International Monetary and Financial Committee

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Statement by Mr. Chidambaram

Statement by Honourable Finance Minister
Shri P. Chidambaram
Leader of the Indian Delegation to the
International Monetary and Financial Committee
Washington D.C, October 2, 2004

Representing the Constituency of Bangladesh, Bhutan, India and Sri Lanka

Mr. Chairman,

1. At the outset, may I convey my good wishes to Mr. Rodrigo de Rato on assuming the leadership of the Fund. I am confident that he will continue the rich tradition of his predecessors in strengthening the Fund's role in promoting international financial stability and supporting growth and poverty reduction in the Low Income Countries.

The Global Economy and Financial Markets:
Outlook, Risks and Policy Responses

2. The economic outlook and policy prospects to meet emerging challenges now appear more positive than it did at the last IMFC meeting in April. Since then, the signs of a global recovery have become stronger. World economic growth is expected to peak to its highest level in thirty years. Nevertheless, some risks and challenges remain. A heartening feature of the recovery is its broad base across the membership and in an increasingly integrated global economy, such broadbased expansion enables each region to strengthen the prospects of the other.

3. We are in broad agreement with the assessment and policy recommendations of the World Economic Outlook and the Global Financial Stability Report. Risks to the expansion from geo-political and oil market uncertainties have increased in recent months. While supply constraints have surfaced in addition to demand pressure, speculative forces may have added volatility and contributed to deviation from fundamentals. An enduring solution to these problems calls for strengthening the cooperation between the oil importing and exporting countries to stabilize the oil market and for international financial institutions to stand ready to support countries vulnerable to potential shocks. In the medium- to long-term, concerted effort needs to be launched. Measures to contain demand would include enhancing efficiency in use of energy, in particular in growing emerging economies including India and tapping alternative sources of energy. Simultaneously, there is an urgent need to augment supply by enhanced investment in exploration of oil reserves .

4. No doubt, compared to periods of earlier oil price shocks, countries have become more resilient through the pursuit of sound macroeconomic policies. Central banks have developed tools and communication policies to achieve price stability without causing serious disruption to the recovery currently underway. We also notice that the policy reversal to a neutral or moderately higher interest rate regime is expected to be gradual

and phased in a guarded manner. However, the combination of risks of oil price and reversals in monetary policy regimes make the management of macro-policies in oil-importing emerging economies a particularly complex task.

5. In recent discussions, particular attention has been drawn to the reverse capital flows from emerging markets to mature markets. We appreciate the recognition of 'self-insurance' role of reserves build up and its implications for global growth. We would like to reiterate that this is also a sign of weakness in the international financial architecture in providing any viable collective insurance to otherwise well managed economies. Any discussion on the opportunity cost of high reserves should duly take account of financial market developments in advanced countries and of possibilities of disruptive exchange rate adjustments among major currencies.

6. The international community needs to recognise and accept the increasing role of the Emerging Market Economies in sustaining the present phase of recovery, and accordingly evolve an appropriate approach towards adjustment to the changing environment. We reiterate that sustaining the global recovery process and bringing about an orderly correction of the global imbalances require a coordinated and cooperative approach with an equitable sharing of the burden of adjustment. Key elements of this coordinated approach should include different policy responses across different countries or regions.

Developments in Constituency

7. Along with China and emerging Asia, **India** is poised to become a major driver of global growth in the medium term. India has pursued its own design of domestic economic reforms since the early 1990s duly incorporating the impact of domestic political cycles. The new government is committed to a determined continuation of reforms but with a human face, involving emphasis on health, education, and employment. The key to growth, the government believes, is enhanced investment: public and private, domestic and foreign. Despite a delayed monsoon and oil price pressures, the economy is expected to grow in the range of 6.5-7.0 per cent this year. A strong revival of investment demand and business confidence is evident. The external position has added to overall confidence and the country's credit standing has improved in international markets. Fiscal consolidation remains high on the agenda; and the new government has demonstrated its commitment by notifying the Fiscal Responsibility and Budget Management (FRBM) Act and the detailed rules for its implementation in July this year. Further liberalization of the external sector has been announced, and the government is committed to promoting multilateral trade liberalization policies in the spirit of the Doha round. No doubt, the current outlook for oil prices makes the macro-economic management in India very complex. Monetary policy will continue to emphasize price stability with growth.

8. **Sri Lanka** continues to maintain its broad-based growth in the current year. The new government has spelt out its economic vision in its policy framework document. It will continue to pursue market-based policies supported by public-private partnership.

Poverty alleviation and employment generation will receive added emphasis with particular attention to rural and infrastructure development within the scope of the PRGF/EF arrangement. The Sri Lankan government is committed to furthering the peace process.

9. In **Bangladesh,** despite a difficult political environment, progress in implementation of structural reforms covering nationalized banks, tax administration, and State Owned Enterprises has continued. The government is taking a number of policy initiatives to mitigate the likely impact of the phase out of Multi-Fibre Agreement at end-2004. The focus is on diversifying the export base, enhancing competitiveness, and preparing a better business climate by removing structural impediments, upgrading infrastructure, and improving governance. As these initiatives may take time to fructify, the government intends to avail of augmented access under the PRGF-supported program through the Fund's new Trade Integration Mechanism. The government is confident that the international community will continue to be supportive of our endeavours.

10. With strong GDP growth and low inflation, **Bhutan** continues to enjoy a stable macroeconomic environment conducive to sustained growth with the major impetus coming from the construction, manufacturing, transportation and tourism sectors. With a view to implementing a comprehensive poverty reduction strategy, the Royal Government of Bhutan has finalized a PRSP after an extensive consultation process.

11. I am happy to add that there is increasing recognition and efforts in our region in working together for greater regional cooperation to promote economic development and address the common problem of poverty reduction.

Making IMF Surveillance More Effective and Strengthening Crisis Prevention

12. Effective surveillance to promote stability through enhanced resilience of countries to economic shocks and markets is the key to crisis prevention. In an increasingly integrating global economy, combined with regional integration through common trade and currency and economic unions, the impacts of policies as also of macroeconomic performances are felt across national boundaries. Therefore, the current multilateral surveillance process and regional surveillance of currency and economic unions by the Fund need to be strengthened further.

13. The 1997 East Asian crisis and subsequent crises in Russia, Brazil, Argentina and Turkey have exposed several weaknesses of the international financial architecture in terms of preventive requirements, surveillance system and crisis resolution measures. The IMF has taken several steps towards strengthening its surveillance mechanism, both at the multilateral and bilateral levels. These efforts towards redesigning the traditional instruments of IMF surveillance reflect the Fund's increasing emphasis on using surveillance as the primary instrument for vulnerability assessments in member countries. The recent Fund initiatives including the proposals to (i) integrate the 'balance sheet approach' for assessment of member countries, (ii) redesign the

framework for debt sustainability in low-income countries, (iii) include additional items of data requirements under Article VIII of the IMF, and (iv) emphasis of the analytical aspects of vulnerability assessments in the IMF tools of multilateral surveillance reflect such a change in focus. In this context, we welcome the Fund effort to streamline/evaluate the process of surveillance in its *Biennial Review of the Implementation of Fund's Surveillance* 2004. The review not only provides an in-depth analysis of the Fund's bilateral, regional and multilateral activities over the past two years, but also examines the possibility to improve the contents and strengthen the modalities of surveillance, drawing upon cross-country experiences and outreach activities.

14. Much remains to be done in improving the effectiveness and even-handedness of Fund's bilateral surveillance across membership. There is a perception in emerging market and developing economies that while policy recommendations are more or less uniform, they have to be demonstratably more even handed, and adequately capture the country's own priorities as well as its institutional setting and circumstances including the political economy factors. It is also felt that the Fund on occasions tends to be intrusive in its approach and some times uses surveillance as an instrument to rate country performance for signalling, thus in some ways subordinating its primary role of a confidential advisor. The surveillance reports in the case of advanced economies need to be more forthright, in terms of candour and the strength of their message, since distortions in the macro-economic policies of these countries have the potential of larger global impact. It is necessary to bridge this confidence gap to make bilateral surveillance really effective. Appropriateness of policy recommendations and implementation resulting out of surveillance should recognize a set of key priorities in close dialogue with the authorities, and tailor them contextually to the time and stage of economic and financial market development.

15. Apart from assessing risks and potential vulnerabilities, successful home-grown policy experiences in many countries should be identified and best practices cross-referred for appropriate implantations in other regions. Also, while using independent and non-obligatory findings of private sector reports, data and information, the assessment and recommendations should reflect Fund's ownership and should be arrived at after full discussions with the country authorities. Last, but not the least, while the role of Fund surveillance in program countries is curative, in non-program countries it is preventive and this distinction needs to be appreciated. Extending principles of program reviews and monitoring to policy assessments and reviews in non-program countries for 'signalling' assessments, in our view, is counter-productive. The primary objective should be to strengthen the current instrument of Article IV consultation and increase its value addition to every member country.

16. Apart from surveillance, an important dimension in strengthening crisis prevention is the development of Fund facilities in contingent situations to help countries which are otherwise well managed but may have potential problems. This will truly make the Fund a lender of the last resort, infuse confidence in the market, and minimize the regional and contagion risks arising out of imperfect and uncertain private market capital

flows. In this regard, I welcome the announcement of Trade Integrating Mechanism to support multilateral trade liberalization. There is need for a similar constructive approach to a precautionary arrangement. The 'moral hazard' issue of such a facility seems to be exaggerated, without any adequate empirical support. The Fund's shrinking resources and liquidity compared to the global capital flows and the inadequacy of 'collective' insurance currently provided by the existing facilities prompt the emerging markets to either build up their own 'self insurance' or attempt alternative funding avenues at regional levels to insulate themselves against external shocks.

17. We are encouraged to note further progress towards establishing voluntary institutional mechanisms for orderly and cost efficient resolution of financial crisis. It is encouraging that inclusion of Collective Action Clauses(CACs) in bond issues has gained greater acceptance and this has not impacted pricing adversely. We continue to emphasize that the design of CACs needs to be left to the issuing countries. Any effort to standardize will result in straitjacketing, and limit its acceptance. We are also encouraged by further progress in developing a voluntary Code of Conduct by debtors and creditors and commend the work being carried forward by G-20 and the international finance community. In our view, the Fund could facilitate formulation of the code without being seen as an "interested party".

Enhancing International support for Low Income Members:
The Role of the Fund

18. The recent initiatives undertaken by the Fund to support the low-income countries as a part of the global initiative to meet the millennium developmental goals (MDGs) is creditable. We believe that the Fund must continue to support the efforts of its low-income member countries towards poverty reduction and meeting the MDGs through policy advice, capacity building, and financing, including debt relief. However, it is important to clearly define the Fund's role in low income countries, consistent with its mandate, and clearly delineate the division of labour between the Fund and other multilateral institutions, especially the World Bank. We look forward to a clear, succinct statement, following the report of the Committee on Low-Income Country Work, stipulating a framework for Fund engagement in low-income countries.

19. We broadly support the stand that the primary focus of the Fund support to low-income countries should be based on its core area of expertise, i.e., helping members establish and maintain macroeconomic and financial stability. However, the results of Fund's involvement would need to be weighed in the light of two broad principles. First, the imperative of making equitable allocation of development assistance to countries. Second, the need to reduce transaction costs of development assistance through better harmonization of procedures and processes. It may also be worthwhile to disentangle hidden costs associated with foreign aid, and make it more transparent for better evaluation of aid effectiveness.

20. While focussing on its core expertise of helping members establish and maintain macroeconomic and financial stability to foster durable growth and poverty reduction, the

Fund can improve its interventions in low income countries by incorporating relevant Poverty and Social Impact Analysis into its advice. The Fund should also step up technical assistance to help the low-income countries in capacity and institution building. The Fund can optimize its efforts by coordinating more effectively with other multilateral institutions, bilateral donors, and with the member countries themselves, under the umbrella of the poverty reduction strategy process. We agree that it is the primary responsibility of low-income countries themselves to put in place the policies and institutions appropriate for their development. However, their efforts need to be fully complemented by the international community. We believe that the Fund should play a stronger role in encouraging policy reform in industrial countries in trade, removal of agricultural subsidies, and channelizing official development assistance and adequate debt relief in the context of the MDGs.

21. In the context of the primacy accorded to the voluntary Poverty Reduction Strategy (PRS) approach in framing the IMF's role, we would like to highlight the findings of the recent evaluation by the Independent Evaluation Office (IEO) of the PRS approach. These have been further corroborated by the recent Fund review on the implementation of PRSPs. Notwithstanding the broad-based participation, we note with caution that actual achievements have fallen considerably short of the potential partly owing to shortcomings in the design of the initiative, including a lack of clarity about the role of the IMF. Moreover, problems relating to limited feedback from initial implementation to policy design, particularly in the area of macroeconomic policy, capacity constraints and the limited effectiveness of the Joint Staff Assessment (JSAs) have been important factors in limiting the effectiveness of the PRS approach.

HIPC Initiative – Promoting Debt Sustainability

22. We appreciate the overall progress in implementation of the heavily indebted poor country (HIPC) initiative and the reduction of the overall debt stock and the debt service ratios as highlighted in the latest Fund report on the status of implementation of the HIPC initiative. In this context, we stress on the need to facilitate a fruitful completion of the forthcoming HIPC Technical Meeting and the IDA-14 replenishment meeting. In the context of the issues relating to the extension of the 'sunset clause', the definition of eligibility for extension of the 'sunset clause' clause should be designed to maintain the balance between the moral hazard problems associated with a flexible definition and the principles of uniformity of treatment for determination of eligibility under the HIPC initiative as required under the IMF's PRGF-HIPC Trust Instrument.

23. Given their higher vulnerability to shocks, policy deficiencies, weak institutions and most importantly their high dependence on official concessional debt and grants, for low-income countries, the concept of debt sustainability is quite different from that for middle-income countries. Thus, the design of the operational framework for measuring debt sustainability in such countries has to strike an appropriate balance between rules and discretion.

Mobilizing Aid for the Millennium Development Goals

24. The Fund's commitment to the fulfilment of the MDGs is reflected in its efforts to mitigate poverty, especially in the low-income countries through the adoption of comprehensive policy framework with the PRGF/ HIPC initiative and the PRSPs to serve as the focal points of Fund involvement. The IMF approach crucially hinges on strengthening the PRS approach as an instrument for achieving of MDGs. In this context, we appreciate the initiative to bring out the Global Monitoring Report jointly by the Fund and the World Bank to review the progress and policy actions for achieving the MDGs in the developing countries. In the context of the significant shortfall in the provision of official development assistance (ODA) to developing countries in comparison to the committed target under MDG, there is need to re-examine the role of the Bretton Wood Institutions in facilitating the fulfilment of such commitment under the present multilateral frame of global governance.

IMF Quotas, Voice and Representation

25. A number of proposals have been mooted in recent years to strengthen the voice and representation of developing countries. But, it is unfortunate that there has been very little progress.

26. We appreciate the enormous complexities involved in any such an exercise. The current state of impasse reflects the reluctance of the major shareholders to give up their present disproportionate strength. The real issue, therefore, is of political will. The IMFC has been asking the Board to continue working on a revised formula. We would like to emphasize that while the Executive Board discussions can be useful in fine-tuning the detailed aspects of alternative formulations, the real momentum for change has to come from the capitals, particularly the large shareholders, who hold the key to any fundamental reform.

IEO

27. We are happy to note that IEO has continued to produce high quality reports, facilitating the promotion of a learning culture within the Fund and enhancing its credibility as an institution willing to adapt and refashion its policies. I will like to take this opportunity to place on record my appreciation of the important role played in this by IEO's first Director, Mr. Montek Singh Ahluwalia.

Thank you.