Adjustment with Growth in the Developing World
A Challenge for the International Community

Excerpts from three addresses by
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In the spring of 1986, World Bank President A. W. Clausen spoke on the theme of adjustment with growth in the developing world to audiences in Europe and the United States. Excerpts from Mr. Clausen's remarks in London, Bonn, and Washington are presented here in a single essay that addresses five major adjustment themes.
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Introduction: Adjustment with Growth

Economic adjustment and growth are widely perceived as an issue confined to the highly indebted middle-income nations, especially 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 large role to play in assisting these countries to secure growth, revive the momentum of development, and enhance their creditworthiness—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, noninflationary growth. And we should also remember the especially cruel and difficult issues that confront the low-income nations.

In my remarks, therefore, I intend to focus on how we can help the developing nations in an economic adjustment process that is truly a growth-oriented process. And in doing so, I want to explain what role The World Bank has in this process.

In the aftermath of the severe economic shocks of the 1970s and early 1980s we could see the growing need for support for policy reform and institutional change in many of our developing member countries. And we could see that the need would be there for some years to come. We responded then, and we continue to respond today, with an operational strategy resting on twin pillars: assisting our borrowers in formulating satisfactory programs of adjustment and more rapid growth and helping mobilize the external resources necessary to sustain that program.
The overriding objective of this response is the alleviation of poverty and the acceleration of social progress. But this objective is simply unattainable in developing nations where sustained economic growth remains but an illusion. And so it is imperative that The World Bank do all it can to help our developing member countries secure that economic growth through a process of growth-oriented adjustment.

But the issue is not now, and never has been, whether adjustment is necessary for development. The two are inseparably linked. Development has always involved adjustment—adjustment to new economic realities, to changing technologies, to the introduction of new knowledge, to different incentives and policies. The ability to embrace change is fundamental to the establishment and renewal of economic growth.

Today the global community of nations is having to face the consequences of an accumulation of overdue adjustments. And we are having to do so at a difficult moment when the world economy is increasingly volatile and its future increasingly uncertain.

The costs that must now be met are the unintended results of the deliberate policies of developed and developing countries alike, which have for various reasons sought to insulate their economies entirely or at a minimum buffer them against adjustments which they saw as politically inconvenient.

Let me give just four examples:

• Some of the proceeds of the unprecedentedly large-scale borrowing by middle-income countries in the 1970s was put to effective use. But too much was used to support consumption, substitute for domestic savings, and underpin unsustainable exchange rates.

• Aid flows were allowed to continue to sustain obviously flawed development strategies and exchange rate practices well
beyond the point where they could have been sustained without that aid.

- Development strategies were pursued which caused high prices through the prohibition of competition; which produced stagnation by refusing remunerative incomes to farmers; and which promoted the inefficient use of scarce capital—all this in an effort to avoid the consequences of change.

- Many countries have been adjusting to the profound economic and social implications of the dramatic changes in population dynamics which advances in medicine and health delivery have brought about. But still far too many have not. As a consequence the world environment faces large-scale and perhaps irreversible degradation, not just in Africa but throughout the developing world. Moreover, savings, domestic and foreign, are needed in increasing volumes merely to maintain inadequate incomes.

The lessons we clearly have to draw from this experience are, first, that the failure to adjust on a timely basis can carry an appalling price tag and, second, that a development effort that seeks to avoid adjustment cannot be sustained.

There is a third and no less important lesson to be drawn too: while a measure of economic growth can result purely from internal adjustment, sustained and larger economic growth depends on the measure of adjustment undertaken in the economies of the industrial countries, in the world trading system, and in international institutions. The concomitant is that external adjustment alone will not produce growth in developing countries which avoid necessary internal adjustments. The two must go hand in hand.

There has been widespread realization that adjustment both within and outside the developing countries, together with adequate capital flows and an open trading system, is essential to their growth and to the progressive alleviation of their poverty.
This is indeed one of the more encouraging developments of recent times. A strong consensus on this emerged at the 1985 World Bank and International Monetary Fund (IMF) Annual Meetings in Seoul, Republic of Korea. And with it emerged explicit agreement that all the participants in the process—developed and developing countries, international lending institutions, and commercial sources of finance—had to collaborate actively if current threats were to be removed and sustained growth restored. The growth-oriented development strategy of each developing country was a challenge around which all the participants should rally in support.
Coping with Debt and Reviving Growth in the Middle-Income Developing 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 retarded the rate of growth of exports from developing countries while at the same time commodity prices fell. Terms of trade declined by just over 1 percent. And as net capital flows into developing countries also declined, many had no alternative but to restrain the growth in their imports.

While it is true that many developing countries will gain from the 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 and elsewhere which are almost totally dependent on oil exports for export revenues.

During the disappointing year of 1985 a consensus emerged in the development community that the long-term solution to the debt-servicing problems of many if not most 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.

One has only to look at the experience of the heavily indebted middle-income countries, mostly in Latin America, to see that adjustment does not automatically bring growth. In 1982–83 the
debt crisis had called for an initial response from those coun-
tries which was unavoidably painful. There were very sharp cut-
backs in imports, accompanied by reductions in public expen-
diture programs, which necessarily depressed the levels of
domestic income. Inevitably, rates of growth of output, inputs,
and investment dropped precipitously as these indebted coun-
tries launched their macroeconomic adjustments. The resulting
reduction in current account deficits was a remarkable achieve-
ment. But the region's economy experienced negligible per cap-
ita growth during 1984 and failed to regain the ground lost
since the outbreak of the debt crisis.

For the people, the price has been very high. Domestic austeri-
ty measures have not permitted economic activity to keep pace
with the expanding labor force. As a result, unemployment has
risen and, on a per capita basis, output has declined in more
than two-thirds of the countries of the region. Per capita gross
national income has declined to the level of the early 1970s.
These increases in unemployment, accompanied by still high
rates of inflation in most countries of the region and a general
decline in the standard of living, are very uncomfortable remin-
ders that a large-scale adjustment effort does not automatically
bring growth.

Adjustment is an external as well as an internal process. The
adjustment efforts of a developing nation may well correct some
ills and help to rebuild lost creditworthiness. But if the external
environment is unhelpful, the prospects for a resumption of
sustained growth are bound to be diminished.

But I cannot stress too strongly that what the developing coun-
tries themselves decide to do is the determining factor. It is the
country itself and its policymakers who will in each case make
success possible by putting in place the appropriate adjustment
programs with realistic growth objectives—and by doing what is
necessary, with the help provided, to implement them. Help
starts at home!
In the heavily indebted countries, this means designing programs that will enable each country to achieve a reasonable rate of growth and substantially reduce the debt-service ratio to a sustainable level by a specific date. Each program should therefore set forth over the medium term a feasible and attainable time path for the key variables, notably exports, imports, savings, investment, and GNP. Each program also should estimate the capital flows necessary to follow that path and should specify the policy measures necessary to achieve the objectives.

The actions necessary to achieve these objectives will vary in magnitude from country to country. But they are most likely to embrace measures on the pricing and trade policy front to increase the export orientation of the economy; the review of public sector investment programs to ensure the most efficient use of capital; the planning of investments to restore the productive capacity of existing infrastructure and industry; and the framing of policies to increase domestic savings. To increase those savings, interest and exchange rate policies need to be pursued that not only stimulate that increase, but also encourage the increased savings to stay at home and attract back what has already fled. Capital flight has for too long been an appalling strain on the savings of too many heavily indebted middle-income countries.

We at The World Bank will assist—we are assisting—in the formulation of these growth programs and in the monitoring of their progress. Given the expertise that the IMF has in many of the policy areas, the development of these growth-oriented programs will generally require close coordination between the Bank and the Fund, and that coordination is assured.
III
Alleviating Poverty
in the Low-Income Developing Countries:
Focus on Reviving Africa’s Decline

Before turning to the theme of adjustment with growth in the
lowest-income nations, let me stress that there are large num-
ters 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 ad-
justment 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 num-
ber of adjustment programs. Reduced subsidies will entail high-
er costs to consumers, but rural producers of these commodi-
ties 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 can, however, be a more effective instrument for 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 removed, many domestic producers discover ways to increase their efficiency, and export activities develop that were not previously anticipated, creating new jobs. But liberalization of this kind will also 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 affect the poor adversely. 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 effect 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 prices to agricultural producers, 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 greater 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 fundamental ob-
jective. 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 toward 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, both the effectiveness of current programs and the adoption of further reforms are threatened by inadequate external capital flows.
The debt problems of the region are serious and growing and they 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 understate 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 International Monetary Fund 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. These problems in debt servicing also create a climate of uncertainty that hinders development. They can lead to disrupted disbursement flows, a decline in new commitments of development finance, higher prices for imports as suppliers seek coverage against possible nonpayment. 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 even further over the next four.

Now a more recent problem must be reckoned with. During the 1970s Africa's rate of investment remained at around 18 percent of gross domestic product (GDP) as flows of foreign capital compensated for lower terms of trade and for a decline in domestic savings rates. But in the 1980s 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 entire developing world.

Statistics, we must remember, disguise a great diversity of country situations, in debt, in economic performance, and in 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.

Take for instance 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 1985.

The role of the public sector in the economies of sub-Saharan Africa is larger than in other regions, in both employment and the share of total investment. The rapid growth of the public sector has often been accompanied by inefficient management, overextended 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 1980s and have reformed the operation of many others. In Mali, for example, the operating deficits of thirteen key public enterprises were reduced by 50 percent between 1981 and 1984.

So adjustment is under way 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 difficult 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 and then turning around 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.

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, about $1 billion of which can be met, we believe, through the multilateral institutions. The remaining $1.5 billion gap can be met only through bilateral efforts, both with additional aid flows and with further reschedulings. The role of industrial nations in promoting growth-oriented adjustment, however, embraces a wide range of activities and responsibilities.
It can be argued that a measure of economic growth and poverty alleviation can result purely from internal adjustment by developing countries themselves. 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 priorities stands the maintenance of a steady rate of real growth in the GNP of the industrial nations, creating durable noninflationary growth in world demand. Continued high budget deficits in some of the principal industrialized countries will, however, 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 industrial economies with persistently high deficits must work to reduce them. And taking the route of cuts in public expenditure 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 defense. 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 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 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 to help stimulate new industrial capacity is another neces-
sary 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.

I think we can all agree that for the developing countries' own growth prospects, an open, multilateral, international trading system is essential. The period from 1950 to 1973 was, as you recall, the golden era of trade liberalization and expansion. It provided an extremely favorable environment for growth in the developing economies. In the 1950s, however, many developing countries followed inward-oriented, highly protectionist policies and failed to take advantage of the expanding international market. By the 1960s a number of countries, particularly in East Asia, were shifting to an outward-looking policy. And the huge benefits they then reaped from that shift gave a clear signal to those who had not shifted: with small internal markets blocking successful economic development, these countries would have to rely on international trade as the key to their growth. That in turn called for reasonably open trade regimes and appropriate incentives for exporting. And the greater the access to markets, the higher the payoff of an outward-looking trade policy.

But that still leaves the persistent and serious problem of protectionist trends. The recent steep rate of decline in the growth of exports from developing countries 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 nontariff 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 Communities. 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 on June 30, 1986. 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 General Agreement on Tariffs and Trade (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 bring protectionism to a standstill and to support trade liberalization have been made again and again by the industrial powers. 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 their pledges 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 billion and $21 billion of net capital flows annually.

With respect to flows of private capital, we all are aware of the extreme importance of reviving commercial bank lending to those heavily indebted middle-income countries that are undertaking growth-oriented, medium-term adjustment programs. In his proposals at our 1985 Annual Meeting in Seoul, U.S. Secretary of the Treasury James Baker called for $20 billion in net new lending by the commercial banks in 1986, 1987, and 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 ensure a shift of emphasis of new export credits away from lower-priority, large new investment projects and toward completing or rehabilitating existing investments.

Governments of the industrialized countries who have not yet done so can help stimulate the flow of direct foreign investment to the developing countries by signing and ratifying the Convention establishing the recently proposed Multilateral Investment Guarantee Agency, whose principal task will be to insure direct foreign investment against noncommercial risk. More than the required number of fifteen developing countries have now signed, among them five Latin American and Caribbean countries, with a sixth 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 under way.

With regard to official flows of capital, it is disappointing to note that such flows, including both official development assistance—that is, concessional money—and nonconcessional lending, declined slightly in 1985 from the 1984 level. Official non-
concessional flows fell by some $3.5 billion in 1985. 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.

The growing commitment to adjustment by the low-income developing countries, including those in Africa, returns the ball directly into our court. It raises the question of whether we can 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.

By our calculations there will be a yearly external financing gap in low-income Africa of some $2.5 billion from 1986 to 1990, about $1 billion of which can be met, we believe, through the multilateral institutions. But that must assume a satisfactory outcome of the current negotiations to replenish the resources of the International Development Association (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 be met only through bilateral efforts, both with additional aid flows and with further reschedulings.

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.

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 peo-
pies. 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 good 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. Industrial countries 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.

With worldwide military expenditure now reaching $1 trillion a year, the industrialized nations, particularly the major powers, need to consider whether a dollar more at the margin on defense budgets buys more security for them and for future generations than a dollar more in economic development assistance.

Today there is wider agreement than ever on how to support growth-oriented adjustment in the development process. But we cannot be complacent.

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. The principal industrial nations can brighten the hope of those in need by pledging to act on the critical fronts of trade, aid, and capital flows.
These days there are two important 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, in which 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.

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. And this raises the question of how we have 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 formulation, 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

• In extending our catalytic role to enhance the mobilization and coordination of private and official flows.

These initiatives are not new departures for The World Bank. Rather, they represent a considerable strengthening of certain of our regular activities. Endorsement of this strengthened role was explicit in Treasury Secretary Baker's proposals at our last Annual Meeting, 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, irrigation schemes, 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 under way, approximately one-third of the Bank's lending in Latin America already takes the form of policy loans. Most of these are sectoral loans—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:
changes to improve efficiency, to provide incentives for increased production, to diversify foreign exchange earnings, to better allocate scarce indigenous resources, to mobilize greater savings, to prevent capital flight. 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.

The World Bank's $350 million loan, approved in April, to assist the adjustment process in Argentina's agricultural sector is the largest such adjustment loan to date, and two more large policy-based loans to that country are under active consideration. A $500 million loan in support of Mexico's trade liberalization is among 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 Côte d'Ivoire. Recently we arranged policy-based lending to Chile, Colombia, Costa Rica, Ecuador, and Uruguay, which are also growth-oriented.

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 1 percent in 1985. This situation will not 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 World Bank, in close association with the IMF, have such an important role to play.
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 the attendant difficulties for The World Bank in designing and bringing adjustment programs to fruition, 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 International Bank for Reconstruction and Development (IBRD), the World Bank’s lending affiliate for the middle-income countries, our review of country assistance plans for the heavily indebted countries and all other IBRD borrowers suggests that the lending program of $40 to $45 billion which we originally proposed for fiscal 1986 to fiscal 1988 now underestimates the potential. We have therefore proposed instead a range of $40 to $50 billion, with an annual lending level of up to $21.5 billion in fiscal 1990. Lending commitments in our current fiscal year ending June 30 could be up by as much as 18 to 20 percent more than what was achieved last year. 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 the industrialized countries—indeed of all our members—for the increase we shall be seeking.

Policy reform is 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 simply must be removed.

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 worldwide requirements, and at our initiative sixteen 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 Africa Facility’s support for adjustment must therefore be assumed by IDA.

This points in particular to a need to strengthen IDA. In the ongoing negotiations to replenish its resources, IDA’s Deputies representing the thirty-four 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 from 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 of 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.

There is encouraging news to report on the availability of con-

cessional 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.

Capital flows are crucial to the adjustment with growth process, and we simply cannot allow the effort to fail for lack of adequate financial support. Bilateral donors, multilateral institutions, and commercial banks must work together to ensure that the flow is maintained and expanded.

We at The World Bank have a special catalytic role to play in the mobilization of additional resources. Our aim is to stimulate an increase in the flow of official development assistance, export credits, commercial bank lending, and direct private investment. Through our expanding role as aid coordinator we can help stimulate the flow of official funds by showing that aid is effective when it is made available in a disciplined way and for carefully evaluated purposes. We continue to encourage official agencies to join us in cofinancing high-priority projects.

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 into our developing member nations. And our Multilateral Investment Guarantee Agency will in time also help to stimulate the flow of investments.

We at The World Bank have always been vocal and practical supporters of a healthy private sector. Promotion of the private sector and encouragement of foreign private investment are critically important to the developing countries. That is not an ideological slogan. We recognize the public sector’s vast importance and government’s fundamental responsibility to protect its
citizens' basic interests through the provision of vital services. Our support for the private sector is simply a recognition of the little-appreciated fact that almost three-quarters of the gross domestic product of the developing countries is generated by the private sector.

It is a recognition too of the fact that the most rapid economic growth in developing countries has been achieved where private initiative has been given scope and encouragement and where the role of the state has been relatively restrained. It is also a recognition of the fact that in developing countries plagued by unemployment, strengthening the private sector is the way to create jobs—jobs, that is, which are truly productive.

The process of adjustment with growth is an enormous challenge to us all. Sustained growth is the real objective. Not simply growth for growth's sake, but growth which is deliberately designed to alleviate poverty. Growth that will help ease the scourge of high unemployment; growth that will raise the incomes of the rural and urban poor; growth that will arrest the degradation of the environment; growth that will promote food security and spread social services. In other words, growth that will provide better lives for all the peoples of these countries.

And that is what we at The World Bank are striving for. We can help and we are helping governments formulate policies that focus on poverty alleviation, just as we are seeking to ensure that the poorer segments of the population are a major consideration in the design of each lending operation.

It is up to us now to ensure that the international community as a whole reaches out in fellowship and humanity—and, might I add, enlightened self-interest—to help the developing world as a whole to adjust to the new economic realities and to secure sustained growth. But the industrial world must adjust to the new economic realities too. If it does not, then the task will be difficult and may be impossible to achieve. And for hundreds of
millions of people determined to break the chains of poverty, the future will be dark indeed.

That is something that we cannot, must not, allow to happen.
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