

**BOARDS OF GOVERNORS•1999 ANNUAL MEETINGS•WASHINGTON, D.C.**

**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

**INTERNATIONAL MONETARY FUND**

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Press Release No. 38

September 28–30, 1999

Statement by the Hon. **PETER COSTELLO, M.P.**  
Governor of the Bank and the Fund for **AUSTRALIA**,  
at the Joint Annual Discussion

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In the past two years, beginning with events in Thailand in July 1997, we faced some of the greatest challenges to the international financial system ever. And in East Asia, financial crisis quickly led to economic recession and worse.

The region which had been the world's strongest growth region for a decade or more suddenly reversed. Millions of people had their standards of living savaged and their opportunities shattered.

But the situation has now stabilised. There are signs of strong growth in Korea. Japan shows signs of recovery. The US is strong, Europe is picking up and the world economy is likely to continue improving in the remainder of 1999 and into 2000.

However, optimism about the outlook needs to be tempered by a strong note of caution. Many economies still face substantial policy challenges. We remain concerned by economic developments in Indonesia and the very troubled state of affairs in East Timor. I call on the international community to lend its humanitarian hand to address the crisis in East Timor.

In crisis affected economies there is a continuing need to push on with domestic structural reforms and on the international front to address management challenges.

The Australian economy is expected to continue growing strongly, albeit at a more moderate pace than the 4.5 percent this last year. Sound macroeconomic policies have set the foundation for sustained low inflation outcomes, a low interest rate environment and strong employment growth. The cornerstones of those policies have been a focus on transparency, in the conduct of both monetary and fiscal policies, and a commitment to ambitious medium-term goals.

The Government has a medium-term fiscal strategy that includes maintaining budget surpluses while economic growth prospects remain sound and halving Commonwealth general government net debt to 10 per cent of GDP by 2000-01. Australia is achieving both these fiscal objectives. With its privatisation program, there is the real possibility that Commonwealth general government net debt might be completely eliminated within the next few years.

Ongoing structural reforms in both the product and financial markets have led to a leap in productivity. In the face of severe economic circumstances in our region, exporters were able to maintain export volumes through diverting to other markets. The flexibility of the economy and its performance through this crisis illustrate benefits from policy reform.

It is important to remember, however, that the task of reform is a continuing one. We must always look forward, anticipating problems before they arise and maintain the momentum of reform to meet them.

That is why our country is tackling the difficult area of tax reform. This has been a huge area of work for the last two years. From 1 July we will introduce a value added tax, major reductions in income tax, the abolition of a wide range of inefficient taxes and reform a wide range of social security benefits.

Building on that, this month, the Government announced details of the reform of the business tax system in Australia. The new tax system will be more commercially focussed and internationally competitive, while at the same time providing a sustainable revenue base.

Company tax rates are being lowered, and will be among the lowest in the Asian region. The new system will also improve incentives to save and invest by lowering capital gains taxes. Small business tax will be simplified and lowered.

Reform is just as important at the international level. Recent economic difficulties exposed weakness in the operation of the international financial system, in the traditional policy and surveillance frameworks used by international financial institutions, as well as structural weaknesses in the countries themselves. Australia is contributing to the work being undertaken by the international financial institutions to strengthen the international financial architecture and I would now like to turn to a number of issues on this important agenda.

#### *Highly Leveraged Institutions*

Australia has concerns about the potential impact of destabilising short-term capital flows and the role of highly-leveraged institutions, particularly their potential ability to manipulate small to medium sized foreign exchange markets. Steps are necessary to ensure adequate disclosure by hedge funds and other highly leveraged institutions and to ensure appropriate risk management on the part of creditors and counterparties in dealings with such entities. We are pleased with the Financial Stability Forum's work on highly leveraged institutions and strongly support the development of that work into concrete proposals for change.

#### *Involving the Private Sector in Forestalling and Resolving Financial Crises*

We have also been pursuing the issue of the role of private sector borrowing in the international financial system, encouraging consideration of the issue in the Fund, as well as through APEC and the Manila Framework Group. It was also an area examined by a high level Task Force that I chaired in 1998 to report on how Australia could contribute to international financial reform. I am pleased to see that a number of practical options

that were raised in the report are now under consideration by the international financial institutions.

Australia welcomes the establishment of the G-20 which will be able to look at private sector involvement in prevention and resolution of crisis. We support a framework of guiding principles and tools which are not overly prescriptive. We are greatly encouraged by the agreement of the Interim Committee at this Meeting to ask the Executive Board to report at the Committee's next meeting on the ways in which the broad principles could be implemented. We would encourage the Fund to extend the excellent work done to date - and develop ways on how the private sector involvement might be activated and negotiated in particular circumstances. We would expect there to be sufficient room for flexibility to allow common sense solutions to prevail and take into account the circumstances of individual cases. A set of practical "ground rules" that can shape expectations about the handling of a crisis would facilitate discussion between debtors and creditors and speed up the resolution of these extremely difficult situations.

#### *Enhancing the HIPC Initiative*

The developments in the last few days which will lead to an Enhanced HIPC Initiative holds the prospect of great benefit for indebted countries and their poverty-stricken peoples. Australia will more than double its contributions to this initiative and I congratulate both the Bank and the Fund for the tireless work on financing the initiative.

Write offs offer new hope for countries crippled by debt. Economic policy to harness this opportunity will be required to build high hopes for a new start into reality. Economic growth is the best way of breaking poverty. High quality growth and the conditions that promote it - honest institutions, accountable and transparent policy, declining trade barriers, open society, respect for human rights and property are the foundations for raising living standards, opening opportunity, hope and achievement.

And achievement of policy in the face of crisis over the last two years should strengthen us to continue this work to the future.