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Folder Title: Society for International Development, Rome, Italy. July 3, 1985

Folder ID: 1776089

Series: Speeches

Dates: 07/01/1985 - 07/31/1985

Subfonds: Records of President A. W. Clausen

Fonds: Records of the Office of the President

ISAD Reference Code: WB IBRD/IDA EXC-09-3962S

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The World Bank

1818 H Street NW

Washington DC 20433

Telephone: 202-473-1000

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Society for International Development - Rome, Italy - July 3, 1985



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 **Archives**
A1995-266 Other #: 2 **1776089** 209437B
Society for International Development, Rome, Italy. July 3, 1985

Address
As Delivered
By

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

before the

Society for International Development

Rome, Italy
July 3, 1985

Thank you, Mahbub, for your kind welcome. It is a pleasure to join with everyone this morning at this meeting of the Society for International Development.

I would like to talk with you today about the contribution that international capital can make to economic development. You will agree that this is a topical issue because of the global concern with external debt over the past several years. Yet it is an issue that has been neglected. It is only recently that financial links between industrial and developing countries have become as integral to the world economy as trade links. It is only now that governments are starting to see that their financial policies, like their trade policies, have international consequences. Even more slowly, it is being recognized that a healthy liberal trading order can exist only in the context of a viable and well-functioning financial system, and that a healthy financial system cannot exist without trade. Both are essential to developing countries' growth.

The growing financial interdependence between nations is a development of profound significance. The more a developing country is linked with the rest of the world, the greater the potential benefits -- but also, if policies are inappropriate, the more vulnerable it is to external shocks. In a badly designed policy environment, foreign capital can be wasted on inefficient investment or be used to delay essential economic reforms. The result can be an accumulation of debt that makes an economy even more vulnerable to financial pressures from the world economy.

On the other hand, in a well designed policy environment foreign capital can promote growth and help an economy to adjust to internal and external shocks. Foreign capital allows a country to invest more than it could if it used only its own savings. In the early stages of a country's development, when its capital stock is small, returns to investment are in many cases higher than in industrial countries. This is the basic economic justification for developing countries to obtain capital from abroad, and results in the promotion of global economic efficiency. External capital also allows deficit countries to strike the right balance between reducing their deficits and financing them. It thus permits an efficient time-phasing of adjustment and diminishes its social and political costs.

THE UNIVERSITY OF CHICAGO

THE UNIVERSITY OF CHICAGO
DEPARTMENT OF POLITICAL SCIENCE
1100 EAST 58TH STREET
CHICAGO, ILLINOIS 60637



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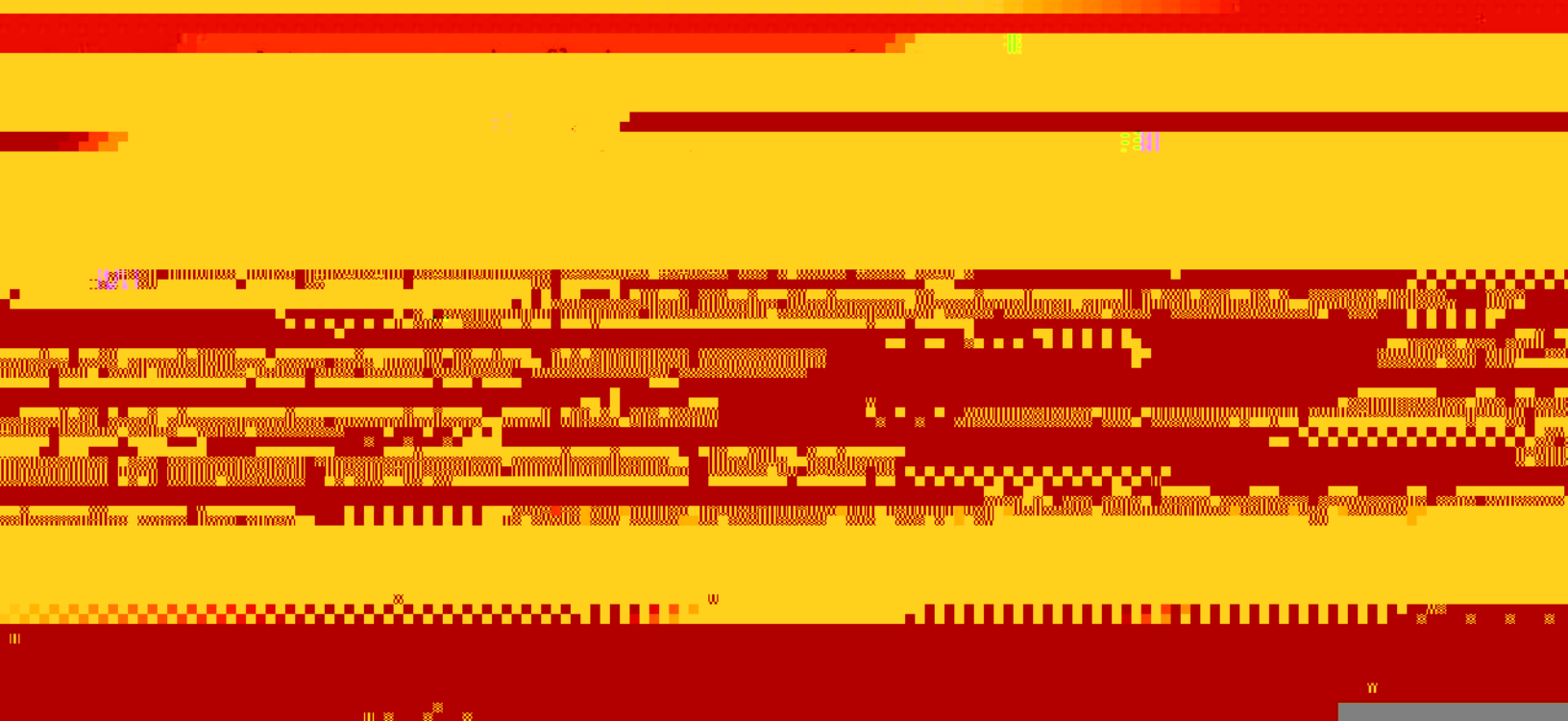
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their financial links with the industrial countries? The first point they must take to heart is that it is not in their interests to change out of their own accord the quality of their domestic policies that determines what they

can do. They must first of all ensure that their domestic policies are sound and that they are able to maintain a high level of growth and employment. This is the only way in which they can be in a position to negotiate with the industrial countries on an equal footing. It is not enough to demand that the industrial countries should open their markets to the products of the developing countries. The latter must first of all be able to produce goods which are competitive on the world market. This requires a high level of productivity and a high level of investment in research and development. It also requires a high level of savings and a high level of capital formation. In short, the developing countries must first of all improve their domestic policies and their economic performance. Only then will they be able to negotiate with the industrial countries on an equal footing.



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to make the **Another lesson is that the policies required to**

best use of external finance are essentially the same as those that

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macroeconomic policies.

An overriding consideration

in managing their financial links is that

the level of domestic savings and invest

need for foreign capital. This clearly

of capital flows should be an integral part

Some procedures for influencing
prior approval for borrowing, minimum maturity of deposits

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Lastly, in managing foreign capital

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capital is available depends, of course, on mechanisms. How mu

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investors.

Schematically, we can think

maintaining its own creditworthiness

of these mechanisms in five parts:

First, there is the choice between equity and debt

, for some countries there needs to be a choice

o Lastly

between concessional and non-concessional borrowing.

Obviously a higher proportion of concessional borrowing

eases debt-servicing burdens; which are so critical a constraint for low-income countries.

I would like to add a couple of qualitative comments

about these mechanisms. The first concerns commercial bank lending

and its role in increasing its role in financing economic development. As you will

st private lending to developing countries

recall, in the 1970s most

a single group of creditors -- the

was concentrated among a few concentrated among

commercial banks themselves. Their share of total net

flows to developing countries increased from 15 percent in 1970 to

36 percent in 1983! In the years ahead, private bank lending must

continue to grow; but a future strategy must strive for broader

risk-sharing among financial intermediaries and more imaginative

use of different lending instruments.

My second comment concerns private direct investment. As a proportion of net capital flows to developing countries, it stood at 19.8 percent in the early sixties, but only 12.9 percent in the early eighties. A sustained recovery in private direct investment is needed to complement commercial bank lending. The problem is that it has tended to be concentrated in a small number of sectors

lending expanded rapidly, only to be withdrawn just as abruptly. This was partly because of the policies followed by developing countries, and partly because of low real interest rates on commercial bank loans. There can be no doubt that an ill-balanced mix of foreign capital is partly to blame for the debt-servicing and generalized economic problems faced by developing countries in the early 1980s.

* * * * *

... the financial links I have described are strengthened and strengthened

to the mutual benefit of both developing and industrial countries,
and if the capital which flows between them is used to best

I believe we would be well on the road to recovery advantage

in of the next five years. We can take heart during the transition

growth by about 8.4 percent in 1984, and world that world trade grew

4.2 percent. The basic imperative is continued output increased by

adjustment by developing countries combined efforts at structural adjustment

which result in with policy adjustments by industrial countries

their economies expanding by 3.5 percent a year for the next five

years. This would set the basis for accelerated growth in years. This would

and for more normal relationships between developing countries

debtors and creditors.

needed. For example, if But some imaginative thinking is needed

we are to accelerate the return to creditworthiness of countries

that are pursuing sound economic policies, we must recognize that

many of them may experience short- to medium-term debt-servicing

problems. On a case by case basis, multi-year debt restructurings

for official credits and the like may be appropriate as part of an

overall package of economic policies and financial flows supporting

adjustment and growth. We should be especially

low-income sub-Saharan African sensitive to this need in the low

to strong adjustment efforts. countries which commit themselves

stagnation is a dire risk. The prospects do not exclude the possibility of further uncertainty for many developing countries. In fact, present policies in industrial and developing countries may well lead to undesirable outcomes in the next five

Frankly, prospects for the next ten years are bleak. The continuation of present policies in industrial and developing countries may well lead to un-

need to slump, as it

years. Certainly, the world economy does not need to slump, as it did in 1981 and 1982, for debt problems to recur. If all that happens between now and 1990 is that the industrial economies grow at 2.7 percent annually in an environment of high real interest

rates and increased protectionism, we can be sure that several

groups of developing countries could find themselves with heavier

debt-servicing burdens at the end of this decade than they had at the beginning.

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Under such a constrained scenario, many heavily-indebted

developing countries would find it virtually impossible to double their trade

developing countries would

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surpluses merely to sat-

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try. Serious as such outcomes are, they would just be part and

parcel of much wider failures. Slow economic growth and high

unemployment would persist in industrial countries, while economic

liberalization in the developing countries would be frustrated by

Such dismal outcomes are obviously avoidable. As we move

into the twenty-first century, the prospect of people living longer, healthier, and fuller lives, and enjoying development in its widest sense, need not take second place to sheer economic survival. Low-income African countries need not face a further five years of decline in average per capita incomes, to compound

the tragic decline of the past fifteen years. For example, an average increase in official development assistance of 2.7 percent a year -- similar to the growth rate in the fifties and sixties -- would permit some increase in concessional lending to low-income Africa without diverting aid from low-income Asian

services, and improving creditworthiness for every group of developing country, are within reach. Much more must be expended on

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policy reform will remain at the forefront of our w

coming decade, along with the broad outreach of our

financing. We will continue to position ourselves s

complement capital flows from other sources and exer

to other regions. 

- o Second, with the various co-financing instruments we have developed, we can increase the confidence of investors in projects and in country development prospects. Through our assessment of investment programs and industrial projects we have a unique perspective on a country's economic prospects and needed policy reforms. We also have a long history of collaboration with export credit agencies and with commercial banks. We can therefore support the efforts of our cofinanciers to improve the quality of their lending, thereby increasing the development benefits of such flows while strengthening the portfolios of the lending institutions.

- o Third, we must continue to emphasize foreign direct investment as a discrete and important aspect of our catalytic role and encourage private investment directly and indirectly, whether through project financing or through structural adjustment lending. We will expand the outreach of the International Finance Corporation, whose capital is being doubled. From its inception we will highlight the potential of the Multilateral Investment Guarantee Agency, which will complement the established role of the International Center for the Settlement of Investment Disputes. It is necessary that The World Bank itself, and our concessional loan affiliate the International Development Association, have sufficient resources to play a full and effective role in the international economic arena.

- o Fourth, in our proposals for responding to the crisis in Sub-Saharan Africa, we have stressed that increases in the volume of aid to the region must go hand in hand with improvements in aid coordination and in aid targeting and effectiveness. Without that, too many efforts to support policy reform will be wasted. And as part of our coordinating function, we must be prepared to assist borrowing governments strengthen existing mechanisms for investment review. This will help ensure that their projects are consistent with their explicit development priorities and with their capacity to effectively implement them.

Perhaps I should mention, that while these remarks are focused on the financial aspects of development, I hope it can go without saying, for this morning, that our involvement is that of a partner with each developing country; our mandate remains to help countries raise the standard of living of their peoples with always a particular focus on poverty alleviation. Our own research confirms that there is no reduction in the economic rate of return of projects which contain a component for poverty alleviation. Our economic priorities remain agriculture and rural development and energy. Our geographic priority remains Sub-Saharan Africa, and our development emphasis remains that of engaging in policy dialogue, helping developing countries create wealth through attention to adjustment, attention to development of the human resource, including awareness of the impact population growth has on development, and through the transfer of financial resources!

- o Finally, both The World Bank and the International Monetary Fund must provide consistent, effective support to their members on a coordinated basis. The resumption of growth in the developing countries will not be sustainable unless continuing adjustment efforts are based on a stable economy and a sound medium-term policy framework. Recent Bank-Fund collaboration in Colombia provides an instructive example. There we recently made a \$300 million loan to support a trade adjustment program following intensive discussions with the Government of Colombia, the International Monetary Fund and the commercial banks. We worked closely with the Fund to mobilize complementary financial support from other institutions. As the process of adjustment proceeds, the Fund will review the overall effect of the government's stabilization program while we will monitor Colombia's trade policy performance and public investment programs.

That's our agenda for action. The emphasis is on the team approach. This is a partnership endeavour from beginning to end, for developing and industrial countries alike. Both stand to gain by success, and both will certainly lose by failure.

Thank you.

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Address

As Prepared for Delivery

By

A. W. Clausen, President

The World Bank

and

International Finance Corporation

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Society for International Development

Rome, Italy

July 3, 1985

Thank you, Mahbub, for your kind welcome. It is a pleasure to join with everyone this morning at this meeting of the Society for International Development.

I would like to talk to you today about the contribution that international capital can make to economic development. You will agree that this is a topical issue because of the global concern with external debt over the past several years. Yet it is an issue that has been neglected. It is only recently that financial links between industrial and developing countries have become as integral to the world economy as trade links. It is only now that governments are starting to see that their financial policies, like their trade policies, have international consequences. Even more slowly, it is being recognized that a healthy liberal trading order can exist only in the context of a viable and well-functioning financial system, and that a healthy financial system cannot exist without trade. Both are essential to developing countries' growth.

The growing financial interdependence between nations is a development of profound significance. The more a developing country is linked with the rest of the world, the greater the potential benefits -- but also, if policies are inappropriate, the more vulnerable it is to external shocks. In a badly designed policy environment, foreign capital can be wasted on inefficient investment or be used to delay essential economic reforms. The result can be an accumulation of debt that makes an economy even more vulnerable to financial pressures from the world economy.

On the other hand, in a well designed policy environment foreign capital can promote growth and help an economy to adjust to internal and external shocks. Foreign capital allows a country to invest more than it could if it used only its own savings. In the early stages of a country's development, when its capital stock is small, returns to investment are in many cases higher than in industrial countries. This is the basic economic justification for developing countries to obtain capital from abroad, and results in the promotion of global economic efficiency. External capital also allows deficit countries to strike the right balance between reducing their deficits and financing them. It thus permits an efficient time-phasing of adjustment and diminishes its social and political costs.

It is the economic policies that the industrial and developing countries adopt in the next five years that will determine whether developing countries can make a smooth adjustment back to creditworthiness and steady growth, or whether debt-servicing difficulties will once again disrupt their progress. In this sense we are living at a time of transition -- an essential and intermediate phase before returning to sustained growth and normal relationships between debtors and creditors. Obviously, the amount of foreign capital developing countries will get to help resume their growth largely depends on their success in restoring their own creditworthiness. This in turn hinges on the quality and flexibility of their economic policies. Countries that score well on that account will also score well in attracting international capital flows.

About 60 percent of the debt held by developing countries will need to be rolled over or amortized in the next five years. Constructive and collaborative actions by debtors, creditors and international institutions to smooth out debt service payments need to be continued. At the same time the international community must respond to the needs of the poorest countries for sustained and increased flows of concessional capital. The plight of sub-Saharan Africa is particularly depressing, with average per capita income lower today than it was 15 years ago. But with a concerted effort by all parties, there are solid grounds for optimism.

These are some of the lessons to be drawn from our eighth World Development Report, published today. Its focus on the contribution that capital flows make to economic development is, I believe, most timely. So today I want to touch upon several aspects of the crucial dynamics of capital flows in the 1980s and the realities of our situation. And then briefly describe The World Bank's role in this context.

* * * * *

My first point is about uses and misuses of international capital. Clearly, with the best intentions, countries may borrow too much if they misjudge the way that external economic conditions are going to evolve. That is a risk which governments have to contend with whatever their degree of economic foresight. But there is another risk which it is within the power of any government to contain. It is the temptation to use external capital to delay economic adjustment.

The record of the 1970s shows time and time again that those countries that complemented their borrowing with needed policy adjustments -- price, trade and exchange rate reforms are conspicuous examples -- were the very countries that managed to restore rapid growth and avoid debt-servicing difficulties. Conversely, countries which used borrowing to avoid policy reform tended to be the very countries that ran into debt-servicing problems -- and had to make even more drastic and costly adjustments later on.

Provided it is well planned and well directed, the benefits of foreign borrowing far outweigh the risks. There is ample evidence that capital flows, often accompanied by technical knowhow, contributed to the substantial progress that most developing countries made in the sixties and seventies. Those were the decades when their GDP growth averaged six percent a year, while the principal social indicators -- notably life expectancy, infant mortality and school enrollment -- also showed dramatic improvement. To be sure, these advances reflected principally the efforts of the developing countries themselves. But external flows played their part in the process of capital formation and in raising productivity. Foreign capital was also valuable in cushioning internal and external shocks, whether of harvest failure, recession in industrial economies, or major changes in commodity prices.

Private capital flows have helped assure growth in the middle-income countries. In low-income countries, it is concessional assistance which has played that role. Many investments in low-income countries show high returns -- be they in health, education, agricultural research or infrastructure -- but the yield may be spread over a period of 30 or 40 years, with little to show in the beginning. This makes these otherwise worthwhile investments unsuitable for financing by private banks, with their traditional aversion to very long-term funding.

The fact is that official flows, such as from The World Bank, are a custom-built vehicle for providing capital, technical assistance and policy advice. We all know that economic development depends on more than just accumulating physical capital and improving human resources. It also requires institutional development, technology transfers and adaptation, and an appropriate framework for economic policy. Official lending helps to build basic infrastructure, develops institutions and promotes appropriate policies, thus encouraging inflows of private capital. Conversely, stagnation in official flows undermines the prospects for private flows as well.

As you know, the low-income countries depend heavily on concessional flows, which represent about two-thirds of their net capital receipts. Provided sound policies are in place, they can make highly effective use of such assistance. The sad fact is that since 1980 concessional flows to low-income countries have stagnated from 15.9 billion dollars in 1980 to 15.1 billion dollars in 1983. Many low-income countries have at times had to borrow commercially, in the face of stagnant official flows and a deteriorating economic environment. This has contributed significantly to the debt-servicing difficulties that many of these countries are now experiencing.

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As my second point of departure, let us pause and reflect how capital flows have helped developing countries sustain high levels of investment, while also smoothing their progress along the path of adjustment. There seems to be little appreciation of how much more the global community could benefit from stronger financial links between developing and industrial countries. Of course all kinds of variables are at work here, including economic policies in industrial and developing countries, and the smooth functioning of financial transmission mechanisms. Let's take a look at the interplay of each of these elements one by one.

Consider first how changes in the availability of capital, and movements in interest rates and exchange rates in the industrial countries, condition the economic outlook for the developing countries. The fiscal, monetary, and trade policies of the industrial countries influence movements in each of these variables and are therefore a matter of international concern. Easing of public deficits in industrial countries would permit changes in the monetary-fiscal balance required for non-inflationary growth. Real interest rates could then be expected to come down and more appropriate exchange rate relationships could follow. If industrial countries would reduce their deficits, they'd be helping themselves every bit as much as they'd be helping the developing countries. There is no avoiding the fact that large budget deficits in industrial countries remain an obstacle to lower real interest rates.

There is the same convergence of interests when it comes to protectionism. To service their debts, the biggest debtors will need to run large trade surpluses in the next few years. Yet many import restrictions -- on steel, sugar, and beef, for example -- have affected primarily major debtors. Other restrictions, such as the Multifibre Arrangement, affect a broader range of countries. The harder it is for the big debtors to access export markets and service their debt, the greater the strains on the world's banking system. The links are as brutal as that.

Next, what should developing countries do to get more mileage out of their financial links with the industrial countries? The first point they must take to heart is that it is the quality of their domestic policies that determines what they gain from these links. In the 1970s, with an abundant supply of international capital, developing countries could borrow in the relatively relaxed conditions of low or even negative real interest rates. At that time, the cost of not following appropriate policies and of not investing in economically justified projects was less painful than it is now. Today the difficult global environment gives short shrift to mistaken policies and mistaken investments. Higher oil prices, high real interest rates, prolonged recession in the industrial economies, and more trade barriers have taken their toll!

The interesting twist to the tale is that the most vulnerable countries have been those that borrowed and failed to adjust -- or that did not tackle their new problems with sufficient urgency. For example, the low-income countries of Africa have been a major casualty. Their development is a long-term process constrained by weak institutional structures and a shortage of skills, compounded by a tragic run of natural disasters. Commercial borrowing in order to finance increased import bills as aid stagnated was a costly mistake for low-income African countries, especially in the light of what happened to interest rates, not to mention the adverse impact of declining commodity prices.

Another group of countries in difficulty are some of the major debtors in Latin America and elsewhere. Their financing problems are complex, but show three common features. First, their fiscal and monetary policies have been too expansionary to achieve a sustainable external balance. Second, overvalued exchange rates have prevented their exports from competing on world markets, and have also encouraged capital flight. Third, while their domestic savings efforts have accelerated, investment expenditures have accelerated even faster.

These and other examples suggest a few lessons about how developing countries should manage their financial links with industrial countries. The first is the need for flexibility. Foreign borrowing requires that both creditors and debtors take account of uncertainty by maintaining a capacity to respond flexibly to changes in the external environment. The most critical challenge in the short term is the ability to reduce fiscal deficits and to adjust real exchange rates and real interest rates. If for political or other reasons countries cannot adjust such policies quickly, they should certainly be conservative in resorting to foreign borrowing.

Another lesson is that the policies required to make the best use of external finance are essentially the same as those that make the best use of domestic resources. This means that economic prices must be aligned with opportunity costs and domestic savings efforts must be strengthened. In this regard, foreign capital must be treated as a supplement, not as a substitute. And overvalued exchange rates or distorted trade policies must be avoided.

An overriding consideration for developing countries in managing their financial links is that the policies which determine the level of domestic savings and investment also determine the need for foreign capital. This clearly implies that the management of capital flows should be an integral part of macroeconomic management. Some procedures for influencing capital movements -- prior approval for borrowing, minimum maturity or deposit requirements, withholding taxes -- have sometimes proved a helpful complement to macroeconomic policies. However, controls over international capital flows are not a substitute for sound macroeconomic policies.

Lastly, in managing foreign capital, developing countries obviously need access to a variety of sources of finance and mechanisms. How much capital is available depends, of course, on world economic conditions and on the preferences of foreign investors. The mechanisms are very sensitive to each developing country's success in generating its own economic growth and maintaining its own creditworthiness. Schematically, we can think of these mechanisms in five parts:

- o First, there is the choice between equity and debt financing. An appropriate balance helps ensure that interest or dividends correlate with the ability to service external capital.
- o Next, loans can be taken in different currency denominations. Well managed, this reduces exchange rate risks.
- o Another choice is provided by fixed and floating rate finance. A judicious mix mitigates the interest rate risk.
- o Borrowers will also need to offset long-maturity borrowing for projects against short-term borrowing to finance trade. Each contributes to smoothing out debt service payments and to reducing refinancing risks.
- o Lastly, for some countries there needs to be a choice between concessional and non-concessional lending. Obviously a higher proportion of concessional lending eases debt-servicing burdens, which are so critical a constraint for low-income countries.

I would like to add a couple of qualitative comments about these mechanisms. The first concerns commercial bank lending and its role in financing economic development. As you will recall, in the 1970s most private lending to developing countries was concentrated among a single group of creditors -- the commercial banks themselves. In fact their share of total net flows to developing countries increased from 15 percent in 1970 to 36 percent in 1983! In the years ahead, private bank lending must continue to grow, but at the same time we must strive for broader risk-sharing among financial intermediaries and more imaginative use of different lending instruments.

My second comment concerns private direct investment. As a proportion of net capital flows to developing countries, it stood at 19.8 percent in the early sixties, but only 12.9 percent in the early eighties. A sustained recovery in private direct investment is needed to complement commercial bank lending. The problem is that it has tended to be concentrated in a small number of sectors in higher income countries. Undoubtedly there is scope for expansion of private direct investment in most developing countries. The efforts of our affiliate, the International Finance Corporation, are important in this regard. Following meetings in Washington last month, I am also encouraged by the outlook for our proposed Multilateral Investment Guarantee Agency, which will provide a guarantee against political risk for private investment in developing countries.

Overall, when we look back on the 1970s, we see that the developing countries failed to maintain a prudent balance between different sources of finance. In particular, commercial bank lending expanded rapidly, only to be withdrawn just as abruptly. This was partly because of the policies followed by developing countries, and partly because of low real interest rates on commercial bank loans. There can be no doubt that an ill-balanced mix of foreign capital is partly to blame for the debt-servicing and generalized economic problems faced by developing countries in the early 1980s.

* * * * *

If the financial links I have described are strengthened to the mutual benefit of both developing and industrial countries, and if the capital which flows between them is used to best advantage, I believe we would be well on the road to recovery during the transition of the next five years. We can take heart that world trade grew by about 8.4 percent in 1984, and world output increased by 4.2 percent. The basic imperative is continued efforts at structural adjustment by developing countries combined with policy adjustments by industrial countries which result in their economies expanding by 3.5 percent a year for the next five years. This would set the basis for accelerated growth in developing countries and for more normal relationships between debtors and creditors.

But some imaginative thinking is needed. For example, if we are to accelerate the return to creditworthiness of countries that are pursuing sound economic policies, we must recognize that many of them may experience short- to medium-term debt-servicing problems. On a case by case basis, multi-year debt restructurings for official credits and the like may be appropriate as part of an overall package of economic policies and financial flows supporting stabilization, adjustment and growth. We should be especially sensitive to this need in the low-income sub-Saharan African countries which commit themselves to strong adjustment efforts.

Frankly, procrastination is a dire risk. The prospects for the next ten years do not exclude the possibility of further debt-servicing difficulty for many developing countries. In fact the continuation of present policies in industrial and developing countries may well lead to undesirable outcomes in the next five years. Certainly, the world economy does not need to slump, as it did in 1981 and 1982, for debt problems to recur. If all that happens between now and 1990 is that the industrial economies grow at 2.7 percent annually in an environment of high real interest rates and increased protectionism, we can be sure that several groups of developing countries could find themselves with heavier debt-servicing burdens at the end of this decade than they had at the beginning.

Under such a constrained scenario, many heavily-indebted developing countries would virtually have to double their trade surpluses merely to satisfy their interest obligations! It is highly doubtful whether they could do that -- or whether an increasingly protectionist trading regime would even allow them to try. Serious as such outcomes are, they would just be part and parcel of much wider failures. Slow economic growth and high unemployment would persist in industrial countries, while economic liberalization in the developing countries would be frustrated by trade barriers and by the limited availability of official development assistance.

Such dismal outcomes are obviously avoidable. As we move into the twenty-first century, the prospect of people living longer, healthier, and fuller lives, and enjoying development in its widest sense, need not take second place to sheer economic survival. Low-income African countries need not face a further five years of decline in average per capita incomes, to compound the tragic decline of the past fifteen years. For example, an average increase in official development assistance of 2.7 percent a year in real terms -- similar to the growth rate in the fifties and sixties -- would permit some increase in concessional lending to low-income Africa without diverting aid from low-income Asian countries.

The thrust of my remarks is that faster and more stable growth for both industrial and developing countries, and improving creditworthiness for every group of developing country, are within reach. Much depends on expanding the volume and effectiveness of financial flows to developing countries to constructively supplement their domestic savings and structural adjustment efforts. Let me conclude by summarizing how The World Bank can play an effective role in this process. We, too, must adjust and see our role as promoter of finance and other services in the context of the increased importance of international finance in economic development.

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Our assistance to the developing countries with needed policy reform will remain at the forefront of our work in the coming decade, along with the broad outreach of our project financing. We will continue to position ourselves so that we complement capital flows from other sources and exercise a constructive influence on these flows. In practical terms, this suggests the following priorities:

- o First, lending by The World Bank itself is an important component in maintaining an acceptable balance between official and private sources, between short- and long-term maturities, and between fixed and variable rate instruments. As such, our lending must be on a scale that is meaningful both to borrowing countries and to other sources of finance. We are the major channel through which developing countries access international securities markets. Our lending is particularly critical for countries that rely mainly on commercial capital and are most sensitive to the impact of fluctuations in the world economy.
- o Second, with the various co-financing instruments we have developed, we can increase the confidence of investors in projects and in country development prospects. Through our assessment of investment programs and industrial projects we have a unique perspective on a country's economic prospects and needed policy reforms. We also have a long history of collaboration with export credit agencies and with commercial banks. We can therefore support the efforts of our cofinanciers to improve the quality of their lending, thereby increasing the development benefits of such flows while strengthening the portfolios of the lending institutions.

- o Third, we must continue to emphasize foreign direct investment as a discrete and important aspect of our catalytic role and encourage private investment directly and indirectly, whether through project financing or structural adjustment lending. We will expand the outreach of the International Finance Corporation, whose capital is being doubled. From its inception we will highlight the potential of the Multilateral Investment Guarantee Agency, which will complement the established role of the International Center for the Settlement of Investment Disputes. It is necessary that The World Bank itself, and our concessional loan affiliate the International Development Association, have sufficient resources to play a full and effective role in the international economic arena.

- o Fourth, in our proposals for responding to the crisis in Sub-Saharan Africa, we have stressed that increases in the volume of aid to the region must go hand in hand with improvements in aid coordination and in aid targeting and effectiveness. Without that, too many efforts to support policy reform will be wasted. And as part of our coordinating function, we must be prepared to assist borrowing governments strengthen existing mechanisms for investment review. This will help ensure that their projects are consistent with their explicit development priorities and with their capacity to effectively implement them.

- o Finally, both The World Bank and the International Monetary Fund must provide consistent, effective support to their members on a coordinated basis. The resumption of growth in the developing countries will not be sustainable unless continuing adjustment efforts are based on a stable economy and a sound medium-term policy framework. Recent Bank-Fund collaboration in Colombia provides an instructive example. There we recently made a \$300 million loan to support a trade adjustment program following intensive discussions with the Government of Colombia, the International Monetary Fund and commercial banks. We worked closely with the Fund to mobilize complementary financial support from other institutions. As the process of adjustment proceeds, the Fund will review the overall effect of the government's stabilization program while we will monitor Colombia's trade policy performance and public investment programs.

That's our agenda for action. The emphasis is on the team approach. This is a partnership endeavour from beginning to end, for developing and industrial countries alike. Both stand to gain by success, and both will certainly lose by failure.

Thank you.