C.D. DESHMUKH MEMORIAL LECTURE
1990

GLOBAL ECONOMIC PROSPECTS AT THE TURN OF THE DECADE

E. GERALD CORRIGAN

CONTENTS

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CHINTAMAN DESHMUKH MEMORIAL LECTURES

Chintaman Dwarakanath Deshmukh, who passed away on October 2, 1982, was the first Indian Governor of the Reserve Bank of India. He later became the Union Finance Minister. In recognition of his meritorious services to the Reserve Bank and the nation and to perpetuate his memory, the Reserve Bank of India has instituted an annual lecture series styled Chintaman Deshmukh Memorial Lectures. So far, five lectures have been delivered and published in this series, as mentioned below:

Lecture No.	Delivered by	Subject	Date
1.	Professor Nicholas Kaldor	The Failure of Monetarism	January 18,1984
2.	Professor James Tobin	Central Banks and Government Budget	January 9, 1985
3.	Professor Janos Kornai	State-Owned Firm, Bureaucracy and Market: Hungarian Experience	February 7,1986
4.	Dr. Lawrence Klein	Financial Innovation: Effects on Economic Performance	November 24,1987
5.	Mr. Michel Camdessus	The Evolving International Monetary System: Some Issues	October 4, 1988

The sixth lecture entitled "Global Economic Prospects at the Turn of the Decade" included in this publication was delivered by Mr. E. Gerald Corrigan on January 11, 1990.

Chintaman Deshmukh was born on January 14, 1896 at Nata, near Fort Raigarh, in Maharashtra, in a land-holding family with traditions of public service. Chintaman's father, Dwarakanath Ganesh Deshmukh, was a respected lawyer and his mother, Bhagirathibai, was a deeply religious lady.

Chintaman had an outstanding educational career. He stood first in the Matriculation examination of the University of Bombay in 1912, also securing the first Jagannath Sankersett Scholarship in Sanskrit. At the University of Cambridge he took a first in the Natural Sciences Tripos in Botany, Chemistry and Geology in 1917 winning the Frank Smart Prize in Botany He appeared for the Indian Civil Service Examination, then held only in London, in 1918, and topped the list of successful candidates.

For most of his 21 years with the Indian Civil Service, Chintaman Deshmukh was with the then Central Provinces and Berar Government, where, among other things, he was probably the youngest among those who held the positions of Revenue Secretary and Finance Secretary. While on leave overseas in London, he worked as one of the secretaries to the Second Round Table Conference in which Mahatma Gandhi participated. The memorandum submitted by the Central Provinces and Berar Government, which Deshmukh prepared, for the purpose of the enquiry by Sir Otto Niemeyer leading to the award on the financial relations between the Centre and the Provinces under the Government of India Act, 1935, won him high acclaim.

Chintaman Deshmukh's association with the Reserve Bank of India began in July 1939, when he was appointed Liaison Officer in the Bank to keep the Government of India in touch with the Bank's affairs. Three months later he was appointed Secretary of the Central Board of the Bank and two years later in December 1941, Deputy Governor. He was Governor from August 11, 1943 to June 30, 1949.

Chintaman Deshmukh proved to be an outstanding Governor. He presided over the transformation of the Reserve Bank from a private shareholders' bank to a nationalised institution and secured the enactment of comprehensive legislation for the regulation of banking companies and the establishment of the first financial institution for the provision of long-term credit to industry, namely, the Industrial Finance Corporation of India. He also initiated a number of steps for building up an adequate machinery for rural credit. Commenting on Chintaman Deshmukh's role in regard to the provision of rural credit, a leading co-operator wrote that he "brought about a complete change in the approach from one of hesitant conservatism or laissez-faire to that of a progressive outlook and adoption of positive steps to build up an institutional machinery to provide agricultural credit and for channelling Reserve Bank funds for development of agriculture." With nearly a decade's intimate association with the Reserve Bank, Chintaman Deshmukh reviewed central banking in India in a most thought-provoking Kale Memorial Lecture in 1948.

Chintaman Deshmukh played an important role in the Bretton Woods Conference in July 1944, leading to the establishment of the International Monetary Fund and International Bank for Reconstruction and Development. In both of these institutions, Chintaman Deshmukh was a Member of the Board of Governors for ten years and was the Chairman at the Joint Annual Meeting of these two institutions held in Paris in 1950.

In September 1949, Prime Minister Jawaharlal Nehru appointed Chintaman Deshmukh India's Special Financial Ambassador to America and Europe, in which capacity he conducted the preliminary negotiations for a wheat loan from the U.S.A. Towards the end of the year, Jawaharlal Nehru asked Chintaman Deshmukh to work on the organisation of Planning Commission and appointed him member of it when it was set up on April 1, 1950. Shortly thereafter, Chintaman Deshmukh joined the Union Cabinet as the Finance Minister and held that office with distinction till he resigned from it in July 1956. His stewardship of the country's finances was marked by prudence as well as humane perspective and vision, dealing imaginatively with the changing financial needs of a developing country. Financial policy was directed towards facilitating the achievement of rapid growth, social justice and economic stability. He made significant contributions to the formulation and implementation of the country's First and Second Five Year Plans. He was also primarily responsible for such important landmarks in the area of social control of the financial structure as the enactment of a new Companies Act and nationalisation of the Imperial Bank of India and life insurance companies.

The departure from the Union Cabinet marked the beginning of a different phase of public service by Chintaman Deshmukh in the realms of education and social service. He was Chairman of the University Grants Commission from 1956 to 1960, helping to lay a solid foundation for the improvement of the standards of University education in the country. He was Vice-Chancellor of the University of Delhi from March 1962 to February 1967, building it up as an outstanding institution of higher learning.

Chintaman Deshmukh also gave generously of his time and energies to the building up of other important institutions devoted to the cause of education and research. He was President of the Indian Statistical Institute (ISI) from 1945 to 1964. It was during the period when he was both the President of the ISI and the Union Finance Minister that the National Sample Survey, to be conducted by the ISI, was instituted (1951-52), and the Central Statistics Office established. He was President of the Institute of Economic Growth, New Delhi, from 1965 to 1974. He served as the honorary Chairman of the National Book Trust from 1957 to 1960. He founded the India International Centre in 1959, of which he was Life President. He headed the Court of Governors of the Administrative Staff College of India, Hyderabad, from 1959 to 1973 and was Chairman of the Indian Institute of Public Administration, New Delhi, in 1963-64. Other bodies with which Chintaman Deshmukh was associated included the Indian Council of World Affairs (1960-67) and the United Nations Institute for Training and Research (1965-70). Along with his wife Durgabai, Chintaman Deshmukh participated in multifaceted social service work, especially in the functional literacy and family planning work undertaken by the Andhra Mahila Sabha, Madras and Hyderabad, a social organisation of which Smt.Durgabai was the Founder President. He became its President after Smt.Durgabai's death.

Chintaman Deshmukh's old college at Cambridge, Jesus College, elected him an Honorary Fellow in 1952 in recognition of his distinguished contribution in the areas of Indian and international finance and administration. He was co-recipient in 1959 of the Ramon Magsaysay Foundation's Award for distinguished Government Service. A number of prestigious universities and institutions, international as well as Indian, conferred on him doctorates honoris causa; these included the Universities of Princeton (U.S.A.) Leicester (U.K.), Pune, Delhi, Allahabad, Nagpur and Osmania (India), as also the Indian Statistical Institute.

Chintaman Deshmukh had a great love for gardening and horticulture was his special hobby. He continued to be a deep student of Sanskrit and published a volume of his poems in that language in 1969. He was proficient in a number of foreign languages also.

Chintaman Deshmukh died in his 87th year at Hyderabad where he had finally settled down. With his rare combination of qualities of head and heart, idealism and objectivity, culture and science, integrity, dedication and imagination, Chintaman Deshmukh will always rank high among the eminent sons of India.

WELCOME ADDRESS

R.N. Malhotra

Governor, Reserve Bank of India

Mr. Corrigan, Dr. Chelliah, Ladies and Gentlemen,

It is with great pleasure that I welcome you all to the Sixth Chintaman Deshmukh Memorial Lecture. Many of you are aware that this series of lectures was instituted to commemorate the late Shri Chintaman Dwarakanath Deshmukh, the first Indian Governor of the Reserve Bank of India, who passed away in October 1982.

Chintaman Deshmukh, who was born on January 14, 1896, had a brilliant academic career and an outstanding record of service as a civil servant, central banker, parliamentarian and Minister, economic policy maker and educationist. After securing a first in Natural Sciences Tripos at the University of Cambridge, he was an illustrious member of the Indian Civil Service for 21 years. He joined the Reserve Bank in 1939 and quickly rose to become its Governor in 1943, a position he held with great distinction till the middle of 1949. During the period of his stewardship of the Bank, a comprehensive legislation for the regulation of banking companies was enacted, the Industrial Finance Corporation of India for providing long-term credit to industries was set up and a sound institutional structure for rural credit was initiated. He played a crucial role as an active member of the Indian delegation to the Bretton Woods Conference of July 1944 which led to the establishment of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD). He was a Member of the Board of Governors of both these institutions for ten years and was the

Chairman of the Joint Annual Meetings of the two institutions held in Paris in 1950. He was the Finance Minister of India from 1950 to July 1956, a period during which India's planning process for economic development firmly got under way. The imprint of his vision and pragmatism is clearly seen in the economic policies that were then shaped for promoting economic growth with stability and social justice.

After leaving the Government, Chintaman Deshmukh continued to play an active role in many areas of public life, particularly in education and social service. He received several national and international honours such as election in 1952 as an Honorary Fellow by his *alma mater*, Jesus College, Cambridge, and the Ramon Magsaysay Foundation Award for distinguished Government service in 1959. A man of many parts and wide interests, deep culture and humanity, Chintaman Deshmukh is remembered with great respect and regard.

We have been extremely fortunate in attracting many eminent persons to deliver lectures in this series, the first being Professor Nicholas Kaldor in 1984. The subsequent lectures were delivered by Professor James Tobin in 1985, Professor Janos Kornai in 1986, Professor Lawrence Klein in 1987 and Mr. Michel Camdessus in 1988.

For the sixth lecture today, we are happy to have amongst us Mr. E Gerald Corrigan, President, Federal Reserve Bank of New York.

Mr. Corrigan is a central banker of eminence and repute. Born in 1941, he was educated first at Fairfield University and later at Fordham University from where he earned a doctorate in economics. He was Group Vice President, Management and Planning, Federal Reserve Bank of New York, in 1976 and was specially assigned to the Chairman, Board of Governors of the Federal Reserve System, in 1980. In 1981, he was appointed President, Federal Reserve Bank of Minneapolis, and came to his present prestigious assignment as President, Federal Reserve Bank of New York, in 1985, a post he has been holding with great distinction. It is indeed my great pleasure to welcome Mr. and Mrs. Corrigan to India and to the Reserve Bank.

Mr. Corrigan has chosen to speak this evening on "Global Economic Prospects at the Turn of the Decade", a theme which should interest all of us greatly. From one standpoint, the 1990s could be a decade of fascinating possibilities. There are strong signs of the unwinding of the cold war—witness the firm initiatives towards disarmament and the rapid and revolutionary changes in Eastern Europe. A major relaxation in the international environment could have a highly beneficial impact on the world economy. At the same time, there are many uncertainties. There is evidence of a slow-down of economic activity in both industrial and developing countries. The volume of world trade is expected to decelerate. The outcome of the Uruguay Round is yet unclear and apprehensions regarding trade protectionism persist. The large external imbalances among major countries are far from resolution and exchange rates of key currencies continue to exhibit considerable volatility and misalignment. More recently, interest rates in industrial countries have hardened with implications for investment activities world wide and for the debt problem of many developing countries. Financial flows to developing countries have been declining and external financing of payments gaps has been difficult for many developing countries. Mr. Corrigan with his vast experience as the President of the Federal Reserve Bank of New York and his knowledge of the working of the financial markets would, I am sure, provide us with a comprehensive picture of the various factors and relationships that have influenced the course of events in the 1980s and will affect the future prospects of the global economy.

We are very fortunate to have Dr. Raja J. Chelliah, a distinguished economist and a well-known expert in fiscal affairs, to preside over this function. Dr. Chelliah has had a long association with several universities and official bodies in India and abroad, both as a professor and as an international civil servant. His international experience embraces work with the United Nations, ECAFE and the International Monetary Fund. In his capacity as a Member, till recently, of the Planning Commission as well as of the Finance Commission, he has closely studied the complex problems confronting the Indian economy and has made significant contributions to national policy, particularly in the area of public finance. We are grateful to him for agreeing to grace this occasion with his presence and to offer comments on this evening's lecture.

I once again welcome all of you to this function and would now request Mr. Corrigan to deliver his lecture.

GLOBAL ECONOMIC PROSPECTS AT THE TURN OF THE DECADE

E. Gerald Corrigan

Mr. Governor, Distinguished Guests and Ladies and Gentlemen,

I am honoured to appear before you to deliver the Sixth Deshmukh Memorial Lecture.Governor Deshmukh's long and distinguished career in public service — including his tenure as the first Governor of the Reserve Bank of India — still serves as a source of inspiration to all who know of the man and his commitment to sound policies. He fully grasped the need to shape policies with a view toward long-term results with emphasis not only on their economic consequences but also an appreciation of their social and humane implications. The period of Governor Deshmukh's association with the Reserve Bank of India — including his role as a delegate to the Bretton Woods Conference — was surely a difficult if not turbulent era, but were he still alive, I feel safe in suggesting that he would have regarded the decade of the 1980s as equally challenging in many respects, especially for central bankers.

With that in mind, my purpose today is to share with you some of my own reflections on the '80s, with a view towards seeking to identify what lessons we can learn from the experience of the past decade and how those lessons might help us in the '90s as we seek to secure sustained non-inflationary growth in our national and international economic systems.

Even the most cursory review of the broad sweep of economic and financial developments over the past ten years serves as a forceful reminder of just how much the world economy had to digest in a relatively short period of time. The decade began with much of the world caught up in a virulent inflation the likes of which many countries had not experienced in a peacetime setting in decades. Not surprisingly, that burst of inflation gave rise to major imbalances in economic performance, culminating in a deep recession which for a number of countries — my own included — was the most severe economic downturn since the 1930s. In that same period, the debt problems of many developing countries exploded onto the scene, bringing with them an enormously complex series of economic and social problems for the debtor countries but also placing truly dangerous strains on the international banking system.

Even as the world economy began to recover from the recession of the early 1980s, it was quite clear that powerful forces — some technological, some political and some competitive — were to radically transform the economic and financial setting in which governments, businesses and households would have to manage their economic affairs. In few places were those changes more apparent than in financial markets, where the interrelated forces of technological change, innovation and deregulation induced changes of several orders of magnitude in the manner in which national and global financial markets operate. Partly as a result of these forces, volatility — at times of extreme proportions — became the order of the day in financial markets. The stock market drop of October 1987 provided a vivid, indeed somewhat frightening, reminder of the risks to our collective economic well-being that can be associated with excessive churning and volatility in financial markets.

Yet, despite the LDC debt crisis, the stock market shock and numerous other disruptions in banking, financial and commodity markets, overall economic performance — especially in the industrialized world — panned out remarkably well over most of the decade. Indeed, in a number of countries — the United States included — the duration of the economic expansion has been of record proportions. More generally, the growth in world trade has continued to outpace the growth in overall output and protectionist pressures have been reasonably well contained even in the face of truly massive imbalances in trade and current account positions.

Outside of the major industrialized countries, developments in the '80s were distinctly more mixed. To be sure, a number of newly-industrialized countries — notably on the Pacific rim — showed powerful economic growth over the period and in the process chalked up very large trade and current account surpluses. Perhaps the most graphic example of this is to be found in the case of Taiwan, whose foreign exchange reserves are now significantly greater than those of Saudi Arabia at the peak of oil prices in the early 1980s. In a number of other important cases major economic strides were made. In this regard, India certainly stands out as one of the countries that has made major gains, as illustrated by both the pronounced acceleration in the trend rate of growth in G.D.P. and ongoing efforts to increase efficiency and competitiveness. But, for many countries, especially in Africa and Latin America, the 1980s was indeed a dark decade. Sadly, in more than a few instances, living standards today remain below levels that had been achieved at the end of the '70s and in the early 1980s. Nevertheless, in a growing number of heavily indebted developing countries, important progress has been made, especially in the recent past.

In short, the events of the '80s in much of the developing world must, on balance, be regarded as disappointing. On the other hand, we can claim a measure of satisfaction with developments in the industrialized world. But, that sense of satisfaction must be tempered. For example, it would be tempting to conclude that we have somehow come to master our economic fate such that things that at one time seemed to be a matter of great concern are no longer particularly important. For example, I am struck by the number of commentators in the United States who look back at the 1980s and conclude that concerns about the United States' internal and external deficits were misplaced. After all, they would argue, these deficits did not stand in the way of the longest peacetime expansion in history during which the underlying inflation rate has remained essentially stable at 4 to 4.5 percent for several years running.

It will, I am sure, come as no surprise to you when I say that I do not share that view. Not only do I continue to view the U.S. deficits as unsustainable over time, but I surely don't find an inflation rate of 4 to 4.5 percent in any way cause for celebration. That, of course, is simply another way of saying that the impressive performance of the U.S. and other industrialized countries' economies over much of the '80s cannot be allowed to lull us into a false sense of comfort and security about prospects for the 1990s.

Our success in managing economic and financial affairs in the 1990s will, in no small way, depend on the extent to which we take advantage of the experience of the '80s in framing approaches to economic policy. Looked at in that light, it seems to me that there are several very important lessons to be learned from what we experienced in the '80s. They are:

The **first** lesson of the '80s could probably apply to almost any decade but may be especially relevant for the '80s and that is the utmost need to be cautious about the extremes of economic doctrine and theory. Indeed, whether we are speaking of the Keynesian, the monetarist, the supply sider, the rational expectationalist or any other school of thought, single-minded approaches to public policy can be very misleading, if not dangerous. Let me cite just two examples in support of this view. First, there can be no doubt that cuts in tax rates in the U.S. that were conceived in the context of a supply side view of economics played a major role in the record expansion in the U.S. However, it is also true that those same tax cuts contributed to the budget deficit problem just as it can be said that the major gains in productivity and savings suggested by the supply side school simply did not materialize. Second, the enormous shifts in monetary velocity that we experienced at times during the 1980s make it quite clear that the pursuit of any strict monetarist approach to monetary policy would have been disastrous. That, of course, is not to say that the supply side or monetarist approaches are not helpful schools of economic thought for clearly both have much to offer. But, it is to say that economics and theology don't mix.

The **second** important lesson of the '80s is the compelling evidence that inflation is fundamentally in conflict with stable and growing economies. Whether we look at the industrial world, the developing world, the east, the west, the north or the south, what we see is that reasonable performance on the inflation front is associated with higher levels of overall economic performance, while high and rising rates of inflation are universally associated with instability and subpar patterns of economic activity. Moreover, it is also true that the economic and social costs of correcting inflation, once it has taken hold, are very great indeed. Taking the United States as an example, there is no question in my mind that the depth of the 1981-82 recession was directly related to the severity of inflation that preceded it, just as I have no doubt that the extraordinary duration of the current expansion is importantly related to our relative success in keeping the inflation rate from accelerating in any significant way.

As another example, I would also argue that many of the root causes of the debt problem which still plague so many developing nations today can be traced back to the inflationary environment of the late 1970s and early 1980s. Similarly, I would argue that it is no coincidence that the individual debtor countries in the developing world that have had the greater measure of success in working their way out of the debt problem are the ones that, on balance, have had the best performance in coping with inflation.

Against that background, one would think that broad-based public and political support for monetary policies designed to keep inflation rates in check would be a given. Unfortunately, I do not sense that is the case, especially when it comes to support for pre-emptive policies that work to head off rises in the inflation rate before they are actually reflected in statistics and in behaviour and expectations. In other words. while the evidence is overwhelming that inflation should be viewed as the economic equivalent of public enemy number one, there is often little or no public support for policies aimed at restricting rises in the inflation rate before they become a reality. A little inflation or a little more inflation always seems so benign as it occurs. But, as we all have learned the hard way, there is no such thing as a little more inflation because once the process takes hold it cumulates.

In my judgment, this is the first and foremost reason why central banks should have an appropriate degree of independence from short-term political pressures, even though I fully recognize that the degree and form of that independence will vary from country to country. In that connection, I draw some comfort from the fact that in a number of countries, ranging from Chile, to New Zealand, to South Korea, to Sweden, efforts are now under way or have been recently completed to enhance the degree of independence of their central banks. In this regard, let me also add that I find it more than a bit ironic that there are some in the United States who seem to want to go in just the opposite direction by reducing the independence of our central bank.

A **third** important lesson to be learned from the 1980s is that international cooperation on economic and financial affairs is both necessary and can be made to work. For example, in the 1980s we witnessed several extraordinary examples of international cooperation at its best, including the initial efforts to contain and stabilize the problems growing out of the LDC debt crisis; the emergence of internationally accepted bank capital standards; the extraordinary speed and relative ease with which the European economic integration has proceeded; and the close collaboration among financial authorities, in the time frame of the October 1987 stock market break.

More generally, I regard the post-Plaza Accord efforts of the G-5 and G-7 aimed at improved coordination of macro-economic policy as a distinct plus, even though I recognize that that process is not without its critics. To some extent, however, the critics of the process may have exaggerated expectations about what realistically can emerge from these efforts. At the extreme, there are those who would seem to regard any meeting of the G-7 that does not yield some dramatic policy initiative as a failure.

I simply don't see it that way. To the contrary, from my experience, the simple fact of face-to-face discussion of issues of mutual concern on matters pertaining to economic policy produces the highly valuable result of making all the parties to the discussion more sensitive to the problems and perspectives of others. Accordingly, the measure of success for a meeting of the G-7, the Interim Committee, or the G-10 Central Bank Governors in Basle is not whether there is some major policy change in a communique or, for that matter, whether there is even a communique. Rather, the measure of success is the ability of the participants to grasp more fully all the dimensions of their own situation and the situation of others and their ability to frame their own policies in a manner in which the sensitivities to the problems and perspectives of others loom larger rather than smaller. Looked at in that light, I firmly believe the broad process of collaboration and cooperation on economic and financial matters is necessary and desirable and that our success in such efforts during the 1980s was a significant net plus for the well-being of the world economy.

A **fourth** important lesson of the 1980s is that the globalization, innovativeness and deregulation of financial markets have proven to be very much a two-edged sword. On the one hand, there is little doubt that these developments have expanded the choices for savers and investors, reduced the cost of financial transactions, improved the allocation of saving and investment nationally and internationally and increased the competitiveness and efficiency of financial institutions and financial markets. But, and this is a very large but,there is also no doubt — at least in my mind — that these same forces have also increased volatility in financial markets, introduced new and highly complex elements of risk — possibly even increasing systemic risk — while at the same time contributing to the apparent condition of overcrowding we are seeing in international and wholesale financial markets. Another very troubling phenomenon that seems to grow out of this process is the manner in which credit flows to individual borrowers — whether a company or a country — can suddenly stop. That is, up to a point, credit flows are almost automatic even as the creditworthiness of the borrower may be deteriorating. But once the threshold of concern about creditworthiness is reached, the flow of credit can come to a full and harsh halt. From one perspective, that may illustrate the market-place working at its best but from another it may imply that we have a financial system which is more prone to rather abrupt and potentially destabilizing shocks.

Leaving that particular issue aside, it seems to me that the characteristics of financial markets and institutions as they have evolved over the decade of the 1980s leave an enormous burden on those who manage and those who supervise such markets and institutions. This burden is all the more compelling when evident pressures on profit margins and spreads can give rise to overly aggressive, if not outright speculative, business strategies on the part of individuals or individual firms. In these circumstances, it seems to me important that central bankers and other supervisory authorities should not feel the slightest bit apologetic — even in this age of deregulation — about insisting that prudential standards in such areas as capital adequacy, liquidity, avoidance of concentrations and the presence of strong risk management and controls systems are the first order of business for financial institutions.

The **final** major lesson of the '80s I want to touch on may be the most dramatic and that, of course, would be the sweeping trend toward more open, more competitive and more market-oriented economic systems at the national level. Even before the recent stunning developments in Eastern Europe and the Soviet Union, the handwriting was on the wall as the gap in performance between more open and more market-oriented economies relative to closed and governmentally controlled systems became more apparent as illustrated, for example, by the comparative patterns of economic development in the Pacific Basin relative to Latin America. This is not to suggest that relative economic performance alone accounts for the recent astonishing turn of events in so many countries. On the other hand, and especially in this age of information technology, there can be little doubt that the relative shortcomings of tightly controlled economic systems is an important driving force in these developments. The great challenge, of course, is for the community of nations to do all that it can in support of this shift in direction — a responsibility which falls heavily on all of the major industrialized nations with particular emphasis, in my judgment, on the United States.

Against the backdrop of those reflections on the 1980s, allow me to close with a few comments about the key priorities as we enter the 1990s. Looking first to the major industrial countries as a group it seems clear to me that the priorities are fourfold: First, to keep inflation in check recognizing that many if not most such countries are already in the "yellow zone" with regard to the potential for some build-up in inflationary forces; second, to redouble efforts to reduce the massive trade and current account imbalances among these nations. This is important in its own right but it is especially important in view of the clear and pressing need to redirect international savings flows away from countries such as the U.S. and the U.K. and toward developing countries and the nations of Eastern Europe; third, to do all that can be done through financial support, technical assistance, and technological transfer to help narrow the gap in economic performance and living standards between the industrial countries and the other nations of the world; finally, to strongly resist protectionist pressures and, more positively, to seek out opportunities to reduce and eliminate trade barriers even in such politically difficult areas as services — including financial services — and agricultural products.

As for the United States itself, there are several areas of particular emphasis. For our own sake and for the well-being of the world economy, we simply must do a much better job of coming to grips with the savings imbalance in the U.S. economy. To me that means eliminating the budget deficit even though the private savings rate may be expected to rise somewhat simply on the basis of demographics. As a corollary to this, U.S. economy also needs a large and sustained increase in net private investment, especially in manufacturing, in order to generate the supply of exports that is critical to the shrinkage of our trade deficit. Indeed, I can see no way in which there can be an orderly reduction in the U.S. trade deficit (and a corresponding cut in our claims on the world's savings) unless a significant fraction of that adjustment takes the form of higher exports of manufactured goods — especially "high-tech" goods — to industrialized and newly industrialized nations.

For developing nations it is very clear that the dictates of the '90s will be importantly captured in two words: competitiveness and creditworthiness. Both of these words presuppose the pursuit of sound macroeconomic and structural policies on the part of individual countries. There is nothing new about that. What will be new, or at least different, will be the extent to which the market place will distinguish between strong performance and weak performance. Developing countries, by definition, need external capital flows to develop. In the '90s, I suspect that competition for such capital flows will be especially keen in a context in which there simply will not be enough official money to go around. For that reason, the countries that stand the better chances for success will be the countries that are able to attract private capital flows whether in the form of capital reflows, direct investment, capital market funding or conventional bank loans. This is precisely the reason why short-sighted efforts by some countries to finance themselves by accumulating interest arrearages or by ill-conceived programs of debt reduction can be so very dangerous to their own long run interests. That is not to say — as we have seen — that it is impossible to assemble constructive, innovative and market sensitive approaches to reducing debt service burdens. However, it is to say that where such approaches are necessary they should be framed in a manner that clearly is sensitive to the ongoing need to preserve constructive relationships between the individual country and private sources of fresh credit and finance. It is also to say that countries that follow sound policies which permit them to satisfy their financial obligations in a manner that strengthens their credit standing will be the ones that are much closer to the front of the long line of those seeking external financing during the decade of the '90s.

If those are a few thoughts on priorities for the industrial nations, developing nations and the United States in particular, there is one final thought that applies to all nations. That is, as I look to the '90s the need for a still higher level of international cooperation is clear. Consistent with that I believe the case for increased financial, political and moral support for the key multinational official institutions is compelling. Here, I have in mind not just the Fund, the World Bank, and the Regional Development Banks but also and perhaps especially the G.A.T.T. Our successes or failures in the Uruguay round will go a long way — for better or worse — in setting the tone for the balance of the decade. In this regard, let me also say that I would hope and expect — for both substantive and symbolic reasons — that the United States Congress will act swiftly and harmoniously to pass the legislation that is needed to put in place the U.S. share of the contemplated I.M.F quota increase, once the details on the quota increase are worked out. A failure to do so, even in the face of our obvious budgetary problems, would, in my view, send all of the wrong signals at just the point in time that the opportunities for progress on so many fronts are so great.

In closing, ladies and gentlemen, I wish I could say to you that having reasonably well navigated the unchartered waters of the '80s we could safely look forward to clear sailing for the '90s. But, you know and I know, that's not in the charts. We also know, however,that it is within our capacity to forge policies and programmes to materially enhance prospects for success and progress. We also know that if we opt for the expedient, if we concern ourselves only about today or, even worse, if we each concern ourselves only about ourselves, we will fail. I, for one, see the '90s as a time of enormous opportunity and look forward to it in that spirit.

PRESIDENTIAL REMARKS

R.J. Chelliah

Mr. Corrigan, Governor Malhotra, Deputy Governor Dr. Rangarajan, Ladies and Gentlemen,

It is often said that when you are in the Reserve Bank of India you feel that you are in rich company. Particularly today, on this occasion, I am overwhelmed by distinguished company — the company of distinguished individuals past and present. It is indeed gratifying, and in the fitness of things, that the Reserve Bank of India brings together such distinguished personalities. This lecture naturally evokes memories which we of the older generation have of the late Shri Chintaman Deshmukh who can be counted among the leaders of this country who managed and accomplished with consummate skill the transition of India into modern nationhood at the most critical period in our recent history. Scholar, able and efficient civil servant, a leader of extraordinary vision and depth of understanding, Chintaman Deshmukh was indeed a great son of India who improved everything that he touched.

Deshmukh, the first Indian Governor, was succeeded in the office of the Governor of the RBI, by a series of distinguished persons who upheld the integrity and the high position of the Bank with distinction, not excepting the present. Like others before him Governor Malhotra has brought to his office vast experience in governance and finance and distinguished service to this and other developing countries. This lecture series in turn has brought to the Bank and to Indian audiences eminent economists, specialists in finance and thinkers of a high order including two Nobel Laureates. We must compliment the Reserve Bank of India for endowing this lecture series and stimulating discussion on important monetary and financial policy matters.

We have listened this evening to a scintillating lecture by another eminent economist and public servant Mr. Gerald Corrigan. His presence here tonight for giving this lecture is a testimony to his own high standing in the world of high finance; it also, I believe, symbolises growing economic collaboration between America and India whose economic scholars and practitioners of economic statecraft have for long been engaged in dialogue and discussion to mutual advantage. Sir, I would like to add my own word of welcome to you and to your gracious wife and say that we are indeed glad to have had the opportunity of listening to you.

Mr. Corrigan has painted on a wide canvas and covered a number of important issues in the field of international finance. His broad survey of the economic events, problems and achievements of the 80s, set in the context of international economic and financial relations has been admirably carried out, bringing out through careful analysis the reasons for the successes and failures of policy initiatives, the lessons that we have learnt or could learn and policy implications of those experiences. We are indeed thankful to him for enabling us to understand the interconnections between the actions and problems in the different areas which impinge on world financial relations. If most practitioners could explain so well, there would be better understanding of economic problems.

Truly, the eighties have been a turbulent period causing great hardship to many countries and posing a none-too-easy scenario for the maintenance of world economic stability. But as Mr. Corrigan pointed out, there have also been great technological advances and institutional and basic structural changes that have placed us at a distinct advantage as we enter the nineties. In my view the fading away of the great ideological divide is a distinct gain both for dispassionate analysis leading to the pursuit of national policies and for greater international economic co-operation. The closing months of 1989 have dramatically enacted the breakdown of the regimes based on centrally planned economic system. I think that we all now have a greater appreciation of the need for the effective functioning of a market system not only for the sake of efficiency, but also to secure on a firm basis political and economic freedom. At the same time, market system would have to be guided and regulated, where necessary at the national and international levels, not through vesting enormous discretionary powers in the hands of the State but through rules and financial policies. This is a lesson which we have been slowly teaching and learning in India, but many find it difficult to divest themselves of old socialist institutional framework. We may still talk of socialism and a socialist society but the system that we build must incorporate the criteria of incentives, efficiency and decentralised decision-making through the market and equity. This lesson is crucial for the progress particularly of the less developed countries.

Mr. Corrigan rightly considered inflation as problem no. 1 and enemy no. 1. I can not agree with him more, and I regard the budget deficit as the right root cause of our troubles, as he regards it in the US. We must fully support his plea for autonomy of the central bank in the pursuit of monetary policies. The monetisation of public debt must be avoided or at least be strictly limited. However, I would add that the economy should also be made more autonomous of the RBI. I mean the direct control of the foreign exchange market and administration of interest rates through fiat should gradually be done away with. Let RBI prepare a long-term plan for making the rupee a convertible currency. But I agree all that can be thought of only after the fiscal deficit is brought down drastically and its monetisation strictly limited according to the best judgement of RBI. Mr. Corrigan has drawn attention to the progress in international co-operation and in attempts at co-ordination of policies by governments of industrial countries. We must agree with his comments on the need to reduce trade and current account imbalances, to bring about sufficient quota increases in the IMF and to increase the flow of capital particularly private capital. However, with the cold war gradually subsiding, the prospects for disarmament are bright and there could be greater flow of aid.

The priorities for the 1990s that Mr. Corrigan postulates are: first, policies to reduce budget deficits and keep inflation down; second to reduce massive trade and current account imbalances; third, to help narrow gap in economic performance and living standards between developed and developing nations; and fourth, to continue to reduce trade barriers. I would only add that while I favour increased foreign private investment in developing countries, I believe that action should be taken at international level to ensure that the market mechanism does not exploit or grind down weaker countries.

Mr. Corrigan puts forward two economic goals for the developing world in the area of international economic relations: competitiveness and credit-worthiness—both are needed to achieve self-reliance. In this connection, I was struck, as all of you must have been, by a statistic that he mentioned, i.e., the foreign exchange reserves of Taiwan today are as high as Saudi Arabia's were at the height of the oil price boom in the early eighties. What is the state of our reserves? The goal of self-reliance has eluded us. Have we been pursuing the right policies? I believe that the concept of self-reliance must the redefined in the light of experience — of ours and of several other countries.

Self-reliance should mean: a) the capacity to finance development largely through the country's own resources (i.e. domestic savings) — we have that capacity — and b) ability to pay our international bill through our own earnings, allowing for needed imports to sustain growth and for a reasonable level of trade deficit to supplement domestic savings. We must move away from the concept of self-sufficiency in all the major areas. The emphasis must be on efficiency, competitiveness and comparative advantage, coupled of course with fiscal prudence.

In the end, let me express our gratitude to Mr. Corrigan and the RBI for giving us a rich intellectual feast this evening.

VOTE OF THANKS

C. Rangarajan

Deputy Governor, Reserve Bank of India

Mr. Corrigan, Dr. Chelliah, Governor Malhotra and Distinguished Invitees,

It is indeed a great privilege to have had with us this evening Mr. Gerald Corrigan to deliver the Sixth Chintaman Deshmukh Memorial Lecture. Dr. Deshmukh was not only an administrator with great foresight and wisdom but also a scholar, a serious thinker and writer. It is for this reason that we thought that the best way of commemorating him is to institute an annual series of lectures which can be delivered by distinguished persons and men of eminence. We had the pleasure of listening to Mr. Michel Camdessus, Managing Director of the International Monetary Fund, last year and this year we have Mr. Corrigan, another important personage from the international financial world. Mr. Corrigan has played and continues to play an important part not only in shaping American monetary policy but also in implementing it because the Federal Reserve Bank of New York is the operating arm of the Federal Reserve System. Mr. Corrigan has been very forthright in the expression of his opinions. From time to time, on many occasions, he has while welcoming deregulation and liberalisation warned of the dangers inherent in this change. He talked about it today also and referred to what he called "excessive churning and volatility in financial markets" leading to systemic risk. He laid before us the problems of the eighties and brought out the achievements and failures. While the developed countries have been able to overcome to some extent the trauma of the high inflation followed by the recession of the early eighties it has extracted a heavier toll from the developing countries which are still groaning under the weight of a growing debt. The study of the past is relevant only in so far as it has lessons for the future and I think drawing on the experience of the 1980s Mr. Corrigan has also indicated in what directions policy should be moving in the nineties. I am happy that he brought out one important fact about the perverse direction in which the financial flows are moving and the need for redirecting the international savings away from the rich countries and towards the developing countries. We sincerely hope that the policy makers in the developed countries, particularly in the United States, will heed the advice given by Mr. Corrigan in this evening's function. May I, on behalf of the Reserve Bank of India, convey to you Mr. Corrigan our most grateful thanks for agreeing to be with us this evening and delivering a most stimulating address?

Our thanks are also due to Dr. Raja Chelliah for agreeing to be with us this evening. Mr. Chelliah appears to be even more active after relinquishing his position as Member of Planning Commission. He returned from attending a conference in Oxford yesterday morning. Mr. Chelliah is,of course, well known in this country for his contributions in the areas of fiscal policy and fiscal management and his writings and advice have been responsible for many a tax reform in this country. May I, on behalf of the Reserve Bank of India, thank you Mr. Chelliah for agreeing to be with us this evening and also for offering some provocative comments towards the end, some with which I agree and some with which I do not? I, however, recognize that the vote of thanks is not an occasion to join issues.

To the members of the Deshmukh family and to all of you who have responded to the invitation we are extremely thankful. You have honoured us by your presence this evening.