International Monetary and Financial Committee

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Statement by Pranab Mukherjee
Minister of Finance, India

On behalf of Bangladesh, Bhutan, India, Sri Lanka

Statement by Honourable Finance Minister
Mr. Pranab Mukherjee,
Leader of the Indian Delegation to the
International Monetary and Financial Committee
Washington D.C., April 21, 2012
(Representing the Constituency consisting of Bangladesh, Bhutan, India and Sri Lanka)

Mr. Chairman,

1. We meet at a time when the global economy has been in a phase of heightened uncertainty. Some improvements in the macroeconomic climate and the policy actions undertaken in the Euro area recently have opened a window of opportunity to fight off the recessionary tendencies that continue to shadow world growth and trade. When we met in September last year, we agreed to act decisively and together to restore confidence and stability so that growth could be entrenched. It is worthwhile to take stock of the progress made in these directions so that we are better prepared to chart our course through the uncertain period ahead.

A. The Global Economy and Financial Markets

2. The main risks to global growth prospects remain concentrated in the advanced economies. Both sides of the North Atlantic remain gripped by the perverse dynamic of renewed crisis in Europe jeopardizing the strengthening US economy, and political uncertainty in the US worsening the contraction of activity in Europe.

3. In the emerging and developing countries, growth is facing a real threat of loss of momentum, mainly on account of spillovers from advanced countries through trade, finance and confidence channels, but also through disinflationary policies to deal with inflation persistence. Near-term prospects are also clouded by the volatility of capital flows. Oil importing emerging and developing countries also face a serious threat to both growth and inflation from the ongoing developments in global energy markets. Disruptions related to geopolitical tensions could exacerbate the already sizable and increasingly structural supply-demand imbalances. There is also a serious risk of the downturn in Europe reinforcing the weaker prospects for growth in several large emerging economies, and interacting with geo-political tensions in the Middle-East with potentially global ramifications.

4. Downside risks to global financial stability eased over the past six months. Financial markets exhibited some stability, benefitting mainly from massive liquidity injection by the European Central Bank (ECB). Nonetheless, the downside risks to global financial stability remain at elevated levels. The order of deleveraging expected to be undertaken by large EU-based banks – as much as US $ 2.6 trillion through end-2013 (almost 7 percent of total assets) - combined with refinancing requirements of sovereigns and banks of about 23 percent of GDP, could lead to a significant tightening of credit conditions undermining the prospects for growth and stability. A vicious feedback loop of weak growth, weak fiscal position and weak growth could threaten financial stability going forward. While EMEs have so far managed the strains of deleveraging by European banks, any further pullback in credit

by the European banks could expose existing external vulnerabilities for them. The tension between deleveraging, accommodative monetary policy impinges upon global oil and commodity prices, and capital flow volatility. Given the sensitivity of EMEs to commodity supply shocks, the elevated oil and other commodity prices endangers the pursuit of financial stability in these economies.

Policy Challenges

5. The immediate policy challenges facing advanced economies are increasingly appearing common. The policy imperative for this group of countries is to address short-term vulnerabilities, while strengthening the medium-term foundations for growth in a credible and effective manner. The critical issue is to stay ahead of the curve if the downside risks materialize.

6. For emerging and developing countries, the possibilities of becoming bystanders again is more real this time around. They should evaluate specific vulnerabilities and prepare contingency plans. Countries with fiscal space should be ready for using it; prioritizing social safety nets and infrastructure investments should take precedence over other ways of delivering stimulus. For several of these economies, monetary policy has been tightened and space is available, but it will have to be used in conjunction with fiscal policy, keeping in mind residual inflationary pressures in both goods and services and assets markets. Preparing financial sectors for acute deleveraging and building up buffers to deal with external financing risks is an integral element of this strategy.

7. Perhaps the most daunting challenge in this fragile environment is to press ahead with structural reforms that will recoup losses of potential output and erosion in competitiveness and efficiency.

B. The IMF's Action Plan – Architecture for Global Cooperation

8. We welcome the Managing Director's Action Plan with its focus appropriately balanced between the immediate priorities relating to Europe, the challenges of jobs, inclusive growth, fiscal consolidation, financial sector repair and reform, the building of policy buffers that confront the broader membership, and the overarching issues relating to global cooperation that we will have to address in the context of safeguarding global economic and financial stability in the period ahead.

S**urveillance**

9. We welcome the various initiatives taken by the IMF to modernize the conduct of its surveillance, drawing from the lessons of the global crisis of 2008-09. These important actions demonstrate that updating of surveillance can be achieved within the provisions of the Articles of Agreement. The issue is one of effective implementation.

10. Bilateral surveillance is at the core of the Fund's mandate. Integration of bilateral and multilateral surveillance should not compromise the pursuit of robust and evenhanded bilateral surveillance and better peer review with symmetric treatment of all countries.

11. On proposals for a strategic Plan for Financial Sector Surveillance, it is crucial to strike the right balance between dynamism and stability. There is also the need to consider an overarching framework for macro-prudential policy for financial stability.

12. It is also important to recognize that traction, the final objective of surveillance, is inextricably woven into the IMF's governance structure. Modernizing surveillance must flow from and cannot precede reforms in governance. As governance reforms progressively reflect the changing global economic realities, so also will the IMF's surveillance gain legitimacy, incisiveness and traction.

Managing Capital Flows

13. Policymakers must have flexibility and discretion in the management of capital flows. They should be able to adopt policies that they consider appropriate to mitigate risks through macroeconomic, prudential and capital account management policies without a sense of stigma attached to particular instruments that have been found to be useful during several past episodes of capital flows. In the absence of an accepted intellectual position, judgment based on practical experience and a keen knowledge of country-specific situation should guide policy responses. Within this approach, capital flow management measures (CFMs) may well be the first line of defence, giving authorities time to fashion more durable responses in terms of adjustments to macroeconomic and prudential policies. Furthermore, there should be the flexibility to re-impose or persevere with them, if warranted.

Global Financial Safety Nets

14. The experience of the current crisis shows that scope for exploring further enhancements to the global financial safety nets (GFSNs) to provide timely and adequate liquidity to crisis bystanders may still exist. However, a thorough assessment of the existing lending arrangements, including actual demand during the recent crisis, should inform any consideration of further changes to the toolkit. Our view is that the IMF's instruments have been customized (the Flexible Credit Line and the newly introduced Precautionary and Liquidity Line) to cater to varied needs of different sets of member economies. The instruments approved are largely precautionary and preventive and hence by design should cost less than actual crisis resolution instruments over the cycle.

15. The case for GFSNs must be specific to countries that are genuine bystanders – countries impacted by contagion associated with systemic events and transmitted through various channels such as trade, finance and confidence in an integrated world, notwithstanding strong fundamentals and prudent macroeconomic policies.

Adequacy of IMF Resources

16. In January 2012, against the backdrop of the sovereign crisis in Europe, the Managing Director had made a proposal to augment IMF's resources available for access by members by a sum of $ 500 billion. Several landmark developments have taken place since then which have brought about a welcome change in the global economic and financial environment.

17. The Managing Director's Action Plan also states that the ECB's policy actions have for now lowered downside risks, but that these risks remain substantial and could materialize quickly and to devastating effect.

18. We welcome the recent efforts by EU to raise the size of its firewall and we feel that EU efforts should continue to play the primary role for its members as and when the situation so demands. We feel that IMF assistance should only underpin the EU's efforts and play a catalytic role in order to provide confidence to investors. The amounts of the assistance required will inevitably require a fair burden sharing arrangement between the IMF, the EU and the country concerned.

19. We would also stress that any financial contributions made should be voluntary and not in any way linked with future voice or governance reform. Further these contributions need to retain their temporary character; they should not be looked upon as a substitute to quota resources. At the same time it is important that innocent bystanders affected by the crisis, particularly low income countries, are adequately protected and there should be sufficient resources available for them.

20. We support the MD's proposal that we must complete the 2009 LIC financing package to secure concessional financing under the PRGT through 2014-15 and that we also need to take forward the important issue of long-term sustainability of the PRGT by next September.

Quota and Governance Reform

21. The best possible means to improve governance and legitimacy is to put crucial reforms to the quota formula upfront even as we hope that the 2010 Quota and governance reform will be implemented by the target date of the Annual Meetings of 2012.

22. Since the initiation of the work relating to the reform of the quota formula last year, discussions have revealed little consensus on the way forward, wide divergences in positions by members, and very little progress in updating the data. Against this backdrop, our predominant concern is that we are falling behind the curve. We have to adhere to the timeline for completing this reform by January 2013 so that it becomes the basis for the 15th General Review of quotas to be completed no later than January 2014.

23. GDP is the most important variable in the quota formula as it is the most robust measure of relative economic weight and stake in the global economy. Furthermore, the most appropriate way to measure the real size of an economy is in terms of purchasing power

parity. There is thus a strong case for increasing the weight of PPP GDP as well as to increase weight of GDP as a whole in the formula. It is therefore important that the weight of the blended GDP variable should be substantially increased in the formula through a simple formula with GDP blend as either the sole or predominant variable and with a higher share of GDP-PPP.

C. Developments in the Constituency

I now turn to developments in my constituency.

Bangladesh

24. Bangladesh is steadily moving towards a higher growth path. It has achieved an average annual growth rate of 6.2 percent over the last 5 years. Stable growth in the agriculture sector and an improved performance in the industry and in the service sectors have contributed to this achievement. Moreover, steps taken to reduce infrastructural bottlenecks in the power, energy, and communication sectors have made a positive impact on crowding in private investment and achieving increased real GDP growth. An additional 3300 MW of electricity has been added to the national grid between January 2009 and March 2012. Bangladesh has also made remarkable progress in achieving the targets of most of the Millennium Development Goals (MDGs), particularly in halving income-poverty between 1990 and 2010. However, macroeconomic pressures have emerged since the last fiscal year. Inflation has been in double digits and fiscal pressure has emerged from rising fuel, electricity and fertilizer subsidies, despite the remarkable growth in tax revenues, particularly in the National Board of Revenue (NBR) collected revenues. On the external front, unprecedented but necessary import payments and the impact of the global economic crisis on exports have resulted in the trade deficit amounting to $ 7.3 billion in FY11. Reductions in the current account balance and sluggish capital inflows have led to the depletion of the gross international reserves with significant depreciation of the exchange rate. In order to ease macroeconomic pressures and restore growth prospects the authorities have already tightened fiscal and monetary policies. Concomitantly the authorities have formulated a three-year reform program aimed at improving policies in the fiscal, monetary, financial, trade and investment sectors. The IMF has recently approved the Bangladesh authorities request for access to Fund resources under the Extended Credit Facility in the amount of SDR 639.96 million over a three-year period to meet in part the BOP financing needs and to provide a buffer against shocks until the policy adjustments and reform measures take hold

Bhutan

25. The Bhutanese economy continued to record strong growth in 2010-11 (July-June) with real GDP growth accelerating to 11.8 per cent from 6.7 per cent in the previous year, benefitting from robust activity in secondary and tertiary sectors. Unemployment dropped to 3.3 per cent. Growth prospects remain favorable for Bhutan, and real GDP growth is expected to average 9-10 per cent per annum for the remainder of the 10th Five Year Plan (2008-13). Consumer price inflation increased from 6.1 per cent in 2009-10 to 8.3 per cent in 2010-11 on the back of rising prices of both food and non-food items. Growth in domestic

bank credit remained high, reflecting financial deepening, although it decelerated to 36.6 per cent in 2010-11 from 44.2 per cent in the previous year. Bhutan's current account deficit widened to 22.2 per cent of GDP in 2010/11 from 10.8 percent in the previous year, reflecting a higher trade deficit. However, the overall balance of payments remained in surplus on account of inflows in the form of grants and aid-related loans. Bhutan's international reserves increased during the year and were US $ 906 million as at end-June 2011, equivalent to around nine months of total merchandise imports. Given the development objectives, the overall fiscal policy stance for 2010-11 remained progressive with a budget deficit estimated at around 5 per cent of GDP as against a surplus of 1.8 per cent of GDP in 2009-10.

India

26. In the Indian economy, growth moderated to 6.9 per cent during 2011-12 (April-March) after a robust rebound from the knock-on effects of the global crisis of 2008-09. The current slowdown can be attributed almost entirely to the weakening of industrial growth, which is increasingly correlated with the global manufacturing cycle in an adverse external environment. Weakening domestic demand conditions, especially with regard to investment, also played a role in the moderation. There has been some softening of inflation during January-March 2012, though inflationary risks remain on the upside. Accordingly, the Reserve Bank of India reduced policy repo rate by 50 basis points to 8 per cent on April 17, 2012. Going forward, inflation is expected to be range bound around 6.5 percent and GDP growth could show a slight recovery to 7.3 per cent in 2012-13. Global energy prices continue to pose a risk to growth and inflation due to geo-political factors and the global macroeconomic situation. The gross fiscal deficit (GFD) of the Central Government is estimated to have exceeded the initial forecast of 4.6 per cent of GDP to reach 5.9 per cent of GDP in 2011-12. It is projected at 5.1 percent of GDP in 2012-13. Public debt continues to follow a downward trajectory with the Central Government's gross debt expected to fall to 45.5 percent of GDP in 2012-13. With export growth outpaced by import growth, the current account deficit for 2011-12 is expected to be higher than in the preceding year as a proportion to GDP. In face of the widening current account deficit, the moderation in capital inflows during 2011-12 caused largely due to deleveraging by the European banks and adverse global sentiments could pose an additional challenge in macroeconomic management in the period ahead.

Sri Lanka

27. The Sri Lankan economy grew by 8.3 per cent in 2011, sustaining a growth momentum of over 8 per cent for the first time in two consecutive years. Improved consumer and investor confidence arising from the peace dividend, favorable macroeconomic conditions, increased capacity utilization, expansion of infrastructure facilities and renewed economic activity in the Northern and Eastern provinces underpinned this growth. Inflation remained at single digit levels for the third consecutive year supported by improved domestic supply conditions, prudent liquidity management by the Central Bank and benign inflation expectations. The government reiterated its commitment to the fiscal consolidation process by maintaining the key fiscal indicators broadly in line with the budgetary estimates for

2011. Despite the shortfall in revenue collection, prudent management of recurrent expenditure helped maintain the fiscal deficit at 6.9 per cent of GDP. The budget for 2011 introduced major tax reforms to simplify the tax system, broaden the tax base and improve tax compliance with the objective of strengthening tax collection, while creating an environment to attract private investment. Rationalization of recurrent expenditure and a slower growth in interest expenditure given the favorable interest rate environment helped contain recurrent expenditure while investment on public infrastructure was maintained at a level to support the high growth momentum. Reflecting the improvement in the fiscal sector, the debt to GDP ratio declined to 78.5 per cent in 2011 from 81.9 per cent in 2010. The external sector, which strengthened in the first half of 2011, came under pressure during the latter part of the year due to adverse global developments and rapid growth in imports. Despite the healthy growth in exports, significantly high import expenditure reflecting high oil prices and a surge in investment and intermediate goods imports led to a rise in the trade deficit to an unprecedented high level. Although improved foreign inflows through private remittances and other inflows to the services account helped to cover a substantial part of the trade deficit, the current account deficit as a percentage of GDP, increased to 7.8 per cent in 2011. In order to address the widening current account deficit, a package of measures was implemented in February 2012 allowing more flexibility in the exchange rate, further tightening of monetary policy and adjustment of domestic petroleum prices in line with international prices. The stability of the financial system further improved supported by conducive macroeconomic conditions and strengthened supervision and regulation. Prudential indicators were maintained with adequate capital and liquidity buffers, improving asset quality and healthy profit levels.

Conclusion

28. Recent macroeconomic and financial developments have served to underscore the increasingly integrated and interconnected world in which we live. Our responses to global developments must be equally integrated and interconnected for them to be effective in securing growth in an environment of global stability. The IMF has a critical role in anchoring global coordination in order to effectively harness the positive externalities of durable global economic and financial stability. This will create the basis for more fundamental reform that creates a virtuous cycle of inclusive growth with low inflation, growing trade, and an international financial architecture that prevents future global financial instability and mitigates the adverse effects of crises.