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Remarks

By

A. W. Clausen, President

The World Bank

and

International Finance Corporation

to the

National Italian American Foundation

A. P. Giannini Commemorative Conference

Washington, D.C.

November 11, 1983

Thank you, Fred.

Good afternoon, Ladies and Gentlemen.

I am particularly pleased to be a participant in this conference today because of my long association with the financial institution founded by the truly visionary giant which this Commemorative Program honors.

The genius of Amadeo Peter Giannini was that he saw that to help develop the potential of poorer people was a means to improving the lot of society as a whole. He realized in his earliest days that the savings of city dwellers could meet the seasonal needs of the rural dwellers, assuring them the purchasing power which would stimulate the local economy as a whole. His was a bank for the "little people" -- intermediating financial resources and services from surplus areas so that deficit areas could be helped to grow and prosper -- and to ensure that these services would be readily available to all peoples, poor and rich alike.

Translated into global terms, that is precisely how we should be viewing economic relations in the interdependent world of today. It is really a very simple concept: helping others to help themselves helps everyone. Helping the developing countries to expand their economies is a plus for the entire global economy. Every country benefits -- developed and developing -- and standards of living of all peoples increase in the process.

What we in The World Bank are therefore trying to do is to assist our developing member countries to push ahead with their economic and social development. It is a long, uphill struggle. And for the developing world as a whole, the struggle through the years of global recession and its aftermath makes King Sisyphus's problem with his rock look small indeed.

I need scarcely remind this audience what the recession's impact has been on individual developing countries. In varying degrees most of them have suffered deteriorating per capita income growth, stagnating government revenues, and serious balance-of-payments and debt-servicing difficulties. And they have had to cope with these difficulties in a hostile world economic environment of stagnant markets, low commodity prices, increased protectionism and high interest rates. Little wonder so many of them have had to slash their investment plans, thus jeopardizing future levels of productivity and growth. Once more they have seen the rock roll back down the hill.

Anyone who says: "well, let it roll on down to the bottom and stay there" is blind to the fact that it will drag all of us down with it. The international debt problem is one feature of the current global economic disorder that ought to drive that fact home. You have asked me to put this problem in perspective and to suggest what roles the multilateral financial institutions and the commercial banks should be playing in containing the problem. And I'm happy to do so.

Let us look first, and briefly, at the dimensions of the problem.

The medium- and long-term debt of the developing countries as a group accumulated rapidly through most of the Seventies. Private lending in particular rose at an average rate of 14 percent per annum between 1970 and 1980. And despite a decline in the rate of growth of such lending in 1981 and 1982, the share of medium- and long-term debt owed to the private lenders by the developing countries had reached an estimated two-thirds of the total debt outstanding at the end of 1982. That total now amounts to an estimated $530 billion.

The years of global disinflation -- a deliberate policy of the major financial powers and of many other countries -- coupled with very high real interest rates, have created special difficulties for two distinct categories of countries.

High real interest rates have struck particularly hard at countries like Argentina, Mexico and Brazil which are the biggest developing country net debtors to the international banking system. Most of their commercial bank loans carry floating rates of interest. And a change of a single percentage point in short-term dollar interest rates has an annualized impact of more than $1.2 billion on the cost of their combined net debt service.

At the other end of the scale, a number of the poorer countries, who are heavily if not wholly dependent on commodity exports for their foreign exchange earnings, have had to reschedule parts of their external debt following steep reductions in world raw material prices. Of the eleven countries who negotiated public debt reschedulings through the Paris Club in the four years 1979 to 1982, ten were in Sub-Saharan Africa. The number of debt renegotiations by developing countries -- both middle-income and low-income -- is an indication of the extent of the problem: so far this calendar year, for example, there have been 30 private and public debt reschedulings involving 24 countries.

These renegotiations can be expected to result in a slight but welcome reduction in the debt-service ratios -- that is to say, the ratio of debt service to receipts from exports of goods and services. The ratio for medium and long-term debt for all developing countries rose from 14 percent in 1980 to 21 percent in 1982. For the top 20 borrowers, those responsible for three quarters of all Third World debt, this same ratio climbed from 26 percent in 1980 to 34 percent in 1982. Several Latin American economies -- Argentina, Brazil, Chile, Mexico and Peru -- had debt service ratios in 1982 of more than 60 percent. It is true that the steep fall in U.S. interest rates during the second half of 1982, and a parallel decline in other key interest rates, has eased the cost of debt for major net borrowers. But the rates still remain at historic highs in real terms.

There is no doubt that the developing countries' management of their external debt has been seriously complicated by the 1980-82 recession with its very high real interest rates, the stagnation in world trade, and the sharp reductions in commodity prices. But, while citing these adverse external elements as the principal cause of the problem, we have to face the fact that there was imprudence on the part of some lenders. Equally, we must lay inappropriate borrowing policies and poor macroeconomic management at the door of some of the borrowers.

And so the question is: are we going about containing and solving the problem in the right way? First and foremost, we have to recognize that the developing countries' debt problems are not going to be solved in the short-term; they are going to be with us for a very long time. Secondly, the debt problem is, I submit, a developmental problem rather than a purely financial problem.

Let me explain.

While treating the debt problem as long-term, there are obviously urgent measures required to cope with the immediate difficulties faced by the indebted nations. Large interest payments are looming up in the short-term before economic recovery in the industrial world will have had time to translate into any real expansion of export income for the developing countries. And such income is essential to the debt servicing equation. These interest payments are also falling due at a time when the growth of new lending is falling off.

The problems of some major borrowers have shaken confidence in international commercial lending, and slowed its rate of growth significantly. Clearly, some slowdown was to be expected. But the reduction in the rate of increase in 1982 was dramatic. The Bank for International Settlements has just reported that new lending to non-OPEC developing countries accelerated from \$1.6 billion in the first quarter of 1983 to \$4.2 billion in the second quarter. At least the trend is to be welcomed. But the equivalent second quarter figure for 1982 was \$13 billion!

The International Monetary Fund, the Bank for International Settlements, and certain industrial-country governments have been taking, and are continuing to take, action to restore creditor confidence in the heavily indebted nations. Such action ought to help the major commercial banks decide to sustain their lending, not curb it. Debt restructuring, involving the packaging of funds from these institutions, some governments and the commercial banks, is surely a cause for restored confidence. But if, for lack of adequate funds, the IMF cannot continue to function as the world's front-line defense against a total collapse of confidence, those who fail to give timely support to the Fund will have only themselves to blame for the ensuing chaos. The passage of the IMF quota increase legislation through the United States Congress is therefore absolutely indispensable.

But whatever action the international financial institutions together with industrial governments may take to help meet the immediate difficulties, the action cannot be effective without the continuing and increasing participation of the commercial banks. It is imperative that the banking system as a whole continue prudently to provide new finance.

Those are the immediate concerns about debt which daily catch the headlines. But we need at the same time to take a longer view. The pace and quality of development can be greatly enhanced through the appropriate infusion of borrowed capital. The United States found that out when it was itself a developing country. We sometimes forget how heavily dependent our country was on capital flows from Europe in the nineteenth century. And a very little remembered fact is that the United States was actually a non-creditworthy developing country for a period of years just prior to the mid-nineteenth century.

Today, the question is: how can conditions be created in which debt-servicing for the developing countries is a norm, not a nightmare? The answer surely is: through a restoration of sustained growth in their economies. And that is why I call the debt problem a developmental problem.

And how is that growth to be restored?

Certainly, in an increasingly interdependent world, external factors have a highly important influence on the growth process. Sustained recovery in the industrial world; the maintenance of a liberalized global trading system; the assurance of a steady flow of external capital; all of these are crucial factors. But there can be no doubt that a country's developmental performance depends in the first instance on the appropriateness of its economic and social policies.

As I noted earlier in my remarks, the impact of the three-year recession has been harsh on the developing countries. The adjustment process now necessary to help bring these economies back on track will be neither easy nor painless. Production processes may have to be restructured, labor and capital may have to move, and consumption patterns may have to change. And the restoration and maintenance of growth will require the generation of savings, the efficient investment and management of new capital, the vigorous promotion of exports, and restraint on imports. Outward-oriented trade policies have historically promoted growth, and those countries that were able to maintain such policies through the recession have emerged from it in much better shape than those who could not.

Adjustment and sound economic management are crucial to the restoration of growth. And it is encouraging that the developing countries are increasingly showing themselves willing to make those adjustments and to improve their economic management. But they need the international community's help in doing so. Growth; lower interest rates; maintenance of an open trading regime and an early rollback of the protectionist measures that have crept into the system in recent years; increased prices; lower inflation -- all of these -- will help! But these favorable global economic conditions alone will not be sufficient to cure the debt-servicing problems of the Third World. In addition, we must have an adequate flow of capital to the developing countries to help them make the adjustments they and we so urgently need.

And at this point, let me turn to the multilateral financial institutions, the International Monetary Fund and The World Bank. These institutions have important contributions to make in support of the developing countries' efforts to adjust. With the slowdown in new lending from commercial banks -- with the low levels of official bilateral development assistance substantially unchanged since 1980 -- the contributions of the Fund and the Bank and other developmental institutions have become absolutely essential for the long-term recovery of global economic growth and social stability.

The IMF has been tremendously effective in keeping international debt problems under control. The Fund has helped countries stabilize precarious financial positions caused by balance-of-payments problems, and has also been successful in getting commercial banks to come up with additional loans (in some cases), as well as to refinance existing payments. President Reagan has spoken out forcefully in favor of the IMF quota increase, but the legislation needed for the essential participation of the United States is still stalled in Congress.

In referring to the sister Bretton Woods institution, people tend to think of the institutions comprising The World Bank Group in financial terms: $14 1/2 billion of lending last year; $10 billion of borrowings; $750 million of profit; 38 percent increase in private sector investments by our affiliate, the International Finance Corporation; and so forth.

The financial prowess of the Bank is not insignificant. But our particular contribution to creating a better and more stable global economic environment lies in our ability to help developing countries put into place policies that are more conducive to economic growth, and which ensure a more efficient allocation of resources. Policies, therefore, which will raise living standards for hundreds of millions of people in the developing countries. We are essentially an economic development institution; an institution engaged in a continuing economic policy dialogue with our borrowing member countries...dialogues designed to help these countries expand their foreign exchange earnings capabilities.

But if we are going to make an effective contribution to improving public policy and private confidence in our borrowing countries, our money should accompany our advice. Programs of adjustment can be costly. The IBRD's near-market rate loans and terms of up to 20 years can help meet the costs of adjustment in our middle-income member countries.

The poorer member countries of The World Bank -- 51 of them -- who cannot afford the IBRD's terms must rely instead on the International Development Association (IDA). IDA extends 50-year credits with ten-year grace periods. The only charge is a three-quarters of one percent service fee on the outstanding balances.

We have been working hard to complete the Seventh Replenishment of grant funds from the 33 countries who are donors to IDA. We sorely need the United States, the largest donor, to increase its indicated level of support for the replenishment. It makes sound sense not to let programs of development assistance to desperately poor countries weaken. The economic, political and strategic consequences of chronic decline in the poorest countries will be grave for all countries, developed and developing alike.

The role of the multilateral financial institutions in supporting the development effort is indeed a critical one. But they cannot go it alone. The developing world is also looking urgently for more commercial investment from the industrial world. So The World Bank has moved to strengthen it's role as catalyst by introducing innovative new co-financing instruments in January of this year.

Here is an area where together we can forge a much stronger partnership between The World Bank and the commercial banks. We have recently initiated, on a trial basis, what we call our new "B" loan commercial bank co-financing program. The program has two principal objectives: first, to make additional funds available to countries for high priority investments, and provide access to funds not otherwise available; and second, to encourage a lengthening of maturities and grace periods offered by commercial lenders, and so ensure a better match between the amortization of the loan, the project, and the borrowers capacity to repay. We believe these new techniques will prove highly attractive to both borrower and co-lender.

Innovative and constructive partnerships of this nature can contribute significantly to the international community's efforts to help the developing countries to help themselves and thereby promote a healthy global economy. The United States has a crucial interest in the creation and maintenance of such an economy. No great trading nation can flourish in a world economy that is ailing. And one-fifth of U.S. jobs depends on trade. Two-fifths of U.S. farm production is sold abroad. One-third of corporate profits come from international business. Even more significant: forty percent of all U.S. exports go to the Third World. That's a bigger market than all of Western Europe and Eastern Europe combined. Our country's stake in a healthy world economy is absolutely essential for our own well-being.

So let us work together to promote it. As I said at the beginning of these remarks: "helping others to help themselves helps everyone." And I venture to conclude that Mr. A. P. Giannini, in whose name this commemorative program is offered, would most certainly agree.

Thank you.