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Statement by

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before the

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I appreciate your invitation to appear before this Subcommittee to discuss the multilateral development institutions and their role with respect to the debt and growth problems in the developing countries. Over the years I have had some opportunity to observe the Bretton Woods institutions -- the International Monetary Fund and the World Bank -- and to a much lesser degree the regional development banks. All these institutions, in my judgment, have important ongoing roles to play in safeguarding international stability and in promoting sound growth in the world economy.

In the process, they necessarily have to adapt their programs and approaches to new circumstances as they emerge. That is not an easy task for large institutions, and particularly for those that must operate within the framework of a wide international consensus. At the same time, it is the fact that these institutions are international, with memberships drawn from all nations other than the USSR and most of its satellites, that provides a sense of cohesion and political legitimacy essential to the success of their efforts -- efforts that seem to me very much in accord with the larger interests of the United States.

I believe the constructive response of these institutions to the severe debt and adjustment problems that emerged in the early 1980s illustrates these points. In the initial stages of the international debt crisis, the Fund played an essential and, in key respects, an innovative role. It worked with borrowing countries to develop strong adjustment programs that could command international support. Concurrently, it helped coordinate an unprecedented international cooperative effort to provide sufficient external funds to meet immediate needs and to support the countries' adjustment efforts.

The World Bank and regional lending institutions, geared toward a longer-range perspective and project lending, could not, in the circumstances, at first respond so forcibly. Indeed, borrowing countries cut back on some investment projects that could have received World Bank support.

Now, many of the borrowing countries are or should be moving into a second stage, looking beyond the immediate need for budgetary and monetary adjustments to the essential need to sustain growth within the constraints of servicing existing debt and the less ready availability of private credit. In that context, the role of the World Bank and the regional development lending institutions is likely to become much more critical. The need for innovative approaches and even closer cooperation with the Fund seems to me evident.

There is a natural division of labor between the two Bretton Woods institutions that must be respected. The Fund is concerned with monetary stability, with balance-of-payments equilibrium, and with the broad economic policies necessary to support that equilibrium. The Bank is concerned with longer-term development and projects and policies designed to support that development in particular sectors of the economy.

These are valid distinctions. Essentially the roles are complementary, not competitive. But in practice, both institutions serve as sources of finance, as purveyors of policy analysis and advice to their members, and as forums for economic consultations among governments. In specific areas, those functions can overlap, and should be coordinated. Management of the "debt problem" provides apt illustrations.

First Responses to the International Debt Problem

Beginning in 1982, many foreign borrowers, principally in Latin America but also in other areas of the world, experienced an abrupt curtailment of their access to new loans from the private market. The Fund responded by assisting in the design of stabilization programs to help restore confidence and external balance. It also provided temporary financial assistance to many of the most troubled borrowers. In one perspective, that kind of work is a normal part of the Fund's business. But it has been without precedent in scope and challenge. More or less simultaneous negotiations have been required with a large number of member countries in a highly charged atmosphere. Not only were the fortunes of particular countries at stake, but also the performance of the world economy and financial system as a whole.

In that situation, the Fund became involved to an unusual degree in consultations with the borrowing countries' commercial bank and official creditors. Those lenders clearly recognized that individual, uncoordinated responses to the crisis could not serve their mutual interest in orderly adjustment and servicing of loans. Restructuring of old debt and some new private credit would typically be necessary to provide enough time for the adjustment process to be effective. By working with the Fund, lenders could both be better assured that appropriate adjustment programs were undertaken and financial needs appropriately assessed. From the viewpoint of the Fund, orderly refinancing of outstanding debt and the provision of new private credit, substantially supplementing its own resources, provided essential financial support during the period of economic adjustment.

With its traditional emphasis on investment planning and project lending, the World Bank was not in a position to react as quickly as the IMF to the immediate adjustment needs of the major borrowing countries. Nor were borrowing countries -- faced with overwhelming short-term needs to cut back on budget deficits, to bring monetary expansion under control, and to adjust exchange rates -- able to give priority attention to long-term development and investment programs. Instead, cutbacks in overall investment and consumption expenditures by governments became unavoidable. In these circumstances, both existing and new investment projects assisted by the World Bank and other donors tended to slow down rather than increase.

Even in the "crisis" stage, however, there have been clear opportunities for mutually supportive approaches by the Fund and the Bank.

In advising countries about "adjustment" programs, the Fund is always concerned with measures that should help promote economic efficiency and long-term development. Flexible pricing policies, more open and less discriminatory trade practices, and appropriate exchange rates are normal parts of Fund-sponsored programs. Such approaches are consistent with, and typically crucial to, long-term growth. At the same time, the Bank was, in fact, able to increase or speed up its disbursements of funds to several of the countries affected by the debt crisis.

That response was assisted by the capability the World Bank had developed in 1979 for nonproject lending through so-called "structural adjustment loans" (SALs). The Bank's new commitments for SALs and broadly similar "sectoral adjustment loans" expanded from less than $1/2 billion in FY 1980 to more than $2-1/2 billion in FY 1984, before declining somewhat in the fiscal year just ended.

The SALs and sectoral adjustment loans have the advantage of being fast-disbursing, so that they can have an immediate effect on short-term balance-of-payments financing requirements. At the same time, they are strongly linked to policy actions, designed to promote economic efficiency in particular sectors and to support growth. The recipient government, in effect, commits itself to changes in specific policies that will be sustained over time and which are expected to have a material positive impact on the effectiveness of its investment expenditures and on the growth of the economy.

There is, by now, a record of accomplishment by these kinds of programs in some countries. For example, Turkey has undertaken a series of major reforms, including major steps toward import liberalization, decontrol of interest rates, and reform of state economic enterprises with the support of the World Bank.

These efforts of the Bank overlap with those of the Fund in two respects. The quick-disbursing Bank loans help provide the necessary external financing for the borrowing countries. And, at a sectoral or "micro" level, the policies supported by the Bank should reinforce and undergird the efforts of the Fund to promote economic efficiency and competitiveness.

The recent efforts by the Fund and the Bank in Colombia exemplify these relationships, and could have implications for future cooperation. While that country has not requested or received IMF financial assistance, it has kept the Fund fully informed in developing its economic program. Just last Friday, the Fund, in turn, agreed to monitor progress in implementing the economic adjustment program, which, in the judgment of the Fund, is broadly appropriate to the needs of Colombia. Meanwhile, the World Bank is a major lender to the country, both for specific projects and for sectoral adjustment. The size of that lending program has been facilitated by the efforts of Colombia to implement suitable adjustment measures. The staffs of both institutions will work together in assessing Colombia's progress.

Looking Ahead

The particular circumstances in Colombia are unique, and the arrangements in that country do not necessarily provide a precise prototype for others. However, all the heavily indebted countries in Latin America and elsewhere need to move from a situation of endemic financial crisis to another stage in development, looking toward what is necessary to sustain growth. As they do so, the particular skills and resources of the World Bank become increasingly relevant. Heavy reliance on the shorter-term tools of the IMF should then be phased down and out.

Clearly, either or both of these institutions can only play a supporting role in the economic development of a country. The borrowing countries themselves must maintain a disciplined budgetary and financial environment, enabling them to consolidate the essential gains they have made in achieving better balance in their external accounts and to respect the tight constraints that still prevail with respect to their access to external finance. I believe they will also have to encourage more open and competitive economies, able to sell into world markets as well as to increase their productivity. They will need well-conceived investment programs. More generally, they will need to encourage economic efficiency and well-functioning markets in agriculture, industry, and finance. These are the kinds of things the World Bank and its affiliate, the IFC, working especially with the private sector, can support, but not impose.

Internal reform is critical in circumstances in which access to new foreign bank and trade credits seems bound to remain limited for the time being. The hope occasionally expressed for really major increases in long-term official lending on concessional terms to the middle-income developing countries does not appear politically realistic. Moreover, I doubt that industrial countries are prepared to ease substantially debt burdens by taking over and writing off existing debt to private lenders. Nor do such approaches seem to me essential if well-conceived adjustment efforts are maintained.

In time, renewed confidence could end capital flight and induce repatriation of capital by the citizens of the borrowing countries themselves as well as fresh flows from abroad. That process would be immensely helpful and the best possible evidence of success. But it is, of course, dependent upon a sense of sustained economic performance.

The implication of these conditions is that it is too early for the major borrowers to plan on significant net private inflows of capital. Imports will not be able to grow over time at a rate substantially exceeding the growth in exports. But that is not a recipe for stagnation, so long as exports in fact grow.

One of the lessons of experience is that rapid growth in developing countries, without excessive dependence on new debt, must go hand in hand with participation in international trade. That is why a competitive and relatively open economy is so important. This is a theme that the World Bank has stressed in its structural and sectoral adjustment lending.

Without doubt, there will be more opportunities for working with borrowing countries to help encourage the process. In some countries, for instance, there are urgent needs to improve the efficiency and effectiveness of agriculture, of transport, and of domestic financial markets and institutions. Review of the structure, operation, and performance of state enterprises is sorely needed, including the possibility of greater private participation and incentives in some cases. Structural distortions that hamper or discourage sectors of the economy that potentially could become the most dynamic and efficient need to be eliminated. That in turn may require import liberalization so that companies that have high export potential can in fact make use of the most rational and efficient production techniques. Much of this seems to be recognized, for instance, in the latest steps announced by Mexico only last week, in conjunction with actions to reinforce budgetary discipline and to adjust exchange rates.

In all these areas, there should be potential opportunities for constructive World Bank collaboration, both in consultation as to the design of programs and in financing, dependent on effective implementation. That official financing will not only help the borrowing countries to cover external needs during a period when private financing is so slack, but also encourage some resumption of private lending, through so-called co-financing or otherwise.

You are aware that the World Bank now has under development a proposed Multilateral Investment Guarantee Agency (or MIGA). MIGA would be designed to enhance prospects for foreign direct investment by providing guarantees against noncommercial (i.e., currency transfer and expropriation) risks. Here in the United States the Overseas Private Investment Corporation has offered such guarantees to U.S. investors in many countries for over 20 years, with a considerable measure of success. Some other countries have comparable programs. But, properly structured, I believe wider availability of such guarantees on a multilateral basis could help improve the climate for direct investment in the developing countries.

None of this suggests to me that the major focus of the World Bank on project lending will not or should not continue. The inherent discipline in project lending -- the need to relate a loan to tangible projected returns -- is important. But it also is quite possible that, as a matter of relative priority, heavily capital-intensive, long lead-time projects, with returns deferred far into the future, could give way to areas where more effective use of the existing capital stock is emphasized, with quicker and more evident returns.

I will not pretend to an expertise in these areas that I do not possess. But certain broad conclusions do seem to me valid.

> In the World Bank Group and the regional lending institutions the world has an enormously valuable resource. That resource lies not just in their technical skills and financial resources. As <u>international</u> institutions, they are in a uniquely advantageous position for working constructively with developing countries in the common interest.

> The role of those institutions will be more important -- indeed potentially crucial -- in Latin America and elswhere if those countries are to be able to restore strong and sustained growth in the wake of the debt crisis.
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> The development institutions can only be effective as they build on the stabilization efforts of the countries themselves -- the effort that has been so strongly supported by the IMF.
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> As that implies, the efforts of the IMF and the World Bank in heavily indebted countries have become increasingly intertwined, and the need for close cooperation and operating relationships between the institutions has greatly increased.
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> The entire effort deserves the continued strong support of the United States, including, as and when the need is demonstrated, financial backing in the form of capital increases.

Perhaps I need not emphasize at length that the success of all these efforts is also fundamentally dependent on prosperous, growing economies in the industrialized world. Here and elsewhere, we must maintain reasonably open markets for what others can produce more efficiently and economically. The developing countries, in turn, can again become the most promising and most rapidly expanding markets for our products, as they were during much of the 1960s and 1970s. Flourishing two-way trade will be both the means for recovery and growth and a measure of our success.

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