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Latin American Industrialists Association - Panama City, Panama - August 18, 1982



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Latin American Industrialists Association, Panama City, Panama, August 18, 1982

Remarks

by

A. W. Clausen

President

The World Bank

before the

Latin American Industrialists Association

Panama City, Panama

August 18, 1982

Good morning, ladies and gentlemen; and thank you, Dr. Hoffman, for your gracious introduction.

I am grateful for the opportunity to meet with this distinguished assembly of industrial leaders from Latin America and the Caribbean.

This year marks the thirty-fifth anniversary of World Bank operations in Latin America. In all that time, the region has never before suffered a year like this past one -- a year in which the level of per capita income actually suffered a significant drop.

There are three important messages which we at The World Bank want to share with Latin Americans at this sobering moment.

First, that The World Bank has gained a deep respect for the economic dynamism of this region over the last generation, and that we expect this dynamism to outlast -- and to help overcome -- today's global recession.

Second, that, especially at this critical juncture, governments can ill afford policies which may be comfortable in the short term but counterproductive in the long term.

Specifically, this is no time to neglect investing in Latin America's rich human potential, to tolerate economic inefficiency, or to retreat from the global economy.

Third, and finally, we want to discuss with you how The World Bank can contribute to the region and mention some new initiatives we are launching to expand our impact.

* * *

Economically, the hurt is now! Real wages are not rising. Unemployment is up. Global inflation has added to the chronic inflation problems in the region. Business and industry are in a slump.

We are suffering through our second sharp global recession in ten years, and resolute action -- on a global scale -- will be required to overcome it. The industrial nations of North America, Western Europe, and Japan still account for two-thirds of the world's economic output, so we look to them, in particular, for leadership back toward patterns of robust global growth.

We can already see a few signs that adjustments necessary for sustainable future growth are, in part, being accomplished. Inflation has been falling in most of the industrial countries, and U.S. interest rates have recently declined a bit, too. Somewhat lower oil prices are partly due to actions taken -- around the world -- to conserve energy and to develop new energy resources.

We must press ahead with efforts to keep inflation under control and to adjust to the permanent reality of relatively expensive energy. We also need to stimulate higher levels of saving and investment.

And, especially now, the world must resist protectionism! Protectionism is a cancer, and if we let it start to spread, it would kill off any chance for sustained recovery from the global recession.

In the midst of these current difficulties, it is encouraging to remember that the past generation has seen unprecedented economic expansion in Latin America and the Caribbean. The region's growth record of the last 20 years surpasses that of the major industrial countries and of all the other regions of the world except East Asia.

Latin America cannot escape the consequences of global recession by itself, but global conditions have surely not put an end to the economic dynamism of this region. And so we look to Latin America and the Caribbean to help overcome the world's economic difficulties, and, once we have regained a global pattern of growth, we expect that this region will again enjoy faster than average growth.

The world economic situation has been turbulent throughout most of the Seventies. But notwithstanding, Latin America has weathered the Seventies well. Its average annual growth rate of nearly six percent was virtually equal to what was achieved in the booming Sixties.

And it is important to note for this audience that Latin American industry has been a key factor in this rapid growth. Manufacturing output actually doubled in the Sixties, and has consistently expanded faster than the region's economy overall.

The region's industrial achievements are partly due to improved economic management by many of your governments. But they are also a tribute to the vision, persistence, and hard work of the region's industrialists. You should be proud of your contribution. In all candor, you are one reason why we are optimistic about the long-term future of Latin America and the Caribbean.

The global economic environment is bitter. But another reason to temper the pessimism prevalent today is that all of the large countries in the region which have been adversely affected by higher energy prices now have vigorous programs underway to conserve energy and to develop their own energy potential. Brazil, for example, has adopted far-reaching adjustment policies to reduce its vulnerability to world energy prices.

The small countries of the region, most of them in Central America and the Caribbean, are poor in energy resources. Some of these small countries have good prospects, too, but they are particularly vulnerable to changes in the global economy. They will especially need international assistance in the years ahead.

The World Bank is contributing to this special area of need within the region by chairing the Caribbean consultative group and by supporting the new initiative which the Inter-American Development Bank has launched in Central America.

The region as a whole, however, still represents one of the most dynamic parts of the global economy. It is hard to predict now how soon the turnaround will take place since the economies of the principal industrial countries are still sluggish. However, we think it is realistic to look forward to better days for Latin America and the Caribbean. And, in continuation of Latin America's past patterns of economic dynamism, we look to this region to give high priority -- especially now -- to the kinds of economic policies that will provide a base for future progress.

* * *

One lesson that emerges from the development experience of Latin America over the last generation is that there are two kinds of development policies. The first looks good in the short run, sometimes even for a few years, but eventually leads to crises which retard the growth process. I call these "boomerang policies."

The other kind of policy may be painful initially, but it leads to sustained progress over the long run.

Today there is some risk that governments will respond to the current duress by reverting to policies already discredited by experience -- precisely when sound policies are needed more than ever before!

So let me underline the importance of sound policies toward three broad purposes. First, in developing the potential of a nation's citizens. Second, in striving for efficiency in a nation's economy. And, third, in taking advantage of international opportunities.

Allow me to begin with a social perspective. Even at this moment of relative scarcity, it makes no sense at all to skimp on investments in a country's human potential.

Improving people's standard of living is the basic purpose of being concerned about economics at all. And investing in people is fundamental to economic success over the long term.

During the past generation, this region has made major advances in improving both the quality of life and productivity of its people through advances in education and health.

About two-thirds of all children were in primary school in 1960. Now virtually all children enter primary school in almost every country in the region.

Because of widespread improvements in health, a person born in Latin America today can expect to live to the age of 64 -- eight to nine years longer than someone born in 1960. Then, only two-fifths of the region's population had access to safe water; now, that's up to two-thirds.

On the other hand, much of the region has long been characterized by a sharp disparity between income groups -- or, what often amounted to the same thing, between urban and rural areas and between cultural groups.

This historic gap in many Latin American societies has yet to be overcome.

Rural areas lag far behind in educational and health advances. For example, in most countries the average rural child still spends less than three years in school.

Agriculture is another area of investment with high economic returns for the country at large. Agricultural development helps overcome the historic cleavage between urban privilege and rural poverty. And experience, in this region and worldwide, shows that agricultural progress and economic growth are closely correlated.

Agriculture was often overlooked in the past, because an earlier generation emphasized industrial development in a one-sided way. But more and more governments have come to realize that failure to improve agriculture eventually limits the industrial sector, too, by keeping incomes down and limiting the market for industrial goods.

You, as industrialists, have no small stake in the continuity of investment in socially important sectors like agriculture -- or education and health.

The converse is also true. Social welfare depends, in no small measure, on hard-headed efficiency in business.

The region's population is still growing at an average of 2.3 percent a year, even faster in Central America. This rapid population growth is -- almost literally -- eating up the region's economic gains, and every effort should be made to bring this growth rate down to sustainable levels.

But as long as population is growing at anywhere near its present pace, economic growth is essential -- if only to expand employment and basic social services in line with population.

Unemployment is a serious problem in many countries, especially right now. But, over the last generation, you have managed to absorb a large proportion of the growing labor force into productive employment. It's important to note that you have also managed to increase the proportion of workers employed in high-productivity sectors like industry.

To maintain the rapid economic growth this region needs, economic efficiency must be a second fundamental policy objective.

Partly due to well-intended efforts to keep inflation under control, Latin American governments have come to regulate many prices. But economic efficiency seldom wins out in the push and pull of special political interests over controlled prices. There is, rather, a tendency for inefficiencies to set in ... a tendency for subsidies to proliferate.

A consistent undervaluation of agricultural prices has, as much as any other factor, frustrated agricultural development. And when the domestic price of energy has been kept low, efforts to conserve energy and to develop domestic resources have slowed down. Low energy prices are disincentives for conservation and production.

Most Latin American countries have opted for a mixed economic system. In the major countries nearly 40 percent of fixed investment is in the public sector. A number of governments have, in fact, realized that they were over-extending their public administration by involving themselves too extensively in what the private sector might do just as well or, in many cases, even better.

Insofar as public sector enterprises are still responsible for much of the region's production, however, it is crucial that they set prices realistically and invest carefully. Both the public and private sectors ought to contribute to the overall efficiency of the economy.

But in order to get the most national benefit out of the private sector, stability of policy is basic.

Last year the Central American Institute for Business Administration surveyed private entrepreneurs to learn what they most wanted from government. More than anything, the entrepreneurs said they wanted stable rules of the game -- regulations they could count on to outlast short-term political shifts.

Turning to questions of efficiency in capital markets, "stability" is again crucial, because it encourages long-term financial instruments to match long-term investment needs.

The successful evolution of development banking in the region over the last generation has also helped to make more medium- and long-term capital available, especially for industrial investment.

But, meanwhile, some countries are still trying to hold down interest rates by regulation, a sure way to discourage financial savings and encourage capital flight.

Panama, our host country, provides an excellent regional model of an efficient capital market, for it has become an important international banking center for Latin America.

Efficiency in capital markets, as well as in pricing and in both the public and private sectors, is also fundamental for the region's future economic and social development.

Finally, in addition to socially oriented investment and efficiency, there is a third policy goal which needs to be stressed. Countries in Latin America and the Caribbean should position themselves to take advantage of economic opportunities globally.

The arguments for an outward-looking development strategy are valid, even now that demand is slack throughout the world.

Industry needs economies of scale to continue raising incomes through increased productivity. And the domestic markets of the countries in this region are, in general, not large enough for the necessary specialization.

Everybody is in favor of exports. But not everybody is in favor of reducing restrictions against imports. And restrictions on imports automatically penalize exports. Thus, they tend to limit industry to the domestic market and, at the same time, dampen overall growth. So an inward-orientation keeps industry from developing to its full potential.

You all know how Latin America erected import barriers some decades ago to encourage its own industry. Much of Latin America's industry was, in fact, developed behind high walls of protection. But this process ran out of steam by the early Sixties. Many countries found themselves intolerably burdened with the inefficiencies of general, virtually permanent protectionism.

Trade barriers are crutches for development which, if used too long, actually weaken the economy they are intended to strengthen.

Most of the countries in this region still retain barriers against imports which are far too high! But, happily, over the last two decades many of the region's governments have moved toward more openness to world trade.

As tariffs have come down, Latin America's export sales have gone up quickly. But world trade as a whole has expanded even more quickly than Latin America's share in it. The region has taken some advantage of the possibilities for international trade, but its export potential has yet to be fully developed.

Latin America and the Caribbean have also attracted rapid increases in international investment, but there are some problems in this area, too.

Eighty to ninety percent of Latin America's investment is financed from domestic savings, but this fast-growing region offers more investment opportunities than can be financed locally. And, as the cost of energy imports has gone up over the last decade, many countries couldn't have maintained high rates of growth without sharply increasing their borrowings.

The region's net government borrowings from commercial banks jumped from \$21 billion in 1973 to \$115 billion in 1980. The long-term trend for private direct investment is also up -- from about \$400 million per year in the early Sixties to more than ten times that much now.

A number of countries are having some debt-related problems during the current economic downturn, and international commercial banks are becoming increasingly cautious as Third World debt mounts. There has recently been some retrenchment in commercial lending, but, as a general rule, the governments of this region have managed the huge increase in their debts over the last ten years relatively well.

Everyone is tempted to be less forthcoming during a recession. That also includes governments in North America, Western Europe, and Japan.

Conditions in the industrial nations -- high unemployment, high interest rates, factory closings -- could hardly be more conducive to a retreat from liberal trade policies. The winds of protectionism are, in fact, blowing stronger now than at any time in recent history!

For the nations of North America, Western Europe, and Japan to give in to "protectionist" pressures would be a boomerang policy with negative consequences for the whole world! It would prolong the global recession.

It is somewhat encouraging that the U.S. administration is proposing freer trade and investment policies toward the Caribbean area and Central America. But even before this initiative is approved, the United States has imposed quotas on imports of sugar, and there is much talk in the United States of "reciprocity" in trade relations.

A global orientation on the part of Latin America and the Caribbean certainly makes sense! The recession will be, hopefully, only of short duration, but even if it is not, there is no more promising alternative to export-led growth, especially for relatively small countries.

When countries have maintained trade-oriented policies, including realistic exchange rates, they generally have managed to continue expanding their export sales quite briskly even under difficult circumstances. Brazil in the middle Seventies and Argentina for a period in the late Seventies are examples. In general, Latin America has suffered some loss in its exports of minerals over the last ten years, but has been very successful, even during this difficult period, in increasing its exports of manufactured goods and agricultural products.

* * *

Allow me to turn now, for a few moments, to the supportive role The World Bank intends to play in the continuing development of this region.

The World Bank has lent nearly \$20 billion in Latin America and the Caribbean over the past ten years. We lent \$3 billion in the region just last year, nearly a quarter of our total operations.

And World Bank lending is worth more than the dollar figures alone indicate.

Coming to The World Bank from a long career in commercial banking, I am impressed by the almost unique contribution which The World Bank makes through its evaluation of projects, its emphasis on institution-building, and its in-depth economic and social policy discussions with governments.

Remarkably, in almost every country visited during the extensive travels of my first year at The World Bank, the head of state has expressed special appreciation for the quality of the intellectual and analytical work which backs up the Bank's investments.

Sound economic and social policies are crucial for sustained development, and the Bank makes a significant contribution by packaging sound policies into its lending programs.

Let me give you two examples of the Bank's work along these lines.

You all know how serious the problems of rapid urban growth and uncontrolled settlements of the urban poor have been in Latin America. Over the last ten years, The World Bank has been instrumental in introducing some promising approaches to these problems.

The Bank has advocated a strong social orientation in the housing sector, but has coupled this advocacy with tough-mindedness on the financial side. The Bank has directed its investments in the sector to inexpensive improvements in housing for low- and lower-middle income people: sites-and-services and slum improvement. But, at the same time, the Bank has advocated reducing subsidies and raising interest rates, so that such programs could be replicated.

This approach is now becoming standard practice for housing authorities in many countries, but when the Bank began, it had difficulty finding even a few countries around the world which would give these notions a try.

Let me cite another example.

In 1976, in consultation with the Mexican authorities, the Bank undertook a detailed analysis of Mexico's industrial sector. The study recommended two areas for special attention -- small and medium industries and capital goods manufacturing.

The Bank then collaborated in the design of an exceptionally comprehensive and effective program of support for small and medium industry. In addition to its financial contribution, the Bank helped, for example, by suggesting ways to encourage Mexican banks to lend to small enterprises.

Following up on the other emphasis of the study, capital goods, the Bank worked with the Mexican authorities for three years in designing an incentive framework. Its main elements have been put in place over the last year, and a billion dollar program of investment in Mexico's capital goods industries has now begun.

These are but two examples of the Bank assistance in promoting industrial development in Latin America. Since 1975, World Bank lending to private enterprise through the region's development finance institutions totalled \$2 billion -- averaging \$250 to \$300 million per year in 6 or 7 operations. For this year we are projecting a sizeable increase to some \$500 million in 8 to 10 operations. These projects are designed to strengthen the capabilities of development banking as well as supporting efficient investments in industry.

World Bank analysis helps us tailor our programs to the unique requirements of particular countries. This is essential in view of the vast differences among countries in the region.

We can also provide at least the benefit of World Bank analysis in countries where, because of problems of size or creditworthiness, we are limited in what we can lend. This is the situation in some of the small countries of the region which especially need international support.

Let me reassure you that we have not changed our basic policy regarding the "graduation" of countries from The World Bank's normal lending program. Once a country crosses a certain threshold of per capita income, the issue of graduation comes under study. The Bank then prepares a plan for "phasing out." But the process is always gradual (over a period of up to five years) and is specifically adapted to the overall situation of the country ... taking a number of criteria, in addition to per capita income, into consideration.

At the present time, we are innovating, in a number of ways, in order to expand our impact in the developing countries at a time of general contraction.

Last month our Board of Executive Directors approved the Bank management's recommendation to undertake limited borrowings in the rapidly expanding market for short-term and variable-rate instruments. The overwhelming bulk of our borrowing will still be long-term at fixed rates, but now the Bank is also permitted to enter the short-term market in order to provide some additional insurance for future expansion.

From now on, the interest rate charged on outstanding indebtedness to the Bank will include a small element of variability. At the same time, our ability to tap into short-term markets helps to remove a potential constraint on the amount of lending that The World Bank will be able to do over the coming years.

To support our lending programs, we must be able to borrow approximately \$9 billion in the 12-month period to June 30, 1983.

Another way to stretch the resources available to us is by attracting commercial investment as a complement to The World Bank's own funds.

We are therefore encouraging IFC -- the International Finance Corporation -- to expand. IFC is the affiliate of the Bank which specializes in promoting private investments and attracting international capital in support of private enterprises. Unlike the Bank, IFC loans without government guarantees, and it can also provide equity funds.

To give you an idea of what IFC does, it recently approved an investment that will help a Colombian company access the Eurobond market for the first time without government sponsorship. This past year, IFC also helped establish the first agricultural leasing company in Brazil. A \$5 million IFC loan to a Jamaican milling company will double its capacity and allow it to meet virtually all of Jamaica's wheat-flour needs.

IFC has undertaken more investments and invested more money in Latin America than in any other region in the world. Of its total investments of nearly \$4.7 billion, almost \$2 billion has been in more than 170 companies in 22 countries of this region.

As many of you may know, The World Bank is making a major effort to expand co-financing with commercial banks. We were able to build \$1.8 billion worth of commercial co-financing into the projects approved during our 1981 fiscal year. In the 1982 fiscal year just completed, we raised that to \$3.3 billion.

Our efforts to increase the flow of resources to the developing countries by increased emphasis on co-financing has particular importance for Latin America, because almost half the funds so mobilized over the last five years have been for this region.

* * *

In summary, ladies and gentlemen, let me briefly reiterate my main points this morning -- that despite current problems we expect continued economic dynamism in this region, that far-sighted development policy is crucial, and that The World Bank will continue to support your efforts.

I believe it is worth repeating something a predecessor of mine as President of The World Bank, John McCloy, said in Bogota shortly after the Bank started its operations in Latin America 35 years ago:

The 19 American Republics had as great or greater influence in determining the charter power of the International Bank as all the rest of the nations put together. If it had not been for the American Republics no such Bank could ever have been created at Bretton Woods. This is your Bank -- it is not something detached or remote from your interests.

We intend that The World Bank's strong traditions of service to Latin America and the Caribbean, coupled with innovations appropriate for our own time, will contribute to the region's prompt recovery and long-term prosperity.

We expect the nations of Latin America and the Caribbean to opt for sound economic and social policies -- policies that don't skimp on investments in human resources, policies that are careful about waste, and that promote expanding productivity by looking outward to the wide world of opportunity.

And despite the hurt and uncertainty of the moment, we have every confidence that most of Latin America and the Caribbean will return to a pattern of vigorous social and economic development in the years ahead.

Thank you very much.

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