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Jodidi Lecture - Harvard - February 24, 1983

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The 1983 Jodidi Lecture, Harvard University, Boston, MA. February 24, 1983

"Third World Debt and Global Recovery"

The 1983 Jodidi Lecture

by

A. W. Clausen, President

The World Bank

and

International Finance Corporation

at

The Center for International Affairs

Harvard University

Boston, Massachusetts

February 24, 1983

Professor Huntington, ladies and gentlemen. It is indeed an honor for me to speak in this distinguished forum. The Jodidi lectureship was established to "promote tolerance, understanding and goodwill among nations, and the peace of the world." Inviting The World Bank's participation this year strengthens us in our determination to promote global cooperation, especially at this time of worldwide economic strain.

The unprecedented prosperity which most of the world has enjoyed since the Second World War has been built on an equally unprecedented integration of the world economy. Nations have worked together to encourage international trade and investment. Now that the momentum of global development has been more decisively broken than at any previous time in the postwar era, nations and institutions are tempted to pull back from cooperation in order to protect their short-term interests. But that is the recipe for disaster. We need now to intensify cooperative efforts among nations and institutions, both public and private, to overcome our common problems.

Few expected the global recession to be as severe or universal as it has been. In 1982, production in the industrial countries and the volume of international trade both declined. The prices of non-fuel commodities are still at their lowest levels since the Second World War, and interest rates have only recently begun to drop from historic highs.

Debt problems among the developing countries, my topic today, comprise one of the most pressing aspects of this global economic malaise.

Falling export sales and high interest rates have resulted in a rash of serious debt payment problems. Just eight countries are responsible for half of all Third World debt, and four of them -- Mexico, Brazil, Argentina, and Chile -- have recently had to defer repayment of principal. Almost as many developing countries have had to reschedule loans in the last two years as in the previous 25 years.

Commercial banks, especially smaller banks, have understandably been sobered by these problems and have pulled back somewhat from international lending. In the third quarter of 1982, commercial banks lent less to the oil-importing developing countries than they received in principal repayments. It is not yet clear whether this sharp decline in lending will establish a trend, but it has already made the liquidity problems of borrowing economies worse and has contributed to their sudden contraction. The resulting drop in the sale of exports to the developing countries is an important reason why the recession in the industrial countries has been prolonged.

The total medium- and long-term debt of the developing countries now stands at \$530 billion, and \$350 billion of it is from private sources. Statistics on short-term debt are not reliable, but short-term debt probably brings the total debt of the developing countries to some \$700 billion. Nervousness about the capacity of borrowing countries to service this debt now gnaws at the fabric of confidence on which, not only banking, but nearly all economic dealings depend.

In the first half of this lecture, allow me to explain why problems of Third World debt, painful as they may be, are manageable, and to focus some of the current concern about debt onto the underlying issue of global economic recovery and the need for expanded, more open trade. The second half of this lecture will outline how banks, developing nations, the industrial nations, and the international economic institutions must cooperate to overcome today's problems of debt and development. There must be an appreciation by each party of its responsibilities, and of how they are complemented by the responsibilities of the others.

* * * *

Let me begin with three reasons for confidence that the problems of Third World debt can be brought under control. First, expanding international investment is a normal aspect of healthy global development. Second, most of the developing countries managed the economic stresses of the 1970s exceptionally well. Third, the international lending system is strong and resilient. There is also, however, one reason for profound concern: problems of debt and stalled development in the Third World can only become more severe until we achieve global economic recovery.

First, the expansion of international lending is normal, healthy, and most necessary.

International capital flows between developed and developing nations have fuelled the engine of economic progress over most of the last two centuries. In the nineteenth century, developing countries normally borrowed internationally by selling bonds. They sometimes lapsed on payments when the terms of trade turned against them, so risk premiums were substantial. There were several waves of repayment difficulties, each followed by lender retrenchment. But international borrowing expanded nevertheless. In the nineteenth century, the United States was a developing country, and it borrowed more than any of the other developing countries of the time.

This system of capital flows was destroyed by an abrupt reduction of credit and massive defaults at the start of the Depression in the 1930s.

The present system of international capital flows to the developing countries took shape after the Second World War. Official intermediaries, like The World Bank, began borrowing on capital markets and lending to creditworthy developing countries. Official lending was supplemented by development assistance, grants and concessional loans from the governments of high-income countries. Development assistance grew steadily in real terms over the last two decades until 1981, when it declined.

Developing countries also have access to several types of commercial credit -- export credit, direct foreign investment by multinational companies, and commercial-bank lending. Commercial-bank lending to developing countries grew especially rapidly in the Seventies.

The expansion in commercial-bank lending actually began before the oil price increase of 1973, but there was a surge of lending in 1974 and 1975 as commercial banks "recycled" OPEC savings to oil-importing developing countries. Commercial-bank lending was relatively stable for several years thereafter, until a new surge of lending began in the very liquid markets of 1978 and 1979.

Between the first few years of the Sixties and the last years of the Seventies, the net flow of capital to developing countries -- official lending, aid, export credit, direct investment, and commercial lending together -- tripled in real terms. This expansion in international investment contributed to, and was supported by, the dynamism of the world economy as a whole. The volume of international trade, for example, also roughly tripled in the same period.

All types of capital flows increased, but the various forms of commercial investment increased fastest -- from a third of total capital flows in the early Sixties to half in the late Seventies. Commercial lending (not including export credits) increased by eleven times in real terms, swelling from one-fourteenth to one-fourth of the total flow of capital to developing countries.

For purposes of analysis, The World Bank often divides the developing countries into low-income and middle-income categories. By "low-income" we mean countries -- like Chad and Bangladesh -- with incomes below \$410 per person per year. By "middle-income" we mean developing countries -- like Malaysia, Ivory Coast, and Mexico -- that are above that threshold.

Very little commercial lending has been attracted to the low-income developing countries. Even though individual investments in low-income countries may yield high returns, the poverty and narrow economic base of the low-income countries make it risky for them to rely much on commercial borrowing. Also, most low-income countries still need to make basic public investments -- in infrastructure, for example, or education -- before commercial investments in sectors like industry can routinely yield returns high enough to attract much private capital from abroad. Thus, low-income developing countries depend mainly on concessional assistance for the foreign capital they need.

In contrast, some of the middle-income developing countries have provided fertile ground for commercial lending. Many of the middle-income economies are dynamic and diversified. The expansion of lending to some of the middle-income countries -- and the resulting debt -- is due, then, not to their weakness, but to their vitality and growing maturity.

The historical experience of international investment, its expansion as part of the global economic dynamism of the last two decades, and its concentration among the middle-income countries all confirm that expanding capital flows are a normal and essential aspect of global economic vitality.

* *

My second point is that the success of the developing countries, especially the middle-income countries, in coping with the stresses of the Seventies is strong evidence that their present payment problems are liquidity, not solvency problems.

Liquidity refers to the capacity to meet obligations in the short-term. If the price of a staple export falls, or the price of a major import rises, a country may have trouble meeting its obligations on time. The country can, in due course, expand other exports or cut back on imports, but such adjustment takes time. Liquidity problems can arise even for countries with no underlying solvency problems.

Solvency refers to the capacity to carry a certain level of debt over the long-term. A country's ability to pay back debt depends on growth in its national income and long-run ability to export, so a growing economy can safely carry a growing debt.

Sustaining economic growth became more difficult in the 1970s. In the industrial countries, economic growth has slowed from 5 percent a year in the Sixties, to 3 percent in the Seventies, to less than 1 percent a year so far in the Eighties. The developing countries, by contrast, managed to achieve average growth rates between 5 and 6 percent a year throughout the Sixties and Seventies. The only group of developing countries which suffered a major slump in the Seventies was the smaller low-income countries, mostly in Sub-Saharan Africa.

One reason for the continued rapid growth of the developing countries was investment. In the industrial countries, the rate of investment growth collapsed from 6 percent in the Sixties to 1.5 percent in the Seventies, but the middle-income developing countries managed to accelerate the rate of their investment growth to 8 percent a year in the Seventies. And nine-tenths of the investment of these countries was financed from domestic saving.

The developing countries also increased their exports rapidly in the Seventies. The oil-importing developing countries expanded their exports by 9 percent a year, with manufactured exports growing most rapidly. The payments of the oil-importing developing countries on medium- and long-term debt climbed from 15 percent of their export income in 1974 to only 18 percent in 1980. The ratio between their level of debt outstanding and their export income rose from 1.0 in 1974 to only 1.1 in 1980.

Finally, during the Seventies the developing countries also demonstrated their ability and political will to adjust to adverse circumstances, if necessary by cutting imports and thus slowing down their rate of economic growth. The current account deficit (relative to national income) of the oil-importing developing countries jumped in 1974 and 1975 to roughly twice what it had been before the 1973 oil price increase. But these countries managed to bring their current account deficit down to its previous range again by 1976, and to keep it there until the second oil price increases of 1979 and '80.

It is not difficult to find examples of imprudent borrowing and lending during the Seventies. Also, many countries borrowed on the basis of expectations about future growth which, in retrospect, have turned out to be too optimistic. But the overall dynamism of all but some of the poorest developing countries in the Seventies suggests that, by and large, the credit they received was productively used.

The countries with payment problems today fall into two very different groups. One group consists of normally dynamic middle-income countries that were able to borrow heavily from commercial sources. Some of these countries now have acute liquidity problems, because of high interest rates and low export revenues, but their flexible economies and proven resilience bode well for recovery and future growth.

At the other end of the scale, eight of the 15 developing countries that rescheduled debt in 1981 and 1982 were low-income African countries. Seven of the eight had significant commercial debt, and, in fact, only two low-income African countries with significant commercial debt were able to avoid rescheduling. Many of the smaller low-income countries are dependent on one or two commodity exports, and when commodity prices fall, as they have in the last few years, these countries have difficulty shifting into other lines of economic activity.

A few low-income countries may indeed face long-term debt repayment problems. But the commercial debt of the low-income African countries amounts to only two percent of the total commercial debt of all the developing countries. And so, the overwhelming bulk of today's global debt problem amounts to a severe liquidity crunch.

* *

A third reason for thinking that Third World debt problems are manageable is the strength of the present international financial system.

The special risks of sovereign lending are that it is not covered by bankruptcy laws, and that creditors cannot repossess the assets of a sovereign nation. On the other hand, nations cannot disappear, as companies can, by legal fiat. Nations continue to exist, and they need credit to finance trade and buffer current account fluctuations as long as they are part of the global economy. Thus, although many countries are now unable to make payments on time, not one has repudiated its debt. By contrast, about 53,000 U.S. businesses went bankrupt in 1982, and a great proportion of their debt obligations disappeared with them. The developing countries that have the biggest debts outstanding are deeply involved in international trade and technology, so for them the cost of being cut off from the world economy -- which is the price of debt repudiation -- would be enormous.

One quarter of everything produced in the world is now traded across national borders, and this unprecedented integration of the global economy gives all parties to debt problems powerful incentives to find cooperative solutions. In the postwar period, international default has been almost completely avoided through rescheduling, usually supported by International Monetary Fund stabilization programs. Banks have had to postpone earnings, but have not lost assets. Borrowing countries have sometimes suffered sharp contractions in demand, but they have been able to maintain access to credit. In addition, stabilization policy reforms -- which often include measures to increase savings, the efficiency of investment, and exports -- tend to foster growth in the long-run. This cooperative approach to debt problems has made international lending more stable than it was in the nineteenth and early twentieth centuries.

The system is robust. Banks are in the business of taking carefully evaluated risks, and they themselves are equipped to absorb heavy shocks. Commercial banks are backed up by central banks, and coordination among central banks has improved. Although the rescheduling of commercial debt is still informal, the rescheduling of the official and officially-guaranteed debt is now coordinated by meetings of the major industrial countries under the auspices of the Paris Club. Since reschedulings are normally undertaken in conjunction with IMF assistance, and since official lending adds an element of stability to the debt structure of the developing countries, the growth of the IMF and World Bank over the last generation has also contributed to the capacity of the lending system to absorb shocks.

The present system of international lending is not perfect, however. For one thing, international lending is too concentrated among a few score big "money center" banks. Lending to developing countries accounts for only 5 percent of the total lending of all banks in the industrial countries, but it accounts for about twice as much of the lending of major banks. Since "money center" banks typically lend 25 to 30 times the value of their equity, loans outstanding to developing countries are equivalent to almost three times the total equity of these banks. In some cases, claims on individual countries exceed half of the total capital of individual banks.

Smaller banks have been less active in international lending, mainly because gathering economic information about a country is expensive relative to what they would earn. To the extent that small banks do get involved, they tend to do so in syndicates formed by the big banks. And when the big banks lend, small banks lend too -- sometimes too much; and when the big banks hesitate, the smaller ones retreat.

In addition to the concentration of lending among the big banks and the information problems of small banks, the lending system is also limited to very low-risk countries. Banks do vary the spreads and fees they charge to different countries, but banks are hesitant, beyond a fairly narrow margin, to charge high risk-premiums to borrowing countries. Such loans might weaken a bank's own credit standing. Other types of investors would be more willing to take higher risks for a price, but the developing countries have not gone that way; rather, they have relied heavily on bank lending.

These various factors help to explain why solvent nations are having trouble borrowing to get through the current liquidity crunch. They represent areas for improvement in the international lending system, but, in my view, they do not seriously detract from its overall strength and resilience.

The three main points I have made so far all argue for confidence, and we need confidence as the basis for responsible action. But we also need to be concerned. The problems of Third World debt are still manageable, but they will continue -- and could become more dangerous -- if exports of the developing countries cannot grow. That growth is essential in order to make debt service burdens more tolerable and to permit resumed increases in imports -- increases that are needed if the developing nations are to return to satisfactory rates of economic growth.

The global recession has contributed greatly to current difficulties. Between 1980 and 1982, falling export income and rising debt service have together had a negative impact of about \$70 billion on the balance-of-payments of the developing countries. For the oil-importing developing countries, the ratio between the payments on medium- and long-term debt and export income jumped from 18 percent in 1980 to 24 percent in 1982. The ratio between debt outstanding and exports jumped too -- from 1.1 to 1.3.

The top 20 borrowers are responsible for three-fourths of all Third World debt, and for them the ratio between payments on medium- and long-term debt and export income has climbed from 26 percent in 1980 to 34 percent in 1982. The four big borrowers that have had to delay payment of principal all faced payments on medium- and long-term debt that exceeded 50 percent of their export income in 1982.

These high debt-service ratios had their origins primarily in the recession. The export sales of the developing countries were virtually stagnant in 1982. The terms of trade, and export prices, have deteriorated for most developing countries, making the real burden of their debt even greater. The low-income countries have been particularly affected by the fall in commodity prices. These nations suffered a 30 percent drop in their terms of trade between 1979 and 1982.

About half the increase in Third World debt-service payments since 1980 has been due to higher interest rates. Real rates of interest averaged two percent in the Sixties, were negative in the mid-Seventies, but then jumped to five percent by 1981. Although nominal interest rates have declined now, real rates are still high by historical standards, especially for countries whose exports are not rising. The main cause of high interest rates has been the combination of anti-inflationary monetary policies and burgeoning budget deficits in the industrial countries.

A one-point increase in interest rates costs Mexico, Brazil, and Argentina \$1.2 billion a year. The burden of high interest rates has been especially onerous for the middle-income developing countries. They have depended more on commercial borrowing, much of which has been at variable interest rates. Higher interest rates and shorter terms on commercial debt result in payments that are more than double what they are on the same amount of official debt. Since no rapid increase in official lending or development assistance is on the horizon, the developing countries can be expected to continue relying heavily on commercial financing, especially as their export earnings and domestic economies resume more satisfactory growth rates.

Some countries have responded to adverse export prices and interest rates by rapidly accumulating short-term debt. Individual banks sometimes preferred short-term lending, because they felt it lowered their risk. But, in fact, the rapid expansion of short-term debt made their borrowers more vulnerable to shifting conditions.

Volatile oil prices have also complicated liquidity problems. In 1979 and '80, oil-importing countries had to cope with a sharp price increase. And now oil-exporting developing countries are caught off-guard by the unexpected fall in revenues from oil.

Developing countries have drawn down their reserves and have cut back on imports. The current account deficits of the oil-importing developing countries dropped from \$80 billion in 1981 to \$68 billion in 1982. Adjusted for inflation, the developing countries are almost back to their current account deficit of 1979. The middle-income countries have reduced their imports dramatically, so that many of them are now severely and suddenly depressed. Average per capita income for the developing countries declined in 1981 and, more sharply, in 1982.

If developing countries' foreign exchange earnings do not start growing rapidly, then the debt-servicing burden of these countries will grow even heavier, and their living standards will fall further. If the historical relationship between imports and income would hold, no growth in both lending and exports in 1983 would cause the average real income of people in the middle-income countries to fall by nearly one-tenth in 1983. More likely, many countries would cushion the effect on incomes, mainly by imposing controls on imports that would make their economies less efficient and discourage long-run growth.

Economic retrogression in developing nations means economic hardship, rising levels of malnutrition and of child mortality, as well as higher unemployment. Economic retrogression strains the capacity of institutions to cope, it aggravates social conflict, and it tends to undermine political stability.

Depression in the normally dynamic middle-income countries also makes the global recession worse. The developing countries together account for one-fifth of global production, about the same share as the United States, so their crash from rapid growth to a sudden stop affects the whole world economy. When factories close in Brazil, for example, Brazil cuts its orders for machinery from the United States and puts people out of work here, too. When Brazil reduces its imports in order to service debts, then this too hurts export sales from industrialized countries. The United States, for example, sells two-fifths of its exports to developing countries.

So some of the current concern about Third World debt must be channelled into action to secure the rapid expansion of exports from developing countries. That will avoid further declines in their living standards and permit a healthy expansion of their economies. And that, in turn, would provide a framework in which debt burdens would return to lower levels, so enabling development to be financed once more by further borrowing from commercial sources on a sound basis.

Many developing nations have taken the necessary and often painful measures to encourage the growth of their export earnings. These measures have been thwarted by the worldwide recession, and also by protectionist measures in the developed countries. The industrial countries must necessarily take the lead in achieving global recovery. These countries account for two-thirds of global production. After all, the developing countries can do little until their liquidity problems ease. Moreover, the stagnation of the global economy is rooted primarily in the industrial countries, due to their gradual economic slow-down since the Sixties and to their current set of macroeconomic policies.

Several of the major industrial nations are now beginning to show signs of recovery, and it is likely that some will pursue somewhat more expansionary demand policies. The upturn is tremendously important to global recovery. But to revive sustained, non-inflationary growth requires structural changes. Marginal variations in the money supply, or in aggregate government spending and taxation, without complementary structural changes, might well lead to a renewal of inflationary pressures, of rising interest rates, and to an early halt to further expansion of real output.

There is a real risk of stop-and-go growth in the decade of the Eighties. People and governments will be wary of any hint that inflation is climbing once again.

One type of structural change needed in both developing and developed nations is further adjustment to post-1973 energy prices. Another course that needs to be pursued by both rich and poor nations, which would accelerate their economic development, is to slow the growth of military spending. Such spending accelerated in 1982, while productive investment in, for example, the industrialized nations, declined by four percent -- a decline caused in part by the effect of government budget deficits on interest rates.

To be sure all countries today are cutting back on account of the recession, and they find this an especially awkward time to make investments and policy changes to improve their economic dynamism. But this is precisely what must be done. For peoples and governments to support structural changes during a recession, economic development must be treated in the industrial countries as a higher political and cultural priority than it has been in recent years.

Probably the most necessary structural change in the developed countries concerns their adjustment to international competition. The benefits of liberalized trade were one of the major reasons why the post-World War Two era witnessed such unprecedented growth. The current recession has intensified protectionist pressures. These pressures have in turn increased rigidities in protectionist nations, so contributing to the inflationary cycle. A reversal in the protectionist trend is crucial for the future growth prospects of the industrial countries.

Adjustment to international competition is often painful. But the benefits of unhindered trade are so great that nations can afford to provide generous assistance to citizens who are hurt by competition. No nation can afford to go it alone in the Eighties.

Open access to the markets of the industrial nations is essential for the resumption of export growth by the developing nations. The prospects for the developing countries will be favorable if growth resumes among the industrial countries and, at the same time, protectionist pressures are thwarted. But continued protectionism can only undermine the benefits that recovery could bring.

The clearest lesson that emerges from the development of the Third World nations is that openness to foreign trade encourages efficiency, adaptability, and growth. The most dynamic middle-income developing nations have generally succeeded by exploiting opportunities of international commerce. And even among low-income countries in Africa, there is hard evidence that more trade- and market-oriented economies achieve more output per unit of investment. Should trade barriers to products from developing countries rise, then prospects for satisfactory growth will be grim, even with worldwide recovery. Foreign trade opportunities are the only way debt-laden developing countries can earn their way out of their predicament and expand their economies again.

Given the benefits to all of a liberalized trading system and the immense dangers of rising protectionism, it is now more important than ever that nations respect, use and fortify the General Agreement on Tariffs and Trade (GATT).

* * * *

Let me now turn to the complementary roles of governments, banks, and the international financial institutions. The global economy is served by an integrated system of capital flows, and overcoming our common problems of debt and stalled development will require disciplined cooperation.

The industrial nations have a critical role and I have spoken earlier of their need to make structural changes, in order to ensure non-inflationary, sustained recovery and to reverse the dangerous trends of protectionism. They must also ensure strong support for the international financial institutions, and I shall talk of the roles of these institutions in a moment. In addition, the governments of the industrial nations must avoid imposing new regulations that would discourage international lending by the commercial banks. Such action could do immense harm. Wisely, the world's central banks have avoided such a course.

And the commercial banks dare not over-react to the liquidity problems of some of their foreign borrowers. Sustained commercial-bank lending is vital.

Banks have been building broad commercial relationships with developing countries -- including local branches, advisory services, and trade operations, as well as lending. And since the developing countries are bound to increase their demand for banking services as their economies grow, it is in the banks' self-interest to maintain these relationships through this period of strain.

It makes no more sense for bankers to cut back on lending to Thailand or India because of problems in Mexico, than to cut back on lending to all corporations because some corporations are in trouble. Debts are country-specific. Some countries have been hesitant to borrow, and several of these countries could, by any measure, prudently borrow more.

The safest, most sensible way for banks to deal with payment problems is to restructure the debt, and to gauge their continued exposure in particular countries on the basis of those countries' efforts to cope with worldwide economic problems. In making these judgments, commercial banks can take advantage of information and analysis which the Bretton Woods institutions provide.

The immediate burden of avoiding debt crisis is being borne on the shoulders of the borrowing countries themselves.

They are well aware that capital markets did not fully recover from the wave of default in the Thirties until the Seventies (some 40 years later) and that efforts made to meet their commitments now will determine their access to credit in the future. They also know that the global economy is likely to remain sluggish for some time, so that domestic efforts to mobilize and allocate resources more efficiently are now more important than ever.

Many developing nations have taken impressive steps to adjust. Last month, for example, Indonesia raised the price of domestic petroleum by 60 percent to encourage more efficient energy use. Despite balance-of-payments pressures, Thailand and the Philippines have lowered trade barriers to increase the efficiency of their economies. Brazil has launched a program to cut its federal-government deficit in half this year, and to reduce its balance-of-payments deficit through accelerated devaluations.

Sometimes, developing countries have waited too long to rectify budget and balance-of-payments deficits. If a country delays adjustment until creditors have begun to lose confidence, the reforms necessary for stabilization must be more drastic. So countries should take action early, before a liquidity crisis is upon them, and take advantage of financial assistance and advice from the IMF and The World Bank.

Over the long-term, stabilization by itself is not enough. The capacity of countries to carry debt burdens depends on the resumption of growth in their production and exports. So the bridges that borrowing countries are building over their cash problems could stop in mid-air, if they do not also succeed in getting development underway. Prolonged stagnation in export earnings would further strain political stability and the confidence of creditors, and might eventually turn liquidity problems into solvency problems, even for a few of the larger borrowers. If satisfactory growth in export earnings does take place, then commercial banks will again become increasingly important sources of development finance.

* *

Clearly the Bretton Woods institutions -- the International Monetary Fund and The World Bank -- also have significant roles to play in both the present short-term difficulties and in the longer-term resumption of growth.

Our sister institution, the IMF, was designed to deal with international adjustment problems, and the Fund has been on the front line in assisting countries to cope with the crises of the last few months. The Bank for International Settlements and the major powers have acted quickly to provide emergency assistance to major borrowers in severe liquidity difficulties. The Fund has helped countries frame programs of policy reform to win back the confidence of creditors, and it extended an additional \$6 billion in net transfers in 1982. Increasing the Fund's resources is urgent and vital, so it was gratifying that the recent meeting of the IMF Interim Committee of ministers got that process underway.

The World Bank complements the IMF. While the Fund emphasizes short- to medium-term adjustment, the Bank was designed to focus on longer-term economic development. Since the Third World debt problem will not finally be resolved without a recovery of Third World development, the Bank's support for development -- although its effects are not as immediate -- is just as urgent and vital to the solution of the problem as is the Fund's support for adjustment.

Perhaps the most important contribution which The World Bank makes to development is through its policy dialogue with member countries. The projects the Bank finances are all designed, not only to yield direct returns, but also to assist in the evolution of more effective policies and institutions within the borrowing country. In addition, The World Bank maintains a dialogue with developing countries on their overall economic management.

Over the last few years, in response to the difficult situation of our borrowing member countries, the Bank has substantially increased its program of economic analysis and strengthened its policy dialogue. Many of the middle-income countries now obtain much less financing from The World Bank than they receive from commercial lenders, but The World Bank is uniquely equipped to review and discuss issues of development policy.

Just this week, on Tuesday, the Bank has decided to embark on a special action program -- to accelerate disbursements and to further strengthen its economic policy dialogue. We hope to collaborate on this action program with the regional multilateral development banks and with bilateral aid agencies. Together, we can give developing countries a meaningful boost in their efforts to cope with liquidity problems and stalled development.

One way we can accelerate disbursements is by providing a higher proportion of the financing for both new and ongoing projects. This should encourage countries to finish up half-completed projects and go ahead with high-priority investments, despite shortfalls in domestic investment funds during this period of contraction.

The other aspect of the action program, increased attention to policy reform, is even more important. We will continue to devote more effort to economic analysis, and we will accelerate disbursements only to those countries which indeed take needed policy action to overcome their economic difficulties.

As part of the special action program, the Bank intends to make more "structural adjustment loans" in support of programs of policy reform. The World Bank's structural adjustment loans are planned in close collaboration with the Fund, but the Bank's emphasis is on actions that will get development going again despite balance-of-payment problems.

The present strains on international lending are bringing the Bretton Woods institutions and commercial banks together in new and fruitful ways. For example, the Fund recently worked out a stand-by program to help Yugoslavia avoid rescheduling its debt. Other governments, export credit agencies, the Bank for International Settlements, and commercial banks have all agreed to complement Fund assistance, and The World Bank is cooperating, too, with plans for a structural adjustment loan.

This brings me to another way in which The World Bank is adapting to present needs: the Bank's expanding role as a catalyst for commercial investment.

Last month The World Bank introduced new techniques that will allow it to associate more closely with commercial banks in co-financing. We are also developing the investment program of the International Finance Corporation, the affiliate of The World Bank that deals exclusively with commercial investments.

These efforts are designed to attract more commercial funds to developing countries, and to promote project lending and somewhat longer-term lending by commercial investors. We have no intention of "bailing out" commercial banks. Instead, we want to encourage them to get involved more deeply in the important and profitable business of lending to developing countries.

Finally, The World Bank can help by sharing knowledge about the developing countries.

The Bretton Woods institutions can do more to help countries evaluate foreign borrowing in relation to their economic policies and prospects. By then making such information on debt and development more readily available, we can help stabilize international capital markets and encourage commercial lending, especially by smaller banks.

The Bank chairs consultative groups for 21 developing countries. These consultative groups help bilateral and multilateral development agencies coordinate their activities in the context of a broad understanding of the developing country's economic problems and policies. At the invitation of the developing country, consultative group meetings are sometimes followed, either formally or informally, by discussions with commercial lenders. Without violating confidentiality or acting against the interests of our borrowing member countries, the Bretton Woods institutions should do more along these lines.

Strengthening our policy dialogue, speeding up disbursements, encouraging commercial investment, and upgrading the world's knowledge about the developing countries -- these are ways in which The World Bank is adapting to better complement the efforts of borrowing member countries and the commercial banks, and thus to help restore stability and growth in the global economy.

Finally, before closing, allow me to mention the International Development Association (IDA), the World Bank affiliate that provides assistance to the poorest of the poor countries. I mentioned the severe problems of the low-income countries earlier, but the debate about debt has generally drawn attention away from the potentially explosive effects of the recession in the world's poorest countries. They need development aid, especially now. But aid budgets face fierce competition for public funds during the current recession.

IDA has suffered severe funding problems, almost entirely due to shortfalls in contributions from the United States. The other donor nations have, despite their own budget problems, contributed more than they originally agreed to help compensate for U.S. shortfalls. If we are to be effective in helping the world's poorest nations cope with global contraction, it is essential that Congress appropriate the commitments to IDA that the U.S. administration recommends.

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Let me summarize. Today's Third World debt problems are manageable, but they add to the urgency of global economic recovery. It is in the interests of both banks and borrowing countries to act responsibly and to maintain their relationship of confidence. Meanwhile, the industrial nations must take the lead in achieving a prompt economic recovery and structural changes -- notably an expansion of international commerce -- that will sustain rapid non-inflationary growth. Finally, the Bretton Woods institutions are adapting to the needs of the moment -- to help both with immediate liquidity problems and with the equally urgent tasks of development.

The current malfunction of the world economy begs for a fresh impulse of international economic cooperation. The principle of the Marshall Plan -- which George Marshall announced here at Harvard in 1947 -- is precisely appropriate now. The rising standards of living that people around the world have enjoyed since then have been fostered by global economic integration, and a failure of cooperation now would just as surely provoke falling standards of living around the world.

But if we all pull together through this tough time, the global commonwealth will emerge more unified -- like a family that has been through suffering together. National economies will be more flexible, and what we learn from today's problems will make the world's future prosperity more secure.

The human family may even emerge from straitened circumstances with a clearer vision of what is important in life, and of how best to use economic development to achieve more fundamental human purposes.

END