A new global architecture

INTERVIEW WITH DR MANMOHAN SINGH
PRIME MINISTER, THE REPUBLIC OF INDIA

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Dr Manmohan Singh, Prime Minister of the Republic of India

What has been the impact of the current global crisis on India?

Before this year began, we knew that it was going to be a year of cyclical downturn in the industrialised world. We did not know at that time that the financial difficulties in the sub-prime mortgage landing sector in the US, which had already surfaced in 2007, would quickly snowball into a truly global financial crisis and that in turn, would lead to a severe recession which has been described by many as the worst crisis since the Great Depression of the 1930s.

The US, Europe and Japan are currently in recession and are expected to show negative growth for the year 2009 as a whole. Global financial markets remain clogged with very high levels of risk perception. Capital flows to emerging markets have been choked. A global crisis of this magnitude was bound to affect India and it has. Export demand has contracted. The stock market has come down sharply, as it has all over the world, posing severe financing difficulties, in addition to the hardship caused to individual stock holders. Traditional sources of finance have dried up.

How is your Government responding to the crisis? What steps are you taking to address this?

The governments of the industrialised world are well aware of the seriousness of this crisis and are taking an unprecedented series of proactive steps to counter the recession. Our government has also taken a number of steps to counter the global downturn. We have relaxed monetary policy in a series of steps since October 2008. We are encouraging the banks, especially the public sector banks, to lend more freely to help otherwise viable production units to cope with the temporary stress of the economic downturn. Steps have also been taken to allow a greater flow of credit to the non-bank finance companies which have become an important part of our financial system.

Special efforts have been made to expand credit to small and medium industry and to sectors such as housing and automobiles which are especially hit. These steps in monetary and credit policy have been supplemented by measures to ease restrictions on commercial borrowing abroad. We have also taken major steps in fiscal policy to give a stimulus to the economy. Tax rates have been reduced in a number of areas. Budgetary provisions made for expenditure in a number of schemes in the current fiscal year have been substantially increased. These increases are largely for the development of much needed infrastructure in rural and urban areas.

Infrastructure development through Public Private Partnership based on competitive bidding has been an important part of our strategy. However, these projects will now face a difficult financing environment. To deal with this problem, a new mechanism for providing refinancing through the India Infrastructure Financing Company Ltd has been announced. IIFCL will provide low cost refinancing to banks against long term loans provided by the banks for competitively bid infrastructure projects. Exporters are another group that are directly impacted by the global downturn. We have paid special attention to their needs.

Will these policy commitments be sufficient to mitigate the worst of the global downturn?

The range of steps taken is unprecedented. Nevertheless, I recognise that they do not take care of all problems. This is because our domestic policy action cannot completely negate the effect of a global downturn as severe as the one we face today. We can at best minimise its negative impact. There will be a full recovery to our normal economic potential, but this will take place when the global economy reaches normality.

Meanwhile, growth in the current year will be lower than last year. GDP grew by 7.7 per cent in the first half of 2008-09. It will be much lower in the second half of the year. The latest estimates for the final outcome in 2008-09 vary between 6.5 and 7 per cent. The exact figure is not critical. The important point is that although growth is lower it is still much higher than most countries. Furthermore our agricultural sector is doing well.

I must also emphasise that our problems will not be over in the current year. The difficult period will continue throughout 2009-10. The Government will plan on continuing its efforts for a supporting environment. Both monetary and fiscal policy will have to be tailored to that objective. Fortunately, the rate of inflation has eased considerably. Inflation is now 5.2 per cent and is expected to decline further. This gives ample flexibility for monetary policy.

On the fiscal side, our space is limited. The fiscal deficit in the current fiscal year will be much higher than originally planned. This is not something to be tolerated indefinitely. However, we will have to tolerate a high fiscal deficit for the next year to accommodate expenditure needed to stimulate the economy. This expenditure should be mainly in infrastructure development and in schemes that help support incomes of the poor.

What should the priorities be for the G20 leaders?

While our immediate priority should be to deal with the crisis which is still unfolding, we also need to look ahead to see what changes are needed in the global financial architecture to avoid such a crisis from recurring. Much useful work in this area has already been done by Finance Ministers and there is considerable consensus on many areas. I agree with the general consensus that there are several factors behind the crisis and the future global economic architecture must be designed to deal with these. These include failure of regulatory and supervisory mechanisms, inadequate appreciation and management of systemic risks and inadequate transparency in financial institutions.

The new architecture we design must include a credible system of multilateral surveillance, which can signal the emergency of imbalances that are likely to have systemic effects, and also put in motion a process of consultation that can yield results in terms of policy co-ordination. I would like to emphasise the importance of broad-based multilateral approaches to our efforts. Bodies such as the G-7 are no longer sufficient to meet the demands of the day. We need to ensure that any new architecture we design is genuinely multilateral with adequate representation from countries reflecting changes in economic realities.

The International monetary Fund is the logical body to perform the task of multilateral surveillance of macro-economic imbalances and their relationship to financial stability. However, it is relevant to ask whether its systems and procedures are adequate to the task. Over the years the Fund has become marginal to the task of policy analysis and consultations on macro-economic imbalances and related policies in the major countries. The task is now performed in other forums, though it is questionable whether it is being performed well. I believe we need a comprehensive review of the procedures of the IMF, leading to recommendations on governance reform that would enable the Fund to perform the role of macro-economic policy co-ordination.

An important element of longer term reform is to restructure the representation in the governance levels of the Fund to reflect the current and prospective economic realities. Quota reform is the normal way to effect a change in voting power, but it has been contentious and incremental, and what has been achieved thus far has fallen far short of what is needed. The Board of Governors of the IMF should be explicitly charged with exploring alternative modalities to achieve a more legitimate representation.

How do you see the future of the international financial system?

Looking ahead, we have to pay attention to the many regulatory gaps in the financial system which allowed the development of excess leverage and the risks associated with it. It is obvious that we need better systems of risk management and better regulation and supervision, especially of institutions that have a global reach and are dealing in financial instruments that are exceedingly complex. Managers of financial institutions, credit rating agencies and regulators have to do a much better job. The structure of incentives in the system has to be aligned to this end. We also need to examine whether the existing forums of regulators that are there are adequate and cover the entire gamut of regulatory and supervisory activities that are required.

These are technical issues that should be tackled in the specialised forums dealing with financial stability, notable the Basle Committee on Banking Supervision and the Financial Stability Forum. However, both these bodies need to have broader representation than they do at present. International co-ordination on regulatory issues would be more easily achieved in the principal forums where these issues are discussed were seen to be more representative. Broad basing the present representation in these forums is much easier to achieve and I hope this Summit will give a clear signal in this direction. It will certainly build confidence in our intention over the longer term to achieve significant reform in the governance of the global financial system. F

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