Remarks by Chairman Greenspan
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Global Economic Prospects and the LDC Debt Problem
(for February 16 Presentation to Bretton Woods Committee Annual Meeting)

I am pleased to join this distinguished group today. I was on the edge of accepting an invitation to join this group when my attention was diverted to other activities last summer.

The realization of the goals of the IMF and the World Bank, particularly with regard to the international debt problem, is very much intertwined with the economic performance of the global economy. A favorable world economic, financial, and trade environment is a necessary but not sufficient condition for heavily indebted countries to make further progress in restoring orderly debt servicing and regaining access to international credit markets.

The United States is now into the sixth year of economic expansion. There also are signs of some rebound in economic growth in Japan and to a lesser extent in Western Europe. Despite these developments, the prospects for more

buoyant economic activity in the industrial world are patently not great. The lingering impact of the stock market plunge and the ongoing correction of global external imbalances are factors that add to both the fragility and uncertainty of the growth prospects in industrial countries.

The United States is in the midst of adjusting its own economic imbalances, with resulting slow growth of domestic demand as resources are appropriately being shifted to the export sector. Correspondingly, our major trading partners are absorbing in their export sectors the effects of the sizeable swing in exchange rates that has occurred over the past two years. Some adjustments in policies have been taken in these countries to offset the weakened contribution to output from the external side. At best, however, we will see on balance only moderate economic growth in the near term in the major foreign industrial economies.

On the inflation front, the industrial countries have made impressive strides during the 1980s in lowering inflation rates. However, we must be vigilant not to forfeit the gains achieved. Increases in inflationary expectations can too readily feed into wage and pricing decisions that, in turn, could initiate an inflationary spiral that would be difficult and costly to unwind.

Another area where there is increasing evidence of progress is the adjustment of global imbalances. Recent U.S. trade data are encouraging, particularly those on export volumes. We can also reasonably look forward to further progress in narrowing the large nominal external imbalances, but this progress is likely to be more gradual and irregular.

We have been fortunate that the industrial countries, despite at times facing severe economic difficulties in recent years, on the whole have maintained an open trading environment. Nevertheless, as shown in

recent World Bank studies, for example, the general level of protectionism and the intensification in protectionism that has occurred in recent years have had a disproportionately greater impact on the developing countries than on industrial countries. This has been particularly the case with regard to agricultural products, textiles, and steel. These are trade categories where some of the developing countries have faced particular difficulties in expanding their markets. If the heavily indebted developing countries are to grow out of their debt-servicing difficulties, it is critical that their access to the markets of the industrial countries expand.

As you know, we have experienced wide swings in exchange rates between the dollar and other major currencies in recent years. The exchange rate movements have not been a major source of problems for the major developing countries, in part because the exchange rates of many of these countries are tied to the U.S. dollar. However, it

would appear that a more stable exchange rate environment would contribute to more stable economic and financial conditions particularly in the industrial countries, which would redound to the benefit of the developing countries.

Exchange rate stability, while a desirable objective, cannot be decreed. Exchange markets are influenced not only by developments in goods markets but are also subject to shifts in currency preferences by holders of a vast pool of liquid and shiftable financial capital. In the end, what will determine whether exchange rates among major currencies will exhibit stability is whether there is stability in the underlying factors that affect exchange rates -- economic policies, relative rates of economic growth and inflation, interest rate developments, and external accounts.

In light of the uncertain and fragile economic and financial environment in the industrial world, economic policies must be directed at achieving sustainable economic

growth with low inflation. This is essential if we are to make progress in ongoing efforts to correct the large global external imbalances. Sound economic management in the industrial countries that will achieve these objectives will obviously be most helpful for the heavily indebted developing countries.

A favorable world economic environment by itself, however, will not be sufficient to restore the developing world to economic health. What is certainly even more important for the heavily indebted countries is to deal with their debt problems by exhibiting a political capacity and will to pursue sound economic policies. In the end there are no clever financing schemes or fiscal gimmicks that can substitute for sound policy. Debtor countries will be restored to full access in the internatinal financial system because of their policies, not those of their creditors. Fortunately there is increasing evidence that debtors

understand this. It is not clear that they would have two or three decades ago.

Even as recently as 1982 when the debt crisis hit, the possibility that the demagogic appeal of repudiating debts in the name of narrow nationalism and anti-capitalistic slogans was a major threat to the international banking system and to an even greater extent the debtor nations themselves.

However, in recent years there has been a dramatic shift in political philosophy of the industrial world and the changes have spilled over into the economic management of the developing nations. The leaders of these countries have shifted from the socialist planning "model" espoused by the Group of 77 in the 1970s, for example, to the more market-oriented policies being advocated more aggressively today. This has been occurring most notably in many Asian economies, but also increasingly in Latin America and Africa, and even in Mainland China and in the Soviet Union.

Financial leaders of debtor nations, have only recently begun to understand the dangers to developing countries in withdrawing from the international financial system -- especially the risk of losing trade credits and interbank deposits. Responsible leaders in these countries instead are beginning to more fully recognize the benefits to be derived from being a functioning participant in the international financial system.

Some positive results of this shift in policy emphasis are already evident -- a resumption of economic growth, improved export performance, particularly for nontraditional exports, and a halt and even a reversal of capital flight.

Those countries that are opening their economies, by privatizing public sector enterprises, by removing trade barriers, by deregulating, and by allowing more scope to market forces, in conjunction with following sounder and more consistent macroeconomic policies, can look forward to

becoming more self-reliant. Such countries should also regain the confidence of their domestic investors. This would be manifested in a more effective mobilization of domestic savings and by the repatriation of flight capital. In addition, such more "outward" looking policies are the best route for these countries to regain access to international credit markets. Continued gains will not be automatic. There remain great political strains within many developing nations. It's part of the process of developing.

We, in the industrial countries and in the international financial community, must do our best to support and encourage the trend towards productive policies in order to increase the probability of success.

The IMF and the World Bank also have important roles to play in nurturing this process. The emerging agreement for a sizable general capital increase for the World Bank and the approval of the Enhanced Structural Adjustment Facility in the IMF demonstrate the readiness of

the membership of these institutions to enlarge the capacity and scope of these organizations. Such developments will allow these institutions to play an even larger supportive role in assisting borrowing countries to deal with their debt-servicing problems.

In providing assistance to the borrowing countries, as Barber Conable and Michel Camdessus know from experience, the IMF and the World Bank must be sensitive to the circumstances of these countries. The stabilization and structural adjustment programs arranged under the auspices of these two institutions will only be successful if they are "home grown" and have domestic support.

The IMF and the World Bank, however, cannot be counted on to be the sole providers of the financial resources needed in the near term by the borrowing countries. Commercial banks, to whom the borrowing countries owe a major portion of their external debt,

continue to have a self interest in helping the borrowing countries restore an orderly debt-servicing capability.

Debt-equity conversions and arrangements such as the Mexican debt exchange are useful on the margin in helping borrowing countries to ease their debt-servicing requirements. But these countries are likely to require additional capital inflows to allow them to develop their economies. Some of these inflows will need to come from those commercial banks that have a continuing stake in the successful development of these economies.

Much has been achieved in dealing with the debt problem in recent years, but much remains to be done. It would be regretable if efforts invested in dealing with the debt problem were to be dissipated because of fatigue and frustration with the thus-far limited results.

Politicians are often accused of having short time horizons. It is impressive that there are a number of leaders in developing countries who are increasingly

taking the longer view. They have shown a determination to pursue sound economic management and to reform their economies in spite of still strong political pressures to go in less productive directions. These leaders merit the support of the creditor countries, the international lending institutions, and the commercial banks.