Adjustment with Growth in the Developing World:

A World Bank Perspective

Remarks

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By

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I am very pleased to be able to join you here in Bonn today, and for that privilege I am most grateful to the members of the German Foreign Policy Association, to the President of the Association, Ambassador Diehl, and to the German Government's Minister for Economic Cooperation, Dr. Jurgen Warnke for their warm hospitality and for their generous efforts in hosting this valuable meeting.

In my remarks today I would like to deal with the crucial economic issue of growth-oriented adjustment. This is widely perceived as an issue confined to the highly indebted middle-income nations, particularly those of South America. In this particular context, The World Bank has come to be seen increasingly as a key actor. It is indeed true that The World Bank has a major role to play in assisting these countries to secure growth, revive the momentum of development and enhance their creditworthiness -- and as you know, this is a role we are intent upon expanding.

But when we talk of adjustment with growth we should not think only of the highly indebted middle-income nations. We should also consider the need for industrial nations to adjust their economic policies, and to address their own structural economic problems, in a quest for sustained, non-inflationary growth. And, we should also remember the especially cruel and difficult issues that confront the low-income nations.

Today I want to start by discussing the general issue of growth-oriented adjustment. Then, I will consider how the issue relates to the middle-income highly indebted nations, and will proceed to look at some of the problems which the poor in developing nations can face as a result of adjustment programs. I will then focus on the crucial adjustment problems of the poorest nations before concluding with some remarks on the role of the developed countries.

The people of the Federal Republic of Germany are no strangers to the need for adjustment to new conditions and challenges and the dramatic impact of sound economic policies. In the summer of 1948, almost overnight, Economic Minister Ludwig Erhard introduced a far-reaching program of economic adjustment in the Währungsreform. In one bold stroke, the relics of the war were swept away -- a worthless currency, price controls, severe rationing of all essential goods, and blackmarket profiteering. In their place emerged a free economy that helped launch Germany on a dramatically successful path of growth and monetary stability.
External financial support from the Marshall Plan also contributed to Germany's revival, but Germans clearly helped themselves through an ambitious program of structural adjustment which met the challenges of the post-war economic environment.

Adjustment, as this audience knows from experience, is not at odds with economic development. Far from it; the two are inseparably linked. Development has always meant adjustment — to new economic realities, to changing technologies, to the introduction of new knowledge, and to new competitive alignments. The ability to embrace change is fundamental to the establishment and renewal of economic growth.

In many developing countries, though, the process of adjustment has been allowed to lapse. Today many nations are facing the consequences of an accumulation of overdue adjustments. This is not simply the result of mistaken policies adopted by the developing countries. Industrial countries and commercial lending institutions have also contributed to the problem. Undisciplined aid flows and heavy commercial lending, it must be said, have helped insulate many economies against inconvenient or unpopular reforms.

The protracted difficulties of the heavily indebted middle-income countries have acted as a strong stimulus to the evolution of international attempts to promote adjustment. Today, I am glad to say, there is broad agreement that adjustment, together with adequate capital flows and an open trading system, is essential to growth and to the alleviation of poverty. And to secure economic health we must forge an active partnership between the developing countries, the industrial nations, international lending institutions, and commercial sources of finance. Together these actors must take concerted, and not sequential action, if economic dangers are to be removed and sustained growth achieved.

We believe that restoring growth and creditworthiness in the middle-income indebted countries will require large amounts of additional net flows of capital. The World Bank's current estimate for 17 important middle-income debtors is for flows in the range of $14 - 21 billion annually over the next five years — with the range determined by the economic performance and GNP growth achieved by the industrial countries.
To achieve such objectives, each of the four partners in the process must fulfill certain responsibilities. The indebted countries are, of course, the most important actors. These countries need to focus on measures that will stabilize the macroeconomic environment and prevent capital flight, increase total investment and improve its productivity, expand domestic savings, give greater encouragement to private enterprise, and contribute to rapid export growth. At the same time, the attainment of sound growth rates in these countries should allow for some increase in consumption, without which further progress in adjustment may not be politically feasible. Programs of this type will require very substantial effort and strong political will, and success will not come overnight.

The OECD countries must also adjust if they are to play their role in this framework. Their priority actions should include continued progress toward lower interest rates, and the restoration of monetary and fiscal balance in order to ensure that sustainable non-inflationary growth is maintained. Protectionist pressures must be resisted, and existing measures rolled back. There is no more direct way to starve debtor nations of export earnings than to reduce their access to industrial country markets.

While no one believes that private capital flows can or should reattain the levels of the late Seventies, the continued participation of commercial banks in expanding the overall flow of new capital to the middle-income countries in support of adjustment is indispensable. Commercial banks need to adjust, too, especially in the way they approach developing country creditworthiness — this they need to see as the product of their continued lending, and not as the precondition for it.

In that connection, we were encouraged by the announcement of the leading German banks in January that they were prepared in principle to participate in concerted action to help address the financial requirements of debtor nations undertaking structural adjustment. As The World Bank takes further steps to provide support for adjustment among the middle-income debtors, we hope to welcome the German financial community in joint efforts to improve the availability of external finance.
As to our own role, gross World Bank disbursements to fourteen of the most highly indebted countries had already risen from $2.7 billion in 1982 to $3.9 billion by 1985. We expect to disburse somewhere between $5.5 and $5.7 billion to these countries in 1986, the bulk of it in support of adjustment in the Latin American and Caribbean region. Our $350 million loan approved the week before last in support of adjustment in Argentina's agricultural sector is the largest such operation to date. A $500 million loan to assist Mexico's trade liberalization process is one of a number of operations of this kind now under discussion. We have undertaken similar work in several countries outside the Latin American region, too, such as Morocco and the Ivory Coast.

But our work should not be measured by loan commitment totals alone. Working closely with our borrowers, we are deeply involved in the formulation of adjustment programs that will enable each country to achieve a reasonable rate of growth and thereby emerge over time from the grip of debt. Our contacts with commercial banks have greatly increased, as we have worked in our efforts to catalyze additional financial support for these programs of adjustment. Our work with these lending institutions is very much a collaborative endeavor; so too is our cooperation with other multilateral agencies, particularly the IMF.

Moreover, we are expanding the work of our private sector affiliate, the International Finance Corporation. IFC can and indeed will play a most valuable role in reviving private investment in these middle-income nations, as well as in others, and in providing advice designed to foster a more favorable investment environment.

To sum up then, The World Bank plays a vital role in a four-point strategy for the middle-income heavily indebted nations -- it assists in the formulation of growth-oriented adjustment programs; it provides substantially expanded resources for such programs; it serves as a catalyst in mobilizing additional private and official finance; and it secures coordination between each player in this vital partnership process.

Before turning to my prime theme for today, that of adjustment with growth in the lowest income nations, let me stress that there are large numbers of poor people in the developing world whose lives can be affected by the adjustment process. The relationship between poverty alleviation and adjustment is of course complex. In designing adjustment programs, we must recognize that some lower income groups may be adversely affected over the short term by certain adjustment measures and reforms. But we should not conclude from this that poverty alleviation and adjustment are therefore inconsistent objectives ... on the contrary.
Let me illustrate. Take the case of reduced subsidies for food and other staples, a necessary reform measure in a large number of adjustment programs. Reduced subsidies will entail higher costs to consumers, but rural producers of these commodities will usually benefit from higher crop prices. The reduced subsidies also help narrow fiscal deficits, thus reducing inflation and freeing up government resources for programs important to the poor—such as health, education, and rural water supply.

The studies we have on food subsidies indicate that open-ended subsidy schemes are, on balance, inefficient mechanisms for redistributing incomes. In one such case, it was found that 46 percent of the subsidy provided in urban areas went to the richest 27 percent of the urban population, while in the rural areas only 15 percent of the cost of the subsidy went to people suffering from serious undernutrition. All too often the benefits of food subsidies flow disproportionately to urban workers and civil servants, who are politically potent but who are not the poorest members of society. A target program of food coupons for affected groups, on the other hand, can be a more effective instrument of poverty alleviation.

Another frequent component of adjustment programs is the removal of protectionist barriers such as import tariffs, quotas, or onerous licensing procedures. With these measures, many domestic producers discover ways to increase their efficiency, and export activities develop that were previously not anticipated. But liberalization of this kind will mean that more competitive imports capture some internal markets from inefficient, high cost domestic producers. As a result, employment among the affected industries may decline over the short haul; and here, once again, the adjustment process can impact adversely on the poor. Nevertheless, it is usually not the unskilled, relatively mobile work force which resists such measures, but rather the industrial managers who must shift their investments to new enterprises, and the skilled laborers who have been earning a comparatively high wage. When such inefficient, low-growth industries are preserved, they only perpetuate the low growth of industrial employment—and that has a direct negative impact on the poor.

Over the medium term, let me emphasize, it is not active adjustment efforts, but the failure to adjust which harms the poor—through spiraling inflation, through low agricultural producer prices, through industrial stagnation and high unemployment, and through inadequate social services. Without efficient adjustment, conditions will worsen and the poor will be forced to endure even more hardship.
Sometimes this issue has been falsely presented. The real choice is not between poverty alleviation and adjustment programs; more accurately, the choice is between inappropriate programs and policies which aggravate poverty, and effective adjustment programs which will sustain economic growth over the medium term and thereby reduce poverty.

For The World Bank, poverty alleviation is our most fundamental objective. We will continue to improve the design of our adjustment programs so as to address the transitional costs to low-income groups, and that includes interim compensatory programs targeted on those adversely affected by reform measures. And I should add that we have no intention of diminishing our traditional project lending in such poverty-related areas as agriculture, health, education, and water supply.

Let us now turn our attention to the low-income nations. Here, the urgency of adjustment, as one would expect, is not uniform. In Asia, such poor countries as China, India, and Pakistan, for example, face serious economic problems, requiring policy changes to accelerate adjustment; but their situation cannot be described as critical.

Nonetheless, the necessity and importance of policy reform in these nations is increasingly accepted and acted upon. Consider, for example, the remarkable series of agricultural and industrial reforms undertaken in China. Several of these countries are registering impressive rates of growth and are avoiding the accumulation of unmanageable external debt. Indeed, the Asian low-income countries do confront the difficult task of improving their economic performance and ameliorating the plight of their poor — but they do so without the constraints imposed by overall negative economic trends. The World Bank is pledged to assist their continuing efforts, with advice, with adjustment support and with project finance for new investments.

In contrast to the Asian low-income countries, the situation in the low-income countries of Sub-Saharan Africa is truly grave. While saddled with the most daunting development problems of any region in the world, many African countries also must face rapidly mounting debt-service obligations which act as a severe constraint to the implementation of growth-oriented adjustment programs. Under such circumstances, the effectiveness of current programs and the adoption of further reforms are both threatened by inadequate external capital flows.
The debt problems of the region are serious and growing and have not received sufficient consideration from the international community. Between 1980 and 1984, debt service increased from 18 percent of export earnings to 26 percent for the low-income African countries. But these actual debt-service payments understated the problem. If it had not been for debt rescheduling, and in some cases a build-up of arrears, debt service payments in 1984 would have been much higher — some 38 percent of export earnings.

Complicating the debt issue in low-income Africa is the high proportion of debt service owed to official creditors over the next two years. Over a third of the total is owed to the IMF and other multilateral agencies which enjoy a preferred status, and which therefore do not permit rescheduling. For twelve low-income African countries we foresee particularly severe debt-service problems. In these countries, present rescheduling arrangements will not be adequate.

The implications of these debt-service difficulties for African development are of serious concern. Frequent reschedulings and the accumulation of arrears use up the scarce managerial resources of Africa's policymakers. They also create a climate of uncertainty hindering development and can lead to disrupted disbursement flows, a decline in new commitments of development finance, and higher prices for imports, as suppliers seek coverage against possible non-payment. Under such conditions, crucial adjustment programs become far more difficult to formulate and implement.

Debt-service difficulties in Africa, serious as they are, must be seen in the context of the underlying problems of the region — problems related to inadequate economic structures, to population pressure, to environmental deterioration and to social conflict; problems which have combined to perpetuate a continuing economic crisis in the region.

Per capita income in low-income Africa has declined by 12 percent in the last six years. Today Africans are, in real terms, poorer than they were in 1960. The terms of trade for the region have declined dramatically over the last fifteen years, and are projected to decline further over the next four. Now a more recent problem must be reckoned with. During the 1970's, Africa's rate of investment remained at around 18 percent of GDP as flows of foreign capital compensated for lower terms of trade and for a decline in domestic savings rates. But in the 1980's the investment rate has slipped, falling to 14 percent in 1984. Low-income Africa now has acquired another measure of crisis and decline — the lowest investment rate in the developing world.
Statistics, we must remember, disguise a great diversity of country situations, in terms of debt, economic performance, and the scope of adjustment efforts. In that diversity of experience, there are visible the beginnings of positive change, giving hope that in time Africa's long-term economic decline can be reversed. A number of low-income African nations have launched programs of adjustment with growth. Especially in the past two years, more countries have started to act and changes are going deeper than before.

On the issue of exchange rate reform, long a highly sensitive issue in Africa as elsewhere, it is notable that in 1984 the effective exchange rate for low-income Africa began to decline after a full decade of appreciation. The trend continued in 1985. Several countries have adopted more flexible exchange rate regimes and some, such as Gambia, Zaire, Guinea, and Zambia, are establishing systems which will lead to a unified market determined rate.

As for the agriculture sector in Africa, years of neglect are now giving way to a recognition that agriculture is the backbone of African economies and that the policy bias in favor of urban consumers must be corrected in favor of rural producers. The recent exchange rate reforms have helped producers of agricultural exports. Prices paid to farmers for a wide variety of crops are being increased and even decontrolled in a number of countries. The improved incentive environment has stimulated, for example, a 25 percent increase in cocoa production in Ghana over the last two years, and the current crop is exceeding projections by 10-15 percent. Marketed maize was up 55 percent in Zambia during the 1984-85 season, almost meeting Zambia's domestic needs for the first time in ten years. Cotton production is estimated to have doubled in Togo between 1984 and '85.

The role of the public sector in the economies of Sub-Saharan Africa is larger than in other regions, both in terms of employment and the share of total investment. The rapid growth of the public sector has often been accompanied by inefficient management, over-extended investment programs, and a tendency to discourage private sector activities. These are important factors in the present economic difficulties in the region. First steps are now being taken to reduce public sector expenditures and to make the public sector efficient, while encouraging private enterprise. Four governments have abandoned their policy of guaranteed employment for secondary and college graduates; others have frozen new public hiring. Overall, low-income African governments have divested themselves of about 5 percent of public enterprises during the 1980's and have reformed the operation of many others. In Mali, for example, the operating deficits of 13 key public enterprises were reduced by 50 percent between 1981 and '84.
So adjustment is underway in parts of Africa, and concrete progress is being achieved. But I must emphasize that the reforms so far undertaken are no more than first steps. Much more remains to be done. The task is extremely difficult since it involves dealing with delays in adjustment which have accumulated over two decades -- and in an environment hampered by still weak institutions, fragile political systems, and major long-term development problems.

It would be convenient if programs of structural adjustment and reform were cost free, in Africa and elsewhere in the developing world. But that is not realistic. Economic growth requires resources, and if we accept, as we should, the goal of halting Africa's decline in per capita income, significant new flows of concessional resources must be made available to support adjustment programs in low-income Africa.

In the severely deteriorated conditions that are found in the region, growth-oriented adjustment programs cannot be implemented unless the long-term decline in import capacity and in essential investments is reversed. Per capita import capacity needs to return to 1980-82 levels, which translates into an annual import capacity of $28.5 billion per year at current prices over the next four years. That target has direct financial implications for the donor community.

The growing commitment to adjustment by the low-income developing countries, including Africa, returns the ball directly into our court. Can we mobilize the necessary resources to prolong and expand the scope of economic reform in these countries, and thereby promote sustained economic growth and the alleviation of poverty?

An indispensable source of concessional resources for low-income developing countries has been the International Development Association, or IDA, The World Bank's concessional financing facility. Demands on IDA are growing, not only from low-income Africa but from other poor countries in the developing world. Negotiations are underway for the eighth replenishment of IDA, and I am pleased to report to you that in our discussions so far, virtually all donors have affirmed their support for an eighth replenishment of $12 billion. New IDA resources of this magnitude are a necessary response to the global needs of the low-income countries which IDA was established to serve.
The future of adjustment programs in Africa is directly tied to the adequacy of IDA's resources. The last replenishment of IDA fell short of world-wide requirements, and at our initiative 16 donors established a Special Africa Facility, both as a response to the deepening crisis in Africa and as a de facto supplement to the low level of the IDA replenishment. This Facility, endowed with $1.6 billion for the support of economic adjustment and reform programs in Africa, is a one-shot, three-year operation. But Africa will require special adjustment finance for much longer than that. The continuation of the Special Facility's support for adjustment must therefore be assumed by IDA. And in addition to the needs of Africa, IDA must also be equipped to respond to the legitimate requirements of such countries as China, India, Bangladesh, and Nepal, as well as very poor nations in the Middle East and the Latin American and Caribbean region.

Germany has long been a willing and generous contributor to IDA, and has subscribed over $4.2 billion since IDA's inception in 1960; this is nearly 12% of the total. But IDA is also of direct interest to Germany. Your country's suppliers have won over $1.5 billion in contracts for goods and services financed by IDA projects. IDA is good business for Germany, and Germany's generous support for IDA makes it a more effective instrument of development. This is a productive partnership which you deserve to be proud of.

There is also encouraging news to report on the availability of concessional resources from the IMF. We warmly welcome the decision of the IMF Board late last month to establish a Structural Adjustment Facility. This Facility will make available some SDR 2.7 billion for balance of payments assistance to low-income countries which have developed medium-term programs of adjustment. The World Bank is exploring ways in which we can collaborate actively with the IMF to enhance the effectiveness of this new initiative.

Although we should be encouraged by these developments on the concessional resource front, there remains for Africa a sobering financial shortfall. If we agree that halting the decline in per capita incomes in low-income Africa by 1990 is a minimal objective, and if we recognize that external financing must be secured to restore the import capacity in these countries to 1980-82 levels, then by our calculations there will be a yearly external financing gap of some $2.5 billion from 1986 to 1990 -- even allowing for known and expected aid flows, and for debt rescheduling.
We believe that about $1 billion of that $2.5 billion gap can be supplied through the multilateral institutions. The new IMF Structural Adjustment Facility is one source, and assuming a satisfactory replenishment, IDA is another.

The remaining $1.5 billion gap can only be met through bilateral efforts, both with additional aid flows and further rescheduling. The actual mix between debt relief and quick-disbursing program assistance must be resolved on a case-by-case basis. On one general principle, though, I believe that there should be unanimity among the industrial countries: no donor country or agency should be a net recipient of resource flows from any African country which is undertaking credible reform programs.

Germany's bilateral aid program has a long record of effectiveness and responsiveness to the needs of Africa. I have no hesitation in predicting that Germany will once again step forward to contribute, striking a pragmatic balance between multilateral and bilateral support for growth-oriented adjustment in low-income Africa.

I should also mention the importance we attach to Germany's timely participation in The World Bank's Multilateral Investment Guarantee Agency, or MIGA. MIGA will help to stimulate flows of direct foreign private investment to the developing countries, and the convention establishing MIGA is now open for signature. We are much encouraged by the progress achieved so far. Seven more countries signed the MIGA convention last week, and we have now reached the required total of 15 developing country signatures. As far as the developed countries are concerned, we need one more signature to meet the required number of five in that category. Once we have the needed signatures and once one-third of MIGA's capital has been subscribed, we will then be in a position to organize the drafting of MIGA's initial policies and plans. MIGA is an important initiative and OECD support for it will enhance its impact and influence.

Ladies and gentlemen -- today there is wider agreement than ever on how to support growth-oriented adjustment in the development process. But we cannot be complacent. Sometimes rhetoric runs ahead of action. There are still some troubling anomalies in OECD behavior, and I wish to draw your attention to them.
Protectionism has not declined. Indeed, the recent slowdown in the growth of developing country exports to the industrial nations cannot be attributed solely to exchange rate movements, or to other technical factors. We must conclude that OECD protectionist pressures are partly responsible for curbing developing country exports. On these trade issues, the developed countries risk what one thoughtful observer has described as "asymmetrical liberalism" -- whereby the actions of some countries contradict the free trade tenets that they themselves preach so vigorously to the developing world.

A second anomaly concerns the commercial banks. They have not as yet reentered the developing country markets with the resources required. I must repeat that multilateral finance institutions cannot do this job alone; the capital requirements are much too large and the withdrawal of commercial finance has been much too complete. Let me add that domestic owners of capital in the developing countries must also contribute -- by returning the capital they have exported, and putting it to work where it is desperately needed -- in their own countries.

And lastly, with respect to flows of official development assistance, industrial nations have not yet responded sufficiently to the widely recognized need to commit more resources to adjustment, development and growth in the low-income developing nations. Nor has the donor community taken the necessary steps to coordinate its assistance so that aid resources are used as effectively as possible.

Let there be no doubt about the high price of inaction. In low- and middle-income countries alike, new policies are unfolding and bold experiments are taking shape. In South America, Asia, and Africa, governments are taking the crucial first steps in the directions which we all agree make great sense and hold high promise. These efforts must be strengthened and expanded. We cannot permit these initial steps to falter for lack of support and encouragement. In a few weeks time the major industrial nations will hold their annual economic summit -- and they can brighten the hope of those in need by pledging to act on the critical fronts of trade, aid and capital flows.

No country can appreciate better than Germany how adjustment and economic reform can benefit all parties. For all of us, though, making growth-oriented adjustment work will be an enormous challenge. Above all, it is a challenge which is crucial to the future of the world's poor.
For it is the poor who suffer most deeply — from unemployment, declining incomes, environmental degradation, the decay of social services, and the insecurity of their food supply. For the poor, we have a very special responsibility to lend our support reliably and generously. Inspired by the determined efforts of the low-income countries to launch effective programs of adjustment with growth, I am confident that this assistance will be forthcoming. Indeed, ladies and gentlemen, that must be our pledge. The developing world, is counting on our support.

Thank you.