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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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Statement by the Hon. YASHWANT SINHA ,
Governor of the Fund and the Bank for INDIA,
at the Joint Annual Discussion

MR. YASHWANT SINHA,
MINISTER OF FINANCE, INDIA
October 7, 1998.

Mr. Chairman,

1. Let me join my fellow Governors in congratulating you on your taking over the chairmanship of the 1998 Annual Meetings.

2. Let me also take this opportunity to congratulate Michel Camdessus and James Wolfensohn for the tremendous efforts they are making, despite all odds, through the IMF and the World Bank during these trying times for the global economy.

3. This Annual Meeting of the World Bank Group and the International Monetary Fund is of crucial significance. It provides a timely forum for evolving a strategy to deal with the serious crisis confronting the world economy. Both the Fund and the Bank have responded with commendable speed to the Asian crisis. However, although more than year has now been spent on the struggle to achieve a turn around in the crisis-ridden economies there is, thus far, little ground for optimism. For the crisis-hit East Asian economies real GDP growth rates in 1998 are predicted to be negative, ranging between 5 and 6 percent in some countries to over 15 percent in the case of Indonesia. These economies will continue to incur massive social and economic costs in terms of lost output, rising unemployment and growing poverty. The social and economic stress on these countries is truly awesome. Moreover, entire regions of the world economy now appear vulnerable to significant risks and uncertainty arising from the contagion that seems to be spreading with every passing day. Economies hitherto deemed immune from the spillover of the crisis are no longer projecting reassuring robustness in their medium term economic prospects. In fact, we may be at the edge of a full-blown global recession.

4. The brute fact is that after five days of intense discussion and debate, we are still at a loss as to why contagion has continued to spread. Nor do we seem to have achieved clear, agreed and effective measures to contain the crisis, a crisis which has grown unrelentingly over 15 months. Mr. Chairman, I wonder if our apparent ineffectiveness in coping with this now global crisis could be due to the limitations of the Bretton Woods institutions in handling crises spawned by massive reversals of private capital flows in a highly integrated global capital market, where billions are transferred in an instant with a computer keystroke. The Bretton Woods institutions were created essentially for providing temporary balance of payments support by the Fund for current account imbalances, and long-term development financing by the Bank. Confronted by the new generation of crises impelled by massive volatility in the capital account, the systems and resources at the command of the Bretton Woods institutions have been found wanting.

5. Clearly, we must think afresh about the nature of the crisis and the appropriate measures for its containment. While the Fund and the Bank have responded with speed, the quality and content of the response needs sober review. In particular, we must think creatively to ensure

early and preemptive response to emerging crisis. We must also find ways to better reflect the political dimension of crisis management in the decision processes of the Bretton Woods institutions, especially since the enduring economic and social consequences of crisis pose severe challenges for political management.

6. On the other hand, the present crisis has also highlighted the need to maintain and, indeed strengthen, the capacities of the Fund and Bank to discharge their normal, traditional functions of temporary balance of payments support and long-term development financing. Much of the financial help mobilized by the Fund and Bank in the present crisis has effectively been by way of liquidity support with the objective of stemming financial panics. Given the unprecedented financial commitments made, economies that are presently outside the envelope of the contagion, have reason for feeling vulnerable if the situation was to take a turn for the worse. This, in itself, may have adverse implications for external confidence in these economies. This must not happen.

7. In working towards a new financial architecture, we must deal effectively with a wide range of issues. Let me emphasize a few points:

- First, while greater transparency and disclosure of financial information could clearly be helpful, the responsibility for transparency must be symmetric. Large private financial institutions (including hedge funds) must also follow higher standards of disclosure.

- Second, the search for international Codes of Conduct or Practice in fiscal, financial and monetary dimensions should eschew one-size-fits all norms, which do not allow for differences among countries in institutional development, legislative framework and stages of development.

- Third, the resources of multilateral institutions must be augmented quickly so that they can play a more effective role in coping with the new kinds of crisis posed by high levels of mobile private capital.

- Fourth, the imperative for strengthening domestic supervision and prudential norms must be extended to private lenders in international financial centers.

- Fifth, the sequencing of capital account liberalization must be carefully predicated on the strengthening of national fiscal and financial systems. Restraints on short term capital flows should be viewed as prudential norms.

8. We support the HIPC initiative and have noted its progress with satisfaction. We welcome its extension and widening of coverage. We also support the initiative to assist the Post-Conflict countries and the proposal to establish the Trust Fund for this purpose. The increasing cost, however, remains a concern. To ensure optimal use of the facility, tighter eligibility criteria linked to investment in human resources and effective monitoring of the assistance that is provided may be required. We advocate the need for greater role of the bilateral creditors in its

funding. The trade-off between the resources devoted to this purpose, and the assistance available to other peace loving countries for their development needs has to be kept in mind.

9. We reiterate that there is urgent need to evolve guidelines so as to limit the pressure on IBRD's Net Income. Thus far, the emphasis has almost entirely been on imposing higher lending charges to increase revenue. This, of course, increases the cost of borrowing from the Bank by the poorer economies. Therefore, it is important that principles of burden sharing be deployed for financing such initiatives as HIPC and Post Conflict Assistance. We hope that when the decisions regarding funding reached in July on the basis of voting are revisited in a year's time, a consensus based on equitable burden sharing would be reached. This may entail using incremental costs, including those for new programmes for determining the voting strength of contributing member countries.

10. Let me take this opportunity to apprise this distinguished gathering of the recent developments in the Indian economy. Since the early 1990s, we have made far reaching progress in addressing underlying structural distortions in the economy and encouraging private sector activity. Trade and tariff reforms, financial sector liberalisation, and the opening of the investment regime prompted a strong supply response. The real economy grew at an average annual rate of over 6 ½ percent in the last three years; export growth was buoyant for most of this period; and the share of foreign trade to GDP rose sharply. Concomitantly, the external position continued to remain easily manageable. The current account deficit was modest; foreign direct and portfolio investment inflows increased strongly over much of the period; and external debt parameters continued to improve.

11. In 1998/99, although the external environment will be decidedly adverse, we are confident that under the circumstances, the Indian economy will perform creditably. Growth is expected to be in the order of 6 – 6 ½ percent, the current account deficit is expected to be a little over 2 percent of GDP, the debt service ratio will continue to decline and sound external debt management has meant that short-term liabilities constitute less than 6 percent of our aggregate external debt. Foreign exchange reserves are expected to remain at a comfortable level and will provide for an import cover of about 6 months. However, more recently we have not entirely been spared the spill-over effects emanating from the continuing Asian financial turmoil. Against the backdrop of anemic world trade performance, our export growth has also suffered, in particular because East Asia accounts for about 20 percent of India's exports. Moreover, given the retreat of global stock markets, the impact on financial flows through portfolio investment into India has also been affected. However, thus far the outflow has been modest in comparison to other economies in the region.

12. We have continued to press ahead with our far-reaching reform agenda. We have strengthened prudential norms and supervision practices of our financial sector. Our foreign trade policies have been liberalized further. Capital market reforms have continued. Policies for foreign investment have been further liberalized. Major reforms have been enacted to promote investment in infrastructure sectors such as power. A new modern law on foreign exchange management has been introduced in Parliament. We have undertaken wide-ranging initiatives to

spur investment in housing and information technology. We are pressing ahead with our programs for privatization of and disinvestment from our public enterprises.

13. Mr. Chairman, all these reforms are aimed at accelerating the growth of output and employment and thus lifting millions of households from the scourge of poverty. The difficult global environment has strengthened our resolve to conquer adversity and press forward with rapid economic growth with equity.