Economic Growth
The Path to the Alleviation of Debt and Poverty

Address
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The World Bank
Washington, D.C., U.S.A.
I am with you here this afternoon with one overriding purpose in mind: to reconfirm The World Bank's commitment to do all we can to help those of our middle-income member countries with severe debt problems to regain sustained, noninflationary economic growth with social progress.

That is your goal. The international community can, and must, help you achieve it. For our part, The World Bank intends to strengthen substantially its support for your efforts. We now have the mandate to do so, and the challenges and problems faced by the heavily indebted countries, including those here in Latin America, demand that we act boldly on that mandate, and without delay. So now I want to share with you some thoughts on how we can work together to help you regain the momentum of development and accelerate the climb to higher living standards for all.

We at The World Bank are acutely conscious of the pain and suffering which the countries of this region have been bearing—and bearing courageously—during the past three years. Your confrontation of the crisis-level debt problem has entailed significant sacrifices, which in some cases are clearly unsustainable over an extended period of time. And we have profound admiration for the courage and skill with which the government of Argentina has seized the nettle and acted to curb inflation and to restore the confidence of the private sector in the country's financial management. Continued action on these fronts is crucial to setting Argentina back on the path of growth.

The debt crisis—whose origins are well enough known for me not to have to repeat them here—called for an initial response from the heavily indebted middle-income countries that was unavoidably painful. There were very sharp cutbacks in imports, accompanied by reductions in public expenditure programs which
necessarily depressed domestic income levels. Although most heavily indebted countries took steps to attract resources into export-oriented industries in order to enhance their future debt-servicing capacity, such measures were in many instances hampered by the severe restrictions on imports necessary to effect a quick reduction in the current account deficit.

Inevitably, rates of growth of output, inputs, and investment dropped precipitously as the indebted countries launched their macroeconomic adjustments. Altogether the imports of Latin America dropped from $77 billion in 1982 to $55 billion in 1983. At the same time, investment rates fell as low as 18 percent. This first response succeeded in reducing current account deficits and easing the immediate debt-servicing problem. In 1984 falling domestic consumption, coupled with substantial excess capacity in most of the heavily indebted countries, produced a surge in the supply of exportable goods. This was happily matched on the demand side by healthy growth rates in the industrial countries, led by the United States, providing a buoyant external market for developing-country exports, especially manufactures.

As a result, the export earnings of the heavily indebted countries increased. The export earnings of the major debtor countries of Latin America rose by 11 percent that year, thanks in part also to reforms made in the area of exchange rate alignments. This permitted some increase in imports, for the first time since 1982, and a rise in real output. But the increases were fractional. In spite of adjustment efforts, the region's economy experienced negligible per capita growth during 1984 and failed to regain the ground lost since the outbreak of the debt crisis.

Certainly, the reduction in the current account deficits of the heavily indebted countries was a remarkable achievement. But the price, as you well know here in Latin America, has been very high indeed. Domestic austerity measures have not permitted economic activity to keep pace with the expanding labor force. As a result, unemployment has risen, and, on a per capita basis, output has declined in over two-thirds of the countries of the
region. Per capita gross national income has declined to the level of the early 1970s. These increases in unemployment, accompanied by still high rates of inflation in most countries of the region and a general decline in the standard of living for most of the peoples of Latin America, are unacceptable. It is imperative that we work with you to put them right.

But what has gone wrong? It was the conventional wisdom that sufficient economic realignment in the indebted countries, coupled with a satisfactory rate of noninflationary growth in the industrial countries and assured access to their markets, would have several beneficial results. It would bring an increase in capital flows as well as permit an unwinding of the debt problem and a restoration of the indebted countries' creditworthiness over a three- to five-year time horizon.

These were reasonable, rational assumptions, based on what were then perceived to be the roots of the problem. The fact that today there is growing concern that prospects for further growth and for reduction in debt-service ratios are clouded does not invalidate the rationale for that earlier decision to do what was necessary to reduce the external imbalances, which clearly needed reducing. They were reduced thanks in no small part to the overall rate of growth of the industrialized countries, led by the United States, which itself accounted for some 85 percent of the increase in Latin America's exports.

But why is there now this growing concern over the prospects for resumed growth and a reduction in debt-service ratios? Why has the cautious optimism of 1984 given way to doubt at a time when nominal U.S. interest rates have declined significantly and the inflation rate in industrialized countries has been remarkably well controlled over the years?

Such doubts are largely engendered by the realization that a resumption of growth, which is absolutely essential to the heavily indebted countries, cannot take place without adequate resources to support the increasing investments and continuing
policy reforms which are needed to secure that growth on a sustained basis. But the availability of those resources is threatened from a variety of quarters, both external and domestic. This has given rise to fears that even countries which have undertaken significant domestic adjustments may get caught in the low investment–low growth trap. We must act together, now, to prevent that happening.

We at The World Bank never believed that the debt problem could be solved overnight. Far from it. But, like many others, we overestimated what would be forthcoming in voluntary capital flows, and how soon, to help the heavily indebted countries return to a growth path as quickly as possible. And we underestimated the degree of suffering there would be until that growth path was reached.

External factors have undeniably contributed to impeding the return to growth. Slower output growth in 1985 in the industrial countries has slowed down the growth of their imports from developing countries. Real GDP growth in the industrialized countries as a group is likely to be below 3 percent in 1985 compared with 4.9 percent in 1984. Growth in the U.S. economy, which provided the main impetus in 1984, is now estimated at between 2.5 and 3 percent for 1985, with no offsetting growth impetus expected from Western Europe.

Meanwhile, the dollar value of imports into major industrial countries from developing countries as a whole, and from Latin America in particular, has declined by about 2 percent in the first half of 1985 over the same period in 1984. Imports from non-oil developing countries such as the major manufactured goods exporters of East Asia have continued to show some increase, but the same cannot be said of either Sub-Saharan Africa or Latin America. Exports by Latin American countries are running below the levels of last year.

The negative impact of the import slowdown has been compounded for many developing countries by the continuing weak-
ness of commodity prices. Although commodity price movements in 1985 have been a continuation of developments in the past few years, real commodity prices have reached their lowest levels since the Great Depression. Even the depreciation of the U.S. dollar in recent months has been insufficient to offset the impact of unfavorable demand-supply balances for several commodities crucial to this region’s exports.

At the same time, there are as yet few signs of a resumption of voluntary commercial bank lending. Data from the Bank for International Settlements (BIS) indicate that after a rise of only 2 percent in the claims of reporting area banks on developing countries in 1984, those claims stagnated in the first half of 1985. The bunching of repayments falling due in the next few years, continuing high debt-service ratios, and concern about export prospects all combine to inhibit new lending.

Debt-service obligations on the present scale inevitably drain domestic savings, and the problem is compounded by the flight of capital when domestic policies are unable to give adequate assurance of the attractiveness of the domestic currency. Without additional resources to support investment—from increased exports and increased capital flows—growth just cannot resume. Thus the problem of debt-overhang sits as a deadweight on the shoulders of the heavily indebted countries.

There is therefore a vicious circle in which some heavily indebted countries are caught: they must increase domestic resource mobilization to service their debt. Simultaneously, they must create an environment that encourages sustained expansion of exports in order to permit a gradual decline in their debt-service ratio and an ultimate restoration of their creditworthiness. To increase their exports on a sustained basis, however, will require both macroeconomic policy reforms and significant new investments in export industries—investments generating high rates of return once policies are in place that provide meaningful incentives. But the savings that might finance such productive investments are already mortgaged to meet debt-servicing obligations.
If the financial markets were to provide the capital flows to finance the additional investment, that investment would permit the expansion of exports. And where the rate of growth of exports is in excess of the world interest rate, there will be an eventual lowering of the debt-service ratio and a consequent strengthening of creditworthiness.

Additional capital is clearly needed to support productive investments. But investors are reluctant to provide resources to those countries where they judge the existing level of debt to be too high, and where the necessity to service existing debt effectively mortgages a part of future earnings. Suppliers of external capital therefore need to recognize the restoration of creditworthiness as a product of their continuing lending, not the precondition for it.

This brings me, then, to the concerted action that must now be taken by all the participants in the process to break this vicious circle. Let us be clear. Unless it is broken, the heavily indebted countries will not be able to pursue their strategies for accelerating economic growth and social progress. By concerted action, I mean action by both the industrial and the developing nations, by the commercial banks as well as the multilateral financial institutions.

I feel bound to place at the head of the list of actions to be taken the need for the industrial countries to maintain a steady real growth in their GNP. It is crucial. To do that, and to permit a return to lower real interest rates, they must move to restore monetary and fiscal balance. They must also act to ease rigidities in their labor markets to reduce high unemployment and help stimulate new industrial capacity. Stronger economic growth will help the industrial nations to resist the protectionist pressures which now cloud the expectations of the heavily indebted countries for increased export revenues. For if the industrial countries increase their protectionism, there would be no way that debt-service ratios could be reduced in the heavily indebted countries short of domestic cutbacks in their imports—clearly doomed
them to a deep drop in output and living standards. That must not be allowed to happen.

I am much encouraged by the recent agreement to start the preparatory process for a new round of multilateral trade negotiations under the aegis of the General Agreement on Tariffs and Trade (GATT). This is an opportunity for the industrialized countries to take steps to enhance market access for the developing countries. It is also an opportunity for the developing countries to improve their own trade regimes. Such negotiations should aim at rolling back protectionism worldwide, giving special consideration to those trade barriers of particular importance to the developing countries.

What other concerted actions are essential to the strengthening of the growth prospects of the heavily indebted countries? In broad terms, there are three:

• The design and implementation of comprehensive growth-oriented policies in the heavily indebted countries

• The provision of substantial new net resources by commercial banks

• The enhanced participation of the multilateral development banks, including The World Bank and the International Monetary Fund (IMF).

These, including the actions of the industrial countries, are not sequential actions; they need to be closely integrated within a consistent framework, if the goal of growth is to be achieved.

With regard to action by the heavily indebted countries themselves, I have already noted that the vigorous adjustment efforts made in Latin America have been largely at the expense of growth. A return to sustainable growth now requires a resumption of investment and capacity expansion. The magnitude and nature of the actions that will lead to this resumption will of necessity differ from country to country. But in general terms,
there are three areas that seem to deserve attention:

• Trade policy

• Domestic savings

• The quality of investment.

It is a striking feature of major Latin American countries that exports are low in relation to gross domestic products, and manufactured exports are particularly low as a proportion of total exports. These characteristics yield some unfortunate results. First, the burden of debt service on export earnings is the result not just of debt service being high, but also of export earnings being low. There are developing countries where external debt is just as high as it is here in Latin America in relation to GNP, but the burden is sustainable because exports are relatively so much higher. Second, the small size of manufactured exports in total exports means that Latin America’s export structure lacks the flexibility needed to adapt to rapidly changing world markets. Indeed, when one sees how important the industrial sector is in most countries of the region, one has to ask why manufactured exports are so unimportant.

The answer is that for decades trade policies have been biased against exports in general and against manufactured exports in particular. There has been too much dependence on commodities. Let me suggest that the time has come to eliminate this bias and to encourage the growth of manufactured exports. It is time to let Latin American industry take its proper place in world trade.

My second area for attention is the encouragement of savings. How can this be done, you will ask, when a quarter or more of domestic savings is now swallowed in servicing just the interest on foreign debt? Indeed, the net outflow of interest and other factor payments now absorbs between 5 and 10 percent of GNP of the heavily indebted countries every year. It is not easy in such conditions to increase savings, but there are some important
things that can be done. To increase domestic savings rates generally, interest and exchange rate policies need to be pursued which stimulate that increase, encourage the increased savings to stay at home, and induce repatriation of capital that has already fled abroad.

But increased savings must be effectively used. In too many countries, public enterprises are inefficient and waste scarce resources. The skills exist in Latin America, as elsewhere, to change that and to make public enterprises sources of savings rather than losses. Perhaps it would be possible to go further, as some governments are now considering, and sell some of them to private investors in an effort to improve still further the quality of their management. Of course, private managers will become all the more efficient as the incentives environment in which they operate is made increasingly competitive. And one sure route to increased competitiveness is trade reform.

My third area for attention is the quality of investment. The 1970s were years of substantial investment in many countries, although unfortunately not in all. Even in those countries where there was investment, large resources seem to have been devoted to projects where the return was low. Moreover, despite the rapid growth of the labor force in most countries and the need to provide jobs, too much investment was in highly capital-intensive form that did little to provide the jobs that are so badly needed. Making investment more efficient and making it more relevant to needs—especially the need to provide work—could be profoundly important to the stimulation of growth and to the employment of people. That, surely, is among the very highest of priorities for all countries.

Such domestic policy actions as I have briefly described will not only help promote an earlier resumption of growth; they will also surely help restore the confidence of the commercial banks. The participation of these banks in expanding the flow of new capital to the heavily indebted countries in support of their programs of adjustment for growth is indispensable. While no one believes
that private capital flows can or should reattain the levels or rates of growth of the late 1970s, it is for many heavily indebted developing countries inconceivable that growth can be resumed without larger overall capital flows than those now in prospect.

There is growing recognition of the value of multiyear rescheduling arrangements in the context of growth-oriented programs. Both the Interim Committee and the Development Committee of the Boards of Governors of the IMF and the Bank have endorsed them. We urge the commercial banks, and the export credit agencies too, to show maximum willingness to make such arrangements where they can really enable the indebted nation to focus with greater assurance on what needs to be done in the medium term. For the medium term is where the commercial banks should also be focusing their attention. It is in support of medium-term growth strategies that new voluntary lending can be most productively applied.

The World Bank is ready and anxious to forge ahead and to play a major role, without delay, in what must be a much enlarged, much more dynamic cooperative effort—an effort directly involving all three key actors in an agreed medium-term program to restore growth in each heavily indebted country. These key actors are the country itself and its policymakers, the international institutions and official bilateral agencies, and the commercial providers of capital.

These programs must be aimed at enabling each country to achieve a reasonable rate of growth and substantially reduce its debt-service ratio to a sustainable level by a specific date. Each program should first set forth a feasible and attainable time path of key aggregate variables—exports, imports, savings, investment, and GDP over the medium term. It should spell out the growth rates of these key variables that are judged feasible and that permit the gradual restoration of sustainable debt-service ratios by the end of the period. And the capital flows essential to the following of this path will need to be estimated.
Naturally, given differences in the policy environments of individual countries, the precise programs would have to be tailored to individual country circumstances, although all would start with the establishment of reasonable time paths of the major variables that would be involved in the restoration of sustainable debt-service ratios.

The programs should specify the policy measures necessary to achieve their objectives. Given the expertise that the IMF has in many of the policy areas, the development of these growth-oriented country programs will often, if not usually, need the collaboration of that institution. And that collaboration has been assured.

But let me stress here and now that we are not talking simply of marginal increases in resources to support merely incremental programs of adjustment. That is absolutely not an adequate response to the problem. We are talking about programs that address problems that were not addressed in the initial response to the debt crisis. We are talking about a quantum leap in resource availability to support these new programs.

The Bank has already increased its lending to Latin America. It rose to a record level in the fiscal year ended June 30, 1985—21 percent above the level of the previous fiscal year—and disbursements have increased by more than 50 percent over the past two years.

But it is abundantly clear that, within the framework of such agreed medium-term programs, we can and should do vastly more for those willing to design and implement truly bold adjustment programs. In support of such programs, we will increase the proportion of our lending in the form of quick-disbursing sectoral and structural adjustment loans.

The World Bank, then, has three distinct roles to play in this crucial initiative. First, it will assist in the formulation of these growth programs and in monitoring their progress. Second, it will
provide an expanded volume of capital necessary to support the programs. Third, it will act as a catalyst in the mobilization of capital needed from other sources. In addition to the encouragement that the programs should give to the commercial banks, The World Bank will be aggressively pursuing its co-financing activities, especially its B-loan syndication program. Meanwhile, the International Finance Corporation, whose capital we expect shortly to see doubled, will be working hard to attract higher levels of direct foreign private investment into productive enterprises in this region. And we look forward to seeing the Multilateral Investment Guarantee Agency (MIGA) also encouraging a greater flow of capital to the private sector.

We believe that vigorous action along these lines responds positively and constructively to the many calls for bold new initiatives—calls coming from industrial and developing countries alike—that we heard in early October at our Board of Governors meetings in Seoul, Korea. We have also welcomed U.S. Treasury Secretary Baker’s call for a greater concerted international effort to help the most heavily indebted countries back onto the path to sustained growth. And we have welcomed his call, and the calls of numerous other governments, for an expanded role for The World Bank in this effort.

Our relationship with this region has been the longest with any developing region of the world. And it has been impressively fruitful. But now, with our new mandate, we are embarking upon a new era in that relationship—an era as full of promise as it is of challenge.

We pledge to you that we will be long-term, constructive partners of yours and of the other actors in this determined endeavor to break the vicious circle and to help the heavily indebted countries to resume growth. Because sustained growth is the real objective. Not simply growth for growth’s sake, but growth designed to help alleviate poverty. Growth that will help cure the scourge of high unemployment; growth that will raise the incomes of the urban and rural poor, arrest the degradation of the
urban environment, promote food security, spread social services; in other words, growth that will provide better lives for all the peoples of these countries.

That is your goal. We want to help you to achieve it, and we will spare no effort to do so.

Thank you.
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