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Remarks

By

A. W. Clausen, President

The World Bank

and

International Finance Corporation

to

The Business Council

Hot Springs, Virginia

October 8, 1983

Harry,

I want to congratulate you on convening a program, yesterday and today, which focuses on the role of U.S. business in advancing public policy goals in the areas of economics, finance, trade, national security, foreign relations policy, and international competition.

These are critically important issues in critically important times.

The speeches on the program, yesterday and this morning, have addressed in eloquent terms the U.S. economic recovery; the impact of the strong dollar on the recovery; the problem of growing trade deficits; the importance of getting control of our budget deficits; the importance of reducing interest rates in real terms; the role of monetary policy in the recovery and in achieving a sustainable and durable recovery. At the same time our understanding of foreign relations policy has been enlarged, and the importance of defense and arms control has been emphasized. There are linkages between all of these issues and objectives.

This morning I'd like to continue our discussion on the U.S. recovery. I want, however, to approach it from what one might call "the other side of the recovery equation", namely from the economic conditions existing in the developing countries.

What reference there has been so far to this "other side" has been primarily in terms of the developing world's debt problems. Perhaps that is why you asked me to participate in this program.

I represent, as you know, the "unknown sister" of the Bretton Woods institutions. Unknown because the IMF is front and center in its lead role of helping countries achieve financial stability in the wake of acute balance-of-payments problems.

These problems stem from a variety of factors, including the deepest global recession since the early 1930s in which economic growth in terms of both volume and foreign exchange revenues have at best stagnated, and actually dropped for most countries, thereby causing severe liquidity problems in country after country. But these emergency balance-of-payments problems have also stemmed from distortions caused by economic policies which, in some cases, have proven dramatically inadequate for these difficult times.

Yesterday's speakers, Marty Feldstein, Paul Volcker and Chuck Percy, all commented on the importance of the enabling legislation, now in the U.S. Congress, for the IMF's Quota Increase.

President Reagan, in his welcoming address at the opening session of the Annual Meetings of the Bank and the Fund in Washington, just ten days ago, said:

> "This legislation is not only crucial to the recovery of America's trading partners abroad and to the stability of the entire international financial system; it is also absolutely necessary for a sustained recovery in the United States."

And he is right! There is currently no higher priority item on the international agenda than passage of this critically important legislation here in the United States. It is truly a U.S. jobs bill of global importance.

But, at the same time, let us not forget that the long-term solution of so many of these current domestic and international economic problems can be found in the continued development of those countries which are now in the Third World.

Chuck Percy said yesterday morning that "we can't have a strong foreign relations policy without a strong defense policy. And we can't have a strong defense policy without a strong economy."

That is absolutely true. But I would add another couplet to the Senator's assertion, and that is: economic recovery in the United States, or for that matter in the industrial world, just isn't going to fly for very long -- no matter what happens to budget deficits and interest rates -- if there is no real recovery in the Third World.

During the three-year recession, most developing countries have seen, in varying degrees, their per capita income growth deteriorate, government revenues stagnate, and their balance of payments and their debt-servicing run into greater and greater difficulties. With the exceptions of China and India, the very poorest countries have fared particularly badly, and none more so than the countries of Sub-Saharan Africa.

It does not take a genius to see that economic decline and reduced purchasing power in the developing world is very bad news for the industrial countries. And it is particularly bad news for this country.

Trade is the engine of growth in the global economy, and all nations have a very high stake in it. One fifth of U.S. jobs depend on trade. Two-fifths of U.S. farm production is sold abroad. Four-fifths of new jobs in U.S. manufacturing are coming from trade. One-third of corporate profits come from international business.

Even more significant: forty percent of all U.S. exports go to the developing countries. That's a bigger market than all of Western Europe and Eastern Europe combined. And that has been a very rapidly growing market for U.S. exports, which stood at about 29 percent of a much smaller volume of exports as recently as 1970. But the developing countries have had to slash their imports in 1982, and in the early months of 1983, mainly because of the crisis in commercial-bank lending. The sudden contraction in developing countries was one of the main reasons that the global recession lasted longer than most of us expected.

The U.S. Treasury's estimate is that Mexico's debt crisis alone cost the United States $10 billion in export sales over the last year. And by their reckoning, that translates into unemployment for roughly a quarter of a million Americans.

That's one powerful reason why the American business community should be rooting for a maximum U.S. commitment to the international effort to get the Third World's economies back on course. There is a real self-interest in helping the developing countries to get back on their feet and thus expand their absorptive capacity for goods and services from developed countries.

And how can that be achieved?

If the developing countries are going to be able to import the goods and services essential to the restoration of sustained growth, and at the same time service their external debt, they are going to have to be good earners. And that means expanding exports. Access to the industrial world's markets is therefore crucial to them. But very high unemployment in the industrial world has strengthened protectionist pressures. It is true that many increased trade restrictions have been principally among the industrial countries themselves -- notably in automobiles and steel. But many restrictions also hurt developing countries' exports such as textiles and agricultural products.

In the Sixties and Seventies we were beginning to get somewhere with successive rounds of trade liberalization negotiations. But then the recession put us on a reverse course. The world cannot afford to continue on it; protectionist measures must be decisively rolled back.

At the Williamsburg summit earlier this year, the leaders of the industrial world committed themselves to halt protectionism and dismantle trade barriers. But, in referring last week to the Declaration drawn up at that summit meeting, President Reagan said:

> "Everyone is against protectionism in the abstract. That is easy. It is another matter to make the hard, courageous choices when it is your industry or your business that appears to be hurt by foreign competition." End of quote.

Sure it's hard. But the long-term benefits for all of an open trading system are certain. What's good for the developing world's economies is good for the industrial world's business. So the U.S. business community should be urging resistance to protectionism.

But export earnings alone will not fuel sustained economic recovery in the Third World. The developing countries have always needed a steady flow of external capital to help finance their development, and will continue to need it in the years ahead. 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 we were actually a non-creditworthy developing country for a period of years prior to the mid-19th century. Today the developing countries need capital from a variety of sources, depending on their economic condition and the stages reached in their development.

International private capital has been and continues to be essential to the development process in much of the developing world. Despite a decline in the rate of growth of commercial lending in 1981 and 1982, the share of medium- and long-term debt owed to the private lenders by the developing countries had nonetheless reached an estimated two-thirds of the total debt outstanding by the end of 1982.

We have to face the fact, however, that servicing that total debt of more than $500 billion is quite some headache. And the problems of some of the major borrowers have shaken confidence in international commercial lending, and slowed its rate of growth significantly. But the problem will only be aggravated if individual banks lose confidence and precipitate a general withdrawal. The banking system as a whole should continue prudently to provide new finance. International institutions, notably the IMF and the Bank for International Settlements, and certain industrial governments, have been taking concerted action aimed at restoring creditor confidence in financially troubled countries. This should be an encouragement to the commercial banking community to sustain its lending, not curb it.

There is a tendency to think of the Third World debt problem in financial terms. But I would submit that the debt problem is really a developmental problem. And that is where the World Bank comes into the picture.

I think we would all agree that the debt problems of developing countries are not going to be solved quickly; they are going to be with us a very long time. All the more reason, then, that strong support should be given to the multilateral financial institutions in these times, so that they can be even more effective in fulfilling their mandates -- I say "in these times" -- when Official Development Assistance and commercial bank lending flows are constrained.

The World Bank is sometimes thought of more in financial terms, i.e., as a big financial institution: \$14 1/2 billion of lending last year; \$10 billion of borrowings; \$750 million of profit; 38 percent increase in private sector investments through our affiliate, the International Finance Corporation; and so forth.

But, while the financial prowess of the Bank is not insignificant, our particular strength -- our particular contribution to creating a better and more stable global economic environment -- lies in our ability to help developing countries put appropriate economic policies 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 institution; an institution engaged in a continuing economic policy dialogue.

Because the Bank does not have any political ideology -- i.e., it must deal with non-market as well as market economies, and can therefore only worship at the altar of pragmatic economics -- it is better able to influence the kinds of policies that developing countries utilize; better able than development assistance coming from bilateral sources.

Here again, I am not making any argument against bilateral development assistance. The problems of Third World development are so great that all available resources are needed.

What is needed most (and first, in my opinion) is adjustment. All countries must adjust, developed and developing alike. And we need growth -- non-inflationary, sustained growth. We need growth through increased investment from multilateral as well as bilateral sources, and from the private sector. And Third World countries need to manage their economies with heightened efficiency. The Bank's World Development Report this year provided powerful empirical evidence of what most of us already believe -- that economies with widespread regulation and price distortion tend to be less efficient, and to suffer slower growth, than economies in which prices reflect scarcity values. Thus it makes a strong case against subsidies that distort the efficient rationalization of economic activities.

The Bank has also documented the fact that countries oriented toward international trade tend to be more efficient and dynamic than protected economies. Nothing is more vital to sustain growth in the Eighties than a roll-back of the barriers to international trade that have accumulated during recent years!

Finally, we must also assure adequate finance for Third World development. The stagnation of international finance for the developing countries is the Achilles heel of world economic recovery.

And when country after country is now becoming increasingly aware that adjustment is what is necessary, we must ensure adequate financial support of the institutions that can assist in that wholly desirable process.

Three of these institutions are ones with which I am associated.

The International Finance Corporation (IFC), which is our private sector affiliate, is a merchant bank, if you will; a deal-maker, working with private entrepreneurs making investments in Third World countries. IFC can make loans, form syndications, purchase securities, and give technical assistance to ventures in the private sector of developing countries.

The International Development Association (IDA) is the affiliate that extends credit to the poorest of the poor countries in the world; non-creditworthy countries like Pakistan and Bangladesh in Asia, and Zimbabwe and Senegal in Sub-Saharan Africa. There are 51 countries currently eligible to borrow from IDA. These countries are so poor that they cannot afford to pay the interest on loans. So we charge only a service fee of three-quarters of one percent on the outstanding balances, and extend terms of 50-year maturities with ten-year grace periods.

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 from a pro rata participation in a $9 billion replenishment to a replenishment level of $12 to $13 billion -- the minimum level which all the donor countries are willing to support. Mind you, the level of the Sixth Replenishment of IDA some four years ago was $12 billion. Therefore we must not reduce the support for concessional assistance to the desperately poor countries which contain hundreds of millions of the world's population which subsist at or below the poverty level.

The International Bank for Reconstruction and Development (IBRD) lends money to the middle-income developing countries -- countries like Mexico and Brazil in Latin America; Indonesia, Thailand and Korea in Asia; Egypt, the Ivory Coast and Kenya in Africa; and Yugoslavia and Turkey in Europe. The loans are at near-market rates for terms of up to 20 years of maturity.

The IBRD is a powerful intermediary between the world's capital markets in the developed countries and the developing countries which are borrowers, at a moment when intermediation is clearly needed. IBRD's projects are thoroughly prepared. They average an economic rate of return of 18 percent. No country has ever defaulted on a World Bank loan, and we have never suffered a penny's worth of loss in 37 years of operations. And on some $40 billion of loans outstanding, arrears of principal and interest -- what can be called past due -- average only about $50 million.

In essence, then, the mission of The World Bank is to help developing member countries expand their economies so that the standards of living of peoples can be improved, and their absorptive capacities for imports to help that process can be accelerated. Our priorities are in helping countries expand their agricultural capabilities; build infrastructure such as roads, rail systems, ports, hydroelectric facilities. The overwhelming bulk of what we do, one can see. We finance projects!

The understanding of the American business community of the operations of The World Bank and its affiliates -- their purposes, their effectiveness, and their role in building a stronger global economy -- is important to us. And to you. We now know that the developing countries are willing to undertake significant changes in their economies to adjust to the changed global economic environment. And they now know that without such changes, they won't be able to attain or maintain apropriate levels of growth. And both they and we now know that such adjustments are expensive.

So, if the Bank, through its continuing economic policy dialogue with its borrowing members, is going to contribute really effectively to improving public policy and private confidence in these countries, its money must accompany its advice. And that applies equally to IDA.

Helping the developing countries get their economies back on track so that we in the United States and the global economy as a whole can prosper, is the broad rationale for supporting and strengthening the work of the Bretton Woods institutions. And it's one that ought to make eminent sense to anyone who seeks a stable and healthy environment in which to do business.

Thank you.