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ORAL VERSION

"Third World Development and the Global Economy: The Absolute Priorities"

Remarks

By

A. W. Clausen, President
The World Bank
and
International Finance Corporation

before the
World Affairs Council of Northern California

San Francisco, California
March 2, 1984

Thank you, Peter.

It is a real pleasure to be with you here this evening at your 37th Anniversary Dinner. And how delighted I am that our friend David Packard is here, too, as your guest of honor.

It goes without saying that I am always happy to come home to the Bay Area. And I especially appreciate your invitation to join you tonight because I have always felt very much at home here at the World Affairs Council. Even if I have to sing for my supper!

I am particularly happy to hear that the lecture series established as a memorial to that wonderful citizen of the world, Scudder Mersman, Jr., a former colleague of mine, will be inaugurated this May. And I am gratified to hear that the first lecture will be delivered by Andre de Lattre. Andre just recently helped us at The World Bank with the difficult negotiations to replenish the resources of our concessional lending affiliate, IDA -- the International Development Association -- before he went off to head up the new Institute of International Finance.

The global economy and the problems of the Third World may seem a rather somber subject for after-dinner remarks. Maybe you at the World Affairs Council would think it more suited to your "Crisis of the Month" series! But I want to take the high road tonight, and share with you a little positive thinking on the matter.

I recall that when I was last a guest of your Council just two years ago, I remarked that one of the problems of trying to get agreement on what ought to be done about our very complex global economy was the fact that everyone got bogged down in oversimplification.

I have no reason tonight to revise that opinion. But I must say that the icy shower of a three-year global recession, the worst recession in more than forty years, woke many people up to some stark truths about international economic relations. It has imprinted upon our minds, more clearly than ever before, just how economically interdependent the nations of the world have become.

It has also reminded us forcefully that when the global economy is in trouble, there is no such thing as a quick fix. The world is recovering from the recession, but the recovery is uneven, and many developing countries still confront acute economic problems. In most of them, growth in per capita income has been halted, needed investments are being postponed, and efforts to reduce poverty have been interrupted. And the creditworthiness of a number of countries has been seriously weakened.

There is no doubt about it: the prospects of the Third World have been badly damaged, and it will take years to repair that damage. There can be, I repeat, no quick fix.

So tonight I would like to suggest to you what the absolute priorities for action are if we are going to repair the damage and achieve sustained non-inflationary growth for the global economy as a whole.

As we are now all aware, economic recovery is underway here in the United States. Most economic forecasters failed to foresee just how vigorous the 1983 expansion would be. Maybe they were hedging their bets after the widespread forecasts of a recovery in 1982 which doggedly refused to materialize. It seems now that the U.S. economy is expanding at a rate and with a momentum that can be sustained for some time. The same can be said for Canada. Most forecasters see an increase in the real GNP of the U.S. of 4.5 percent from the fourth quarter of 1983 to the fourth quarter of this year, compared to the 6 percent increase over the previous year. This slower pace should be sustainable for quite a while.

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. And our World Bank estimates suggest that the developing countries will average growth of 3 to 3 1/2 percent this year, up from less than 1 percent in 1983 and almost 2 percent in 1982. Unfortunately, population is still growing more than 2 percent a year in the developing countries. Too high rates of population growth pose serious problems for development and we at The World Bank are seeking to help resolve these. Per capita income in developing countries 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. In contrast to the rest of the developing world, those two vast countries, India and China, have maintained high rates of growth in per capita income throughout the recession. They have been somewhat shielded from the world economy's recent dislocations, and have been pursuing programs of economic rationalization and reform, which have enabled them to secure continued growth.

But the headline-catching aspects of the Third World's economic troubles have undoubtedly been the debt crisis and the plight of Sub-Saharan Africa. Latin America has been dramatically affected by the debt crisis, but even the oil-importing countries of the region should achieve at least some growth in per capita income in 1984 after three years of decline.

The low-income countries of Africa, on the other hand, have been suffering declines in per capita income for more than 10 years now! Even though rising commodity prices may give Africa a bit of relief in 1984, we still expect no growth in per capita income. And given the fact that Africa's population is expected to more than <u>double</u> by the end of this century, prospects for per capita growth in the foreseeable future look gloomy indeed.

Some developing countries in other regions also face gloomy prospects. But, we believe that the developing countries can and will move back during the rest of the 1980s toward the economic growth rates they achieved in the Sixties and Seventies.

While we expect this to happen, I must add that it will depend mainly on how both the industrial and the developing nations handle the difficult economic issues confronting them now and in future years. Economic recoveries are by nature cyclical phenomena which cannot be expected by themselves to solve underlying problems such as inadequate capital flows, heavy indebtedness or a protectionist trade environment. What the current economic recovery in the industrial world can do, and does do, is give the international community the opportunity to introduce policies that will help solve these problems and pave the way to sustained growth around the globe. It is an opportunity which must not be allowed to pass.

Allow me to suggest to you, then, some absolute priorities for action.

First, the economic policies and performance in the industrial countries must be improved so that the present recovery translates into sustained, non-inflationary growth. The momentum of today's recovery cannot be sustained without a reduction in government budget deficits. This is important here in the United States. The prospect of budget deficits continuing on the order of \$180 to \$200 billion may well keep upward pressure on already too high real interest rates. And that can only dampen business investment and confidence.

The move from recovery into sustained growth will also require policies in the industrial countries that permit and facilitate structural change in their economies. A failure to keep up with the need to adapt, will as we have already seen in sectors such as steel and textiles, contribute to falling returns on investment and to slow growth.

Sustained growth in the industrial countries will also require improvements in external policy and performance. Another absolute priority, then, is the further liberalization of international trade.

One hears it argued that protectionism has been a pragmatic, unavoidable response to rising unemployment exacerbated by the recession, and that as recovery shortens the unemployment lines, there will be a spontaneous relaxation of protectionism. But this overlooks the fact that protectionism was rearing its ugly head well before the recession boosted unemployment. It has been a trend, not a knee-jerk response.

Trade barriers were gradually lowered over the last generation through successive rounds of negotiations under the aegis of GATT. But this liberalization process proved only a qualified success in regard to trade between the industrial and the developing countries.

Most developing countries maintain higher levels of protection than do most industrial countries. For their part, the industrial countries generally impose higher-than-average tariffs on products from the developing countries. For example, agriculture, which is important to many developing countries, has not only been left out of the liberalization process; barriers to trade in agriculture have actually increased in recent years.

This is the sort of trend which has to be stopped.

Both industrial and developing countries have great need of each other as trading partners. 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. When the debt crisis forced the developing countries to cut back on their imports, industrial country exports to the Third World dropped by a dramatic $43 billion in the four quarters that began in mid-1982 compared to the previous four quarters. This was very bad news for the businesses and workers, and therefore for the economies, of the industrial countries. If the developing countries had been able to keep importing at the 1982 level, the industrial countries' growth rate in 1983 would have been 3 percent instead of 2 1/4 percent. That, my friends, is economic interdependence.

On the other side of the coin, growing Third World exports to the industrial countries are essential to the former's recovery of growth and creditworthiness. If Third World countries are going to return to the 5 or 6 percent economic growth rates of the Sixties and Seventies, they probably need to expand their exports by at least 6 to 7 percent a year in real terms. And since one can expect relatively slow growth in commodity and fuel export revenues, they may well need to expand their manufactured exports by some 12 percent per annum.

Experience shows that many developing countries can improve their export performance by pursuing more outward-oriented development strategies. An increasing number of developing countries were moving toward more open trade policies when their mounting balance-of-payments problems forced them to curb imports. This stopped the trend dead in its tracks, leaving them on the horns of a dilemma. Liberal trade is essential to their long-term growth, but slow recovery in large parts of the world makes it difficult for many industrial and developing countries to resist increasing barriers to trade. The heavily indebted countries in particular need to generate trade surpluses for some time to come in order to cover interest payments on their debts. Yet financial pressures are tempting them to resort to import controls which can only make their economies less efficient and discourage exports for years to come.

This brings me to the next absolute priorities: managing the debt problem and reversing today's unsatisfactory trends in international capital flows.

The total debt of all the developing countries -- medium-, long- and short-term, official and private -- amounted to an estimated $810 billion at the end of 1983. Since mid-1982 (just in the last 20 months) some 30 countries have renegotiated terms on as much as $100 billion of that debt.

While these reschedulings, together with arrears and lower interest rates have slowed the growth of debt-service payments, these payments are nonetheless still growing. At the same time, new commercial bank lending to developing countries, especially to the major borrowers, has fallen dramatically. Today the developing countries are paying back to the commercial banks -- in principal and interest -- more than the banks are lending. Twenty-one billion dollars more in 1983, according to our estimates!

Now, all of us agree that foreign investors should expect to get back more than they invest. But it is much too early for the developing countries as a group to be transferring resources to the high-income countries on this scale. In 1983 the 13 major borrowers among the developing countries were transferring net the equivalent of 2 percent of their national income to private lenders.

The eagerness of the banks to lend in the late Seventies and their precipitous withdrawal in 1982 raise questions about development lending. Much of the lending was done on a short-term, variable rate basis. Both the lenders and the borrowers may be faulted to some extent because of the scale of the transactions that were involved. And as we reflect on the rapid build-up of short-term debt, we are bound to ask how appropriate this type of financing is to the needs of the developing countries.

Well, the answer is that short-term borrowing is essential to the development process. And at present there is no alternative source of international capital able to provide funds on the scale of the commercial banking system. But the lending and the borrowing must be prudent! And commercial banks cannot and should not become the sole source of international development capital.

We must recognize that there is a relationship between commercial lending on the one hand and official lending -- that is non-concessional lending as opposed to development assistance -- on the other. They are not alternatives in the middle-income developing countries. On the contrary, the expansion of commercial lending was made possible in part by the stable base which the relatively favorable terms of official lending provided.

What went wrong was that commercial lending eventually assumed too high a proportion of the total for stability to be maintained through the trough of the business cycle. Now, looking to the upswing, more official lending will be needed, not so much because there will be less commercial lending available, but precisely because it will contribute to a restoration of creditworthiness and so provide a stable base on which to rebuild the confidence of commercial lenders in the mid- and late-Eighties.

The net transfer of medium- and long-term lending from official sources remained virtually stagnant between 1981 and 1983. This is not a healthy situation. Given the likely trends in other capital flows and the continuing need of the developing countries for medium- and long-term finance, official sources such as The World Bank and the regional development banks _must_ increase their lending. A larger World Bank lending program will constitutionally require an expanded base of our guarantee capital. So we are now working towards expanding that base; a process that has minimal budgetary implications for our shareholder governments.

The low-income developing countries -- that is, countries with incomes below about a dollar per person per day -- depend on official development assistance for three-quarters of all the external capital they receive. These are, for the most part, countries which are not creditworthy not even for loans from The World Bank. Yet the total flow of development assistance is also stagnant. And 70 percent of _bilateral_ development assistance goes to middle-income, rather than low-income, developing countries.

The 33 nations that contribute to IDA (The World Bank's concessional loan affiliate) have just completed negotiating its funding level for the next several years. They agreed on $9 billion for three years -- a sum advocated by the United States, but a sum which almost all of the other

32 donor nations felt to be unrealistically low, and a sum that is in fact much lower, even in nominal terms, than that agreed upon in 1979 for the last replenishment of its resources. This disappointing result suggests continued stagnation, or even substantial reductions, in official development assistance in the years ahead.

We cannot, and must not, be content with this result. For the world's low-income countries, especially for those in Sub-Saharan Africa, effective programs of official development assistance are absolutely essential. So we in the Bank will continue to urge governments -- even if not especially the United States -- to increase their IDA contributions. It will not be easy, but it is vital for the achievement of global economic growth and social and political stability.

Discouraging trends in the flow of international capital to the Third World have had a predictable and painful result. Many developing countries have been forced to reduce imports and chop current account deficits dramatically. Cutting back imports and government spending in the heavily indebted countries has thrown their economies into deep difficulties. Mexico halved its public deficit in one year, and reduced its imports by two-thirds between 1981 and 1983. Industrial employment in Brazil has fallen 20 percent since

1980, and 25 percent of her manufacturing capacity is idle. Even some countries who had spent their borrowings wisely on investment rather than unwisely on consumption have suffered from the general decline in international lending.

Sustained growth and resistance against protectionism in the industrial countries will help the heavily indebted countries generate a trade surplus to cover part of their interest payments. But several countries with promising medium-term prospects will still face acute short-term financing problems because of uncertainty among lenders. There are likely to be more reschedulings, and the difficulties resulting from today's debt problems may be with us for as much as a decade.

Since mid-1982, the parties to the debt problem have worked together effectively -- borrowing countries, commercial banks, industrial-country authorities, the International Monetary Fund, which has played a crucial role, the Bank for International Settlements, and official lenders like The World Bank. That must continue.

The commercial banks have helped their borrowers through three extremely lean years, and it makes little sense to withdraw support now that global recovery and the adjustment process in developing countries are both well underway. If the debt problem gets worse, the industrial countries would suffer further trade losses, and there might be further shocks to the international financial system. The authorities of those countries would do well, therefore, to encourage prudent bank lending to the Third World. It would be unwise of them to exacerbate the current downward trend in commercial-bank lending by the imposition of arbitrary new banking rules and regulations.

Increasing capital flows, both public and private, concessional and non-concessional, is for all the reasons I've cited an absolute priority. But the fourth absolute priority is really the most important. It is that the developing countries themselves must improve their economic policies and performance. This is an essential complement to the three priorities I have already mentioned: sustained recovery in the industrial world, liberal trade, and increased capital flows.

Economic policy reform is complex and often painful, and I want to acknowledge the courage and tenacity with which many developing countries are "biting on the bullet." Many have already taken impressive measures to improve their balance-of-payments position and to restructure their economies. While encouraging them in these efforts, we must not forget that the speed of economic adjustment is limited by the need to maintain political cohesion and stability. And specific adjustments must be tailored country-by-country. There are for sure no global recipes.

But here the international economic institutions can be, and indeed are, of great help. While the International Monetary Fund uses its resources to support policies designed to address balance-of-payments problems, our responsibility at The World Bank is to help our developing member countries design and enact complementary reforms to foster a revival of economic and social development. Such reforms entail difficult structural change and take time to come into effect, so that The World Bank, together with other lenders, need to provide assistance for this purpose. But let me make it clear that each and every World Bank and IDA loan is conditional: conditional on the borrower taking such measures as are seen to be necessary to ensure that borrowing from us will truly contribute to the economic and social progress of the country.

The international economic institutions that have served the global economy so well over more than a generation of rapid growth and increasing interdependence -- principally the IMF, The World Bank and its affiliates, the General Agreement on Tariffs and Trade (GATT), and the regional development banks -- must be strengthened to help restore the global economy to health. At The World Bank, we have begun an intensive process of reflection on the institution's future role. And one thing is clear: World Bank support for improved economic policies in the developing countries will be extremely important -- if not for some countries, absolutely decisive -- in the years ahead.

In conclusion, let me sum up, then.

To restore the global economy to health, and to maintain it in that condition, there are four absolute priorities:

- there must be a sustained recovery in the industrial world;

- there must be true liberalization of international trade;

- there must be the creation and maintenance of an expanded flow of international capital to the developing countries; and

- there must be improved economic policy formulation and performance by the developing countries themselves.

A short list, but a long task ahead. In an age when we expect everything from fame to food to come ever faster, we do well to remember that there are no quick fixes for a globaleconomy. But, it is neither beyond the means nor the ingenuity of the international community to master those priorities. It requires only the will.

Each and every one of us in this interdependent world has a real interest in seeing the health of the global economy secured. We should not be ashamed to acknowledge that self-interest. It is, after all, not selfish interest. Indeed, when combined with a generous humanitarian concern for our less privileged cohabitants of this earth, it is a powerful force for good.

You, my friends, understand that.

So spread the good news!

Thank you.