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DEVELOPMENT FINANCE AND THE AGRICULTURAL SECTOR:
SOME PRIORITIES FOR THE EIGHTIES AND BEYOND

Remarks

As Prepared for Delivery by

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The World Bank

to the

Annual Conference of

The International Fertilizer Industry Association

Mexico City, Mexico

May 1, 1984

Mr. Chairman;

Ladies and Gentlemen:

I would like to thank the International Fertilizer Industry Association and, in particular, Secretary General Kenneth Windridge, for inviting me to participate in IFA's Annual Conference here in Mexico City, and to address your opening session. I had the pleasure of addressing this Conference some years ago, and I have been following the fortunes of the Association and the industry it so ably represents with great interest.

You have asked me to address, on behalf of The World Bank, the question of financing development in the present world agro-economic situation, with particular reference to the problems of Latin America. And I am happy to do so. In the course of my remarks, then, I shall:

- o briefly review the current global economic situation;

- o discuss the economic adjustment process now underway in the developing countries, with special reference to Latin America's experience, and The World Bank's role in that adjustment process;

- and then I shall look at the role of the agricultural sector in the restoration of Latin America's economic growth, touching in particular on fertilizer production and consumption, and the involvement of The World Bank in this sector.

Let me begin then with a brief overview of the global economic situation as we see it at The World Bank.

The world is currently recovering from the worst recession in more than forty years. But the recovery is very uneven. In many developing countries growth in per capita income has been halted, needed investments are being postponed, and programs to reduce poverty have ground to a halt. Third World development prospects and the creditworthiness of a number of countries have been seriously weakened, and the damage will take years to repair.

In our increasingly interdependent world, any confidence in the staying-power of recovery in the industrial world is misplaced if there is not, at the same time, a determined effort made to repair the damage inflicted on the economies of the developing nations. There can be no sustained, non-inflationary growth in the industrial world if the developing world's economies are left to stagnate and decline.

Economic recovery is now clearly underway in the United States, and according to the Organization for Economic Cooperation and Development, the industrial countries as a group are likely to raise their economic growth to 3 1/2 percent this year. Our World Bank estimates suggest that the developing countries will raise their growth to an average of 3 to 3 1/2 percent. But since population is still growing more than 2 percent a year in the developing countries, their per capita income fell in both 1982 and 1983, and will increase only modestly in 1984.

The impact of the recession on the developing countries has been varied, but the headline-catching aspects of the Third World's current predicament have undoubtedly been the debt crisis and the plight of Sub-Saharan Africa. Latin America has been dramatically affected by the debt crisis. Nonetheless we expect the oil-importing countries of this region to achieve at least some growth in per capita income in 1984 after suffering a decline of 14 percent over the last three years.

The low-income countries of Africa, on the other hand, have been suffering declines in per capita income for more than 10 years. Even though rising commodity prices may give Africa a bit of relief in 1984, prospects for the region's per capita growth within the foreseeable future look gloomy. Indeed, it could be lower by 1990 than it was in 1960.

On the brighter side, however, we believe it possible for the developing countries as a whole to move back during the rest of the 1980s toward the growth rates they achieved in the Sixties and Seventies. But that will depend on how well post-recession adjustment, a very difficult process seriously complicated by the debt crisis, is made to work. And let me emphasize that it is not upon the developing countries alone that the burden of responsibility has fallen. Monetary and fiscal management in the industrial countries is going to be a key factor. The momentum of today's recovery in the industrial world, which is so crucial to global recovery as a whole, cannot be sustained without a reduction of those budget deficits which are at a level threatening to push up already too high real interest rates. Upward pressure on interest rates can only dampen business investment and confidence in the industrial world while aggravating the debt-servicing problems of the developing world. Too stringent monetary management, producing the same effect, must also be avoided. Careful management is an essential, but if it reaches a point of stringency that has a hurtful impact across national borders, then it has been carried too far.

Nor is protectionism a justifiable tool in the adjustment process. Exports to the developing countries currently account for 28 percent of the total exports and 6 percent of the national income of the industrial countries. That vast market cannot be sustained and expanded if protectionist measures against Third World exports deprive the developing countries of their purchasing power. Furthermore, and very importantly, improvement of the indebted nations' ability to service their debt depends substantially on their ability to expand their export revenues.

For the developing countries' part, the vigorous pursuit of economic policy reform is fundamental to the adjustment process. Bringing their balance of payments back under control is proving no simple matter. Slashing public deficits and sharply reducing imports can all too often mean increased unemployment, social programs delayed or shelved, and more manufacturing capacity made idle. It is a painful process, but it has to be done. And nowhere is that understood better than here in Latin America.

The overall impact on the region's economic growth has been drastic. For the entire region, per capita GDP fell by 5.6% in 1983, and for a number of countries (Argentina, Bolivia, Brazil, Uruguay, most of Central America and the Caribbean), 1983 was the third consecutive year of decline. And per capita income, adjusted for losses in the region's terms of trade, is now estimated to have declined to the level of the early 1970s. What was expected originally to be a short-term cyclical downturn is now in its fourth year, and for Latin America and the Caribbean has turned out to be the deepest and longest recession in 50 years.

The persistence of high real rates of interest throughout the recent recession, combined with a decline in export earnings in 1982 and 1983, placed enormous pressure on the balance of payments positions of Latin American countries. Austerity programs aimed at restoring external liquidity were adopted, but these have resulted in sharp declines in output and employment. Unfortunately, the capacity of some of these countries to grow while adjusting to the adverse external environment by expanding their exports has been reduced by earlier heavy reliance on import substitution which permitted inefficient industries to become established behind high protective barriers.

It was not only high interest rates, depressed export markets and collapsed commodity prices that placed such a strain on the region's external resources. Since 1981 the flow of capital into the region has dryed up and become a reverse flow. In 1982 there was a negative net transfer of $4 billion. In 1983 it had risen to an estimated $10 billion. Confronted with these ever tighter constraints on external resources, Latin American countries have had no alternative but to slash both imports and investment. Last year, Latin America's imports were just one-half in nominal terms what they were in 1981. This country, Mexico, reduced its imports by two-thirds over that same period, and halved its public deficit in one year. In Brazil, industrial employment has fallen 20 percent since 1980, and twenty-five percent of her manufacturing capacity stands idle. Nutrition, education, housing and health services, where significant gains were made throughout the region during the 1970s, have all suffered severe set-backs. And despite these painful adjustments, pressing financial problems and external payments difficulties continue to plague these nations.

What can the multilateral financial institutions do to help these countries through this difficult period? The International Monetary Fund, has the key role in handling the short-term aspects of the debt crisis. Together with the Bank for International Settlements and a number of industrial country governments, the Fund has been putting together the financial packages and proposing the policies that will help these heavily indebted countries through the immediate liquidity crisis and help restore creditor confidence in them. It is essential that the commercial banking system continue prudently to provide new finance. The action being taken by the Fund and its partners to help restore creditor confidence ought to persuade the major banks to sustain, not curb, new lending, and, where necessary, to arrange further restructuring of debt.

We have to recognize the fundamental importance of moving to secure long-term growth even while we are addressing the short-term problems. One cannot follow the other; the two must proceed in tandem. While the IMF works on the immediate liquidity aspects of the problem, The World Bank works to create the conditions under which the process of long-term development can be fed with external funds without recreating the crisis conditions of today. Short-term solutions to the immediate problems are essential. But they will be no more than Pyrrhic victories if no long-term solutions are provided. That is why a complementary effort has to be made, and is being made, to help these countries design and enact programs offering prospects of a return to real economic growth and sustained development. This crucial complementary role is the one that The World Bank is playing.

Minimizing the adverse impact of the external resource squeeze on the development process is the challenge facing the countries of the Latin American region. Policies and investment programs have to be designed with that objective. And this means accelerating adjustment to the new economic realities while preserving a core program of high priority investments required to prevent the development momentum from being lost altogether. The key to meeting this challenge is the acceleration of exports which, in most cases, will depend on the adoption of aggressive export promotion policies and the reform of incentive systems to eliminate existing anti-export biases.

In light of this, The World Bank is placing great emphasis, in the assistance it is providing, on the analysis of both short- and medium-term policy options. Through what we call our structural adjustment lending and special assistance programs, the Bank is disbursing funds more rapidly than in the past to nations that are demonstrating a determination to adjust policies. Our lending and our advice, each of which is important, aim to ensure the adoption and implementation of programs that will help restore creditor confidence in the borrowing countries.

The principal policy areas that are receiving urgent attention are inflation control, public expenditure control and the promotion of greater trade surpluses. Policy changes in these areas are not easy and the structural adjustment process is indeed a very costly and difficult one for most countries of the region. The promotion of much greater trade surpluses, which have thus far come mainly from cutting back imports, must ultimately come, through reallocations of resources, from expanded exports and more efficient import substitution along the lines of comparative advantage. And this will require more liberal trade and domestic incentive policies, and greater reliance on the private sector.

That is the advice we are giving. And those are the policies our lending is intended to support in the adjustment process.

The agricultural sector plays a very important role in the adjustment process, as I shall shortly demonstrate in the case of Latin America. But then it has played, and will continue to play, a crucial role in the development process as a whole. And that is why it has long been a major area of activity for The World Bank.

In the last decade, the Bank has provided two-thirds of the multilateral aid, and nearly one-third of all external resources for agricultural development. Between 1974 and the end of this calendar year -- 1984 -- the Bank will have invested some $33 billion in agricultural production, as our contribution to a total project investment of between $90 to $100 billion in that sector. Over the ten years, the Bank's investment in agriculture has averaged 28 percent of total Bank investment.

Three subsectors have dominated the Bank's lending in the agricultural sector: irrigation, area development and rural credit. They have accounted for 70 percent of all commitments. This has been the pattern over the past decade, with about one-third of all investment devoted to irrigation. In recent years there has been a marked increase in investment in agro-industry, particularly in Latin America. There has also been an increase in research and extension. Altogether, the current level of Bank lending to agriculture is in line with our stated objective of giving priority to this sector.

After the South Asia region, which, during this last decade, has absorbed 25 percent of the Bank's agricultural lending, Latin America and the Caribbean rank second with 21 percent, and a total of $6.8 billion in borrowings. While India was by far the largest borrower for agriculture during this period, Mexico ranked second and Brazil fourth.

The agricultural sector has a key role to play in the Latin American adjustment process, because of its extreme importance to foreign trade. The share of agricultural exports in the total often exceeds 50%, as it does in Paraguay, Argentina, Brazil, and Colombia. The sector also is important in total employment, despite the large migration to urban areas that has been taking place for many years. If the problems of the severe unemployment levels at the present time are to be minimized, the sector has to absorb much more labor. This will also be consistent with long-run growth with equity since the two resources most abundant in many of the major countries of the region are labor and land.

The promotion of greater labor-intensive exports will require fundamental changes in incentive policies. With some exceptions, the agriculture sector in the region has been a heavily taxed sector -- through the maintenance of overvalued exchange rates, export taxes and quotas and sometimes import policies which effectively subsidized imports, even at ruling exchange rates. At the same time, the various subsidies provided on modern inputs and on credit have tended to accrue only to the richer and more capital-intensive farms. Coupled with various consumer subsidy programs, production subsidies have proved very expensive, contributing significantly to budget deficits and inflation.

Long-entrenched policies need urgently to be rethought, in order to plan for long-term growth. The often remarkable performance of the agriculture sector in the region has been due to area expansion rather than productivity increases -- especially in large countries like Brazil and Mexico. Yet, frontier expansion, requiring large amounts of scarce capital, is now showing diminishing returns. There is little doubt that future performance of the sector will be much more sensitive to productivity increases than to expansions of cultivated areas. And productivity increase is something to which The World Bank is paying particular attention. We are supporting programs to improve research and extension services, and yield-improving programs such as the rehabilitation of existing irrigation areas. And, needless to say, the provision of such vital inputs as fertilizer, seeds, and pesticides, receives considerable attention from us.

As you are aware, farmers in developing countries often face difficulties which prevent the proper use of fertilizer to enhance agricultural production. There are know-how, financial, infrastructural, and institutional constraints. There can be widespread lack of knowledge on the importance of fertilizer in food production, methods of fertilizer application, timeliness, and level of fertilizer use. There can be problems of financing, which limit farmer purchases. In some cases where the importance of fertilizer use is realized and the financial resources to purchase fertilizer exist, there are inadequate transportation and storage networks, and inefficient institutional and marketing arrangements, aggravating problems of distribution. All of these factors can badly hinder agricultural production.

There are, of course, ways of alleviating such constraints. Extension programs geared to fertilizer application can contribute to a better appreciation of the potential benefits they offer. Distribution of fertilizer can be facilitated through improvement in transport networks, construction of storage facilities, and strengthening of marketing institutions. Insufficient domestic capital can be partly offset through external sources of capital to pay for fertilizer imports, or to supplement domestic credit sources.

Latin America has not been immune to such constraints, but one of the biggest has been the region's own economic problems, which resulted in a 15 percent drop in fertilizer consumption in 1981/82 from the peak level that had been reached in 1980/81; from 7.5 to 6.4 million tons of nutrient. Consumption picked up only marginally -- by about 2 percent -- in 1982/83. The 1983/84 level in Latin America is expected to be 8 percent higher, but would still be well below the 1980/81 peak. Two countries -- Brazil and Mexico -- account for 42 percent and 28 percent respectively of the region's consumption.

While Latin America has about 9.2 percent of the world's arable land, the region shares only 5.7 percent of the world fertilizer consumption. Latin America used only 46 kilograms per hectare of nutrients in 1981/82, which suggests that agriculture in this region is relatively less intense, and has considerable potential for further development.

The region's economic and financial problems, however, could negatively affect the future rate of growth in fertilizer consumption in the region, and the availability of fertilizers could be the major constraint. In spite of relatively low international prices, fertilizer imports are being cut back to reduce the outflow of foreign exchange. The future trends in fertilizer consumption will, therefore, depend largely on the rate of the region's economic recovery.

The FAO/UNIDO/World Bank Working Group on Fertilizer, which, as you know, was created in 1975 to provide a continuing analysis of world fertilizer supply and demand, has estimated that the fertilizer demand in Latin America will increase to about 8.87 million tons of nutrients by 1988/89. This would correspond to an annual increase in consumption of about 5.4 percent. Over half the increase in consumption will be in Brazil to recover part of the drop in consumption between 1980 and 1983.

This raises the important question of how much fertilizer Latin America can produce for itself. In 1981/82, the region produced about 3.4 million tons of finished fertilizers -- meeting about 50% of its own fertilizer needs, but accounting for less than 3 percent of world fertilizer production. The region has only a small potash production in Chile. Nitrogen and phosphate production share about 55 percent and 45 percent respectively of the rest of the region's production. Mexico and Brazil currently account for the lion's share of the region's production: about 78 percent.

The Working Group on Fertilizer has estimated that production from facilities being installed or firmly planned within Latin America will increase supply to about 6.34 million tons of nutrients by 1987/88, with Mexico claiming the largest installed capacity. About two-thirds of the supply will be as nitrogen with most of the rest as phosphate and some potash. However, even at this level of production, the region will need to import significant amounts of fertilizers.

The local production of fertilizer, if economical, can bring measurable benefits to a developing country. To a great extent it insulates the country from supply uncertainties, and the country's agricultural development benefits from the stability of supply. Of course, the long-term balance between domestic fertilizer production and imported materials must be struck with due regard to comparative advantage. Raw material resource endowment, size of domestic fertilizer market, and opportunity cost of the natural resource are important factors.

Many developing countries have approached The World Bank requesting help in meeting their fertilizer needs, and they frequently ask us for advice on the development of their countries' fertilizer sectors.

We have responded in three practical ways.

First, we have sought to develop the market for fertilizer through the agricultural projects that we finance, most of which involve assistance in the provision of seasonal inputs, including fertilizer. Bank support for the development of agricultural credit institutions has been an important factor in expanding the market for these inputs.

Secondly, we have, where we feel it justified, helped to develop a country's domestic fertilizer production capacity.

Thirdly, we have helped improve the distribution system.

With regard to direct financial assistance to fertilizer projects, over the last fifteen years The World Bank and its two affiliates, the International Development Association (which is our concessional finance arm) and the International Finance Corporation (our affiliate working in the private sector) have together financed more than 50 fertilizer projects in 18 countries for a total of about $2.5 billion. Overall, our institutions have been involved in roughly one-third of all fertilizer projects implemented in the developing countries during the recent past. And in connection with these projects, we have attracted considerable amounts of co-financing from other sources, both official and commercial.

In Latin America we are participating in five types of activities related to fertilizer.

First, The World Bank has cooperated with the member countries of the Andean region in estimating their projected fertilizer requirements and in evaluating in economic terms the available alternatives for optimally meeting the requirements. This regional study aims to identify facilities to be set up on a cooperative basis to meet the fertilizer requirements of more than one country.

Second, the Bank has assisted the member countries in the region through project preparation work financed under an engineering loan from The World Bank or executed with UNDP financing. Such studies have identified for investment possibilities the phosphate fertilizer facilities in Peru for the mining of rock phosphate and its conversion to phosphoric acid and ammonium phosphates for export; a natural gas-based ammonia/urea complex and a phosphate fertilizer complex for the local market in Colombia; and a potash fertilizer project in Chile.

Thirdly, The World Bank has participated in the construction of five fertilizer production projects in the region, three in Brazil, and two in Mexico. Four have been successfully completed, and the fifth is in an advanced stage of construction. The IFC has made three investments in Latin America's fertilizer industry.

Fourthly, The World Bank is reviewing with the fertilizer companies in Brazil the possible improvements to existing facilities to optimize production, decrease production costs and reduce energy consumption.

I believe that all of us here understand and appreciate the critical importance of fertilizers to the agricultural sectors of the developing countries. The incentives to use them have to be created. But that effort is in vain if supplies cannot meet the created demand. And like other inputs, the provision of fertilizer in an economically efficient manner is crucial. Developing country governments may be justified in subsidizing prices in selected cases where it will get farmers accustomed to the benefits of such inputs. But subsidies should not be excessive or indiscriminate. The efficiency of domestic production is also an important factor: no one gains by excessively high cost local production of fertilizers when cheaper imports are available.

These are some of the important issues with which developing countries, international agencies, and the fertilizer industry world-wide have to grapple. The industry has, in IFA, a very valuable instrument for collecting and disseminating the knowledge and technology that can help resolve some of these issues. IFA needs to be widely heard. And speaking as a financier, I believe it particularly important that the international financial community hear what you have to say. International financial cooperation in facilitating the matching of fertilizer supply with demand is indispensable to the strengthening of the agricultural sector and food production in the Third World.

I say this because we are fully aware at The World Bank that the financing of future fertilizer supplies to the poorest developing countries is an issue of great concern to you. We share your concern and would like to be constructive in offering suggestions as to how the issue might be approached.

The Bank itself has been very little involved in the direct financing of fertilizer imports. Over the last five years we have helped Bangladesh and Pakistan, and to a very limited extent Malawi, with some IDA financing for fertilizer imports. But neither the Bank nor IDA have financed any specific import projects in Latin America. Seasonal inputs, including fertilizer, have been components of many agricultural and rural development projects financed by us, but only in a few cases have fertilizer costs been specified separately. And although fertilizer is an important component in some food crop development projects the Bank is financing in Nigeria, in none of them does the Bank finance the fertilizer themselves.

Given the rarity of the intervention of the international financial institutions in directly financing fertilizer imports, I believe that your industry would do well to look to the commercial banking system for support. We have to realize, however, that in the present situation, commercial bank lending is based for the most part on sovereign credits. There is need, therefore, for an innovative approach to the question of commercial bank support. Might IFA not consider bringing the fertilizer exporters of the industrial countries together with the importers of the developing countries to develop a viable system of financing which would attract commercial bank support without laying undue strain on the importing-country's credit? I offer this as a suggestion you might find worthy of consideration.

But, in the final analysis, the level at which developing countries will import fertilizer, to the extent that they need to, will be largely determined by the extent to which their economies are growing and their foreign exchange earnings rising. And helping bring <u>that</u> about is the role that the international financial institutions have primarily to play.

Mr. Chairman:

I am hopeful about the prospects for agriculture and world food production. I say, but with proper caution, that futurists have frequently been proved unduly pessimistic in the light of ensuring events. In the Sixties and Seventies there was much talk about famines to come. And while we are painfully aware and stirred to action by the desperate situation in many areas of the African continent, the massive global crises earlier foreseen did not materialize. And the food deficits in developing countries that were estimated prior to the 1974 World Food Conference turned out to be gross over-estimates. The drop in Indian production was mistakenly assumed to be a trend; few predicted the unworkable upsurge in India's production that followed.

Few foresaw the high supply and income elasticity of grain, and the explosion in international trade, and the ability of the market to handle it. And despite dire warnings, the oil crisis of the Seventies did <u>not</u> inhibit increased production in the United States, the world's most energy intensive agricultural producer.

The Green Revolution did not precipitate the mass displacement of small farmers as many had forecast. The evidence seems to be that the small farmers have adopted the new technology as readily as the large farmers. And the consumers have been the big beneficiaries.

One could go on. But I, for one, am convinced that the world has at its disposal the know-how and the resources to accelerate agricultural development, increase productivity, and feed a hungry world. But this will not be done without political will and an international commitment to cooperate in the effort.

Your deliberations here can help strengthen that commitment. And I wish them well.

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