Remarks

As Prepared for Delivery

By

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The World Bank

and

International Finance Corporation

before the

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Thank you.
Good afternoon, Ladies and Gentlemen.

I am delighted to participate in this 17th Washington Conference for Corporate Executives, and I thank David Rockefeller and the Council of the Americas for inviting me.

These days there are two major and timely questions being asked about The World Bank: What are we doing to help alleviate the situation in the most heavily indebted countries? and what are we doing to help Sub-Saharan Africa cope with its chronic economic crisis?

I must emphasize at the outset that what we are doing — and we are doing a great deal — is, and has to be, part of a concerted international effort involving the developing countries themselves, the industrial countries, the multilateral financial institutions, and, where appropriate, the commercial banks.

We are encouraged by the tangible progress being achieved in a growing number of developing countries, both middle- and low-income, where medium-term growth-oriented adjustment strategies are being implemented. Perseverance with policy reform is essential to the restoration of growth and creditworthiness. But the situation remains fragile, and no developing country can tread that path with confidence unless the cooperation of the other key participants whom I have identified is clearly assured.

In recent speeches in London and Bonn, I have focussed on the broad range of cooperative and complementary actions to be taken by all the participants in this endeavor. Today, after reviewing briefly the efforts currently underway to restore growth and creditworthiness, I want to focus on how critically the effectiveness of the developing countries' efforts to help themselves depends on the policies and actions of the industrialized countries.

In 1984, oil-importing developing countries as a whole had reason to hope for a revival of growth and an easing of the debt problem. For many of them, extra export earnings and the rescheduling of substantial amounts of existing debt allowed the first increases in imports and per capita incomes since 1980. But 1985 was a different story. Slower growth in the industrial countries and in world trade pulled back the rate of growth of developing country exports, while at the same time commodity prices fell. Terms of trade declined by just over one percent. And as net capital flows into developing countries also declined, many had no alternative to restraining the growth in their imports.
While it is true that many developing countries will gain from the recent decline in interest rates and oil prices, the situation for others has deteriorated badly, not least for those among the heavily indebted middle-income countries of Latin America which are almost totally dependent on oil exports for export revenues.

During the disappointing year of 1985, a consensus emerged that the long-term solution to the debt-servicing problems of many heavily-indebted middle-income countries depended critically on the restoration of sustained growth. It was therefore essential that the process of adjustment, which had slackened in many countries during 1985, should be given not just new impetus, but new direction.

Adjustment in most indebted countries had hitherto been accomplished primarily through compressing both imports and investments rather than through increases in exports and savings. That was certainly the pattern in Latin America. It produced, it is true, an impressive turnaround in current account positions. But this had often been at the cost of much reduced expenditures on health, education and other social services. It took care of urgent, short-term problems, but it severely jeopardized economic growth and political stability. The message was clear. Henceforth adjustment measures had to be compatible with sustained growth and an improved capacity to service debt.

If today many nations are facing the consequences of an accumulation of adjustments that are long overdue, it is not just their own mistaken policies that are to blame. Industrial countries and commercial lending institutions have also contributed to the problem. Undisciplined aid flows and ill-directed commercial lending have helped insulate many economies against inconvenient or unpopular reforms.

But the protracted difficulties of the heavily-indebted middle-income countries have taught us all a salutary lesson: timely adjustment, together with adequate capital flows and an open trading system, is absolutely essential to sustained growth, restored creditworthiness, and the alleviation of poverty. On that, thank heavens, there is now broad agreement. And on that there is at least an expressed collective will to promote and support such adjustment.
There is broad agreement that the plight of the low-income countries of Sub-Saharan Africa must also be handled with the same three tools: growth-oriented adjustment, adequate capital flows and an open trading system. Adjustment is underway in parts of Africa, but there is no such thing as cost-free adjustment and reform in Sub-Saharan Africa any more than there is in the highly-indebted middle-income countries of Latin America and elsewhere. To carry through the adjustment programs that will facilitate growth and reverse the decline in low-income Africa's per capita income, significant new flows of concessional resources must be made available.

How to promote and support growth-oriented adjustment is the considerable challenge The World Bank faces in its heavily-indebted middle-income member countries -- mostly, but not all, in Latin America -- and in its poorest member countries, mostly, but not all, in Sub-Saharan Africa. How have we been responding?

In the indebted middle-income countries we have been expanding our role in three crucial areas:

- in assisting, in close association with the IMF, in the development, implementation and monitoring of the medium-term adjustment programs in pursuit of the objectives of countries committed to policy reform;

- in expanding greatly our own lending in support of such programs; and

- in extending our catalytic role to enhance the mobilization and coordination of private and official flows.

These initiatives are not major new departures, but rather a considerable strengthening of certain of our regular activities. Endorsement of this strengthened role was explicit in Treasury Secretary Baker's proposals at the meetings of the Boards of Governors of the Bank and Fund last October in Seoul, and it was explicit in the clear consensus that emerged from those meetings.

We have acted energetically upon that consensus, rapidly raising our direct lending in support of adjustment and strengthening our country economic and sector work. Gross World Bank disbursements to fourteen highly indebted middle-income member countries increased to $3.9 billion in 1985 from $2.7 billion in 1982. They will be somewhere between $5.5 billion and $5.7 billion in 1986, the bulk of it in support of adjustment in the Latin American and Caribbean region.
Traditionally The World Bank has financed specific projects — electric power stations, roads, schools, agricultural credit and so on. They are, and will continue to be, the core of our activities since our borrowers need finance to help with specific projects. In support, however, of the fundamental policy changes needed and indeed already underway, approximately one-third of the Bank's lending in Latin America already takes the form of policy loans. Most of these are sectoral loans supporting policy changes in a particular sector. Some are structural adjustment loans supporting a range of policy changes simultaneously in several parts of an economy. But whatever the form they take they are designed to support basic policy changes and to provide funds that are disbursed quickly, thus making an immediate contribution to a country's external capital needs. Our plans are that a rapidly growing proportion of our total lending in Latin America will take the form of these fast-disbursing policy loans.

Our $350 million loan, approved just a month ago, to assist the adjustment process in Argentina's agricultural sector is the largest to date, and two more large loans to that country are under active consideration. A $500 million loan in support of Mexico's trade liberalization is amongst a number of operations assisting adjustment in the Latin American region which are currently under discussion. And we are undertaking similar operations in a number of countries outside the region, such as in Morocco and the Ivory Coast.

Meanwhile we are working hard to encourage the commercial banks to convert the recent trickle of private lending to these countries into an adequate — and much needed — flow. Commercial capital is a crucial component of their financing program. Yet, even including the effects of rescheduling, commercial bank disbursements to the highly indebted among the middle-income countries increased by less than one percent in 1985. This situation won't be turned around unless we help these highly indebted countries design and implement the policy reforms that will markedly strengthen the confidence of lenders and investors in the prospects for resumed growth. That is where we, at the Bank, in close association with the IMF, have such an important role to play.

Policy reform is also the key to reversing the deteriorating economic situation in much of Sub-Saharan Africa. The Bank is actively engaged in helping our member countries of the region to formulate such programs of reform. But, as our most recent report on the region's resource requirements demonstrates, the effectiveness of programs in place and the spread of such reforms are threatened by inadequate external capital flows. That is a threat which has to be removed.
By our calculations there will be a yearly external financing gap of some $2.5 billion from 1986 to 1990, about $1 billion of which can, we believe, be met through the multilateral institutions. But that must assume a satisfactory outcome of the current negotiations to replenish the resources of IDA, our concessional financing arm upon which the low-income countries of Sub-Saharan Africa rely so heavily. The remaining $1.5 billion gap can only be met through bilateral efforts, both with additional aid flows and with further reschedulings.

These, then, are the concerns with which The World Bank grapples daily in its efforts to help its more troubled member countries. It can be argued that a measure of economic growth and poverty alleviation can result purely from internal adjustment. But the measure can never match the need. Sustained and adequate growth together with real progress in the alleviation of poverty cannot be achieved unless the industrialized countries play their required role. And that role is to create and maintain a trade and financial environment that is supportive of, not inimical to, the growth objectives of the developing countries. So let me turn now to the particular actions we ask of them and seek to show just how crucial they are.

At the top of our list of priority actions stands the maintenance of a steady rate of real growth in the GNP of the industrial nations, creating durable non-inflationary growth in world demand. However, continued high budget deficits in some of the major industrialized countries will make it very difficult to sustain a steady rate of growth. The domestic effects of large and persistent deficits are principally on real interest rates and the expectation of inflation. There is surely no doubt that large deficits contribute to high real interest rates, and as they climb they are bound eventually to be accompanied by an accelerating rate of inflation and increased protection. The resulting stop-go policy mix that governments would adopt in their attempts to control either inflation, unemployment or the trade deficit would inevitably slow world growth.

The message is clear: those economies with persistently high deficits must work to reduce them. And taking the route of public expenditure cuts seems the most appropriate approach. That is undeniably hard in political terms, especially if it involves cutting back on growth in social benefits, the second fastest growing item of public spending in the industrial world after defence. Governments should look to see whether, for example, expenditures on subsidies to manufacturing, especially in steel and shipbuilding, all in the name of easing structural change, are really to their long-term benefit. Even more critically should they look at the rapid growth of subsidies to agriculture. Internal prices set well above world prices, especially in Europe,
but also here in the United States, encourage domestic production and depress domestic consumption. The resulting surpluses flooding the world at depressed prices do particular damage to those developing countries trying to raise their output of agricultural products in which they often have an absolute advantage.

Whatever route is taken, reduction in the deficits is crucial, and the more the major industrial countries can manage to coordinate their macroeconomic policies, the less disruptive will be the process of reduction. The recent concerted intervention in the foreign exchange markets by the Group of Five to reduce the value of the dollar illustrates the potential usefulness of such cooperation. And the fall in interest rates is also a welcome reflection of new efforts at international cooperation to achieve macroeconomic adjustments.

Lower real interest rates are crucial to the debt-servicing capacity of the heavily indebted countries. The fall in dollar interest rates was one of the few changes in the external environment of benefit to the developing countries in 1985. But interest payments continued to absorb 36 percent of exports in the Latin American region in 1985. One percentage point knocked off the interest rate means a reduction in the region's debt-servicing burden of more than $3 billion. And that really makes a difference.

Easing rigidities in labor markets to reduce high unemployment and help stimulate new industrial capacity is another necessary area of adjustment for the industrialized countries if economic growth is to be sustained. Policies to encourage flexibility and to reduce marginal labor costs need to be pursued. Training and mobility need to be improved, and reductions in the protection afforded certain industries will be needed to promote the movement of labor into more efficient and competitive activities.

Correcting distortions caused by inappropriate fiscal and monetary policies and labor rigidities can create the conditions for strong sustained growth in the industrial countries, and thus increase import demand among them and boost both exports and imports of developing countries. This in turn creates the conditions needed to reduce international trade restrictions, as reduced they certainly must be.
An open trading system is essential not just to the growth prospects of these countries; it is also essential to the heavily indebted countries whose hopes of restoring their creditworthiness will be dashed if they cannot expand their export earnings. The current decline in the growth of developing countries' export receipts and the continuing deterioration in the overall trading environment is therefore alarming. Developing countries' export receipts grew by only 1 percent in 1985. Since 1980, non-oil commodity prices have fallen by 26 percent in dollar terms. In addition to supply conditions that have affected the prices of individual commodities, dollar-denominated commodity prices were falling while the U.S. dollar was appreciating, and are still being affected by a reduced demand from industrial countries suffering from a growth slow-down.

Recent analyses suggest that, while dollar denominated commodity prices fell because of the dollar's appreciation, the sluggish demand and the large increase in real interest rates since 1980 have been the factors most responsible for the reduction in the real price of non-oil commodities. If that is indeed so, then accelerating growth in the industrial countries and lowering real interest rates are indeed crucial to the revival of the non-oil developing countries' export receipts.

But that still leaves the persistent and serious problem of protectionist trends. The steep rate of decline in the growth of developing country exports to industrial countries just cannot be explained solely in terms of factors such as exchange rate movements, the phase of industrial country recovery, or supply factors. The rate of decline strongly suggests that protectionist measures, particularly in manufacturing and agriculture, are among the causes.

Especially worrying is the increasing use by industrialized countries of non-tariff barriers, which, like tariffs, are often more restrictive on those products of specific interest to the developing countries, such as agricultural and textile products. Agricultural exports are of vast importance for many developing countries. Yet hardly a day goes by without new calls in the industrial countries for more import restrictions on these developing country commodities. It is true of the United States, the biggest agricultural exporter in the world. It is true of the nations of the European Economic Community. Their import controls greatly harm the interests of agricultural commodity exporters of the Third World, not to mention the interests of consumers of all nations, as does their subsidizing of uneconomic agricultural production for sale in world markets. We absolutely must restore freer trade in those commodities.
The highly restrictive Multifibre Arrangement expires at the end of next month. It has been harmful to all, to both consumers and producers. If, as there are now grounds for fearing, the renewed Arrangement is to be even more restrictive than its predecessor, can one blame the developing countries if they then question whether their interests are being served at all?

Unless trends such as these can be halted and reversed, severe global macroeconomic problems of both debt-servicing and growth lie ahead. In broadest terms, the principles underlying the GATT and the multilateral trading system must be reaffirmed and adhered to. I am therefore greatly relieved that a new round of multilateral trade negotiations under the aegis of the GATT are now finally on the international calendar. This new round is essential to the rolling back of protection, and it will need to take into proper account the legitimate concerns of the developing countries, such as I have just outlined, and the developing countries own interests will be best served if they are integrally involved in the process.

Commitments to a standstill in protectionism and to support for trade liberalization have been made again and again by the industrial powers. I have no doubt they are being made right now at the Tokyo Summit. Yet, despite these commitments, the continuing erosion of the GATT system threatens to eliminate the last vestiges of order in world trading arrangements. Why is it that governments will not live up to their commitments? Dare we hope that the pledges they make this week in Tokyo will also be acted upon? We must earnestly hope so.

Let me now turn to the last, but by no means least important, of the areas of action to be taken by the industrial countries: the provision of capital. The restoration of economic growth in the highly-indebted middle-income countries and in the troubled low-income countries depends to a critical extent on the mobilization of additional capital flows from both private and official sources. For example, our own extensive studies conclude that even with substantial policy reforms in the heavily indebted middle-income countries, restoration of growth and creditworthiness over a five-year period would require, depending on the performance of the industrial countries, between $14 and $21 billion of net capital flows annually.

With respect to flows of private capital, I have already spoken of the extreme importance of reviving commercial bank lending to the heavily-indebted middle-income countries undertaking growth-oriented medium-term adjustment programs. In his proposals at our Seoul meetings, Secretary Baker called for $20 billion in net new lending by the commercial banks in 1986 - 1988 in support of growth-oriented policies in the heavily indebted middle-income countries. If they are indeed to do this, the industrialized country governments must ensure that their regulatory authorities
do not introduce conflicting signals. Certainly it is important to continue strengthening the banking system. We all benefit from that. But the measures intended for that purpose must not fly in the face of the need to continue support for the debtor countries.

A related action that these governments need to take is to encourage an increase in exposure of export credit agencies in countries undertaking difficult adjustment programs. Governments cannot expect commercial banks to increase their exposure to countries for which loan loss provisions have been made if official agencies restrict their own lending for similar reasons. At the same time, we are bound to urge donor governments with active export credit programs to exercise restraint when aspects of those programs are not consistent with the development objectives of recipient countries. The World Bank, which has had a long association with these agencies, is prepared to work with creditor countries to assure a shift of emphasis of new export credits away from lower priority, large new investment projects, and towards completing or rehabilitating existing investments.

Through the expanded programs of the International Finance Corporation, our affiliate working in the private sector, we are moving to stimulate a greater flow of direct foreign private investment to the developing countries. Governments of the industrialized countries who have not yet done so can help stimulate that flow by signing and ratifying the Convention establishing the recently proposed Multilateral Investment Guarantee Agency (MIGA), whose principal task will be to insure direct foreign investment against non-commercial risk. More than the required number of fifteen developing countries have now signed, among them three Latin American countries, with a fourth due to sign shortly. Four of the required number of five industrialized countries have signed. If the United States signs, we shall have both the number of signatories and the amount in capital subscriptions needed to empower the Agency to get underway.

With regard to official flows of capital, it is disappointing to note that such flows, including both official assistance (ODA), i.e. concessional money, and non-concessional lending, declined slightly in 1985 from the 1984 level. Official non-concessional flows fell by some $3.5 billion in 1985. Meanwhile, net lending from multilateral institutions stagnated last year, reflecting the lack of increase in commitments over the past few years. We at the World Bank were not alone in being affected by the continuing economic stagnation in many developing countries. The difficult economic environment, and with it the attendant difficulties for the Bank in designing and bringing to fruition adjustment programs, and, for many of our borrowers, in generating domestic resources for new investments, were bound to constrain lending. This should not be the case in the future, as we assist our borrowers in formulating and implementing satisfactory programs of adjustment.
With respect to the IBRD, we are planning substantial increases in lending. Our review of country assistance plans for the heavily indebted countries, and all other IBRD borrowers, suggests that the lending program we originally proposed for FY86 to FY88 of $40 to $45 billion now underestimates the potential. We have therefore proposed instead a $40 to $50 billion range, with a lending level of up to $21.5 billion in FY90. We reached understanding in Seoul that the Bank should not be constrained by lack of capital in meeting future demand, and that it should therefore be provided with the capacity to increase its quality lending. We are suggesting no precise size of capital increase at this point. But if present lending plans are implemented, the spring of 1987 would seem to be the latest moment for a specific General Capital Increase proposal to be presented to our Board of Governors. When that time comes, we urge the support of industrialized countries — indeed of all our members — for the increase we shall be seeking.

Meanwhile, governments of the industrialized countries must surely realize that an increase in the flow of official resources to the low-income countries is urgently needed. This points in particular to a need to strengthen IDA. In the ongoing negotiations to replenish its resources, IDA’s Deputies representing the 34 donor nations are all in agreement that they should exert every effort toward achieving a replenishment of $12 billion for commitments over the three-year period mid-1987 to mid-1990. That is very encouraging, and we have to hope that good intentions will be translated into concrete reality.

The urgent need for a high level IDA replenishment goes well beyond the borders of Sub-Saharan Africa. There are large and small poor countries in other parts of the globe, such as China and India, Bangladesh and Nepal, and poor countries of the Latin American and Caribbean region too, which also have legitimate claims to be continuing and substantial beneficiaries of IDA. They must not be let down.

Mr. Chairman: it is a long but absolutely essential list of actions which we believe the industrialized countries must take if the concerted effort to restore sustained growth to the developing world, and to accelerate the alleviation of poverty, is to succeed. In the final analysis, however, we are only asking the industrialized countries to do what is entirely in their own interests. No one can contest the humanitarian imperatives of helping these developing nations toward better standards of living for all their peoples. But the industrialized world also needs the developing world as a huge market with a considerable potential for growth. Even in the troubled year of 1985, eleven of the top twenty-five markets for U.S. merchandise exports were developing countries, accounting for a quarter of the value.
But more than that, it is in the interests of security that the industrialized countries should support the development effort. To leave people with no hope of breaking the chains of poverty is to court political upheaval and violence. And none of us on this shrinking planet will be untouched by such an eventuality.

With world-wide military expenditure now reaching $1 trillion per annum, the industrialized nations, particularly the major powers, need to consider whether a dollar more at the margin on defence budgets buys more security for them and for future generations than a dollar more in economic development assistance. And they need to consider whether the short-term advantages of satisfying domestic political demands outweigh the long-term advantages of an enlightened, positive effort to promote the economic and social advancement of the developing world.

I have no doubt in my mind as to how those choices should be made.

Helping the process of growth and poverty alleviation in the developing nations is the greatest act of enlightened self-interest that the industrialized nations can perform. So let them not hesitate to do so.

Thank you.