C. D. DESHMUKH MEMORIAL LECTURE
1988

THE EVOLVING INTERNATIONAL MONETARY SYSTEM: SOME ISSUES

MR. MICHEL CAMDESSUS

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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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 perpetutate his memory, the Reserve Bank of India has instituted an annual lecture series styled Chintaman Deshmukh Memorial Lectures. So far four lectures have been delivered 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	Nov. 24, 1987

The fifth lecture entitled "The Evolving International Monetary System : Some Issues" is being delivered by Mr.Michel Camdessus on October 4, 1988.

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 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 multifaced 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 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

Shri R.N. Malhotra

Governor, Reserve Bank of India

Mr. Camdessus, Shri Nehru, Ladies and Gentlemen,

I am indeed very happy to welcome you all to the fifth Chintaman Deshmukh Memorial Lecture. As many of you are aware, the Reserve Bank had instituted this series of lectures to commemorate the late Shri Chintaman Dwarakanath Deshmukh, who passed away on 2nd October 1982. He was the first Indian Governor of the Reserve Bank of India.

Shri Deshmukh, who was born on 14th January 1896, had a brilliant academic career and was a very distinguished member of the Indian Civil Service for 21 years. He joined the Reserve Bank in 1939 and became its Governor in 1943, a position he held with great distinction till the middle of 1949. He played an important 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 and the International Bank for Reconstruction and Development. He was a Member of the Boards 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. Shri Deshmukh was the Union Finance Minister from 1950 to 1956.

As Governor of the Reserve Bank and the Union Finance Minister, Shri Deshmukh steered the country's finances with vision and pragmatism. In formulating policies, he emphasised the objectives of growth, social justice and economic stability.

After his departure from the Union Cabinet, Shri Deshmukh remained active in several other areas of public life, particularly education and social service. He held the posts of Chairman of the University Grants Commission, Vice-Chancellor of the University of Delhi and President of the Indian Statistical Institute, to mention just a few. He received several honours, national and international. Among them I may mention his election as an Honorary Fellow in 1952 by his *alma mater*, Jesus College, Cambridge and the Ramon Magsaysay Foundation's Award for distinguished government service in 1959.

A versatile man of great abilities, deep culture, humanity and high values Shri Deshmukh is remembered with respect, regard and affection.

We have been fortunate in attracting many eminent speakers to deliver lectures in this series. The first lecture was delivered by Prof. Nicholas Kaldor in 1984 and the subsequent lectures were delivered by Prof. James Tobin in 1985, Prof.Janos Kornai in 1986 and by Prof. Lawrence Klein in 1987. We are extremely fortunate to have with us today Mon. Michel Camdessus, Managing Director, International Monetary Fund to deliver the fifth Chintaman Deshmukh Memorial Lecture.

Mon. Camdessus was educated at the University of Paris and earned post-graduate degree in economics at the Paris Institute of Political Studies and the National School of Administration. He joined the French Civil Service and has had a long and distinguished career in the French Treasury where he held the top civil service position of Director from 1982 to 1984. He chaired the Paris Club meetings of creditor countries for six years from 1978 to 1984 and was Chairman of the Monetary Committee of the European Economic Community from December 1982 to December 1984. He was appointed Governor of the Bank of France in November 1984 and became the Managing Director of the IMF in January 1987. We warmly welcome him and Madame Camdessus to India and to this city of Bombay.

The title of Mon. Camdessus's lecture this evening is "The Evolving Monetary System : Some Issues". The international monetary scene today is at once exciting and characterised by instability and uncertainty. On the one hand, there has been rapid development of global financial markets aided by unprecedented advances in communication and computer technologies, liberalisation, and free flow of funds and information across national frontiers. On the other, the world faces serious problems – under-development and poverty in many regions, declining flow of funds to the developing countries, the debt crisis, intensifying protectionism, large imbalances within and between countries, interest rate instability and exchange rate volatility and misalignment. No wonder, therefore, that there has been so much talk about the need for improving the monetary system. I am sure that Mon. Camdessus's lecture today, on a subject in which he has vast experience and expertise, would be of great interest not only to this audience but to others in this country and abroad.

We are indeed privileged to have Shri B.K. Nehru to preside over this function. An eminent administrator and diplomat, he is also an economist in his own right. Besides holding a series of senior positions in the Indian Civil Service, he has served as India's Ambassador to the United States and has been Governor of several States in India. His wise counsel on a wide range of matters is heard with respect. We are proud that way back in 1940 Shri Nehru was, for some time, an Officer on Special Duty with the Reserve Bank of India. We are most grateful to him for having agreed to grace this occasion with his presence and to offer comments on this evening's lecture.

I once again welcome you all to this function and would now request Mon.Camdessus to deliver his lecture. Ladies and Gentlemen, Mon. Camdessus.

THE EVOLVING INTERNATIONAL MONETARY SYSTEM : SOME ISSUES

Mr. Michel Camdessus

Mr. Chairman, the Governor, Ladies and Gentlemen,

It gives me very great pleasure to be in India. It is a particular delight to come first to Bombay, a city which from the beginning has been one of the meeting points of the world. And it is comforting this evening -- former central banker that I am -- to find myself in the congenial clutches of the Reserve Bank.

It is also a distinct pleasure and indeed a rare honour to have the opportunity to give the fifth C.D. Deshmukh Memorial Lecture. Dr. Deshmukh was not only highly esteemed in this, his own country. He also made a very considerable mark in international financial circles, particularly in those heady days forty to fifty years ago when a new monetary order was being fashioned and nurtured. As a member of the Indian delegation to the Bretton Woods Conference, Dr. Deshmukh played a crucial role in shaping India's attitude to the Bretton Woods institutions. Subsequently, as Governor for India on the Board of Governors of the IMF and World Bank during the formative years of the two institutions, he was instrumental not only in safeguarding India's interests and speaking out for other developing countries, but also in fostering sound traditions of international monetary co-operation.

Dr. Deshmukh stood four-square for multilateralism, for measures to promote the expansion of international trade, for freedom for capital to move to its most productive use. He did so in both words and deeds. In his valedictory speech at the inaugural meeting of the Board of Governors of the Fund and Bank in Savannah in March 1946, he gave, on India's behalf, an important pledge :

" .... that we shall give of our best to the Fund and the Bank and that we shall choose men who will play their part worthily, with dignity and independent judgement and we shall see that they are placed in a position to give to these institutions the time and attention that the interest of the institutions demand."

It is a pledge that was kept. And it continues to be kept. The Fund is stronger for it. And we are grateful.

In my remarks this evening, I should like to look at the world monetary system and in particular to focus on a number of aspects of the system that have long been of concern to this country. Other, perhaps more obvious topics had of course suggested themselves. I settled on this subject, however, quite deliberately : first, in honour of Dr. Deshmukh's commitment to internationalism; and second, in tribute to the intellectual contribution that this country has made -- and I hope will continue to make -- to the process of international monetary management.

It is also a timely topic following the Fund's Annual Meeting in Berlin, where a number of speakers encouraged us to look at possible ways of improving the functioning of the international monetary system.

I should not, though, want this occasion to pass without saying a few words about policies and developments here in India. Let me first record our appreciation of the tradition of close co-operation between your Government and the Fund. India is an excellent example of a country that approached the Fund when incipient balance of payments difficulties first became evident in the early 1980s. The strong efforts you made then were remarkably successful; in fact, the external position strengthened beyond expectations and India was able to forgo the use of a sizeable portion of the financial resources that had been committed by the Fund.

Since then India has continued to pursue cautious financial policies and has avoided the debt-related problems experienced by many developing countries. Structural reforms, meanwhile, have contributed to an acceleration of growth during the 1980s. Even in the face of an exceptionally severe drought in 1987, you coped well, managing to avert the most devastating social consequences and to maintain the momentum of industrial and export growth. It remains necessary, of course, to continue -- and indeed to speed up -- the structural reform process and the Government's commitment to this course is most welcome.

These various accomplishments have placed India in a sufficiently strong position that it has indicated it does not expect to borrow from the Fund's newly-established Enhanced Structural Adjustment Facility. This is a most generous position for the Government to have taken--enlarging, as it does, the capacity of this facility to help smaller low-income countries. It is essential that it does not result, in any way, in a reduction in concessional financing from other sources. India, which continues to face a formidable task of development, will require the strong support of the international community as well as persistent vigour in policies.

Let me turn now to my main topic for the evening, the international monetary system. And allow me to begin with a few general observations -- to put matters in some perspective.

First, we speak of a "system". This, though, is shorthand for what in reality is a complex amalgam of arrangements, involving institutions, policies, procedures and practices. It has even been suggested that we perhaps imbue such arrangements with more cohesion and predictability than is, in fact, their due. Be that as it may, the point to bear in mind is that we are not speaking of a simple mechanism of interlocking parts, but of an intricate network of arrangements. A network of arrangements, moreover, that, since the demise of the Bretton Woods system in the early 1970s, has allowed for a considerable measure of national policy discretion and thus become more complicated.

What do we look for from an international monetary system? What purpose ought it to serve? To my mind, it should above all facilitate the balanced growth of international trade and promote the efficient allocation of global resources, including world savings, under conditions of low and relatively stable inflation. I look for this because of its essential contribution to a full utilization of the productive resources of all countries -- that is, to economic growth and improvement in social conditions worldwide.

That the arrangements in place in recent years have fallen short on this score has come increasingly to be recognised. And change is now under way. Change to what end? The task facing the international community is, I believe, in general terms well understood. It is to bring about some form of collective management of the monetary system that corresponds better than the current arrangements to the present level of international financial interdependence.

What is less clear at present are the precise contours of a better managed system. On this, two points are perhaps worth emphasising. First, the preferred approach is unlikely to be the same for each and every country and we are thus unlikely to have the luxury of a perfect convergence of views among nations. Indeed, it seems to me inevitable that any adaptation of present arrangements will reflect compromises among different objectives, different perceptions and different degrees of willingness to engage in co-operative action.

But -- and this is my second point -- there seems to me to be no escaping the explicit acceptance of certain limits to national autonomy if the system is to function more effectively. What has yet to be determined is the degree of external discipline to which nations will submit and which will allow the system to operate smoothly. This is likely to become clear only gradually. Impatient though we all are to strengthen the existing arrangements, change is likely to be incremental and evolutionary. In contrast to 1944, it is more likely to emerge from developing patterns of co-operation than as the product of a particular international negotiation.

This, I believe, is the framework in which, realistically, we are working. It is within this framework that I should now like to consider a number of concerns that have been voiced for many years by this country among others. The concerns in question are neatly encapsulated in a statement made in 1973 by India's then Minister of Finance to the Committee of Twenty. This emphasised :

". . . . . . the need for an improved functioning of the adjustment mechanism in a framework of stable but adjustable exchange rates in a manner as would satisfy the aspirations of both developed and developing countries and which would also be equitable as between surplus and deficit countries alike."

and, in addition,

" . . . . . . better international management and control of global liquidity with the objective of moving towards a system in which special drawing rights would become the principal reserve asset as well as the numeraire."

Three issues : symmetry of adjustment; stability of the exchange rate system; and the role of the SDR. Fifteen years later, these matters are as pertinent as ever. Let us look at each in turn.

First, symmetry. The quest for ensuring that all countries enjoy equivalent rights and observe equivalent obligations has been a major preoccupation of the framers of international monetary arrangements. Keynes, in his closing address to the delegates to Bretton Woods in July 1944, saw their task as having been "to find a common measure, a common standard, a common rule applicable to each and not irksome to any." Symmetry was likewise a dominant concern of the Committee of Twenty in its efforts, following the collapse of the par value system, to construct a new monetary order.

Yet the Bretton Woods system was perceived by many to have subjected surplus countries to weaker discipline than deficit countries, while also conferring a privilege on countries issuing reserve currencies by allowing them to finance payments deficits by incurring liabilities rather than drawing down assets. And, ambitious as its approach was, the Committee of Twenty was led to conclude that "there are practical limits to how far and how fast asymmetries in the system can be eliminated."

Today, various asymmetries are still perceived to exist. The one that I should like to focus on is the perceived asymmetry in adjustment responsibilities between different groups of countries ----- and specifically between countries that do not need to approach the IMF for financial assistance, on the one hand, and countries that do, on the other. That the forces operating on the first group to correct its imbalances are not as strong as those operating on the second group clearly continues to be true. The latter are real and pressing; the former are for the most part moral and persuasive. While the impact of appreciating currencies in surplus countries should not be lightly dismissed, flex exchange rates have not sufficed to provide an adequate degree of symmetry. In this sense, the system has not evolved in the way Keynes wished it. to evolve, having "an internal stabilising mechanism, by which pressure is exercised on any country whose balance of payments .... is departing from equilibrium **in either direction**."

But I believe that progress has been made over the years, and particularly of late, in moderating the particular asymmetry in question. Progress has been made on both sides of the equation : in facilitating adjustment in heavily-indebted developing countries, easing its burden, and allowing it to be sought in a feasible time frame; and in injecting more bite into the advice given to industrial countries and bringing greater influence to bear on their policies.

As regards the former, consider the evolution of private capital markets. While the access of developing countries to these markets is uneven, while it is substantially less than it was in the 1970s and while it cannot be compared remotely with that of the industrial countries, many more countries can borrow from such markets today than was the case twenty years ago. Consider also the evolution of the Fund's credit facilities. The compensatory financing facility and its various offshoots; the extended fund facility; the oil facilities; enlargement of the access of members to the Fund's resources. More recently, the structural adjustment facility and the enhanced structural adjustment facility; measures to increase the availability of credit under the EFF and to improve the terms of such credit; and the creation of a contingency financing mechanism. All have enhanced the opportunity for deficit countries to correct maladjustments in their balance of payments without resorting to measures destructive of national prosperity. So also have an expanded level of technical assistance and moral support. True, financing does not reduce the sum of adjustment that is required. But it does ease the burden of adjustment and helps to make adjustment more orderly by permitting it to be stretched out over time.

As regards the other side of the ledger--bringing influence to bear on countries that have no need to approach the Fund -- the main tool at the Fund's disposal has always been the moral suasion that it excercises over members to follow policies that will further the economic prosperity of the entire membership. Here, three things have changed in recent years. First, the scope for exercising moral suasion has become much wider. The Fund's voice is heard not only on the occasion of annual consultations with its member countries, but also during twice-yearly reviews of the world economic outlook and through my participation, as Managing Director, in meetings of finance ministers and central bank governors of the major industrial countries -- as well as through less formal channels of course. Second, the analytical substance of the Fund's surveillance over the policies of its member countries has become sharper, with symmetry in the adjustment process an important objective. In particular, in our bilateral and multilateral discussions with the major industrial countries, we make every effort to see to it that the interests of the rest of the world are taken into consideration. Third, the Fund is speaking out more -- more often and with more candour.

All this, I believe, is injecting more weight into the surveillance process. But, clearly, more needs to be done if the responsibility for adjustment is to be shared more equitably and thus made more manageable. It is a historic challenge, to be sure. But it is vital that creditors not be allowed to remain passive; that effective surveillance be exercised over the policies of those countries with the most substantial spillover effects on the world economy; that efforts continue to achieve a system that members consider fair as well as efficient.

Traditionally, the international community -- through the Fund -- has made cautious use of sanctions or formal remedies,preferring to rely on persuasion and peer pressure rather than punitive action. Traditionally, the Fund has operated on the basis of guidelines, the interpretation and application of which have to a large extent been a function of the objective needs of the system itself. All this is surely right. But the question arises whether greater symmetry might not be achieved if it were possible to formulate more comprehensive principles than what exist at present to guide the Fund in the excercise of surveillance. I believe that this is worth exploring. Not with a view to introducing mechanistic rules, but with a view to giving more precise shape to the expectations of the international community.

Countries in deficit could also help -- by tackling their imbalances at an early stage. There are few better illustrations of the merits of this than India's experience in the early 1980s, to which I referred earlier.The imbalances in this country at that time were not great. But you confronted matters and sought the support of the Fund early. And adjustment was neither unmanageable nor antithetical to growth.

Let me turn now to the second issue : stability.

The breakdown of the Bretton Woods system in the early 1970s ushered in a period of instability and improvisation that is still with us. The regime of generalised floating that emerged in its place failed to live up to expectations and in the event lacked discipline. What ensued were two things : a high degree of exchange rate volatility -- manageable in the industrial economies, but troublesome to many developing countries who lack the institutional arrangements to cope with prolonged uncertainities in exchange markets; and, much worse, large misalignments of exchange rates over extended periods -- misalignments which have resulted in substantial misallocation of resources, stoked the fires of protectionism, and helped give rise to external imbalances on a scale which threatens global growth and financial stability.

All this, not surprisingly, has given rise to some nostalgia for the old days. There is, though, a broad realisation that a return to the Bretton Woods system is not feasible in a world in which capital movements are the prime determinants of exchange rates and in which governments are no longer quite the dominant actors they once were in international financial markets. In any event, one should not exaggerate the discipline and stability that fixed exchange rates can bring. Instability is rooted in the shortcomings and inconsistencies of national economic policies. Fixing exchange rates or setting tight target ranges,to my mind only raises questions as to how monetary and fiscal policies are to validate them.

Nor should one seek to suppress or reduce the role of the exchange rate. Changes in exchange rates have a time-honoured place in the adjustment of payments imbalances. The world economy, moreover, will surely absorb the shocks it will inevitably encounter better -- and with less cost -- in the foreign exchange market than in markets such as the labour market.

What is needed, it seems to me, is a middle ground between excessive rigidity and excessive volatility and misalignments. This, in turn, requires two things : better management of national economic policies, in particular fiscal policy; and greater international co-ordination of such policies.

As concerns the former, there is a limit to which monetary policy can prudently substitute for changes in underlying fiscal positions and to which intervention can counter underlying market trends. Beyond a certain point, exchange market stability will hinge on the adequacy of underlying policies and on the determination of governments to stick to them.

As to the latter, in an increasingly interdependent world deliberate co-ordination is needed if the pitfalls associated with incompatible policies are to be avoided and if the potential for mutually consistent policies to achieve shared objectives is to be realised. Clearly, this will require some sacrifice of policy autonomy by sovereign nations. But co-operative action in an interdependent world is rarely a zero-sum game. At a minimum, it can forestall disruptive consequences and a general loss of welfare. At best, it creates the possibility of gains for all.

Over the past three years significant progress has been made by the major industrial countries in the direction of effective policy co-ordination. A forum for periodic discussions and a political mechanism for decision making have been established. Procedures to guide policy makers have been developed and are steadily being refined.These draw on a range of economic indicators to assess the international consistency, the desirability and the sustainability of policies, to set objectives and monitor progress toward such objectives, and to heighten awareness of the implications of those policies and objectives for other countries, in particular developing countries. In all this it has been the task of the Fund to offer information, analysis and advice, to help bring the main issues to the surface more clearly, and — not least — to ensure the injection of a global perspective into the debate. As the Minister of Finance of the Federal Republic of Germany told the Fund's Annual Meeting, the Fund must continue to assist in this process not only with its analysis and advice, "but also because it represents the interests of the world economy as a whole."

A solid beginning has thus been made in moving toward not only a more stable system, but also a more symmetric system. In a speech a year ago to the Fund's Annual Meeting in Washington, the U.K. Chancellor of the Exchequer, Mr. Lawson, offered five reasons why the major industrial countries had been able to make the move to managed floating work. They had chosen the right time to give a lead to the markets. They had been prepared to commit themselves publicly to appropriate and consistent domestic policies. They had been prepared to give significant weight to exchange rates in the conduct of monetary policy. They had been prepared to undertake co-ordinated intervention, sometimes on a substantial scale,making such intervention, I might add,an accepted instrument in the emerging system. And they had neither revealed the details of their arrangements, nor worked within margins that were too tight to allow sufficient tactical room for manoeuvre.

While a promising departure has been made from the old ways, crises can still occur -- as we saw only too vividly last October. Crises can also be managed, as we have seen since then. The point I would emphasise is that what has been achieved to date in fostering a more appropriate mix of policies among the major countries -- encouraging as it is -- is no more than a beginning. Debate continues on how to move the process forward and what the ultimate *modus operandi* should be.

That this is so--that the economic management (system) is still adapting to a situation of rapidly growing economic interdependence--should not come altogether as a surprise. Nations do have different priorities; they often hold different views on the effectiveness of particular policy instruments; and they have different perceptions of how economies interact. There are also obviously gaps in the understanding of some economic processes and, more so, limitations in the ability to foretell the future. These are what I would call "technical" obstacles to policy co-ordination. In addition, there are "political" obstacles. Even when there is agreement on the objectives and the "economics", there may well be difficulties in undoing arduously worked out domestic compromises, or in obtaining timely action where policy making is decentralised and intermittent -- as it typically is, for example, in the fiscal field. And there are, of course,perennial questions of burden sharing.

For all these reasons, it would be unrealistic to expect giant leaps forward in co-ordinated policy making. The process is inevitably an incremental one. The challenge is to continue to move it forward -- to see that it does not stall.

What can be done to this end? I would suggest two things. First, press on with efforts to develop a framework of analysis that commands a broad basis of acceptance at the technical level and yet is straight-forward and compelling enough to carry conviction at the political level. This is an area in which the Fund has a key role to play.

Second, continue to refine the instruments and procedures of co-ordination. It would, of course, serve no purpose to seek to be more precise than the present grasp of economics would permit, nor than the institutional and political constraint on fiscal policy would allow. But the more that understandings could be reached on key indicators, the more leverage could be created for prodding men of goodwill into remedial policy action when events in fact deviated from a desired course.

Only after further progress has been made in these two areas would there seem to me to be much point in the industrial countries exploring further refinements -- such as introducing into their co-ordination process prescriptive elements which they would be under some obligation to try and fulfil.

It may never, of course, be possible to achieve total agreement among governments as to what policies are best pursued at any particular time. And it would be naive to expect to be able always to induce individual countries to alter their policies. But it should be possible to increase the mutual compatibility of national policies, to ensure that countries take the external effects of their policies more consistently into account and thereby to improve the stability and efficiency of the system as a whole.

Over time, it should also be possible—notwithstanding the various difficulties I have just mentioned in advancing the co-ordination process among even a small number of countries -- to involve countries outside the G-7 more meaningfully in the evolving process of international monetary co-operation. Not only possible, but to my mind essential. But it will take time. And the IMF, it seems to me, is the logical forum for bringing the rest of the world into what is, after all, a matter of common responsibility and universal concern.

An international monetary system involves not only a set of exchange arrangements, but also provisions for the supply and management of international liquidity. This brings me to our third issue : the role of the SDR.

Special drawing rights were created with two basic purposes in mind : to meet the need, as and when it arises, for a supplement to existing reserve assets; and to serve eventually as the principal reserve asset of the international monetary system. In the period of almost twenty years since the SDR was launched, the equivalent of less than US$28 billion of special drawing rights have been created and the SDR remains far from being a world money. It is used as a unit of account; it serves as a store of value to governments that hold them; and there are some privately issued SDR-denominated bonds and bank liabilities. But the SDR is not used as a medium of exchange.

Two realities, moreover, have to be recognised. First, the broad support needed among the Fund's membership to add to the stock of SDRs through a new allocation does not exist at the present time. Second, for the SDR to become the principal reserve asset of the international monetary system, profound changes would have to be made in that system -- changes which, although well worth serious consideration, would inevitably take time.

In the meantime, the question remains whether the SDR cannot play a more important role than it is now doing. Decisions on new allocations of SDRs, of course, turn on an assessment by the Fund's membership of whether there exists a long-term global need to supplement existing reserves. However, judgement must be exercised in making this assessment, including judgement about the quality of reserves and the purposes they should serve. In this context, various issues arise bearing on the question of an allocation of SDRs that did not arise formerly.

Could an allocation, for example, help to provide a liquidity safety net? With borrowed reserves now much more important than they used to be, the adequacy of international reserves has become more vulnerable both to instability in financial markets and to shifts in market confidence in individual countries.

Could it facilitate the financing of co-ordinated exchange market intervention, strengthening the ability of governments to counter any sudden disruption of markets by speculative forces? Already, with the latter objective in mind, we have seen the United States and Japan enter into a bilateral agreement that would make existing SDRs more readily available to exchange for other currencies.

Could it usefully reduce the high cost for many countries of generating reserves through further adjustment of their current accounts? I am mindful here of the broad withdrawal of commercial banks from voluntary lending to many developing countries. This represents a structural change in international financial arrangements which makes it appreciably more difficult for the countries affected to meet their growing need for reserves.

By serving these various ends, could a new allocation of SDRs improve the functioning and stability of the international monetary system? It is a matter that in my view deserves further thought.

More generally, we need to ensure that the SDR is not allowed to atrophy. We need to make it more attractive to use and hold. And we need to put the role it could play on the agenda of our reconsideration of the monetary system as a whole. I am pleased that in Berlin we were encouraged by a number of speakers to give further thought to these matters.

Ladies and gentlemen, it will be clear from what I have said this evening that our agenda is an extensive one. And it is, of course, one that falls centrally within the domain of the Fund, which was brought into being precisely to provide "the " machinery for consultation and collaboration on international monetary problems.

In tackling this agenda and looking to the future, we are fortunate to be able also to draw from the past. The major contribution of the Bretton Woods system was its recognition that international money could not manage itself and needed an element of consultation and co-operation, if not supervision, for order to be maintained. That reality has never been more valid than it is today. But there was also another element in the spirit and vision of those who, like C. D. Deshmukh, were "present at the creation." And that was the need to shape practices and policies in such a way that the varying needs of a diverse membership were adequately met. That too, remains fundamental.

PRESIDENTIAL REMARKS

Shri B.K. Nehru

Mr. Camdessus, Governor Malhotra, Deputy Governor Rangarajan, Ladies and Gentlemen,

My first task in offering my so called presidential comments is to add my own welcome to our distinguished visitor to that which has already been extended to him by the Governor. It is not an everyday occurrence, sir, that the Managing Director of the International Monetary Fund visits India. We are delighted that you are here and we trust that during your stay you will see with your own eyes and not only hear through the mouths of our representatives at the Fund and through our Governors at the Annual Meeting what the problems of this country are, because they are very visible. And the problems of the 'Third World', (a word that was coined by General De Gaulle) should be of concern to the entire world and certainly are, I know, very much of concern to you as you already have shown during your stewardship of the International Monetary Fund. That is why, we have great confidence that by the time you get back to Washington to the palaces that the IMF and the World Bank now occupy - they did not in my time, they were smaller institutions! - that you will not forget the hamlets and the *Jhuggy-zopadis,* the huts and the hutments that you will see here.

I am not sure why I have been dug out, by my distinguished friend, the Governor of the Reserve Bank, from my mountain retreat where I have taken *sanyas.* – as all old horses do if they continue to live-to offer presidential comments on the speech of one whom I am certainly not in a position to comment upon. But perhaps my link to the Deshmukh Memorial Lecture is that I am a pupil of Sir Chintaman Deshmukh or rather of Mr.Deshmukh as he then was, in the sense that I was "Officer on Special duty" at the Reserve Bank. The designation was meant really to camouflage the fact that I was a pupil at the Reserve Bank, learning the elements of high finance ! From whom ? From the then Secretary of the Reserve Bank - Mr.C.D.Deshmukh - who had chalked out my training programme himself with extreme care, listing out the departments that I should visit, the people who should teach me, the time I should spend in each place, etc., and what is more, after doing all that, he disappeared from the scene on leave to England, leaving me to occupy his very comfortable and air-conditioned office. That was perhaps the link.

But I belong, sir, to the *ancien regime;* how *ancien* I am you will be able to judge by my saying that the last Governor of the Bank of France with whom I had any official contact was M. Baumgartner and that was ages ago. But I have, inspite of my mountain retreat, maintained some interest in economic affairs and in international economic affairs. And what I am to say now is first of all to say very humbly that I was most impressed by what you had to say and the clarity of your statements.

And I would also submit that, by and large, in fact, almost the whole of what you said I entirely agree with. I agree with what you say about asymmetry. Obviously there should be symmetry. There is no symmetry. There never has been symmetry and I am not sure at all that there is more symmetry today than there was before because the fact of the matter is that the rich and the powerful throughout history have never agreed willingly either to obey the law which they might themselves have made or to part with their power or their wealth unless they are compelled by necessity of some kind to do so. There is a natural asymmetry between the rich and the poor which is reflected in many ways.

I agree with you also, sir, on the inevitability of gradualness. But General Fabius had much more time than we have. And why are we in such a hurry, why is the 'Third World' in such a hurry? Because the population of the 'Third World' is unfortunately, inspite of our best efforts, growing at a fantastic pace which we have not been able to control. Not only is it growing in numbers, it is growing in its expectations, the consequence of which is that action is demanded here and now. And if that action is not forthcoming, I fear very much that this twin pressure of population and poverty which is interconnected will lead to disorder and anarchy which will not be limited to the 'Third World'.

I agree with you also sir, on what you said about exchange rates. The Bretton Woods system was one of fixed exchange rates and that certainly had its disadvantages. The system of floating rates which we now have has many disadvantages as you pointed out but it certainly also has advantages, one of which can be illustrated by the Indian case. In 1966, one of your other distinguished predecessors - another Frenchman in the position which you now occupy - Mr. Pierre Paul Schweitzer - used me, who happened at that time to be Ambassador of India in Washington, to convey the enormous pressure he was bringing upon the Government of India to devalue the Rupee. That pressure was duly conveyed and it was not only his but of the other people too and there was considerable Indian acceptance, — Indian non-political, official, technical acceptance—of the fact that we needed devaluation. And over one week-end, we devalued by 57 per cent and this resulted in a furore in the country. But now contrast the system then with the present day system. We devalued the rupee by 57 per cent at that time. In recent years the depreciation of the rupee has been much larger, but there has been no upheaval. So obviously there are advantages in the present system.

Sir, you talked about the SDRs. These SDRs, whether you describe them as creating liquidity or creating reserves or creating a unit of account or whatever it is, in essence the allocation of the SDRs is one particular case of capital being injected into the system. And we of the 'Third World', one of our main difficulties in our development is the shortage of capital simply because it is a vicious circle; we are poor, we cannot save enough and because we cannot save enough we remain poor. It is necessary - it is essential - if we are to have a global system, for external capital to be injected into the 'Third World'. But the resistance that you have met in the creation of SDRs is one particular case of the resistance that we have met and your sister institution, the World Bank meets in encouraging the flow of capital to the 'Third World'. Because, once again, as I said, the rich at least at this time are not willing to do so.

You have also talked of the improvement in the global management of the system. I agree with you, sir, that there has been an increase in co-operation. But when you talk of global co-operation, you talk of co-operation of the whole world. Sitting where you are, you are the head of a world organisation. But when the gentlemen who really control the economies of the world gather together, for them the world is not the world as you and I see it. For them the world is of the G-5 or perhaps of the G-7 and when they have solved their problems and when they have conferred with each other and agreed to co-operate with each other, they think that they have solved the problems of the world. But they have not.And what is lacking, sir, is the political will. In all these things there is no political will, because there is no method of creating that political will. There was in the late fifties and the early sixties, a leadership in this matter which was in the United States, thanks very much to the individuals who were at the head of affairs there that time. The first indication of that was the Marshal Plan itself. In the last 20 to 30 years, that has changed. But my American friends at least tell me that there is a generation change every 20 - 30 years; the United States changes itself and renews itself. The time I think has now come when the United States will go back to the ideals of the Declaration of Independence and the real ideals which form the basis of American civilization. If that happens, sir, and even if it does not happen, you sir, are the means, as the head of the International Monetary Fund, to try and create that political will.

VOTE OF THANKS

Dr. C. Rangarajan

Deputy Governor, Reserve Bank of India

Mr. Camdessus, Mr. Nehru, Mr. Malhotra and distinguished invitees

We are indeed greatly honoured and privileged to have had with us this evening Mr. Camdessus to deliver the fifth C. D. Deshmukh Memorial Lecture. Mr.Deshmukh was a many-sided personality who left his deep impression on many walks of Indian life. He was not only an eminent administrator but a scholar and a thinker. It was for this reason that the Reserve Bank of India felt that the best way of honouring him was to institute a series of annual lectures which can be addressed by scholars and men of eminence. In the past four years,we had the privilege of listening to Mr.Kaldor, Mr.Tobin, Mr.Kornai and Mr.Klein. This evening we had the privilege of listening to Mr.Camdessus. I am indeed happy that he chose to speak to us this evening on a topic of great contemporary relevance and significance and a topic which is perhaps engaging his attention all the time. The reform of the international monetary system obviously has many ramifications and therefore he chose to emphasise this evening on three aspects of it--exchange rate stability, an equitable sharing of the burden of adjustment and finally increasing the international liquidity through further issue of SDRs. It is our fond hope sir, that under your leadership the International Monetary Fund will be able to usher in a new international monetary arrangement which is truly a **system** governed by the guidelines and which is also **international** reflecting the needs and compulsions of all countries, both developing and developed. May I on behalf of Reserve Bank of India convey to you, sir, our most grateful thanks for agreeing to be with us this evening and delivering a very stimulating address.

We are equally grateful to Mr. B.K. Nehru for his presence with us this evening.Like Mr.C.D.Deshmukh,Mr Nehru is also an eminent administrator and has now reached the status of an elder statesman in this country. And Mr. Nehru is known for forthright expression of his opinions-- and I may say, sir, age is in no way diminishing this -- and has stimulated discussions on reforms of administration and politics in this country. May I thank you sir, for responding positively to our request to chair today's session and offering very insightful comments tinged with historical perceptions.

Despite inclement weather, you have come in large numbers this evening and I want to thank one and all of you most sincerely for your presence this evening.