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THE BANKER'S ASSOCIATION FOR FOREIGN TRADE

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LADIES AND GENTLEMEN:

Mexico has been on everyone's mind of late.

I am, therefore, especially pleased to have the opportunity to present you with our comments on Mexico's program of growth-oriented structural change and on the associated financing package that was negotiated in Washington, D.C. last week. I will also explain the role of the World Bank in that package.

Overview of the Financing Package

As you know, Mexico and the commercial banks' Steering Committee reached broad agreement last week on a New Money package of about US$ 6 billion plus two contingency lending facilities.

The overall financing package of about US$ 12 billion includes an IMF Stand-by of about US$ 1.7 billion, net new disbursements from the World Bank of about US$ 2.3 billion, including the net present value of its guarantees, and commitments from bilateral official sources. In addition, agreement was reached on a proposed rescheduling of Mexico's outstanding debt. Two weeks earlier, on September 17, Mexico reached agreement with the members of the Paris Club on a generous rescheduling of its official debt.

Mexico's program of fundamental policy changes and the associated financing package is a milestone in the world-wide effort to find constructive and negotiated solutions to the developing countries' debt problem. I do not
think that many people outside of Mexico fully realize how extensive the changes already made in Mexico are, nor do they appreciate the extent of those still proposed. And this is central because without these policy changes, designed to move Mexico toward a more open and competitive economy, it would not be possible to achieve growth, increase private investment, and gradually restore creditworthiness. And it is the strength and scope of the program which justifies your support.

Let me be more specific.

What is the Nature of Mexico's Medium-Term Growth Program?

The need for structural change was recognized in 1983-85, but it has been made more urgent by the dramatic fall in oil prices. The program that is now being implemented by the Government is, in our view, a sound program that will enable Mexico to resume growth and to sustain it, in a more stable environment. It is a difficult program, being carried out in adverse internal and external circumstances, and there are many uncertainties and risks. But, these risks seem manageable, when viewed against the Government's commitment to reform and the measures already undertaken.

We agree with the Government's sense of urgency about undertaking these structural changes in Mexico. Productivity growth in many sectors of the economy had begun to slow in the 1970s, as a result of inward-looking policies, high levels of protection, and extensive subsidies necessary to maintain inefficient firms and keep food prices artificially low.
The most fundamental policy reform that is being undertaken is the shift from decades of inward-directed growth behind high protectionist walls, towards a more outward-oriented development strategy based on gradually declining protection to improve the efficiency and export competitiveness of the economy.

To make this strategy effective and successful, it must be accompanied by appropriate exchange rate and other policies, to facilitate the adjustment to a more open economy. I am impressed by the actions already taken by the Government to reduce trade barriers and to bring about these complementary adjustments.

The program of reducing barriers to trade—which is being supported by the World Bank through the recently signed $500 million Trade Policy Loan—has already started. The Government has eliminated import restrictions on more than half of the total value of imports. Import tariffs have been reduced from a maximum of 100% to 45% at present, and the Government has made public a calendar which calls for a further lowering of tariffs to a maximum of 30% by October 1988. The purpose of making public such a calendar, of course, is to enable firms to anticipate and adjust to declining levels of protection.

In addition, as you know, Mexico recently joined GATT, and has stated its intention to sign several of the supplementary GATT codes, including some to which most other developing countries have not subscribed. If Mexico successfully completes these additional negotiations, and becomes a signatory to those codes, she will, in effect, be joining a very small elite of perhaps half a dozen developing countries that are at the top of the list, in terms of commitments to the principles and codes of GATT.
Mexico's trade liberalization measures are key to the long-term strengthening of the economy and its ability to serve the objectives of increased domestic income, employment, and external creditworthiness.

But import liberalization by itself---to encourage greater domestic efficiency and export capability---would run the risk of inundating the economy with imports. To protect against this risk, the Government has devalued the Mexican peso by nearly 50% in real terms over the past 12 months. As a result, through the first half of this year, imports have actually declined by about 10%, and non-oil exports have jumped by 30%.

To further complement its strategy of moving toward fuller participation in world trade, Mexico has undertaken a series of important structural reforms in industry, agriculture, and the public sector. We intend to continue to work with the Government on further action in these areas, and to support these efforts with additional quick-disbursing loans.

A second fundamental change is the decision to reduce the size of the public sector, improve the efficiency of public sector firms, and cut back on subsidies throughout the economy.

Public sector expenditure has been reduced from a peak of 35% of GDP to 27% by 1985, and is expected to fall below 25% in 1986. This is a reduction of nearly one-third in the size of the public sector. In addition, the number of public enterprises or agencies has been reduced from 1,155 in 1982, to a current...
figure of less than 700. A major steel plant was closed in June of this year, with the elimination of some 11,000 jobs. Some 278 additional public sector firms are in the process of being merged, privatized, or closed, with agreements already completed for 76 of these firms, including the country's largest hotel chain.

Agriculture, too, should become a major beneficiary of a more open economy development strategy. Protectionist policies in the past were directed toward promoting industry at the expense of agriculture, and so naturally resources were induced to move away from agriculture toward industry. This had many adverse consequences: Excessive urban concentration; depressed rural productivity and income, a deteriorating agricultural trade balance, and a slowing of employment in what was historically a very labor-intensive sector. To offset these negative trends, ever-rising subsidies had to be pumped into agriculture---both to producers and to consumers. These subsidies created an untenable fiscal drain.

The Government has moved impressively to reduce agricultural subsidies and to create employment opportunities through agro-industrial exports, partly through the promotion of more joint ventures between Mexico's private sector and foreign investors.

These and other sectoral and economy-wide reforms will reduce the size of the public sector, make the remaining public sector more efficient on a commercial basis, lessen the degree of Government intervention in the economy, and, thus, open up new opportunities for the private sector. This is consistent with Mexico's stated objective of a growing role for the private sector in a more market-based economy.
It is worth noting here an element of complementarity between the program of the IMF and that of the World Bank. The IMF program is focused primarily on reducing the size of the public sector and public sector borrowing requirements. This will gradually reduce the degree of crowding out of private sector credit needs.

In parallel, the World Bank lending program will finance increases in credit to the private sector, through industrial, agricultural, housing, mining, and housing credit programs supported by World Bank loans. And we will work with the Government on the restructuring of those enterprises and industrial sectors identified by it.

Let me mention also that we are now seeing real progress in the modernization of Mexico's approach to foreign direct investment. Rules governing foreign investment have been selectively liberalized, especially in areas related to non-oil exports and the transfer of technology. The administrative steps required for approval of applications have been greatly reduced. Export-oriented projects can now receive automatic approval within 30 days of application, and majority-owned foreign ownership for small firms is no longer an obstacle, so long as at least 30% of production is exported. The Government has recently issued procedures for debt-equity swaps. And, the 15% tax on repatriation of profits is expected to be revoked soon.

What is the Role of the World Bank in all This?

The World Bank is supporting the Government's program of structural change, through the expansion of conventional project lending, and through loans in support of specific policy reforms.
Let me begin by saying that the World Bank's role in Mexico did not develop suddenly during these recent negotiations. To the contrary, we have been working closely with Mexico since the crisis of 1982 began, to help in the analysis of the issues which had to be faced if Mexico was to change its development strategy. The first priority was the program for trade liberalization.

As I mentioned, this has been supported by a US$ 500 million Trade Policy Loan already approved by our Board, and signed. This will be supplemented by an Export Development Loan (US$ 250 million), which we expect to be approved in the next few months. We also expect that our work on the fertilizer and other industrial sectors will be the basis for adjustment related loans in these areas, incorporating and supporting the necessary policy changes. In agriculture our joint analysis is expected to lead to a loan supporting further price liberalization, decontrol and a greater role for the private sector.

Moreover, the Bank will continue to be involved in project lending in almost every major sector of the Mexican economy. This kind of lending is also expected to expand.

All told, we expect to commit US$ 2 billion annually in the next two years compared to a historic lending level of about $ 500 million. Our net disbursements will be about $ 2.1 billion over 1986 and 1987. This is a very large expansion of our outstanding exposure---about a 50% increase in two years.
What is the Linkages between Commercial Bank Lending and World Bank Lending?

First, since 1985, commercial bank exposure in Mexico has declined, while World Bank exposure has grown. In fact, the Bank has been Mexico's principal source of long-term capital over this period. Obviously, this cannot continue. An effective program in Mexico requires the support of all its creditors.

Second, the package that has been negotiated this past week includes arrangements to ensure that commercial bank new money disbursements will become available as Mexico's adjustment program is incorporated in, and supported by the World Bank loans that I have mentioned. Board approvals will signal to the commercial banks that the next step in the implementation of Mexico's medium-term structural adjustment program has been successfully taken. In addition, Mexico, the Fund, and the World Bank will regularly report on the progress of implementation.

Will Mexico Recover from its Present Crisis?

Ultimately, of course, private sector confidence, both in Mexico and abroad, is vital to the success of the Government's reform program and to the financing package that is being designed in support of that program.

I might note that a sensitive indicator of confidence is the differential between the official and the free exchange rates in Mexico. The differential, which has gone as high as 50% in the past, has recently averaged 2-3%.
But there are more fundamental reasons for believing, as I do, that the Government's program has a good chance of success, and that Mexico's prospects for recovery are favorable. The enormous adjustment and restructuring efforts that have become necessary in the wake of the oil price collapse will be costly and difficult in the short run. If pursued steadfastly and consistently, these reforms can be expected to place the country in a relatively strong position to establish a new, more outward-oriented, and less Government-dependent, pattern of growth and employment.

Mexico's prospects for future recovery are based on numerous factors. Let me mention just a few: First, Mexico has a rich natural and human resource base, and close proximity to the world's largest market; second, the drastic fall in the terms of trade is unlikely to continue, and should begin to turn around on even conservative assumptions about the future world price of oil—any improvement in the terms of trade will have significantly salutary effects on fiscal, financial, and balance of payments performance, as well as directly on growth, investment, and, hence, employment; third, the 30-40% drop in real wages that we have seen since 1982 appears to have brought Mexican unit labor costs to internationally very competitive levels, even below those of Southeast Asia.

In short, the fundamentals look promising. But, things will not be easy in the near term. Many firms that banked heavily—and made good profits in the past—on inefficient production for protected or subsidized domestic markets in Mexico, will have to restructure their operations to become export-oriented and internationally competitive. This applies as much to foreign firms doing business in Mexico as it does to Mexican-owned firms.
Mexico's reform program will face uncertainties and risks. But, the progress already achieved augurs well for the prospects of ultimate success, provided Mexico perseveres on its present course and receives appropriate external support.

But, I also want to sound a cautionary note of which you are all well aware. As Mexico becomes a successful exporter, there will be calls for increased protectionism in the countries that buy Mexican exports. If those calls are heeded by Governments around the world, Mexico will not see the full benefits of its present drive to become more efficient, and could become discouraged in its efforts. The consequences would be unhappy for Mexico, and, indeed, for the international economy at large.

In the simplest terms, if Mexico cannot export, neither can it earn the foreign exchange to service its debt. Trade and finance are, therefore, intimately linked.

The program of structural adjustment that Mexico has initiated is as ambitious as it is necessary. Any such program has its risks, and this one does too. But, these risks are understood fully in Mexico and can be managed. And this program can only succeed if adequately supported by external capital. The sums involved are large, and you will want to consider your participation as carefully as we did ours. Our commitment to disburse $2.1 billion, plus our offer to guarantee 50% of $1.5 billion of new commercial bank funds, is a vote of confidence in Mexico's program; it also is contingent on the participation of all commercial bank creditors in your share of the package. Without your
participation, our funds, and those of the IMF, would not suffice to support Mexico's efforts in 1986 and 1987, and the program would be doomed from the outset. This, none of us could wish, and none can afford. I hope, therefore, that you and your colleagues in the US and around the world will join us, and the IMF, in providing the resources necessary to make Mexico's program of structural change work and restore Mexico as a buoyant economic partner.