The Global Economy and Framework

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G-20 Ministerial Meeting

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Chairperson, Finance Ministers and colleague Governors,

1. After its very successful efforts at a coordinated response to the challenges emerging out of the recent unprecedented global financial crisis and safeguarding the process of economic recovery, the G-20 is now turning to the more challenging task of addressing structural imbalances in the global economy. India has had the privilege of co-chairing, together with Canada, the G-20 collective effort towards drawing up a Framework for Strong, Sustainable and Balanced Growth. The success of this initiative is critical for a durable global economic recovery and for better global economic and financial governance. Importantly, the success of this initiative is also critical for the credibility of the G-20 and its ability to forge a consensus in non-crisis situations.

2. At the Seoul Summit last November, the leaders of G-20 tasked us to formulate indicative guidelines for the identification of persistently large imbalances requiring corrective action, including their root causes and impediments to adjustment. Earlier this year at Paris, we decided to break up the exercise into an

integrated two step process. For the first step, while agreeing on a set of indicators, we resolved to firm up indicative guidelines against which each of these indicators will be assessed to identify persistently large imbalances by our next meeting in April. We now need to finalize these guidelines and move on to the second step of the exercise. Presumably, this would focus on root causes, impediments to adjustment and corrective policies and actions.

3. Having set the context, I would now like to make four comments.

4. First, the IMF is doing a commendable job in providing timely technical inputs for our exercise. Developing the indicative guidelines requires selection of reference values or norms for each indicator, as well as rules to guide the assessment of the indicators against the norms or reference value to determine if imbalances are large. This has been done using two different methodologies – structural and statistical. While the IMF's preference is for the structural approach because of its theoretical consistency, given the inherent fragility and contestability of econometric estimates that can deviate sharply from the observed data, the Framework Working Group has designed a method that combines these two approaches. The question we need to consider is whether there is consistency between the results of the statistical and structural approaches. If not, how do we deal with the divergences?

5. Second, in the first stage of the exercise, the criteria applied to the systemically important countries have been more stringent. The screening however has been largely mechanical though, based as it was, mainly on deviations from the

mean or median. There has been no analysis, however, to check whether such deviations indeed constitute large and systemic imbalances warranting corrective action. Such a mechanical approach, without the application of mind, can lead to anomalies. Let me give two illustrations of the type of potential anomalies using India as a case study.

6. Large deviations from the mean is the criteria adopted for screening in on the basis of private savings irrespective of whether the country concerned is running a current account deficit or a current account surplus, or its stage of economic development. If, for the sake of argument, such a country was running a current account deficit and adjusted its private savings downwards, it would need to expand its current account deficit and then get screened in by the external imbalance indicators. In India, for example, our growth has been driven by domestic savings. If because of the mutual assessment process (MAP), India was asked to reduce domestic savings, it will increase our dependence on foreign savings, actually adding to imbalances. This would indeed be paradoxical.

7. The second illustration is the treatment of public debt. Instead of deviations from the mean/median, what was attempted was deviations from asymmetric reference values for developed and developing countries, with higher thresholds for developed countries. These thresholds are based on historic averages rather than on current assessments of debt sustainability related to expected or projected growth rates. The adjustment period to stabilize the debt is also very backloaded. The year 2030 is long-term enough, and to paraphrase the immortal words of Lord Keynes, many of us here may well be dead. One reason why the

fiscal balance in advanced countries is so important to the global economy is that by virtue of being reserve currency issuing countries their deficits have large spillover effects.

8. There are two issues here. First, there is no justification for using different debt to GDP ratios for advanced countries and emerging and developing countries (EMDCs). If we take a forward looking view, it will be easily apparent that EMDCs will need to raise public debt to finance their development and in relative terms their public debt as a proportion of GDP will need to be higher than that of advanced countries. Second, the debt sustainability of countries should be evaluated not on some global norms, but with reference to individual country context. To what extent countries will be able to finance the servicing of their debt through higher growth should be built into the evaluation. Furthermore, the nature of debt has to be kept in view. For example, in India our public debt is predominantly domestic and therefore India's potential to influence global systemic imbalances because of public debt is negligible if not nil.

9. The third comment I want to make has to do with how we are interpreting the intent of our leaders which was to focus on persistently large imbalances. The question I would like to raise is whether we should dissipate our energies in the second step by looking at all large imbalances, or focus instead only on large, systemically important imbalances that have significant spillover effects. Is it so difficult to identify the latter through a simple statistical exercise such as country imbalances as a proportion of total imbalances or global GDP?

This way we can focus our attention on the root causes of persistently large imbalances and impediments to their adjustment as mandated by our leaders?

10. That takes me to my fourth and final comment. A question has arisen whether the Framework exercise should be looking at only net imbalances of countries or also at intra-country or intra-regional imbalances, as appropriate. The critical question to my mind is not whether imbalances are internal or external, or gross or net, but whether the concerned imbalance generates, or has the potential to generate, significant external spillovers affecting the wider global economy.

11. In conclusion, let me say that an effective outcome is needed to provide a signal that the G-20 is not only serious in ensuring strong, sustainable and balanced growth for the world economy going forward, but that it is, and it intends to remain, an effective and relevant institution for addressing current structural problems in a fast evolving global economy. Thank you.