

*Speech*

## **International Financial Architecture: Developing Countries' Perspectives\***

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It is a great honour for me to deliver the 49th Anniversary Lecture of the Central Bank of Sri Lanka. I am thankful to Governor Jayawardena for this invitation. I have had the privilege of knowing Governor Jayawardena personally over a long period of time, and have been an admirer of his immense knowledge and wisdom in the conduct of macro-economic and monetary policies. Under his stewardship, the Central Bank of Sri Lanka is now one of the leading central banks in the developing world with marked excellence in financial and monetary research and policy. The contribution of the Bank in the overall socio-economic development of Sri Lanka has also been immense. I am grateful to all of you, including so many old friends, for being here today.

2. The subject of my talk, as you know, is "International Financial Architecture: Developing Countries Perspectives". This is an opportune moment to reflect on this subject as considerable international discussion has already taken place. The developing countries' stake in equitable and workable solutions to the problems affecting the world economy is naturally very great. What I have to say to you today is more by way of reflections and some loud thinking in order to advance our collective views on matters of interest to developing countries rather than final conclusions. To begin with, it may be useful to understand why there is so much interest now in the new architecture; on what levels the debate has been conducted so far, and how effectively developing countries have participated in this debate. I would then like to deal with some of the major elements of the debate with special reference to developing countries, including the evolution of India's views and policies on some of these issues. Finally, I propose to highlight the institutional arrangements that have emerged, or are in the process of emerging, in order to facilitate effective co-operation among developed and developing countries on monetary and financial issues.

### **Why the Debate Now?**

3. The global crises that occurred after July 1997 have generated enormous international concern over financial stability in the world. The concern translated itself into a debate on how to prevent such crises arising in future and how to manage, such crises, if they do arise. Naturally, such a debate included a review of appropriateness of existing international financial arrangements and the need for redesigning such arrangements. Various facets of relevant reforms considered in the last 18 months or so came to be referred to as the International Financial Architecture (or IFA, for short). At the outset, it may be useful to recall the reasons for considering a new IFA in the context of the current crisis.

4. First, the recent crisis was sudden and unanticipated. Neither the countries themselves nor the credit rating agencies nor the international financial institutions anticipated a crisis of such magnitude. Second, the speed with which the crisis got transmitted to other countries took the financial community by surprise. New technology made capital flows easy and fast; it also made the transmission of panic easy. Third, there was evidence of failure of market mechanisms as

was generally understood, necessitating a review of relative roles of the State and the market in financial systems. Fourth, when the failure of markets resulted in systemic threats, the burden of market failure got shifted to Governments and the public sector. This burden was borne, to a large extent, by the Governments of borrowing developing countries, rather than lending or developed financial centres, though "irrational exuberance" in lending and borrowing are inseparable. Fifth, although the international financial institutions, in particular the IMF, came to the rescue of the affected countries, there were questions regarding the timing, content and adequacy of their assistance package. Sixth, the contagion spread across and beyond the region to developed countries also. Global interdependence was no longer merely a slogan or one-sided affair. It became clear that developments in developing countries were important for stability in the entire financial world.

### **Features of the Debate**

5. The experience with the Asian crisis led to the perspective that international financial architecture as it existed was inadequate to meet the new realities. It started with expression of dis-satisfaction by several experts and some countries on the role of credit rating agencies, and to some extent, on the role played by the International Monetary Fund (IMF). As the debate proceeded, there occurred a distinct shift in emphasis in favour of considering micro-economic aspects in addition to macro-policies, such as fiscal and monetary management. There was also a shift from abstractions to institutional aspects such as corporate governance, regulatory structures, and transparency. Some attention was also given to mechanisms whereby the Government could ensure market accountability, and not merely market efficiency, lest the burden of market failure shifted entirely to Governments. Finally, the debate had to recognise that the divide between developed and developing countries or OECD and non-OECD countries was not as meaningful as it was thought to be. The developing countries themselves represented a wide-range with different degrees of openness of their economies, and consequently different degrees of integration with the global financial system.

### **Levels of the Debate**

6. The debate on IFA occurred at different levels and in different fora. It occurred within the international financial institutions, particularly the IMF and the World Bank. Discussions were also held in the United Nations. Intellectuals from both developed and developing countries, such as, Krugman, Sachs, Bhagwati, Lal Jayawardena, my distinguished predecessor Dr. Rangarajan, and Deputy Governor Reddy expressed their views on various aspects of the IFA and exercised influence on the direction and the course of the debate. The private sector in major financial centres participated in the debate particularly through the Institute of International Finance. The voluntary international organisations consisting of national level regulatory and supervisory bodies, such as, International Organisation of Securities Commissions and International Association of Insurance Supervisors took this issue on board. Policy discussions were also conducted under the auspices of the traditional groupings, such as, the G-7 of developed countries, and G-24 of developing countries where Sri Lanka is currently in the Chair.

7. The debate within these different fora and at different levels contributed to structured and formal discussions in the Development Committee and Interim Committee, especially the latter,

which are formally charged with the responsibility of guiding the international community in matters relating to global economic cooperation. The discussions in these formal groupings were aided by informal and expanded high level official meetings of developed and developing countries. Among these, a mention may be made of G-22 sponsored by USA, and G-33 sponsored by G-7. These later resulted in another Group known as the Financial Stability Forum. India has been involved in almost all the discussions where developing countries have been represented, and an effort has been made by our representatives as well as representatives of certain other developing countries, including Sri Lanka, to present the developing country perspective on various issues.

### **Main Issues in the Debate**

8. The debate on IFA has covered a wide spectrum of policy issues. However, I propose to focus on those which are of particular significance to developing countries, viz., the exchange rate, the policy on reserves, the role of the external private sector, the management of capital flows, strengthening the financial system, transparency codes and standards, reform of international institutions and new arrangements for international liquidity.

### **The Exchange Rate**

9. Appropriateness of the exchange rate regime is considered to be one of the major factors relevant to the Asian crisis. The debate is not new and there are, as always, differing views on an appropriate exchange rate regime. One view is that a fixed exchange rate can promote domestic macroeconomic and financial stability by providing a firm nominal anchor. However, it has been pointed out - and more sharply after the Asian crisis - that there are risks associated with a pegged exchange rate regime. This is reflected in the fact that most of the currency crises in the past two years have occurred in countries with pegged exchange rates.

10. A widely expressed view is that countries should eschew variable peg regimes in favour of either something much harder or the voluntary adoption of "managed floating". Currency board is an option that has been favoured by some developing countries, particularly small open economies. But in most countries, the growing consensus seems to be in favour of a flexible and floating rate regime. While there is also acceptance of the hard reality that the degree of flexibility has to be "managed" in order to avoid undue volatility and panic, there is as yet no consensus on the modalities and the rules which should govern such "managed flexibility". The recent experience of interventions by Central Banks of some industrial countries in the management of the Yen-Dollar/Yen-Euro exchange rates, as also recent market developments and the ongoing debate on the Euro-Dollar exchange rates, vividly illustrate the problems associated with devising a set of hard-and-fast rules concerning an appropriate exchange rate regime, which is valid for all countries.

11. There has also been some debate on the policy measures that can be taken by the central bank to keep exchange rate movements "realistic" and relatively orderly. The broad consensus can be summed up as follows: There is a fair degree of agreement that stability in the exchange rate is well served by the stability in the conduct of monetary policy. An increasing number of central banks, particularly in industrial countries, are directing monetary policy to the sole

objective of price stability. Countries are also increasingly announcing near-term inflation targets explicitly. Transparency in objectives, intermediate targets and operating instruments are expected to play a role in anchoring expectations. However, in spite of cautious policies, if there are unanticipated or unacceptable movements in exchange rates, it is also generally, but by no means unanimously, held that central banks must be prepared to move interest rates in order to stabilise expectations. In these situations, direct intervention in foreign exchange markets by the central bank may also become necessary, although the precise extent and modality of intervention is likely to depend on individual country circumstances, especially the size and depth of the market and the size of a country's foreign exchange reserves. It has been recognised that developed countries, and in particular the central banks of major financial centres, are in a position to intervene in the exchange market on behalf of each other. However, such options are not available to most developing countries. This imposes additional challenges to the central banks both in tactics of intervention in the forex markets and the need for supplementary monetary and administrative measures.

12. Let me, at this point, briefly touch upon the exchange rate policy in India. The exchange rate policy has evolved from the rupee being pegged to a market related system (since March 1993). The exchange rate is largely determined by the market, i.e. demand and supply conditions. The objective of exchange rate management has been to ensure that the external value of the rupee is realistic and credible as evidenced by a sustainable current account deficit and manageable foreign exchange situation. Subject to this predominant objective, the exchange rate policy is guided by the need to reduce excess volatility, prevent the emergence of destabilising speculative activities, help maintain adequate level of reserves, and develop an orderly foreign exchange market. The Indian market, like other developing countries markets, is not yet very deep and broad, and is characterised by uneven flow of demand and supply over different periods. The market is also characterised by a few major players, and lumpy public sector demands, particularly on account of payments for oil imports and servicing of public debt. In this situation, the Reserve Bank of India has been prepared to make sales and purchases of foreign currency in order to even out lumpy demand and supply in the relatively thin forex market and to smoothen jerky movements. However, such intervention is not governed by a predetermined target or band around the exchange rate. While it is not possible for any country to remain completely unaffected by developments in the international exchange markets, fortunately we have been able to keep the spillover effects of the Asian crisis to a minimum through constant monitoring and timely action, including recourse to strong monetary measures, when necessary, to prevent the emergence of self-fulfilling speculative activities.

### **International Reserves**

13. There has always been a continuous but inconclusive discussion on the optimum level of reserves. Traditionally, the adequacy of reserves of a country has been mainly linked to import requirements. Recent experience has, however, shown that countries, which were holding large levels of foreign currency reserves in relation to imports, did not necessarily escape the crisis. These countries had large reserves, but these reserves disappeared quickly as they tried to defend their currencies. Some part of the reserves could not be accessed when it was most required by these countries since they were invested in illiquid assets. Further, there was no transparency with regard to the precise figure of unencumbered reserves.

14. In the aftermath of the Asian crisis, the emphasis has now shifted from measuring the adequacy of foreign exchange reserves only in relation to imports to measuring the usable or unencumbered reserves in relation to short-term liabilities, in particular short-term debt. A notable suggestion on this subject for emerging market economies is that countries should manage their external assets and liabilities (and the so-called "liquidity at risk") in such a way that they are always able to live without new foreign borrowing for up to one year. In other words, usable foreign exchange reserves should exceed scheduled amortisation of foreign currency debts (assuming no rollovers) during the following year. This has implications both for the level of reserves and debt management since this implies a limit on the size of the debt, in particular short-term debt and debt that is falling due for repayment.

15. The link between short-term debt and reserves has come to the fore in the IFA deliberations. There is a cost to building up reserves through large debt flows since the cost of debt would generally be higher than return on reserves. At the same time, a high level of reserves satisfies the need for liquidity, offers insulation against unforeseen shocks and acts as a source of comfort to foreign investors. The essence of reserves management being safety and liquidity, it stands to reason that all investments made out of reserves should be of top credit quality and excellent liquidity. Hence, the return on reserves and the cost of borrowing are not strictly comparable.

16. In India, we have been steadily building up reserves by encouraging non-debt creating flows and de-emphasising debt creating flows, particularly short-term debt. In fact, this strategy, coupled with the maintenance of acceptable level of current account deficit and market determined exchange rate regime were cornerstones of the policy of external sector management recommended by the Report of the High Level Committee on Balance of Payments (Rangarajan Committee), in April 1993. In the context of the changing interface with the external sector, and the importance of the capital account, reserve adequacy is now evaluated by RBI in terms of several indicators and not merely through conventional norms, such as, the import cover. Thus, for instance, we assess our reserves in terms of the volume of short-term debt and stock of portfolio investments also. As a matter of policy, as far as possible, foreign exchange reserves are kept at a level which is adequate to withstand both cyclical and unanticipated shocks.

17. As of now, our foreign exchange reserves are about US \$ 33 billion, which includes \$ 2.7 billion of gold and \$ 30.3 billion of foreign currency assets. Our foreign exchange reserves were only \$ 5.8 billion in March 1991. The last three years saw increases in reserves of the order of \$ 4.7 billion in 1996-97, \$ 2.9 billion in 1997-98 and \$ 3.1 billion in 1998-99, i.e. a cumulative \$10 billion despite the East Asian crisis and a number of other domestic and external pressures on the foreign exchange situation. Forward sales of foreign currency, net of forward purchases, are at present lower than \$ 1 billion or less than 3 per cent of gross reserves. In the interest of transparency, India has also decided to publish figures on RBI's forward liabilities every month. Our policy of building and maintaining adequate level of reserves while at the same time constraining debt, especially short-term debt, has served us well during the Asian crisis.

### **Involvement of the External Private Sector**

18. The role of external private sector lenders and banks in forestalling a debt crisis, and more

broadly in external liability management is assuming importance. Efforts to involve the private sector lenders in liability management has many objectives, viz., bring about more orderly adjustment process, limit moral hazard, strengthen market discipline, and help protect countries against volatility and contagion. The key issue concerning the role of the private sector lenders in forestalling and resolving the crisis is whether by involving the private sector, the overall costs associated with foreign exchange crisis can be reduced, either by smooth-ening the crisis-resolution process, or by reshaping the incentives under which private institutions operate. The idea is to institute mechanisms in place before any crisis takes place - so that resolution of the crisis is more orderly.

19. While there is a consensus regarding the need for the private sector to share the burden, discussions in various fora have centred on the "mode" of burden sharing. Ideas that are being considered include contingent credit lines, embedded call options, debt-service insurance, bond covenants, bankruptcy procedures, debt standstill and creditor-debtor councils.

20. Basically, these mechanisms bind private sector participants to either provide additional funds, or reduce debt service burdens in times of crisis without creating moral hazard or disrupting normal market conditions. For instance, it has been suggested that countries could contract market based Contingent Credit Lines with commercial banks to trigger liquidity support in times of crisis. If the credit lines were fairly priced, they could provide effective insurance against adverse market developments. Similarly, it has been proposed that standstill arrangements, which allow private sector to extend additional credit when there has been default on existing debt, should also be considered. Such mechanisms are considered essential since absence of such arrangements makes it possible for banks holding short-term interbank claims to leave the market unscathed or significantly reduce their exposure, which contributes to a perverse incentive structure inequitable burden sharing - and panic. Creditor-debtor councils could serve to improve the flow of information. Similarly, bond and debt covenants could introduce sharing clauses and provisions for the modification of terms by qualified majorities in order to speed up the negotiation process.

21. From the official sector, the IMF has decided to establish a Contingent Credit Line (CCL) as a precautionary mechanism to ward off financial crisis. This is expected to supplement and not substitute the contingent credit lines from the private sector, as in the case of Argentina. This support would be available to members who are undertaking sound macro policies but are affected by "contagion". The CCL is expected to signal to the market the confidence of the IMF in the policies of the country and boost confidence in the market.

22. It remains to be seen how flexibly the eligibility criteria in the new IMF facility will be operated in practice. For success of the scheme, it seems necessary to ensure that performance criteria are in fact appropriate and objective so that there is no room for subjectivity or introduction of political and other non-economic considerations. The scheme is likely to succeed in avoiding potential problems only if it is operated in a more or less automatic way subject to certain pre-determined quantitative and objective criteria being satisfied by the country. For example, one such test could be the extent of outstanding short-term liabilities in relation to a country's net reserves. Another test could be a pre-specified and agreed level of fiscal deficit or the level of aggregate demand. As long as a country is following policies which satisfy these and

similar quantifiable criteria, it should be able to use this new facility without further ado.

### **Management of Capital Flows**

23. After the Asian crisis, there has been an extensive debate on the issue of capital account liberalisation and controls. The issues that are being debated now relate to the desirability, form and content of capital controls, risk containment strategies in external debt management and the desirable sequencing of capital account liberalisation.

24. It is widely agreed that a major source of vulnerability in the Asian crisis was the accumulation of short-term liabilities of banks and corporates and poor quality of risk assessment. Overall, there appears to be a consensus now in favour of developing countries' restraining the inflow of short-term capital. There is, however, a growing debate on the means by which short-term flows can be controlled. Important suggestions relate to effective monitoring, imposition of Tobin Tax, which is a tax on spot transactions, and unremunerated reserve requirements as prevalent in Chile. The empirical evidence on effectiveness of Chile's approach, though oft-quoted, is however, not entirely conclusive.

25. There has also been a suggestion to impose an increased capital requirement on interbank transactions to bring about greater discipline on cross-border inter-bank market. It is self evident that just as there is no irresponsible borrowing without irresponsible lending, there is no short-term borrowing without short-term lending. Unfortunately, in practice, the current policy is biased in favour of short-term bank loans rather than medium term or long term loans to developing countries. Thus, by and large, short term loans to a country are likely to enjoy a higher credit rating than longer term loans, irrespective of the overall record of a developing country in meeting its debt service obligations.

26. The current Basle Accord provides that all claims on banks incorporated in OECD countries and short-term claims (i.e. up to one year) on banks incorporated in non-OECD countries should carry a risk weight of only 20 percent, whereas long-term claims on banks in non-OECD countries carry a risk weight of 100 per cent. The New Capital Adequacy Framework, which has just been issued by BIS as a consultative paper for comments is reviewing this particular norm. The proposed guidelines, however, seem to permit the use of ratings of international credit rating agencies for imposition of risk weights. As mentioned above, there is an inherent bias towards short-term credit in credit rating agencies' assessments. Hopefully, the BIS will address this issue while finalising the guidelines.

27. Basically, three positions significant to developing countries seem to have emerged from the discussions on cross-border capital movements. First, while reiterating the longer term efficiency of relatively free capital movements, a case has been made for capital controls either as an emergency measure or as a temporary measure in a crisis. This is based on the view that under some circumstances, financial markets do not function well. Second, it is felt that emerging markets should not liberalise capital account in a hurry, without prior action for strengthening their financial systems. Financial markets are prone to rapid changes in perceptions and expectations because of poor information and herding. In developing countries, these are also typically thin and volatile. Third, it is widely agreed that capital account liberalisation should be

supported by a consistent macroeconomic framework, stable exchange rate policies and strong institutional framework in the financial markets. There is also a developing consensus that controls, when necessary, should be temporary; they should be imposed on inflows rather than outflows and they should be market-based rather than direct and, as far as possible, they should be focussed on short-term volatile flows.

28. A related issue is the possible amendment of the IMF's Articles to extend its jurisdiction over the Capital Account. The IMF itself has acknowledged that there is no unique path that defines an orderly capital account liberalisation. In fact, the path and speed at which countries can traverse across this path will depend to some extent on the safeguards that the new international financial architecture can provide. It is worthwhile to note that a significant amount of liberalisation of capital account has already taken place in the developing countries under the existing Articles.

29. From the view point of developing countries, it needs to be recognised that external capital has benefits and acts as a complement to domestic savings. However, short-term reversible flows can also have negative effects on the economy, particularly during periods of political or economic uncertainty. While large inflows pose policy dilemmas for macro-management, large sudden outflows can impose extensive damage to the financial sector and also result in a disproportionate output loss. It must be understood that merely by lifting all capital controls, the markets of a developing country do not get as deeply integrated as a developed country's markets. As such, each country would need to decide on its own path of capital account liberalisation with regard to the timing and sequencing. This in turn is likely to depend upon the extent of stability and institutional structure of the domestic financial sector. Taking all these factors into account, at this juncture, it does not seem necessary to embark on a time-consuming procedure for amendment of IMF's Articles in order to promote capital account liberalisation. At the present time, a constructive consultative process between the IMF and member countries on these issues should be adequate to achieve the objectives in view.

30. India's policy on the capital account has been predominantly influenced by the recommendations of the Rangarajan Committee, mentioned earlier. The Committee's recommendations with regard to discouraging short-term flows stand vindicated by the current international consensus on the need for controlling short-term debt. In India, short-term debt is carefully monitored with differential treatment between trade and non-trade related debt and is subject to a quantitative ceiling. Deposits by Non-Resident Indians are also controlled through specification of interest rates or interest rate ceilings for different maturities. As a result of these efforts, the average maturity of our External Commercial Borrowing is about six to seven years.

31. India has cautiously but systematically moved, over a period of time, from a comprehensive control regime to current account convertibility and market-determined exchange rate. We have managed our capital account to ensure growth with stability, while consistently adding to our foreign currency reserves. Like several other developing countries, we also experienced, and managed, phases of excessive capital movements. There were periods of capital surge during 1993-95, and also two major episodes of volatility in flows in the second half of 1995-96 and again during 1997-98. During periods of exchange rate volatility in the wake of the East Asian crisis, there were major imponderables involved, both externally and internally, and contagion



and herd behaviour had to be guarded against. In these situations, a co-ordinated policy framework and careful calibration of policy instruments resulted in an effective management of capital flows without intolerable shocks to the performance of the economy.

32. In sum, I believe that the policy of cautious movement towards capital account liberalisation that has been adopted by us continues to be valid. Liberalisation of capital account has to be viewed as a process and not as a single event. It has to be embarked upon cautiously as part of overall economic reforms as well as an assessment of the emerging scenario relating to international economic and financial architecture.

### **Strengthening the Financial System**

33. In the debate on the IFA, increased recognition has been given to three prerequisites for the efficient functioning of the financial sector, viz., a well designed infrastructure, effective market discipline, and a strong regulatory and supervisory framework.

34. A well designed infrastructure has many elements. First, it requires a proper legal and judicial framework. A second element relates to fostering good corporate governance. A third element is comprehensive accounting standards and a system of independent audits. The International Accounting Standards Committee has done substantial work related to this aspect. A fourth aspect relates to an efficient payments and settlement systems. Core principles are being established in this area also.

35. Effective market discipline also requires a good credit culture and well developed and functioning equity and debt markets with a wide variety of instruments for risk diversification. The Basle Committee is reviewing its existing capital adequacy guidelines. The BIS has recently circulated a consultative paper to discuss the new capital adequacy framework. The Committee has proposed a new standardised approach for the risk weighting of book assets. The Asian crisis has demonstrated that problems can arise when excessive leverage is coupled with excessive concentration of risk. Improving the assessment and management of risks is, therefore, another area which requires attention.

36. International consensus has already been reached on what constitutes sound practices in many areas of banking supervision and securities regulation. The Basle Committee has released the Core Principles for Effective Banking Supervision and the International Organisation of Securities Commission (IOSCO) has produced similar guidelines for securities industry. Individual countries themselves are taking steps to develop markets, review their ongoing regulatory and supervisory procedures and adopt international best practices. Countries are also making efforts to strengthen the legal environment in which the financial systems are operating. Appreciable steps have also been taken to improve bankruptcy procedures.

37. In India, financial sector reforms were undertaken in the early stages of economic reform, pursuant to the recommendations of the Committee on Financial Sector Reforms (Narasimham Committee), which submitted its report in 1992. This was followed by another Committee on Banking Sector Reforms (Narasimham Committee II), which submitted its report in 1998. As a result of measures taken pursuant to the recommendations of these Committees, the adoption of

prudential norms relating to capital adequacy, income recognition, asset classification, provisioning standards and valuation of investment portfolio in India are now close to international best practices. Asset-liability management is being put in place in the banking system. Supervisory practices by the Reserve Bank of India have been closely patterned on the lines of the BIS Core Principles of Bank Supervision. In some aspects, the Indian standards are stricter than international standards.

38. Supervision of Non-Bank Financial Companies (NBFCs) is also conducted by the Reserve Bank of India. The prudential norms applied for the NBFCs closely resemble those of commercial banks. Capital adequacy ratio for NBFCs is currently 12 per cent. Asset classification, provisioning and income recognition norms have also been prescribed. Both, off-site and on-site supervision methods have been adopted, and CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and System) pattern is used to rate and evaluate NBFCs. All NBFCs are required to publish their audited balance sheets.

39. However, there is a lot more work that needs to be done in order to make our financial system deeper and more vibrant. A number of Committees have been set up to advise the Reserve Bank and Government on further steps. A Technical Advisory Committee on Money and Government Securities Markets has been established as a consultative forum to advise the Reserve Bank of India on an on-going basis. Similarly, a Technical Advisory Committee has been set up to advise on the legal infrastructure. A Government committee is also looking into the legal and judicial aspects. An RBI committee is working on the weak banks issue. Our urban cooperative structure is being reviewed. Another area of work relates to the review of deposit insurance system. A national debate is also taking place on the desirability and other aspects of movement towards universal banking. We have also constituted an internal group to study the consultative paper of the BIS on the proposed new capital adequacy framework.

### **Transparency in Systems and Developing Standard Codes**

40. During the on-going debate on IFA, an influential view was that the information made available to the markets by the official sector or by corporates or even by financial intermediaries, prior to the crisis, did not reflect realities in the emerging economies. The practices of disseminating information as well as its reliability, timeliness, and quality varied sharply from country to country. Hence, considerable attention has been devoted in the recent debate towards developing uniform transparency codes and standards. For instance, IOSCO is coordinating with other agencies, such as the International Accounting Standards Committee, to develop proper accounting and disclosure rules for the securities market. A noteworthy feature of the exercise is that these efforts encompass the private sector also, as many of the standards e.g. accounting, auditing, bankruptcy, corporate governance, and securities market regulation require to be implemented at the corporate level.

41. The IMF has also developed voluntary standards in certain areas in the financial system. The Code of Good Practices on Fiscal Transparency was recently approved. The Code of Good Practices on Transparency in Monetary and Financial Policies is now being developed. The transparency policies listed in this Code are purported to focus on clarity of roles, responsibility and objectives of central banks, processes for formulating and reporting of monetary policy

decisions, public availability of information and accountability.

42. It is, however, important to recognise that while transparency is of paramount importance as it enables and improves the understanding of the stance of policies by market participants, the quality and content of transparency has to be appropriate and in tune with country circumstances. Given the divergence in institutional development and the nature of relations between various arms of national governments, it seems unlikely that a uniform code could be universally valid at this stage. It stands to reason that the accent should be on voluntary adoption and gradualism rather than a "big bang". It is also important that the manner in which these international standards are monitored does not degenerate into categorising countries as performers and non-performers. The goals of transparency could be best served by a balanced and symmetric evolution of information as between the authorities and the market participants.

43. So far as India is concerned, consistent with democratic traditions and free press, an impressive degree of transparency in provision of information is already in place. India is one of the earliest members of the Special Data Dissemination Standards (SDDS) of the IMF. The RBI provides up-to-date weekly data on all relevant macroeconomic and financial indicators through the Weekly Statistical Supplement to the RBI Bulletin. In addition, the RBI and Government disseminate as much information as possible through monthly, quarterly and annual publications. Commercial banks in India are also required to maintain disclosure standards on par with those of international banks. This has been achieved by mandating disclosure of some of the essential strength indicators and performance related parameters as part of commercial banks' balance sheets. In fact, since April 1997, even before the onset of the Asian crisis, Indian banks have been disclosing capital adequacy ratios (both Tier I and Tier II separately), percentage of NPAs to net advances, provision made towards NPAs, and gross and net value of investments. Since March 1998, banks in India have been asked to disclose further information regarding interest and non-interest income as a percentage of working funds, operating profit as a percentage of working funds, and information on the financial position of subsidiaries. The Reserve Bank of India has also advised banks to disclose maturity profile of loans and advances, investments, and lending to sensitive sectors with effect from April 2000.

### **International Financial Institutions**

44. The discussions on the future shape of international financial institutions have revolved round three pillars. These are strengthening the existing financial institutions, creating new institutions, and establishing new groupings.

45. There is consensus that International Financial Institutions (IFIs) must adapt to the changing environment if they have to maintain their effectiveness. Some general agreement on the principles that should guide efforts to enhance the effectiveness of IFIs has also been reached. These include arrangements to enhance accountability, an inclusive process that facilitates a broad range of countries and other institutions, and a more participative and open decision making process.

46. The debate on strengthening the role of international financial institutions has also covered the role of rating agencies. The ratings given by these agencies seemed to have influenced the

decisions of investors in Asia greatly and after the crisis, questions have arisen on the public accountability of rating agencies. An issue that is being debated is whether ratings should be used as they are or should rating agencies themselves be regulated. This assumes critical importance in the context of the consultative paper of BIS on the proposed New Capital Adequacy Framework, which envisages the possibility of assigning risk weights according to ratings.

47. A proposal has also been put forward to create a new international institution called World Financial Authority (WFA) or a Board of Overseers of major International Institutions and Markets with powers for oversight and regulation globally. Various models have been envisaged for the proposed WFA. One proposal would entail the establishment of a body with responsibility for setting regulatory standards for all financial enterprises - funds and insurance companies as well as banks, and off-shore and on-shore entities. National regulators would remain responsible for implementing standards promulgated by WFA. Another model might be for the WFA to serve as an umbrella organisation into which the existing bodies could be brought together. It is however, well recognised that setting up such an institution would be a complex process. As an intermediate step, a suggestion has been made in the Development Committee recently for setting up a new and Permanent Standing Committee for Global Financial Regulation. This intermediate proposal seeks to bring together not only the World Bank and the IMF, but also the Basle Committee and other regulatory groupings on a regular basis.

48. In response to these proposals, the major industrialised countries have now set up the Financial Stability Forum with representatives from the finance ministries, central banks and regulatory authorities of G-7 countries, as well as from the IMF, World Bank, Basle Committee, IOSCO, International Association of Insurance Supervisors, BIS, OECD, Committee on Global Financial System and Committee on Payment and Settlement System. It has been proposed that the Forum should be broadened by including participants from other industrial countries and emerging economies in order to make it more effective.

### **New Arrangements**

49. Finally, new arrangements are being discussed on the provision of international official liquidity to countries or financial markets, including the question of IMF being given the authority and the means to act as the lender of the last resort. The initiatives under consideration in this area can be summarised as follows.

50. It is generally agreed that the IMF should continue to play an important role in providing international liquidity. The major issues regarding adequacy of funds relate to increase in quotas, SDR allocation, sale of gold to augment the resource base, and increased borrowing from members. Proposals for enhancing the accountability and legitimacy of the World Bank have also received some attention. In this context, there is a suggestion that the Interim Committee could be transformed into a Council of Ministers. Reforming the Development Committee along similar lines has also been suggested.

51. As regards the proposal to establish an international lender of last resort, one line of

argument is that there is no such need. A better approach to crisis management, it has been argued, would be to reform the debtor-creditor relationships, including introduction of provisions for orderly debt workouts and arrangements for temporary standstills. A number of other questions have also been raised. Who would function as the lender of last resort? Some favour the IMF, while some others favour a complementary facility for unconditional official lending. Could the IMF function without being able to create reserves? What would be the modalities for access? Would access to funds attract conditionality? What would be the extent of moral hazard? These questions are still being debated.

52. In order to enforce emergency standstill and orderly debt workouts, a suggestion has been made to set up an international bankruptcy court, but this has not been found feasible. As an alternative, UNCTAD has suggested establishing an independent panel to determine whether the country concerned is justified in imposing exchange restrictions with the effect of debt standstills.

53. Thus, there is no shortage of new ideas on new institutions and new arrangements. However, a fair guess, at this point of time, particularly with improved prospects of countries in East Asia, is that the present institutional structure will remain more or less in tact with some changes in operating procedures and management structures.

## **Conclusion**

54. Let me now conclude. I have traversed a fairly large ground, and I do not propose to take much more of your time by attempting a summary of all the issues. I would like to end by highlighting a couple of "over-arching" issues, which deserve to be specially kept in view as we workout the arrangements for financial co-operation in the new millennium. An important consideration that the international community must pay attention to is the hard reality that these new arrangements cannot operate successfully without equal partnership between developed and developing countries, or between capital surplus and capital borrowing countries. The recent history has forcefully demonstrated the close linkages between all countries across the globe, whether they are lenders or borrowers. The recent move to involve developing countries more closely in the discussions on the New Financial Architecture are, therefore, welcome. But these efforts have not yet gone far enough. The institutional arrangements for decision making on the new financial architecture still remain too heavily weighted in favour of industrial countries. An important priority in the coming months is to find ways and means of broadening the dialogue by making the concerned fora more representative.

55. Despite many challenges, and despite their somewhat lopsided voting structure, by and large, the Bretton Woods institutions have served the international community well. As such, the current consensus that there is no urgent need to create new international institutions is perhaps right. Current focus is on measures to make the existing Bretton Woods institutions more effective and responsive. In order to achieve this objective, it is now essential to provide greater representation to developing countries on the Boards of these institutions, and to provide them with a larger voting power. It is one of the ironies of the last forty years that although developing countries, as a group, have grown much faster than the developed countries over this period and their relative economic strength in terms of output and trade has increased substantially, their

actual voting power in Bretton Woods institutions has tended to decline! This needs to be corrected in the next round of Quota exercises in the IMF and capital increase in the World Bank.

56. Finally, for the developing countries, including countries in our region, it is of utmost importance that we accord the highest priority to strengthen our banking and financial systems and bring them up to best international standards. In early development economics, little or no attention was paid to the role of financial intermediation as an essential component of growth and development policies. The concentration at that time was on measures to raise the rate of domestic savings and investment and on acceleration of the pace of industrialisation through direct intervention. In view of the realities of that time and the historical background, this emphasis was understandable. However, the world has changed a great deal since then. The role of financial intermediaries in mobilising and allocating domestic savings as well as external capital has now become crucial. The East-Asian crisis has also demonstrated the vital importance of financial institutions in sustaining the momentum of growth and development. It is no longer possible for developing countries to delay the introduction of strong prudential and supervisory norms, and introduce structural reforms in order to make the financial system more competitive, more transparent and more accountable.

57. This is an area where central banks like, yours and ours, have a special responsibility. In the SAARC forum, under the leadership of Sri Lanka, we have initiated measures to bring about better cooperation among our central banks and Ministries of Finance. We, in the Reserve Bank of India, look forward to working closely with the Central Bank of Sri Lanka in moving speedily towards our common economic objectives.

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