A. W. Clausen Discusses The World's Debt Problem

A. W. (Tom) Clausen, President of the World Bank since July 1, 1981, has been a supporter of vigorous U.S. leadership on international economic issues since his days as President and Chief Executive Officer of the Bank of America and BankAmerica Corporation.

The World Bank consists of the International Bank for Reconstruction and Development (IBRD) and two affiliates, the International Finance Corporation (IFC) and the International Development Association (IDA). The common objective of these institutions is to help raise standards of living in developing countries by channeling financial resources from developed countries to the developing world.

At a time of troubling international economic and financial strain unparalleled in the post-World War II era, we feel that the views of Mr. Clausen would be of interest to our readers. Firmly committed to improving public information in this country about world affairs and, especially, about the importance of helping developing countries to accelerate their economic and social advancement, Mr. Clausen accepted to answer our questions, and we are grateful to him.

Between 1977 and 1980, exports accounted for 27 percent of all the growth in U.S. civilian employment. But international trade has suffered zero percent growth in 1981 and 1982, and more than two-thirds of the drop in national income of the United States since July 1980 has been due to decline in exports.

Mr. Clausen underscores the commercial importance of the developing countries for this country's economy by pointing out that the United States now sells 38 percent of its exports to developing countries, more than it sells to Europe and the Soviet Union combined.

For this reason, Mr. Clausen is concerned that the general economic stagnation may keep banks from lending to developing countries. "The most worrisome aspect of the Mexico liquidity crisis is that commercial banks may, in reaction, curtail their lending to all developing countries," he said in a speech delivered in Boston last year.

Mr. Clausen came to The World Bank after serving 32 years with the Bank of America and BankAmerica Corporation, the last 11 years as President and Chief Executive Officer of both institutions. Bank of America is the largest commercial bank in the world, with branches and subsidiaries in more than 100 countries.

Born in Hamilton, Illinois, on February 17, 1923, Mr. Clausen graduated from Carthage College (Kenosha, Wisconsin) in 1944 and received his LL.B. from the University of Minnesota in 1949. He is a graduate of the 50th Advanced Management Program of the Harvard Business School and is a member of the Business Council, a trustee of the Brookings Institution, and a member of the California Bar Association.

T&E: While president and chief executive officer of the Bank of America, you encouraged international lending. In view of the recent possibility of default by several countries, do you think that American banks overextended themselves in making these loans, or do you think that despite the risks, the loans have had a positive effect on international economic development?

Clausen: Some banks have made bad loans and have sometimes been overeager; that's not unheard of in the business. And some countries have been overambitious in their borrowing. But on the whole the commercial banking system's lending activities have had a very positive effect on economic development. Don't forget that in the 19th century, America, then a developing country, borrowed heavily from European banks, making possible the opening up of the country. Today's developing countries, especially the middle-income developing countries, need a continued and expanding flow of finance from the commercial system if they are to sustain their economic growth. Their borrowings accelerated from the mid-1970s as commercial banks helped to recycle OPEC surpluses resulting from the two oil price increases of 1973 and 1979. The action of the banks was critical to the borrowing countries' ability to adjust to this unexpected shock in the global economy. The commercial banks have also been widening their relationships with the developing nations; from balance-of-payments lending into local-currency lending, and investment in domestic business. They are now, in fact, the major suppliers of foreign capital to them.

A. W. Clausen
World Bank President

But have they overextended themselves? Well, these are the facts: Commercial loans to non-OPEC developing countries represented about 15 percent of all foreign claims of banks reporting to the Bank for International Settlements (BIS) in 1981 and only about 6 percent of their total assets. For all banks, claims against developing countries represented the limit of foreign claims and only 5 percent of total assets.

However, 10 percent of total assets of the major U.S. banks are in developing countries, about three times their equity, and claims on individual countries can reach one-third to one-half of total bank capital.

Therein lies one of the causes of the current concern, and it explains why the major banks are now exercising more caution. That caution is welcome and necessary, but I want to stress very firmly that a general commercial bank retreat from the developing world would bring catastrophic results to those countries that, while struggling with current liquidity problems, are not inherently uncreditworthy and have good growth potential. Such a retreat would be very shortsighted indeed.

T&E: What do you think is the gravest threat to the smooth operation of the international banking system? And how realistic are the forecasts that the international banking system is in a crisis situation?

Clausen: Some pretty wild statements are being made about the situation in the international banking system, and that's not helpful. People read about a "Third World debt crisis" and conclude that the banking system is about to collapse because the Third World cannot repay its debts. Far be it from me to claim that there is no problem. There is! But the nature of it is not sufficiently understood. There is, in fact, no "Third World debt crisis" in a general sense. Debt problems are country-specific, and the problem is concentrated in relatively few. As already mentioned, most middle-income countries should remain creditworthy, and some of them have even underborrowed. Banking credits have been concentrated in a limited number of large market borrowers. Brazil, Mexico, Argentina, Venezuela and Korea alone account for about half of all commercial bank lending to developing countries. The problem has arisen in countries that substantially increased their borrowing from commercial sources at high floating interest rates and are now severely suffering from depressed export markets. The extent and nature of the current worldwide recession are at the root of this liquidity problem. But a look at their growth, investment and export records doesn't suggest that their accumulation of debt has been out of line with their longer-run debt capacity, provided that the productivity of investment can be maintained and protectionist trends in the industrialized countries can be halted. In order to adjust, the larger debtors are going to have to take some politically rather unpalatable measure, such as slowing down growth and reducing both investment and imports. But their relative economic flexibility should permit them to do this. Furthermore, since the Mexico debt crisis hit the headlines, we've seen some encouraging indications that the United States is giving increasing attention to the problems faced by Third World countries. For example, some progress seems to be underway toward increased funding for the IMF, and the recent decline in interest rates, which has been helped by a shift in the Federal Reserve Board's position, will provide some relief to the developing countries which have significant short-term commerical debt. And the quickly coordinated international response to Mexico's crisis has been very encouraging.

All in all, I remain convinced that the debt situation today is manageable, and that, while acknowledging that a serious problem exists, we should be very cautious about talking about an international banking crisis. Borrower and lender concentration and the high gearing of major lenders have aroused concern, but the banking community is resilient and sensible enough to take what corrective measures are necessary. What we ask is that such measures not involve a withdrawal of credit, but a continuation and, where adjustment is underway, additional lending.

T&E: In what ways do the World Bank and the International Development Association (IDA) encourage economic development that the private banking community does not?

Clausen: In a number of ways. But let me emphasize that the work of the World Bank and its affiliates supports and often precedes the activities of the international commercial banks in the developing countries. At the global level, the Bank, together with the IMF and the GATT, have helped to encourage orderly monetary change, to reduce trade barriers, and to develop the weaker parts of the economy and tackle poverty at the very roots. International commercial banking depends on the relatively integrated, dynamic, and peaceful world economy that these official institutions have been nurturing.

At the level of particular developing countries, the Bank's project lending often provides the infrastructural basis for the lending which commercial banks do. And we are instituting new mechanisms for increasing the scale and scope of commercial bank co-financing of our projects. Our loans are long-term, adding stability and balance to a country's debt structure. Even more important, the World Bank's projects involve it in all sorts of issues and activities in which commercial banks seldom get involved, but which are crucial to a country's overall economic development. And few commercial banks ever engage in policy dialogue like the World Bank routinely maintains with borrowing governments. The nonideological, nonpoliticized and wholly pragmatic economic advice and technical assistance that we provide are as valuable and as prized as our loans and credits.

Another obvious feature distinguishing us from the commercial banks is our

ability, through IDA, our concessional-finance affiliate, to extend long-term credits at zero interest to the poorest of our member countries. There are 51 countries that depend on IDA today — 28 of them in sub-Saharan Africa — and past experience with former IDA borrowers indicates that these current borrowers will one day be creditworthy enough to borrow what they need at market rates. But they simply cannot do so now. That is why the negotiations that have just begun with IDA's donor governments to replenish its resources must succeed. We are all aware of the budgetary constraints imposed upon the industrialized nations, but it is in no nation's vested interest — and certainly not in that of the United States — to permit these poorest societies, containing over half the world's population, to sink into greater misery and despair.

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T&E: What is needed for a world economic recovery?

Clausen: Revive the engine of growth in the industrialized countries. That's the first step. It appears that the recovery in the U.S. and other industrialized nations is going to be slow, and if that is the case, recovery in the developing countries, whose principal markets lie in the industrialized world, will also be slow. This must not be allowed to happen. Industrial nations that have made good progress in reducing inflation must now opt for economic expansion. They must find the right mix of policies that will lead to a reduction in real interest rates without reigniting inflation. That's no easy task, but it's got to be done. And the United States ought to take the lead.

In recent years the U.S. economy has been expanding faster than ever before in its history, but other areas of the world economy have expanded even more quickly, so that the U.S. share of world total output is down to about one-quarter as compared to its dominant leadership position in the years after the Second World War when its share was two-fifths of world ouput. But the U.S. is still looked to for leadership on global economic issues, and if it is to lead effectively, it must now elicit coordinated action by other nations, urging faster growth, and strong resistance to protectionism in both developed and developing countries. That is the only path out of the bog of stagnation. And since you were earlier expressing concern over the debt situation, let me just add, with emphasis, that it is far more probable that stagnation will provoke debt crises than that debt-servicing problems will themselves result in global contraction.

T&E: Is the economic development of the poorer countries inextricably linked to economic recovery in the more industrialized countries?

Clausen: Well, I think my last answer makes that point pretty firmly, but in this interdependent world, let's not forget that the economic health of the industrialized countries depends to a growing extent on the developing countries. To take an important example: the current slump in Third World development is aggravating unemployment here in the U.S. Exports accounted for 27 percent of all growth in civilian employment between 1977 and 1980. But international trade has suffered zero percent growth in 1981 and 1982, and more than two-thirds of the drop in the U.S.'s national income since July 1980 has been due to a decline in exports. Since we now sell 38 percent of our exports to developing countries, more than we sell to all of Europe and the Soviet Union combined, you can see the connection. Third World markets for U.S. goods grew very rapidly in the seventies, but today, with international trade growth at zero percent, those markets no longer provide that extra boost to employment in this country. And if the situation is to change, the developing countries must be allowed to earn the foreign exchange they need to buy the industrialized countries' exports. That's why protectionism has to be resisted so vigorously; each side comes out the loser if it isn't.

T&E: You have said that developing countries are likely to push for more volume in their exports as they try to get out of debt and by so doing decrease the prices of their goods. How can this vicious circle be broken?

Clausen: I haven't posed the problem in quite those terms. Certainly the developing countries want and need to expand their exports. Between 1980 and 1982, their annual export revenues dropped $40 billion, while at the same time their annual debt-service payments went up $37 billion. Between 1970 and 1980, the developing countries as a whole had been able to increase their share in the manufactured goods imports of the industrialized countries from under 7 percent to 13 percent. Since then, the deepening global recession has taken its toll, and the gathering winds of protectionism threaten even worse to come. The lesson is clear: a return to economic growth, and a resistance to protectionism, could revive the trend in manufactured exports that had been bringing important rewards to the more successful developing country exporters, such as higher rates of investment, higher per capita growth rates and a rapid reduction in external deficits. In this area, then, increased volume was a definite plus for the developing country exporters.

The more intractable problem lies with those developing countries heavily dependent on primary commodity exports. In the current world recession, commodity prices are severely depressed. Even without a global recession, their prices have a habit of rising and falling dramatically, causing a high degree of instability in the economies dependent on exporting them. In this area, increased export volume can bring few benefits if prices are depressed, and only instability when they are wildly fluctuating. Efforts to deal with the problem through bilateral trade agreements and multilateral commodity agreements have had only limited success. Maybe more effective agreements will be achieved, but the only real long-term solution is diversification into other exports, such as manufactures, and into agricultural products including food, for a more stable domestic market. In the short term, domestic economic management policies to reduce the impact at home of fluctuating external prices can contribute to longer-term diversification.

T&E: What has been the effect of China's membership in the World Bank?

Clausen: For a start, the population of our developing-country membership has increased by almost 50 percent. That's a lot of new people to try to help, a lot of new money for us to find, and a very big challenge. It's clear that China's accomplishments over the past generation in reducing poverty on a vast scale are without precedent, and we want to help them build on that. Our assessment is that China will be one of the best performers in absorbing development capital and implementing projects efficiently. So far we've approved loans for six projects totaling rather less than $700 million, about 40 percent of it in the form of IDA long-term, no-interest credits. China's clearly eligible for larger amounts in IDA credits than that, but she joined the Bank too late to be taken into account in the most recent three-year replenishment of IDA's funds. To what extent we shall be able to support the development needs of China over the next few years will depend on whether the donor countries currently negotiating IDA's next replenishment can agree to substantially increase the level of assistance earmarked for the poorest countries of the world. Western governments participating in those negotiations should bear in mind that World Bank and IDA assistance to China and other poor countries can help create economic conditions favorable to their own commercial interests.

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T&E: What were the real changes facing you in moving from the Bank of America to the World Bank?

Clausen: Well, the private sector was my home, as you know, for more than 31 years. As a commercial banker my whole career was spent in that creative and competitive marketplace, and I developed some strong biases through those years. I find that experience, however, in no way incompatible with my new role as World Bank President. I'm convinced the private companies of the world *can* be a vital engine to secure a growing global economy in which the developing nations increasingly become significant partners. So I've brought my biases along with me with some pride.

But obviously the great change is that I am now working in an organization that is a development institution as well as a bank — one that is owned by 144 member governments and operated by a uniquely qualified staff of international civil servants drawn from over 100 nationalities. That's a particularly stimulating atmosphere in which to work. In my nineteen months as one of these international civil servants I have learned much about international cooperation and global partnership in the economic and social field. I am more convinced than ever that global peace and security depend at least as much on that as on maintaining a military balance. □