement that, I hope, should be well received by Mr. Camdessus. A week ago, on September 29, 1998 the Polish Government adopted the resolution approving the proposed increase of Poland's quota in the IMF. This decision can be seen as a proof that my country is prepared to fully discharge its obligations resulting from the IMF membership and that we share the assessment that an early replenishment of the Fund's financial resources has become a matter of operational necessity. Pending any possible modifications of its future role and functions, the Fund cannot be left without resources allowing this institution to fulfill its current mandate and to provide assistance to countries in need. I call on all member countries to proceed swiftly with the agreed quota increase and I urge the participating countries to speed up the adherence to the New Arrangements to Borrow. Poland is also ready to support the HIPC initiative by depositing, on very beneficial terms, our share in the SCA-2 refund. We have already initiated the internal legal procedures leading to the approval of the proposed Fourth Amendment of IMF's Articles of Agreement and I expect this process to be completed before year-end.

Thank you for your attention.