Bretton Woods Institutions In 2000*

Respected Narasimham garu, Professor Radhakrishna and friends,

I am thankful to the organisers for giving me the honour and privilege of delivering the Dr. V.S. Krishna Memorial lecture. Dr. Krishna, a Professor of Economics in this University was chosen by Pandit Jawaharlal Nehru to succeed Dr. C.D. Deshmukh as the Chairman of University Grants Commission in 1961. Unfortunately his untimely death soon after he assumed charge deprived the nation of his services. His visionary leadership as Vice Chancellor of Andhra University for over a decade ensured starting of new departments, often for the first time in the country, such as Applied Physics, Nuclear Physics, Meteorology, Oceanography and Statistics. His administrative experience as Secretary to the Chief Minister of Madras State, and his banking experience, as an officer of Imperial Bank of India must have added to his effectiveness as Vice Chancellor and earlier as Principal. He graduated from Oxford and is one of the few economists from India to have been trained in Economics in Austria, having obtained his Ph.D. from Vienna. I was only twenty years of age when Dr. Krishna passed away. I was also not educated in this University; with the result that I did not have the pleasure of knowing him personally. However, since the 'sixties, my family and I have developed close ties with his family, especially his daughter, Rama, and his grandchildren. So, there is both a professional and a personal reason for my presence today.

In 1946, Professor Krishna published his work "Bretton Woods and After". I thought that it would be appropriate today to revisit the subject in the year 2000 – especially from an Indian perspective.

Bretton Woods, a place in New Hampshire in the U.S.A. became famous soon after the Second World War when a Conference was held there. As a result of the deliberations in 1944, the International Monetary Fund (IMF or Fund) and International Bank for Reconstruction and Development (IBRD or World Bank) came into existence, usually described as Bretton Woods Institutions (BWIs) or Bretton Woods Twins. There have been significant changes in their role and functioning since Dr. Krishna dealt with the subject in 1946 and a quote from Mr. M. Narasimham's A.D. Shroff Memorial Lecture in 1984 on the subject would be of relevance here. "There is nothing wrong in the Fund evolving with the times, but the evolution of the Fund, at least in respect of its central objectives as stated at Bretton Woods, has been an evolution towards its irrelevance. On the other hand, as we know, the Fund has become central to the management of the international debt crises and has become even more important than it ever was in its role of disciplining developing member countries to the point of its becoming almost an arbiter of their economic destinies". Mr. Narasimham concludes that "Forty years later, we can clearly see we need another Bretton Woods".

In fact, fifteen years after this suggestion, a comprehensive review of these institutions is taking place. I will briefly explain the origin and adaptation of these institutions to the changing times and share with you the current debate on the future of these institutions. Being a central banker, I will focus more on the role of the Fund.

Origin and Adaptation

In the Bretton Woods Conference that took place towards the end of World War II, 44 countries were represented, and most of Africa and much of Asia went unrepresented though India was an active participant. Substantive negotiations were essentially between the U.K. and the U.S.A., and thus between their spokesmen, viz., Lord Keynes and Mr. Harry Dexter White. The problems and perspectives were thus of the post-war era, and the painful memories of the Great Depression. The major contribution of the Conference was the acceptance of the idea that the international monetary system has to operate within a framework of cooperation and consultation among Governments. It also accepted the idea of a provision of resources to a country from the general pool to get over its temporary balance of payments problems, and this is the basis for the creation of the International Monetary Fund (IMF). It also recognised the need for transfer of resources from capital surplus to capital deficit countries through the intermediation of an official multilateral body, viz., the International Bank for Reconstruction and Development (IBRD).

The basic structural characteristics of BWIs remain somewhat unchanged. Governments are political bodies, and these institutions, which are creatures of Governments are bound to be political; and, therefore, their membership and functioning do in some way, and to some extent at least, reflect political realities. Their membership, open only to Governments, is naturally voluntary. They are cooperative in character, though the voting power is weighted by ‘quota’ in the IMF and shares in IBRD, reflecting uneven strength partly due to historical reasons and partly due to emerging economic and trading strengths. So, they are akin to cooperatives whose members have unequal strength. They are also like clubs, where members are expected to observe certain rules regarding conduct of economic policy, within a mutually acceptable framework which allows for some degree of flexibility.

Members are permitted to draw resources from each of the institutions, subject to eligibility criteria and all such drawals, except some technical assistance grants, are in the form of a loan repayable along with some interest or fees. The institutions prescribe conditions or covenants for drawing such resources, and thus those who draw resources are subjected to more severe obligations to the institutions than others. These structural characteristics remain more or less unchanged until now.

The membership, however, has been increasing from less than fifty when they commenced operations, to over a hundred and eighty now. Most of newly independent countries naturally, became members during the ‘fifties, and ‘sixties. Initially, the Americas and Europe dominated, which continues until today in a significant way. However, when the institutions started their operations, the then U.S.S.R did not formally join Bretton Woods, while many of the socialist economies withdrew their membership. But, a few like the erstwhile Yugoslavia continued as members for a long time. During the initial three decades, China was represented by Taiwan. The Bretton Woods twins, were thus functioning for over thirty years claiming to be world bodies without membership of the large socialist bloc. The ‘eighties, however, saw active participation of China which got its rightful place, while the ‘nineties brought Russia into its membership. In brief, these institutions are more representative of the world economy now than ever before in their history.

During their history of over fifty years, there have been both institutional innovations and a changing focus to meet the dynamics of global economy. Thus, IBRD which initially assisted war-torn economies, such as Japan and France soon left this task to the U.S.A. under the Marshall Plan and concentrated on developing countries. Originally envisaged to provide only project-specific loans, IBRD shifted its focus to programme-lending, structural adjustment, and more recently, to policy lending. From commercially viable projects, the focus shifted to social sectors, then to poverty-related issues and more recently to governance issues as well as to institutional development. Efforts of IBRD were supplemented by Regional Banks (like Asian Development Bank, African Development Bank).

In the IBRD, only a part of the subscribed capital is paid-in by member countries and the rest is callable. The members do not claim dividends on profits. The bulk of lendable resources of IBRD are by borrowings from capital markets and hence, IBRD can, in turn, lend only to those countries, which are considered creditworthy. This implied that many poorer countries were not eligible, in the sense that any loans to them from the IBRD would have adversely affected the quantum and rate at which the IBRD could raise its lendable resources from the capital markets. In these circumstances, International Development Association (IDA), an affiliate of the IBRD, was established, consisting of contributions in the form of grants from the Governments of developed countries to provide resources, on soft terms to low income countries. The repayments of such loans are recycled through the IDA. A part of the profits of the IBRD are also made available to the IDA. Another body, the International Finance Corporation (IFC) was also sponsored as an affiliate of the World Bank, specialising in providing finance to the private sector. Membership of the affiliates is, by and large, common to that of the IBRD and these institutions together constitute the World Bank Group. A more recent addition to the family is the Multilateral Investment Guarantee Authority (MIGA), which provides limited guarantees to private investment flows.

Since 1999, the emphasis of the World Bank group is on the Comprehensive Development Framework (CDF). The CDF aims at suggesting a holistic approach to development that recognises the importance of macroeconomic fundamentals and yet assigns equal weight to the institutional, structural and social underpinnings of a robust market economy. Strong participation of Governments, donors, civil societies, the private sector and other developmental actors is emphasised in the CDF. The Bank also reaffirmed its commitment to fight poverty and renamed the new objective as “to fight poverty with passion and professionalism, for lasting results”. The multipronged approach now encompasses Country Assistance Strategies (CAS), new lending and nonlending services, higher IDA replenishment, and debt relief. It is evident that the World Bank has been attempting to adapt itself to emerging needs.

Similarly, the IMF has also been attempting to adapt itself to changing needs. Under the original Bretton Woods exchange rate regime, each country would set a fixed value – called par value of its currency in terms of gold or the U.S. Dollar. The par values of two currencies determined the official exchange rate (also called parity) between them. Exchange rate fluctuations were to be limited to a narrow band around the official exchange rate. While temporary balance of payments deficits were to be covered from a country's own reserves and if necessary by loans (technically termed as purchases) from the IMF, any fundamental balance of payments problems were to be corrected by exchange rate changes. This system ran into problems in the 'sixties, since fixed exchange rate regime constrained monetary policy in most developed countries. Due to difficulties faced in gold supplies and doubts on the role of U.S. dollar as a reserve asset, the IMF agreed to create Special Drawing Rights (SDR). In 1971, USA closed its gold window and this led to floating rate regimes in many countries, replacing gold and par value systems that were bedrocks of the original IMF. Due to several reasons, however, the SDR did not take the central place envisaged.

The IMF responded to several challenges to international monetary order with a series of facilities such as Compensatory and Contingency Financial Facility (1963), Extended Fund Facility (1974), Supplementary Financing Facility (1977), Supplementary Reserve Facility (1997), Contingency Credit Line (1999). Besides, there are concessional facilities for poor countries under Poverty Reduction and Growth Facility (1999). In the context of debt crises of Latin America in the early 'eighties, IMF emerged as a major actor in what may be termed as "bailing-in" the banks or 'bailing-out' the banks that had lent heavily to these countries.

In 1995, the IMF arranged a $40 billion rescue package for Mexico at the initiative of the USA. The IMF's role and capacities were severely tested in the most recent crisis-episodes, viz., East Asian, Russian and Brazilian crisis and herein lies the most serious provocation in their history for a thorough review of Bretton Woods Institutions.

It is worth noting here that until the 'nineties, problems in a country's balance of payments were, barring shocks, essentially a consequence of what could be termed as inappropriate policies of the Governments in the countries concerned. The Asian crisis, however, highlighted a new dimension to the problem. The Asian crisis was largely attributable to failures in the private sector – both in the recipient as well as lending countries. This new dimension is an important element in the set of factors that have urged a fresh look at the role of BWIs and of the international financial architecture.

It would be inappropriate to conclude that the BWIs have been successful in all their endeavours or that they have been totally adequate or objective in all their responses to the global challenges or to the problems of individual countries. Yet, they do represent significant mechanisms for multilateral cooperation and have to be continuously assessed in that light without prejudice to improving their functioning or even evolving parallel or supplementary organisation, if considered worthwhile. The current debate is, in fact, on just such lines.

India and Bretton Woods

India was a founder member, along with 38 countries and has been an active member of the Fund right from its inception. India obtained a quota, which ranked her among the five largest stake holding members of the Fund and the World Bank. India's fifth place assumes significance as each of the five largest stake holding is entitled to a 'permanent' chair in the Executive Board and appoint its own Executive Director. India, thus enjoyed a permanent seat in the Fund at the time of its inception. However, in the early 'seventies, Japan improved its quota and share-holding to rank amongst the five largest stake-holding members, with the result that India moved to an 'elected' status.

India's recourse to the IMF was limited during the period 1945 to the 1980s. Before the First Five-Year Plan, India borrowed a moderate amount of SDR 100 million under the lower tranche (generally up to 50 per cent of the quota). During the Second Five-Year Plan period, to cope up with the problem of balance of payments, an amount equivalent of SDR 200 million was borrowed from the IMF. During the Third Plan period, India encountered severe balance of payments problem and hence borrowed a higher amount of SDR 375 million from the Fund. During 1965 and 1968, the balance of payments situation worsened and India devalued its currency and sought IMF assistance to the tune of SDR 415 million including SDR 90 million under the Compensatory Financing Facility.

The next availment of the IMF facility was during 1973-74, when India was affected by the first oil shock and hence borrowed SDR 775 million including SDR 200 million under the oil facility. Then again during July 1978 and December 1980, India made use of Trust Fund amounting to SDR 529 million.

In the early 1980s, to finance the huge current account deficits, India entered into three year Extended Arrangements with the IMF for SDR 5 billion in November 1981. But, India availed of only SDR 3.9 billion and the balance of SDR 1.1 billion was surrendered.

The oil price hike in 1989 and the Gulf war widened India's current account deficit forcing India to borrow SDR 2,208 million under Stand-by arrangements and SDR 1,352 million under CCFF. These loans are almost repaid and there is only one repurchase left (in June 2000).

Outstanding liabilities to the IBRD as at the end of March 1999 was about US $ 8.1 billion, of which about US $ 2.1 billion was to the non-Government sectors. Taken together, liabilities to IBRD and IDA stood at about US $ 26.4 billion as at the end of March 1999. India experienced a negative transfer of resources to the World Bank group during 1993-98. As against gross disbursements of about US $ 9.7 billion by both IDA and IBRD, repayments of principal and interest amounted to US $ 6.2 billion and US $

4.9 billion, respectively. As a result, there was a negative resource transfer of about US $ 1.4 billion during 1993-98.

Some general observations on the relationship between India and BWIs may be in order.

First, India has always been represented by an Executive Director on the Boards of each of these institutions (even after losing its 5^{th} place) and its contribution in their conduct of business is generally valued.

Second, India has been a responsible and prudent borrower of resources from both these institutions. This includes quality of policy-making and project implementation, which is considered high relative to other countries.

Third, in times of crises, these institutions extended support to India in a timely manner.

Fourth, both the institutions do acknowledge the valuable contribution that Indian policy-makers made to their policies and procedures - though there are many differences.

Fifth, there have been a few instances, such as the recent sanctions by USA, when there have been some disruptions in their smooth conduct of business with India and such instances are attributable to political factors governing select members rather than to the membership as a whole or to the management.

Sixth, the professional talent and technical expertise of economic policy makers in India is acknowledged to be, at the very least, on par with those in the BWI. For example, the contribution of Dr. Rangarajan as Governor, RBI in designing external-sector liberalisation is universally acknowledged and many observers feel that East Asia could have avoided the crisis if they had benefit of such advice. Similarly, the monetary policy initiatives taken by Governor Jalan in steering the economy successfully through domestic and international uncertainties in the recent past are widely appreciated.

To sum up, the relationship between India and Bretton Woods is one of mutual respect for mutual benefit, though not necessarily one of full agreement on many matters. On the whole, India commands greater respect in the BWIs than any time before, for charting its own path towards growth with stability, and that too very successfully, so far.

What is New in 2000?

The international monetary system in 2000 is vastly different from what it was, say when the Bretton Woods Conference was held; and indeed dramatic changes have taken place in the last two decades.

First, and perhaps the most important change, is end of ideological differences among nations. This has paved the way for the emergence of a common approach to solving economic and financial problems. For example, on the role of State *versus* market there are less differences among members now than before.

Second, the convergence in economic ideology also meant greater integration among the economies leading to greater compulsions to find common solutions.

Third, there is a relatively greater convergence in economic thinking between people, Governments and multilateral institutions than before, resulting in a focus on transparency and accountability of all concerned.

Fourth, the developments mentioned have changed the relevance of the Fund in particular, in the sense that BWIs, which were mainly the concern of borrowing countries primarily in the non-socialist part of the world, have now become relevant to the totality of international and financial system, and thus to many more countries, even among the countries, than ever before.

More specifically, the international monetary and financial system has undergone dramatic change.

First, the magnitude of capital flows has grown by leaps and bounds.

Second, the private component of such capital flows has grown exponentially faster than the Government account.

Third, the sheer variety of flows, the instruments and the participants have all grown so rapidly that the share of Governments and banks - the traditional sources - has become relatively less important.

Fourth, technological advances have made such flows highly cost-effective, remarkably fast and immensely mobile - warranting a constant trade-off between efficiency and stability in the financial sector.

Fifth, these developments, affecting both domestic and off-shore financial centres have made the tasks of domestic regulators highly complex.

Finally, the role of Governments in domestic economic management has been, relative to the past, different, yielding greater initiatives to markets and this finds its echo in the role of multilateral institutions, which are creatures of Governments. Further, due to inter-dependence of economies, conditionalities and covenants addressed to an individual borrower may often give only half solutions, and the realisation of this implies that, the Fund especially, has to go beyond what happens in a borrowing country. Like Governments now, these multilateral institutions derive their influence, not so much on account of the quantum of resources that they allocate, as from the working rules that they may prescribe and the safeguards that they may emanate to influence the markets. It is in this context that BWIs are able to command importance in the international financial system, an importance that is disproportionate to the resource transfers that they are able to deliver.

In regard to the changes in the status of developing countries as a group in this changed current monetary and financial environment where BWIs have such a disproportionate influence, the following generalisations could be made:

(a) There is greater realisation about the diversity among the developing countries, though the overall trend is global economic integration.

(b) It is also recognised that merely removing Governmental restrictions does not automatically ensure the integration of the economies.

(c) In the process of globalisation, some developing economies are more broadly integrated than others, and there can be different depths of integration between developing countries and industrialised countries.

(d) The transfer of resources from BWIs to erstwhile socialist economies, especially Russia, brings a new dimension to the division of the world into the developed and the developing.

(e) The large flow of private capital flows to developing countries is concentrated among few economies – often described as emerging economies. There is a substantial increase in savings available in some economies which are in search of investment opportunities and these go to developing economies where the risk weighted returns to capital appear higher. Thus the concentration of investments is among a few economies.

(f) Modern technology has enabled not only massive easy and low cost inflow of capital but also equally large, volatile outflow of capital, and these flows invariably have an impact on currency and trade. In the process, the economies of developed countries have become an integral part of large capital flows and hence are affected by crises and contagion from some developing countries as well.

These features of the ‘nineties meant that the country-specific solutions, usually through conditionalities or covenants of the BWIs, were tending to be not even half solutions. The search for alternatives or supplements to the BWIs and/or a thorough revamp of these should be viewed in this light.

In recent years, the BWIs had to workout “Reserve Packages” involving the private sector and Governments. Thus, the IMF arranged a $ 40 billion reserve package in 1995 to meet the Mexican crisis. The total package for Indonesia, Korea and Thailand was over a hundred billion U.S. dollars of which only a third was from the Fund, and about half from bilateral sources. While the IMF’s prescriptions in respect of East Asia were subjected to severe criticisms, especially at the time of launching of the package, the Russian crises brought into limelight some of the weaknesses of IMF’s surveillance. Following the East Asian Crisis in 1997 and the Russian devaluation in mid-August

1998, the Brazilian economy showed signs of vulnerability to contagion and has since come under the Fund's adjustment programme.

Alternative or Supplementary Arrangements

While the changing realities mentioned necessitated a reform of the international financial system, the recurrent crisis in the recent past triggered a serious debate on a new international financial architecture inevitably affecting the future of BWIs. This debate has put forth a number of proposals and the formation of a number of new forums, and I will refer to a few interesting ones here.

World Financial Authority

The increasing global character of financial markets and its growing links between the different segments of the financial sector has motivated some to propose a global agency for financial regulation and supervision or World Financial Authority (WFA). The second argument for WFA is that the financial sector in many countries involves cross-border transactions and transmission of instability across borders and hence their regulation and supervision should be carried out on a unified and global basis.

There are different models of WFA and these vary from improvement from existing arrangements to the ones that are more comprehensive in terms of responsibilities. One such proposal was by John Eatwell and Lance Taylor, who called for the establishment of a body with the responsibility for setting regulatory standards for all financial enterprises – banks, insurance funds, companies – both on-shore and off-shore. The standards promulgated by WFA are generally sought to be implemented by the national regulators. Another responsibility of the WFA is expected to be to develop innovative means for directing capital flows towards long-term needs.

An important, somewhat open issue, relates to the WFA's relationship with existing multilateral institutions like IMF.

International Central Bank

Jeffrey Garten of the Yale School of Management proposed the formation of an international central bank to serve as an international Lender of Last Resort (LOLR). The global central bank would provide liquidity to ailing nations by purchasing bonds from national central banks, by encouraging spending and investment through acquisition of national debt at discounted prices, and by setting uniform standards for lending and providing markets with detailed and credible information.

The major issue here is obtaining consensus on additional liquidity and compliance of national authorities.

International Credit Rating Agency

Henry Kaufman proposed the formation of a new international institution which would provide public rating of the credit quality of the market participants under its authority. The Agency will have supervisory and regulatory responsibilities over financial markets and institutions. It would supervise the investment and position taking activities not just of traditional financial intermediaries but of non-bank financial market participants such as hedge funds as well. It would be empowered to harmonise minimum capital requirements, establish uniform accounting and disclosure standards and monitor the performance of financial institutions and markets of its members.

One issue here is, who will rate the rating agency, or to put differently, how to ensure accountability.

International Bankruptcy Court

Jeffrey Sachs of Harvard University proposed the formation of an international bankruptcy court. The efficient functioning of domestic financial markets depends crucially on effective bankruptcy law. When firms fail, national bankruptcy laws and courts play a central role in bringing about quick resolution of the crises. Jeffrey Sachs advocates something similar at international level to deal with countries rather than companies.

The major issue here is an enforceable international legal framework.

International Credit Insurance

According to Mr. Soros, a private investor, the efforts to stabilise the global economy should focus on two goals. Firstly, to arrest the reverse flow of capital from the periphery of the global capitalist system to the centre and to revive and stabilise the flow of capital from the centre to the periphery and secondly to ensure the political allegiance of the peripheral country to the global capitalist system and provide for an environment were they to opt out of the global system. To achieve this objective Mr. Soros proposed the formation of a credit insurance mechanism as a permanent part of the IMF. This institution would explicitly guarantee, up to defined limits, the loans that private lenders make to a country.

However, Mr. Soros' proposal for an International Credit Guarantee Corporation raises one serious question, i.e., how would the credit guarantee awarded to an individual country be allocated among the country's borrowers.

G- 22 Reports on International Financial Architecture

G-22 was put together as an *ad-hoc* body of the Finance Ministers and the central bank chiefs of twenty two countries at the initiative of President Clinton, immediately after the Asian crisis and this action itself is considered by some observers to be an admission of inadequate response from BWIs. The Reports of October 1998 in which India was represented recognises that the present system of supervision of the global financial system is fragmented both functionally and geographically. The Group agreed that it would not be feasible to completely overhaul the BWIs, or set up a new large international financial institution. The Report proposed a number of innovations. Among these are: The formation of a Financial Sector Policy Forum with representation from the finance ministry, the central bank, and regulatory and IFIs, and systemically important emerging economies; formulation of a system for the exchange of information on financial sector regulatory and supervisory methods and findings; and formulation of a process of coordination or a clearing house to match demands from individual countries for technical assistance in financial regulation.

Financial Stability Forum (FSF)

The proposal for the establishment of the Financial Stability Forum (FSF) was made by Hans Tietmeyer, President of the German Bundesbank in the platform of Group of Seven major economies of the world. The institutional vehicle of the forum is to be a committee consisting of representatives from the finance ministries, central banks and senior regulatory authorities of the G-7 countries as well as from the IMF, the World Bank, the Basle Committee on Banking Supervision, International Organisation of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), the Bank for International Settlements (BIS), Organisation for Economic Cooperation and Development (OECD), etc.

Financial Stability Forum has since been set up with membership basically on the above lines, serviced by a secretariat from the BIS of which India is a member. Though India is not a member of Financial Stability Forum, India is invited to contribute to many of its Working Groups reflecting our standing in the world intellectual and financial community.

Group of Twenty (G-20)

G-20 was set up last year with G-7 countries as also with India as one of the 11 major emerging market members. Its objective is to encourage informal exchange of views leading to mobilisation of consensus on international issues. G-20 offers a much desired bridge between the G-7, i.e., large industrialised economies and the systemically important emerging market economies. The inaugural meeting of G-20 Finance Ministers and central bank Governors was held in Berlin on December 15-16, 1999 with three important issues for discussion, namely, avoiding financial crisis and promoting sustainable growth in the global economy; role of domestic policy in this; and the extent to which implementation of common standards and codes and enhanced transparency practices could strengthen the international financial system.

The Indian position on each of these three issues largely voices the concerns of the developing world at large. India favours a flexible adaptation of transparency practices, core principles, and codes consistent with the differences in the institutional mechanisms across the G-20. India is also of the view that with regard to “approach to capital account and exchange rate regimes” there cannot be a “one size fits all” approach.

India considers that crises prevention measures include resolving the impossible trinity (i.e. the incompatibility between independent monetary policy, an open capital account, and a rigidly managed exchange rate regime), timely identification of macro-imbalances and appropriate financial sector reforms. Finally, India views that a country must have the appropriate institutional, technological and legal infrastructure to help in adopting the best practices and codes.

For the next G-20 meeting in March 2000, three important notes are to be prepared on the exchange rate regimes, liability management, and private sector involvement. India is one of the active participants in the preparation of background notes also.

Reforms in Operational Framework of the Fund

There have been several suggestions from time to time, to reform the operational framework of the Fund. These gained added momentum in the current context and a brief recall is appropriate.

Lender of Last resort

One of the main criticisms against the Fund has been regarding "inadequate availability of resources" to combat the crises of the magnitude that has happened in East Asia. This raises the question of the need for international lender of last resort (ILOLR) and whether IMF can fulfill that role. It is argued that it cannot act as a lender of last resort because it is not an international central bank and, therefore, cannot create international reserves; it does not have enough resources and IMF is low on resources during emergencies. The defense has been that although it cannot create liquidity and may not be able to provide necessary financing from its own resources, the IMF can perform its role by arranging resources from other sources.

To enhance the resources available, India had argued for issuance of SDR by Fund to itself for use in ILOLR operation subject to pre-determined cumulative limit and other appropriate safeguards. Such a mechanism would not result in any permanent increase in unconditional liquidity (as such newly created SDRs would be exhumed when it is repurchased by the borrowing country) while providing for temporary additional liquidity which can be used to deal with crises.

Contingency Credit Line (CCL)

Many supporters of the IMF see CCL as the first step towards making the IMF a true lender of last resort. CCL enables a country to negotiate advance access in the range of 300-500 per cent of quota and possibly more in exceptional circumstances to meet a "short-term financing need" arising from a sudden and disruptive loss of market confidence consequent upon developments in other countries. There are some pre-qualifying conditions that have to be met by countries seeking access to the CCL.

India's position has been that the conditions of use of CCL are unduly restrictive. There is also a danger that the application of CCL could trigger "panics" and "run" on the country.

Resources

The ability of the IMF to provide "international liquidity" can be analysed in terms of its ability to provide "conditional" liquidity (Quota allocation) and "unconditional liquidity" (SDR allocation). The IMF has been unable to muster the requisite 85 per cent of voting power to make additional allocations on the basis of "global need". Developing countries including India have consistently supported general allocations of SDR.

The access to most of Fund's resources by member countries are set in relation to the quota. There is increasing concern that quota shares of the many developing countries, which have grown in both GDP and trade than in industrial countries have not been given adequate quota increases.

India has been in the forefront to advocate a larger quota for developing countries and has made strong presentations to the Fund Board on various occasions on the need to include "need based" variables in the quota formula and to use more widely accepted PPP-based GDP in quota calculation. The Fund has recently established a committee headed by Professor Richard Cooper to go into the question of adopting new formulas for quota allocation and it is hoped that this committee will come out with an answer acceptable to the developing countries.

Surveillance

Surveillance is one of the mechanism through which the IMF promotes good macroeconomic and financial sector policies among the member countries.

In June 1998, the Fund had commissioned an external evaluation by an expert panel head by Mr. John Crow (former Governor, Bank of Canada) of Fund surveillance over members' policies under Article IV of the Articles of Agreement. The Crow Committee in its report last year, recommended that the Article IV consultation process is "too bilateral" and therefore should have an "international focus". Besides, it recommended that the Fund surveillance devotes substantially larger attention to the "vulnerabilities" of member countries and devotes more resources to the "spillover issues".

India's position is that Fund surveillance programmes should be "country friendly" rather than "market disturbing". At present, there is an "asymmetry" in the treatment of countries in terms of surveillance – developing countries are subject to more frequent and intense surveillance while developed countries are subject to less frequent and less intense surveillence. But, recent experience has shown that the sources of instability could arise in developed countries as well. Hence it is important that advanced countries are also subject to “enough” surveillance along with developing countries.

Moral hazard

There is a strong argument that today’s financial woes are the result of bail-outs of both recipients investors by the Fund. This criticism has been leveled against the backdrop of “ bail-out” of Mexico and Russia. The issue of moral hazard arises when investors and borrowers behave recklessly because they believe that they will be “bailed-out” when there is trouble. The real challenge before IMF is to avoid moral hazard and at the same time provide means of not only avoiding financial crisis but minimising their adverse impact when such crises occur.

India recognises the issue of moral hazard, but has been focussing on the fact that countries such as India which internalised the burden of crisis in 1991-92, should be recognised and rewarded, since the rest of the world was spared of handling crisis.

Approaches to the Reform of the IMF

There have been several suggestions for reform of IMF, and a few of the more serious ones deserve to be mentioned here.

Eichengreen’s Proposal

Eichengreen has argued for making the IMF more independent. According to Eichengreen, “international standards” must form the basis for future IMF multilateral surveillance. He belives that IMF policies often serve the political agendas of its dominant members. Hence, he recommends giving IMF more independence by prohibiting its Executive Director from taking instructions from national Governments and by giving them an explicit mandate to foster policies that “maximise stability, prosperity and growth” .

Lawrence Summers

Mr. Summers, currently Treasury Secretary in the USA, argued that the IMF needs to be more transparent and open in its agreements with countries. Further, the IMF needs to be more accountable to its members; work harder in designing the terms of financial support to make it more market-based and more “exceptional” to its recipients. In designing its programmes, he indicated that the IMF needs to take better account of the broader structural and institutional environment with which they are to be implemented and needs to work with others in the international community to ensure greater private sector burden sharing in the event of any crises.

Transforming the Interim Committee

The objective of this exercise is essentially to bestow decision-making powers to the Interim Committee (IC) as well as to enhance its political accountability. Among the many proposals considered in this connection, one relates to the formation of a Council which would be a political and decision-making body, comprising persons with political responsibility. Yet another proposal relates to converting the Interim Committee into a permanent International Financial and Monetary Committee. The proposal has since been implemented.

A number of measures have already been initiated in order to make the meetings of the IC 'more efficient, productive and participatory', and India had supported these initiatives.

Meltzer Commission Report

International Financial Institution Advisory Commission (Also called the Meltzer Commission) was established last year by the US Congress to report on the workings of the international financial institutions. The Commission submitted its Report to the Congress a few days ago, actually, on March 9, 2000.

The Report's major recommendations are that the IMF should be downsized with unique responsibilities which are that it should be merely a quasi lender of last resort to emerging economies with short maturity loans, collect and publish financial data from members and provide advice (but not impose condition) relating to economic policy. Thus, the IMF should be precluded from making other types of loans, especially long-term subsidised loans. The Commission also suggests that the countries should avoid pegged or adjustable exchange rates and this should be a priority given in the Article IV Consultations. The Commission argues that the debt renegotiation practices are evolving rapidly without official intervention and, therefore, should be left to borrowers and lenders. The Commission recommends that currencies should be divided into G-5 currencies, other currencies considered useful for intervention, and non-usable currencies. IMF is sought to be a stand-by lender and in a crisis the Fund should borrow convertible currencies as needed to finance short-term liquidity loans, rather than maintain significant amount of paid in capital.

It would be premature for us to comment on the report at this stage.

International Financial Standards and Codes

Under the aegis of G-20, the issue of codes and standards has become an important area. Adoption of codes and standards are important for increasing transparency and for facilitating favourable market perceptions. A Code of Good practices on Fiscal Transparency was approved by the Fund in 1998. Similarly, a Code of Good Practices on Transparency in Monetary and Financial policies has also been approved by the Interim Committee in September 1999. Similarly, OECD has brought guidelines on "Corporate Governance" and the World Bank on "Social Sector Policies". Standards set by Bank for International Settlements (BIS) such as those on Bank Supervision are also well known.

A Standing Committee on International Financial Standards and Codes has been constituted in India with the joint membership of Government and the RBI. The main task of this Committee is to identify and monitor developments in global standards and codes and consider its applicability to the Indian financial system. The Committee would also help align to the extent necessary India's practices to international best practices.

Considering that there are a number of codes in a wide variety of areas, the Committee has identified 10 different subjects, based on their criticality and importance and constituted an Advisory Group under the chairmanship of eminent personalities. Thus Advisory Groups have been constituted in the area of fiscal transparency, transparency of monetary and financial policies, banking supervision, securities market regulation, insurance regulation, accounting and auditing, bankruptcy, corporate governance, payments and settlement system and data dissemination.

The Advisory Groups will study the present status, the applicability and relevance and compliance in India of the relevant standards and codes, given the prevailing legal and institutional framework. The Advisory Groups will also compare the levels of adherence in India vis-à-vis industrialised countries as also emerging economies with a view to understanding India's position and prioritising actions on some of the more important codes and standards. The Advisory Groups would chalk out a course of action for achieving the best practices.

The Reports of the Groups will be made available to all concerned in public and private sectors.

Conclusion

It is clear that the international financial architecture is being revisited on several fronts and the role of the BWIs as well as the framework of the functioning of the BWIs are integral to this process of review. There is clearly a consensus, as of now, that no new bureaucracies or international financial institutions be set up. There is also a consensus that multiple fora for consultation and cooperation are desirable and, Financial Stability Forum and G-20 are prime examples. The process of international cooperation is no longer confined to fora where only national Governments are involved though they continue to be critical. The operational framework of BWIs is under review and as to what shape this would take, it is difficult to speculate, but the BWIs will continue to be in the centre stage.

India is closely involved in these processes as one of the giant economies, with a significant interface now with the global financial system.

On the limited issue of utilisation of resources of BWIs, India will be repaying the last instalment amount of about US $ 25 million to the Fund in June, 2000. In fact, by pursuing appropriate policies, we have been able to repurchase almost all our obligations in the last seven years. Besides, during this period, we have built up over $36 billion of foreign exchange reserves while maintaining the external debt almost constant. If the macro policies continue to be sound to ensure progress in desirable directions of efficiency and stability, I believe there will be no need for us to approach Fund for any assistance. With a comfortable external sector position, significant reduction in the Government's fiscal deficit should help the Government to phase out its dependence on IDA whose level of resources is getting depleted. Over the medium-term, it should also be possible to earmark all loans from IBRD for utilisation in long gestation but commercially viable projects such as those in infrastructure, perhaps in quasi-Government sector. In this background, I could envisage a more active role for India in future in the BWIs and also in all fora governing international financial architecture.

The major thrust for policy for the Government in the near future would, therefore, be three-fold. The first major thrust would be to ensure the continued implementation of appropriate macro policies; the second key thrust would be to address satisfactorily social issues, such as poverty, primary education, primary health, environmental protection, governance, etc. The third area of attention would be to benchmark our institutional and procedural frameworks governing the fiscal, monetary, accounting and regulatory areas with international best practices and aligning ourselves with them. The recently established Standing Committee on Codes and the eminent persons associated with Advisory Groups should help us in the third thrust area but this will be of help only if there is matching progress in areas relating to macro policies and social issues.

To conclude, the BWIs role in an environment of high proportion of private capital flows is likely to be relatively one of catalyst, whereby it renders support and advice to outside bodies such as G-20 and BIS in respect of evolution of standards and codes, that do not fall within BWIs core competence. In this context, the need to clarify the respective roles of the BWIs in particular and international financial institutions in general becomes essential. One can envisage a situation where the BWIs reform internally not merely through change in voting rights but also in the manner of its functioning, by exhibiting greater willingness to coordinate more effectively with developing countries.

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* Dr. V.S. Krishna Memorial Lecture delivered by Dr. Y. V. Reddy, Deputy Governor, Reserve Bank of India, on March 18, 2000 at the Andhra University, Waltair. Dr. Reddy is grateful to Dr. Ajit, Director, Department of Economic Analysis and Policy, for his assistance. Dr. Reddy is also grateful to Shri V. Govindarajan for his valuable comments on an earlier version of the draft.