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Statement by the Hon. **CARLO AZEGLIO CIAMPI**,
Governor of the Fund for **ITALY**,
at the Joint Annual Discussion

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Governor of the Fund for Italy
at the Joint Annual Meeting
Washington D.C., October 6, 1998**

1. Mr. Chairman,

The slowing down of economic growth, the financial instability sweeping through key areas of the world, and the sense of grave uncertainty that permeates markets pose great and urgent challenges that are putting our institutions under strain. The world is looking to us for direction and solutions. We must provide them, promptly and effectively. The problems we are facing can be solved, but there is no time for hesitation or disagreement.

Albeit slower, growth is still robust in North America, Europe and China. Other parts of Asia, Latin America, and Africa are also showing continued recovery. It is imperative that economic crises in other parts of the world are not allowed to spread further.

2. Therefore, our policy response must first aim at sustaining growth. This is a shared responsibility. We must use all the means at our disposal, exploiting fully the margins that still exist at the national and regional level to promote consumption and investments, through measures that can strengthen market confidence and minimize the impact of adverse wealth effects resulting from the negative performance in equity markets.

Against an overall background of falling output growth, weakening commodity prices, and historically low inflation, the available margins for interest rate reductions should be fully utilized. It is a response that should not be further delayed. The recent US decision concerning short-term rates, which follows that of Canada, and the fiscal and structural actions taken by Japan go in the right direction.

Adequate domestic policies, supported, when required, by international measures, must be promptly implemented in countries where exchange rate and financial instability are still a problem, or are becoming a serious concern. Domestic responses must be proportionate to the magnitude of the crisis, as in the case of Korea and Thailand, and anticipatory, as in Chile and Argentina, to cite just a few examples. When needed, external support from our Bretton Woods Institutions and the regional banks has to be provided, adequate in size, and fairly priced.

3. Our international institutions have borne the brunt of crisis situations of unprecedented scale and complexity. They have shown flexibility in facing the consequences of the Asian crisis. The hard realities that we face show the need to strengthen their capacity to prevent and manage economic emergencies.

In the first place, they should be provided with the necessary resources. I believe that our first priority is to complete the quota increase of the Fund and put the NAB into effect before the end of the year. It is essential for the Fund to be endowed with sufficient resources to support member countries that follow sound economic policies. This is a feasible goal and, most important, it is in the interest of all of us. Analogously, we should strengthen the financial position of the World Bank, allowing it to continue in its essential development tasks and, at the same time, to help members that face crisis situations arising from, or affecting, their financial markets.

4. In the longer term, learning from past and recent experiences, we must introduce key changes in the architecture of our financial system. Much has been done in areas such as data dissemination, data standards, and codes of good fiscal practices, but much more still needs to be done.

First, we must reconsider the adequacy of some exchange rate regimes in the areas where they are now utilized, in order to reduce rigidities, encourage early adjustments, and decrease foreign exchange market pressures.

Second, our institutions and resources must be used more effectively. Our Bretton Woods institutions and their regional counterparts, while preserving their specialized functions and characters, must increase the level of coordination of their approaches and responses to member countries' financial problems.

Third, surveillance and supervision must be improved. Freedom of capital movements does not mean absence of rules and of monitoring. Early warning systems must be put in place. Disclosure requirements regarding both public authorities and private sector market participants must be strengthened and widened. Short term capital flows--especially debt-creating flows--must be monitored more extensively and in a more timely manner than in the past. Large institutional investors must be properly supervised and off-shore financial centers made to conform to appropriate behavioral norms.

Fourth, the Fund should be given mandate to promote an orderly liberalization of cross-border capital transactions within a rule-based framework that maintains in place appropriate national safeguards, and the strengthening of domestic financial systems, particularly in emerging countries. This will allow members to benefit fully from efficient international allocation of capital and lower costs for it. In order to achieve this objective, an amendment to the Fund's Articles of Agreement can be considered.

Fifth, in dealing with potential future payment crises, we should agree on a set of changes that, on the one hand, could ensure a more active participation of the private sector in their resolution and, on the other, could determine the circumstances and the procedures under which lender of last resort functions will be exercised at the international level.

Finally, we must solidify the architecture of our monetary system, beginning with the strengthening of the Interim Committee, possibly transforming it into a permanent body, capable of effectively orienting the strategic choices of the IMF.

These are our tasks. These are our challenges. Let us face them and work together at their solution.

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5. Let me now turn to Italy: in the last decade Italy has gone through profound changes in its economic culture, to reach what I like to call “the culture of stability.” Inflation is now firmly under control at below 2 percent; we are running a significant primary budgetary surplus; the debt-to-GDP ratio is declining; and our currency is stable, thanks also to our joining the Economic and Monetary Union.

These results were not easy to reach, and they have been possible only with the understanding and the full support of the Italian people and the active cooperation of unions and entrepreneurs, who came to appreciate the advantages of stability and accepted sometimes painful sacrifices to reach it.

Participation in the EURO is both the result of this quest for stability and an important step to reinforce it, as we are seeing in the present financial turmoil. At the same time, it is also a commitment to consolidate these results; accordingly, we are pursuing a medium-term objective of a close-to-balanced budget, consistent with a faster reduction of the public debt-to-GDP ratio. Reducing the debt burden is indispensable to enlarging the range of our fiscal policy options and rebalancing growth and equity objectives in a framework of fiscal stability.

The deterioration of the world economic outlook, combined with some domestic uncertainties, has dampened the Italian economic cycle. The forecast for real GDP growth has been reduced to 1.8 percent in 1998. We still expect substantially higher growth in 1999, about 2.5 percent. More crucially, we are confident that sound macroeconomic policies and pervasive structural reforms will boost the long-run growth perspectives of the Italian economy. In this

way, therefore, Italy will contribute to the momentum of the European economy and play its role in world recovery.

However, this is not time for complacency. We must now focus our efforts on addressing Italy's most serious problem: the high level of unemployment. Unemployment, as its territorial distribution reveals, is the result of a deep regional imbalance.

Fighting unemployment, therefore, demands bridging regional differences and harmonizing still distant economic realities. This requires encouraging the south in its effort to grow, removing bureaucratic obstacles, fostering the development of human capital, increasing the skills of the labor force, and providing an adequate infrastructural network. Italian economic development in the past decades has been based on a process of pervasive diffusion of economic activity and new entrepreneurship from West to East, from North to South. Continuation of this positive process will not only guarantee the development of the South, but also represent the foundations of a sustained and prolonged growth for the country as a whole.

Doing this is not simple. There is no single, ready-made solution. Instead, our development strategy has to be based on a variety of policy instruments: a more active and high quality program of public investments; an enlarged financing program to encourage the birth of new firms; an improved coordination among central government, local authorities and the private sector in designing programs and selecting projects. As in the past, it must be anchored to a solid social contract.

The 1999 budget assumes particular relevance in this context. More resources will be devoted to employment growth and solidarity goals by lowering fiscal burdens, stimulating investments, and supporting the poorest.

Increasing market confidence in our policies has reduced the interest rate premia paid on government securities. This process will find its natural conclusion also in the short term segment

of the interest rate curve with the birth of the EURO in January 1999. Reduction of tax evasion and tax erosion -- which is one of the effects of the recent fiscal reform -- has already allowed a lightening of the burden of taxpayers, including the corporate sector, in 1998. The wide-ranging benefits of tax reform will become even more evident in the subsequent years. Public administration reforms, privatization of state enterprises, deregulation, and liberalization will continue to make our markets for goods, services, and credit more competitive.

To conclude, Mr Chairman, economic policy in Italy will continue to follow the “new policy course” based on social dialogue, macroeconomic stability, and deep-rooted reforms that have helped reshape the role of the State in the Italian economy and set the basis for sustainable economic growth. In Italy, as everywhere else in the world, economic development must be the means to unite peoples and regions. Therefore, we all have the responsibility, political and moral, to insure that growth is not only stable, but that it is shared by all.