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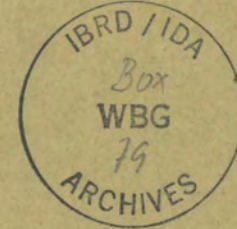
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H. J. Costanzo



Remarks by  
Mr. Henry J. Costanzo  
Executive Secretary, Joint IBRD/IMF  
Development Committee

International Trade Club of Chicago  
February 19, 1976

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The Developing Countries in an Interdependent World

It is a pleasure indeed to have been asked to address this distinguished group. It was only after having been asked that I became aware of the Statement of Position on U.S. Foreign Trade and Economic Policy issued by the Club in January. Let me first compliment the International Trade Club of Chicago on that statement, which I believe is a very realistic and constructive one. After having read it, however, I wondered very much what I could usefully add, and say to the Club on this occasion, in the light of the comprehensive nature of your own statement and the sophisticated awareness it reveals of the basic situation in the present world economic scene, and of the interests of the United States and of the world economy.

As you are aware, I am currently associated with a relatively new international effort -- one among several -- to place some focus on one of the key issues of our times. That issue is, fundamentally, the large and increasing gap between the standard of living and well-being of the developed and the underdeveloped nations of the world, and the common interests of all in at least keeping that gap from



further growing, and hopefully to reduce it gradually over time. To do that requires resources, and specifically transfers of resources from the more advanced to the less-advanced countries -- transfers which can be earned through trade and services, or borrowed in financial markets or obtained through other financial mechanisms, and finally, through mechanisms created to provide aid for this purpose, aid in the form of soft loans or outright grants.

The effort with which I am associated is the Joint Development Committee of the World Bank and the International Monetary Fund, created a little over a year ago, and consisting of 20 members of ministerial rank -- normally Finance Ministers -- representing the entire membership of the two parent institutions, which as you know includes industrial as well as developing countries, and, particularly relevant today, oil-producing as well as non-oil countries. The Development Committee was established simultaneously with another Committee -- the Interim Committee of the International Monetary Fund -- which was specifically designed to continue and complete the work on the creation of an international monetary system to succeed the system which was created during the last war, and which had served the world for more than 25 years before its breakdown under the force of changing world circumstances.

These two new instruments of international cooperation have up to now worked in tandem, with both of them very much aware of, and taking into account in their deliberations, the extraordinarily difficult position in which the world economy has found itself and, particularly,

in which the poorest countries of the world have been placed, since the sharp increase in the price of oil in late 1973 and the subsequent severe recession in the industrial countries. I will not attempt to recount the various actions and decisions which have been taken as a result of their deliberations over the course of the past year or so. I am sure you are aware particularly of the decisions made at the last meetings which took place last month in Kingston, Jamaica, in which the Interim Committee concluded agreements on the shape of a new international monetary system. I would like to review with you, however, some aspects of the current world economic situation as viewed by those Committees, focussing particularly on the circumstances of the developing countries whose resource endowments do not include the ability to produce and export oil to world markets.

These non-oil developing countries have been buffeted by a series of adverse developments since 1973, when they enjoyed a relatively strong position, in a climate of boom demand for their products at good prices. The increase in the price of petroleum, in the first place, dealt them a heavy blow not easy to mitigate, as was possible to some extent in more advanced countries, by conservation measures, recourse to alternative energy sources, or other savings in consumption stimulated by the higher oil prices. The directly concomitant increase in prices of petroleum-based products was also particularly felt by the developing countries through their heavy dependence upon critical supplies of imported fertilizer. The world food shortage of 1973-1974 and its impact on the prices of grains and other foodstuffs which these countries import added to the burden. Finally, the acceleration of inflation in



the industrial countries meant that the manufactures and capital goods which the developing countries must import to maintain the momentum of their development were subject to very large and continuing price increments. All of these elements converged in 1974 to cause the current account balance of payments deficits of the developing countries to triple, from \$9 billion in 1973 to \$28 billion in 1974.

These countries were forced to react to these developments in the most immediately feasible way, by curtailing their imports -- and some of you present today may have had first-hand experience with such curtailments. While import volume growth had previously been running well in excess of 10 per cent per annum, and notwithstanding the harmful effect on their standards of living and economic growth prospects, the non-oil developing countries reduced the volume of their imports by 8 per cent in 1975. This substantial effort toward redressing their position was to no avail, however, as the onset of the most severe recession of the post-war period in the industrial countries affected the demand and the prices of the primary products exported by the developing countries, with the result that their current account deficit rose once again in 1975, to around \$35 billion. Despite further import cutbacks that are anticipated in 1976, and notwithstanding the favorable factors represented by the moderation of the inflation and the economic recovery in the industrial countries, only a marginal reduction in the deficit of the developing countries is expected, to a level of \$31 billion, or still some 3 1/2 times larger than in 1973.

The problem of extraordinarily large balance of payments deficits in themselves is now overshadowed by the problems posed by their persistence for a third successive year. In a truly remarkable demonstration of the strength of the international financial system, the unprecedentedly large deficits incurred by the developing countries in 1974 and 1975 were almost fully financed, by a combination of increased flows of official aid and finance directly to these countries, including significant amounts in various forms from the OPEC countries, by a step-up in amounts of, and new facilities for, finance from the international financial institutions, and -- most importantly -- through the private banking system and financial markets. Although widespread fears had been expressed over the ability of the private banking system to "recycle" OPEC surpluses -- directing the surplus funds deposited with it toward the financing of those who were incurring correspondingly large deficits -- this was in fact accomplished relatively smoothly and with noteworthy success during 1974 and 1975.

Despite the clearly unfounded nature of the earlier fears, the facing of a third successive year of extraordinarily large balance of payments deficits can hardly be viewed with complacency. Many developing countries -- including particularly the strongest and relatively most advanced among them -- have suffered a significant deterioration of their creditworthiness precisely because of the success they have had in financing large deficits in 1974 and 1975. This process not only sharply expanded their debt, but also, because of the bulk of the funds they could raise in the private markets was available only at high cost



and on short and medium-term repayment, worsened their debt profile and resulted in a much heavier debt servicing burden, in relation to their prospective earnings and reserves, in the years which lie immediately ahead. At the same time, the situation in the credit markets may not be as favorable in the future toward further substantial lending to developing countries as they were in the recent past. In the first place, recovery in the industrial countries will generate increasing demands for available supplies of bank credit. In the second place -- and as you are aware from the considerable current public discussion in this country -- many banks may not find it possible or convenient, in terms of their own asset and capital positions, to continue the expansion of their exposures in developing countries at rates like those witnessed in the past two years.

Nor is the situation any brighter attempting to look ahead several years, assuming recovery and a resumption of sustained expansion in the economies of the industrial countries as a group, more normal conditions than recently in the markets for the primary commodities which are exported by developing countries, and no further major shocks to the system such as that from the oil price increase. All the earlier forecasts or targets for growth of the non-oil developing economies have been revised substantially downwards, and growth rates in the balance of this decade are likely to be significantly below those achieved by the developing countries in the first half of the seventies or in the decade of the sixties -- assuming that these

countries will make proper efforts to manage their available resources with reasonable effectiveness and follow generally sound policies. For some countries, including some of the poorest, with the largest populations, this may mean zero or negligible growth of per capita income, and no hope of seeing any improvement in living standards. And the reason, fundamentally, lies in the inadequacy of the likely flows of external resources, both public and private, in relation to the amounts of such resources which would be needed, on suitable terms, to sustain more acceptable growth rates. This is perhaps the crux of the problem facing the Developing Committee in its deliberations over the immediate period ahead. This is the issue being discussed, in various of its facets, and from various points of view, in a number of other international fora, including the Paris energy producer-consumer conference which is just beginning to get under way.

Three of those facets under international discussion are of major interest and importance, and deserve to be given particular attention at this point. The first two which I would like to touch upon deal directly with the transfer of resources as usually understood -- that is, official aid transfers, and access of developing countries to private capital markets -- and the third -- commodity issues -- does so indirectly via an increased ability to earn foreign exchange from expanded exports. There are many other aspects of the development and resource transfer problem being discussed, but I believe these three engage the principal interest of the developing countries at the moment, and are the aspects which will be most intently pursued.



The subject of foreign aid as such -- official development assistance -- is an exceedingly difficult area of the present discussions and negotiations, marked by a sharp divergence between targets and performance. The existing international "target" is for countries in a position to give aid to devote 0.7 per cent of the annual GNP for this purpose; in 1974, the industrial countries met less than one half of the "target" -- 0.33 per cent. What is more, this performance has been steadily deteriorating, falling over the past 10 years from a level of 0.44 per cent. The United States, which bulks large in these aggregate results, has performed even more poorly, with its aid falling from one-half of one per cent to one quarter of one per cent of GNP in this period, with the dollar amount of aid virtually unchanged over a period when its purchasing power has fallen by almost half. In 1974, while ranking third in terms of per capita GNP among 17 aid-donor countries, the U.S. ranked 13th in terms of the share of its GNP devoted to aid. Public opinion polls periodically report a majority of Americans feel that federal budget problems can be solved by "cutting back on foreign aid." Few Americans are aware, evidently, that foreign aid -- development aid, not military aid -- represents only about one per cent of the budget. I need not elaborate before this audience on the myriad of factors which have led to this, nor on the difficulty of envisaging any rapid or dramatic change in this situation.

Where the U.S. has performed substantially better in assisting the developing countries, however, has been in its support of other official programs not strictly classified as aid, including operations of the Export-Import Bank. Especially in recent years, substantial and important amounts of financing have been made available on appropriate and attractive terms through the World Bank and the major regional development banks such as the Inter-American and Asian Development Banks, all of which rely on funds raised in the capital markets with the backing of the U.S. and the other major industrial countries which are members of these institutions. And perhaps the difficult discussion of aid in international forums may find a "way out" by examining possibilities of expanding and emphasizing these institutions as the major channel for officially supported resource transfers to assist development.

Where the U.S. has also performed substantially better -- and very well indeed -- has been in the area of private capital flows to developing countries, which is the second major area I noted of intense international discussion. In this area, the U.S., unlike some other countries, maintains complete freedom for capital to move where it is wanted and can fulfill a productive purpose. Even in the period of severe balance-of-payments problems when the U.S. found it necessary to maintain restrictions against capital outflows, certain exemptions and even inducements remained in force to encourage the flow of private capital to developing countries.



Direct equity investments can, of course, be particularly advantageous for developing countries, because in addition to funds, such investments carry with them transfers of valuable skills, badly lacking in developing countries and crucial for their ultimate advancement. Notwithstanding the complications of a political nature which have entered the discussion of this topic, I continue to believe that many of the developing countries perceive very clearly the unique advantages of private foreign investment and most of them in time will maintain a pragmatic approach toward its acceptance and treatment. In this respect, the current international discussion of the role of the so-called multinational or transnational corporation, and of codes of conduct both on the part of the investor and of the host country can, I believe, usefully clear the air of exaggerated fears more relevant perhaps to a bygone era than to circumstances of the world today.

In the area of debt capital, the past few years have witnessed, particularly in the Eurocurrency markets, an increasing acceptance of the creditworthiness of some of the developing countries, which have been able to borrow large amounts of money to help finance their development. As I noted earlier, such large borrowings do pose a problem at this time, but not because of the amounts involved so much as because of the repayment terms and conditions on which they have been obtained. Major development projects and programs cannot suitably

be financed on a 5 to 7 year basis and the funds thus far available, being drawn from banks rather than long-term institutional and individual investors, have been heavily on this basis. What is needed is for more of the developing countries to gain access to the long-term capital market where funds can be obtained on the long-term basis suitable and necessary for financing development progress. Only one or two countries, after many years of sustained effort, have been successful in tapping such funds with some regularity; others are ready and in a position to do so, but they face a series of restrictions, regulations and difficulties, in addition to a major informational and educational problem in convincing potential investors of the safety of their investments. Clearly, not all of the developing countries are in this position; many would not be able to aspire to borrowings in private capital markets for many, many years. But there should be some way to encourage and assist this process for the more advanced developing countries which have demonstrated their ability to make good use of their own resources as well as those obtained abroad, and have shown over a period of years solid and steady economic progress. This is one specific area in which the Development Committee has established a working group of officials who I hope can come up with some imaginative new ideas for promoting this process.

The third major area on which the developing countries are seeking action is in that of primary commodities and trade. While the dependence of the developing countries on commodity production and trade is well known, it is useful to review a few figures just to remind ourselves how dependent



they are, how vital this area is to them, and why these countries have not ceased, and will not, calling attention to the problems faced and the need, in their view, to do something. Primary commodities account for over one-half of the total exports of non-oil developing countries. For individual countries, moreover, this dependence is heavily concentrated on a very few -- or even one -- commodity. Of 79 non-oil developing countries, 55 depend for 40 per cent or more of their export earnings on only three commodities. For 25, one commodity alone accounted for 50 per cent or more of total exports. Finally, as is unfortunately the case in many such comparative measurements, the dependence is heavily concentrated in those countries which are the very poorest, and least advanced, of the developing nations. Of 36 countries with per capita incomes lower than \$200, 27 derived from 40 to 100 per cent of all their export revenues from three commodities. And in this city, particularly, I need not dwell on the magnitude and frequency of the up and down swings to which primary commodities are subject -- because of the weather, because of conditions in a particular industry, or because of the cyclical economic swings of the industrial, consuming world. While coping with such swings is one thing in a broad-based modern economy with sophisticated financial and other institutions, it is quite another matter in a poor backward nation. It is a matter of subsistence levels for the population, revenues for governments attempting to provide and develop minimal services and investments, and foreign exchange desperately needed on a reasonably stable basis to import

essential goods and services, for investment as well as consumption, and to service debt. While we can speak with conviction of the advantages of free market mechanisms -- and there are very important advantages which I would not wish to suggest should be lightly discarded -- it should not come as a surprise that this message is difficult indeed to convey to those struggling to cope with situations of this kind.

What do the developing countries really want by way of remedies to this situation? As is often the case, the developing countries do not always speak with one voice on this issue. There are those who seek "redistributive justice" and who speak of fixing prices at "just" or "remunerative" or deliberately high levels and keeping them there, tying them to various indexes of industrial prices, or notions of parity between prices paid and prices received, or of what may be required to transfer increasing levels of benefits to the poorer countries. But there are more moderate, reasoned voices, who seek some relief from the excessive fluctuations of prices which so disrupt their economies and constantly sow the seeds of continued fluctuations in production, demand, and prices. They note the variety of arrangements which exist within the wealthy countries themselves, long-since accepted, considered reasonable, and in the interests of the community as a whole -- producers and consumers -- which have successfully attained this objective, and wonder why similar arrangements cannot be worked out, with advantages for all concerned, on an international scale, without necessarily entailing any transfer of wealth from the rich to the poor.



The ability to anticipate some degree of order and stability in the marketing of their primary production would be a major achievement and assist in the already enormously difficult process of trying to plan and assist in the already enormously difficult process of trying to plan and achieve economic and social progress in the industrial countries.

As for the immediate and direct interests of the United States and other major industrial nations, I would note that of 10 commodities selected in current United Nations discussions as "core commodities," the United States alone takes 17.5 per cent of world imports and, with 5 other industrial countries, takes 58.9 per cent. I would be surprised if the greater degree of market stability sought by the developing countries would not also be of great interest and of direct advantage to the industrial countries, certainly to particular industries and consumers, not to mention the indirect advantages accruing from the participation of our industries in a more stable and orderly developing process in the developing countries. And, paradoxically, because the industrial countries are also major producers and exporters of many non-oil, non-agricultural raw materials, they might also derive direct advantages from any arrangements leading toward more orderly and stable markets.

Beyond the immediate problem of marketing their primary commodities, the developing countries also regard as a prime element in their economic progress -- indeed as a key essential -- capturing some greater share of the value added to their primary products up to the point where they reach the consumer -- by various degrees of intermediate processing, distribution, transportation, etc.. An estimate has been made that

the developing countries in a recent year earned \$30 billion from 12 primary export commodities accounting for 80 per cent of their total commodity exports, excluding oil, for which the consumers paid some \$200 billion. If they could capture only a fifth of this \$170 billion spread, this would mean more than doubling their export earnings from these primary products. Beyond this, of course, the developing countries also look forward to establishing industries to process their raw materials into finished products. And here the issue of the trade policies of the industrial countries comes to the fore. It is not just a question of organization and investment to enable the developing countries to achieve these objectives. It is also a question of the willingness of the advanced countries to relax their trade barriers which while on the whole permit free entry of commodities in raw form, progressively restrict in various ways the entry of commodities which have already been subject to degrees of processing.

The question of trade liberalization could pose some more difficult issues for industry and labor, and, as I believe is well understood and accepted, may entail special adjustment measures. But I would also note that there is now an ample experience to draw upon, demonstrating that as developing countries have been able to expand exports of semi-manufactures or finished products to the industrial countries, they have matched such sales expansion with correspondingly greater purchases in the industrial countries of a whole range of products, and not only those of advanced technology. With its new trade legislation, and its participation in the Tokyo Round of multilateral trade negotiations --



which will give particular attention to the situation of developing countries -- the United States appears to be reasonably firmly embarked upon this road.

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The events of recent years have only too clearly, and indeed, painfully, underscored the interdependent nature of the world we live in. Few events affecting the economy of a country anywhere in the world do not have ramifications affecting -- whether favorably or adversely -- individuals in many other countries. Without noting the oil example, I might recall the chain of events a few years back in which the bad luck of anchovy fishermen off the coast of Peru led to sharply higher prices the American housewife had to pay for meat. The current recession in the industrial countries had an enormous impact on the rest of the world; and the difficulties of the developing countries, in turn, which required them to reduce their imports, affected production and employment and added to the problems of recession and recovery in the industrial countries.

Although foreign trade bulks less important in an economy the size of the U.S. than of some other countries, exports as a share of U.S. GNP have been rising steadily, and in 1974 were 60 per cent greater than 5 years earlier. And the share of U.S. exports which went to non-oil developing countries in 1974 was 31 per cent -- higher than the comparable share of any major country except Japan. I need not mention the myriad of other interests which the U.S. maintains in

developing countries -- not only in the economic sphere, but also in the social and cultural, as well as political and security interests.

The U.S., and similarly, other major industrial countries, thus cannot be disinterested or passive onlookers to the difficult circumstances now being traversed by the non-oil developing countries of the world, and of the extremely uncertain and difficult prospects which lie ahead in the search for social and economic betterment. We will all succeed and be better off to the extent that the developing countries are able, with the cooperation of the economically advanced countries, to find reasonable and acceptable solutions to their problems.

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