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"Working Together Toward Growth And Stability"

Remarks by

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It is a pleasure for me to take part in this annual conference. Your theme of "adjustment and growth" could not be more apt. Those are the key words that recur again and again in all the discussions of development. I fear by this time the connotations are as much emotive as economic.

Growth is, of course, "good" -- something to be sought. But "adjustment," except to economists, has a quite different ring -- certainly painful, antithetical to growth, maybe even somehow subversive of democracy.

But viewed more logically, and looking over a reasonable time period, they are not alternative policies that governments are free to choose. They are essential complements. Easy choices are rarely available to countries -- developed or developing. The reality is the sustained growth everyone wants often implies the need for adjustment.

Certainly, for the heavily indebted, middle-income developing countries, with whose economic and financial problems I have gained a certain familiarity over the past four years, the only choice has been how to, rather than whether, to adjust their economies -- adjust away from excessive reliance on external financing and adjust toward capital formation and efficiency. That transition is difficult both politically and economically -- it has necessarily involved large exchange rate adjustments, scaling back budget deficits by cutting expenditures and reducing subsidies, and other means of reallocating resources toward the external sector and capital.

But those approaches, intelligently implemented, are not anti-growth. What the discussion and debate should be about is not whether, but how best to adjust. And, even looking to the past when external financing was so freely available, borrowing to support consumption or to replace a chronic hemorrhage of private capital was hardly a satisfactory basis for growth.

The simple fact is that over the past three or four years, some substantial -- even dramatic -- adjustments have been made on the external side. That is most clearly evident in the fact that the fifteen major borrowing countries that have been identified with the Baker initiative have experienced a dramatic change in their external current account positions. After running unsustainable, collective deficits of about $50 billion per year during 1981 and 1982, their current account position dropped to essentially zero during 1984 and 1985. This shift was not simply a consequence of import compression: the volume of their exports rose by about 15 percent during 1983-84.

The burdens upon the major borrowers of servicing external debt are now significantly lighter than a few years ago. Reschedulings of their debt to banks and official creditors have reduced amortization requirements. Lower world interest rates have produced declines in interest payment obligations. While the reduction in burdens is far from uniform, in some cases interest payments as a percentage of exports of goods and services will be as much as one-third below their peaks.

At the same time, commercial banks' claims on developing countries have clearly moved toward more manageable ratios to their capital positions. The pace of bank lending has slowed substantially as the borrowing countries tried to bring their external debts into better alignment with their productive capacities. Meanwhile, bank capital positions have been strengthened. As a result, U.S. banks' exposure to non-OPEC developing countries in relation to their capital has dropped by about one-third between mid-1982 and the end of last year.

One can question whether, in the past year or so, net lending has not been below levels that will be necessary to complement effective economic programs of some borrowers. In any event, the relative reduction in exposure should continue even as the banks are called upon to provide the moderate amounts of net new private lending that a number of major borrowing countries may need during the next several years to support their plans for structural adjustment and growth. And, as those exposures decline, one of the preconditions for returning to more normal, fully voluntary, debtor-creditor relationships can be achieved.

The massive capital flight which occurred during the late 1970s and early 1980s and greatly added to the needs for external borrowing of a number of Latin American governments has generally subsided. Mexico is sometimes cited as an exception to that more favorable trend, but substantial changes in policies -- including a more competitive exchange rate and restrained credit policies -- seem to have curtailed the outflow more recently.

Despite these accomplishments, obvious problems remain, and some have become more acute. Growth has rebounded smartly in some countries even as they reduced or eliminated their external deficits. The biggest borrower of all -- Brazil -- is a leading case in point, and the Argentine economy is growing as well. But the pattern has been uneven and disappointing in some cases. Looked at as a group, the volume of exports by the major borrowers upon which so much depends, which had grown briskly over the previous two years, showed no growth at all during 1985, in large part a reflection of declines in commodity prices and the performance of the industrial countries that must provide their principal markets.

Since last fall, the sharp decline in world oil prices has added a new and disconcerting dimension to the problems of Mexico, Nigeria, Venezuela and Ecuador. Each of those countries has lost both real income and budgetary revenues in amounts that are critically large in relation to their resources, and the clear implication is that most of them will need to cover larger external needs than anticipated earlier, although not nearly as much as the decline in oil prices taken alone might imply given lower world interest rates and other offsetting factors.

In the circumstances, a sense of fatigue among borrowing countries coping with continuing economic and debt problems is hardly surprising. For some, the reduction in oil prices has added a sharper edge of concern, if not despair. At the same time, commercial banks are naturally impatient and seemingly more reluctant to step forward pending concrete evidence countries are successfully undertaking extraordinary stabilization efforts. Negotiation and implementation of new financing packages or restructurings seem to linger on longer and longer.

But far too much is at stake -- and far too much has been accomplished -- to make it sensible to give way to any sense of frustration. The mutuality of interest of borrowers and lenders in constructive approaches is as strong as ever. It is difficult -- I think impossible -- to deny the simple proposition that the debt problem, as so many others, must be resolved in a framework of growth. The corollary is that sustainable growth requires both financial discipline and structural changes. And none of that is likely to proceed for long unless developing countries are able to defend and maintain their credit-worthiness and access to the markets of world finance as well as goods.

The question is whether we can find the will and the means to act upon those theses with a sense of conviction and urgency. That is why we stand at a kind of watershed. Business as usual clearly will not be good enough. And the whole structure of economic and financial relationships between the developing and developed world will stand or fall together.

Crisis serves a constructive purpose when it galvanizes constructive responses. I believe the so-called Baker initiative can and does provide a kind of rallying point for that effort, not because it is a precise plan made in the USA but because it captures the essence of much of the thinking emerging in many parts of the world -- developed and developing -- over recent years.

The approach recognizes that success can only lie in a mutual, cooperative effort to achieve growth. The borrowing countries must indeed "adjust" -- adjust not just in the sense of effective fiscal, monetary, and exchange rate policies, but "adjust" in the sense of encouraging more competitive, investment-oriented, and open economies capable of penetrating export markets as well as meeting needs at home by generating productivity growth. The returns available in growing, productive economies can justify raising abroad a reasonable margin of the credit and capital needed to support growth, and those can be met through a combination of official and private resources, drawing on the World Bank and other development institutions and the commercial banks around the world with so much at stake.

None of that provides a fixed formula or standard cookbook for dealing with the specific problems of individual borrowing countries, each with its unique history and economic situation.

But it does provide a broad framework within which individual cases can be discussed, detailed approaches developed, financing negotiated, and plans implemented.

And, of course, the approach won't work at all unless it is convincing to the leaders of the borrowing countries themselves, consistent with the way they come to assess their own priorities, and capable of commanding the support of their people.

Are these countries, in fact, willing to work toward more efficient, competitive and open economies? Are they prepared to improve the climate for investment, whether by their own citizens or from abroad? Can pricing policies of state enterprises be more economic, and will those enterprises be sold, reduced in scope, or shut down when the job can be better done in the private sector? Can barriers to trade, including imports, be reduced and rationalized, in part to support the competitiveness of exports? Can their financial systems be made more efficient?

A lot of those directions go against the grain of much of post-war history in certain countries, and against the grain of the established political systems. Suspicions abound about intentions -- fear of invasion of domestic markets by international companies, concern about foreign or private domination of key national industries, a breaking down of bureaucratic control. Long cherished concepts about the proper role of the state are challenged. But the basic ideas and motivations are, of course, quite different -- to promote the efficiency, the capital formation, and the use of technology upon which competitiveness and growth rest. Opposition clothed in nationalistic rhetoric is sometimes a simple defense of vested interest.

It is also true that there are obvious successful role models -- some in the developing world, and some in the industrialized world, even by governments from more socialist traditions. Behind it all lies the simple truth that, in today's world, no single country is likely to prosper and grow without being an effective part of the larger world community, with good credit standing, access to world capital markets, the capacity and incentive to export, and financial stability.

Well, if that's the vision, it's reasonable to ask how it's all going with respect to the Baker initiative. I know that some would say slowly, if at all. They are looking to how many new loan agreements have been signed in recent months, how much money is involved, and how many completed IMF or World Bank agreements.

But I doubt that's the right test, or a fair test, particularly when the oil crisis has inevitably slowed some timetables.

What we do know is that the World Bank has moved quickly to play an increased role. A number of important negotiations are in various stages with Argentina, Mexico, Ecuador, Colombia, the Ivory Coast and others -- more than I might have thought likely at this stage. The Bank's ability to respond quickly reflects both already established criteria for supporting the structural adjustment process and its considerable experience in such areas as trade policy, energy policy, and agricultural sector policy. There are consultations underway with several of the major borrowers with the objective of articulating a sound medium-term framework for growth. These consultations have also had the benefit of insights and advice from the Fund staff to help ensure that Bank-supported sectoral programs are consistent with the country's overall macro-economic requirements and priorities.

But the real test can't be found in the activities of the World Bank alone. Rather one has to reach judgments about the approach of individual countries, their stated policies, and public attitudes. And here, it seems to me, some remarkable changes are in process. We do see important reforms of trade policies, privatization of state enterprises, and rationalization of price and regulatory systems in agricultural and financial sectors. More immediately, most of the major borrowers since the end of 1984 have encouraged the development of more realistic exchange rates, providing a competitive base for future export-led growth. Notably, Argentina, Bolivia and Brazil have embarked since mid-1985 upon bold domestic programs to disinflate and de-index their economies.

More broadly, countries like Colombia, Ecuador, Chile and Uruguay, in close collaboration with the Fund and Bank, are proceeding with important success with broad programs they developed before any articulation of a "Baker Plan."

Altogether, there is little doubt the winds of change are blowing, and some sails are being set to catch the favoring breeze. Now is the time to make the best of it.

There has been a lot of attention given to the problem of capital flight as a symptom of whether, in fact, progress is being made. No doubt that is a serious issue -- a kind of litmus test of the confidence the citizens of a country have in its own policies.

As I indicated earlier, the massive capital flight which occurred during the late 1970s and early 1980s greatly added to the needs for external borrowing by the governments of several countries -- Mexico, Venezuela and Argentina in particular. In that sense, it has been the underlying cause of the debt crisis.

But I think it's also fair to say that capital flight has receded somewhat in recent years, as the policy shortcomings that contributed to such flight have been corrected. While the data have to be interpreted with great caution, recent studies suggest that the pace of capital flight from major borrowers declined significantly during the 1983-85 period from the rapid rate that had prevailed during the previous two or three years. A number of countries have done much better. Even in Mexico -- where indirect evidence set forth by some suggests continuing large capital flight through mid-1985 -- substantial changes in policies have since occurred which have tended to halt and, perhaps, even reverse that process.

I don't refer to this evidence with any sense of complacency. We are a considerable way from any point where we can say, with confidence, that a constructive, self-sustaining process of growth and development is underway, that access to external credit is normal, or that fully effective use is being made of domestic savings.

Certainly, within a political environment, the process of working with the IMF and World Bank to achieve a clear and comprehensive commitment to needed structural adjustments and associated financial policies remains sensitive and challenging on all sides.

Commercial banks have made clear their broad support for the broad concepts of the Baker initiative. But their willingness to mobilize additional financing quickly once a borrower has developed a policy program and received general international endorsement has not been fully tested. Within the general framework of market criteria and covering costs, there may also be room for exploring innovative techniques in borrowing arrangements.

Behind all those particulars, a still larger question remains: Will the global environment be conducive to favorable winds, to strong markets and to sustained growth for the developing world?

One critical variable has been going right: The level of world interest rates has receded markedly, taking at least part of the sting out of the collapse in oil prices. The LIBOR rate to which most loan agreements are keyed is more than 5-1/2 percent below its mid-1984 level, and 1-1/4 percent below the level as recently as December. Most loans are denominated in dollars, so the decline in the dollar exchange rate is also helpful to most borrowers.

The major countries just this week meeting in Tokyo stated the importance they attach to a capital increase for the World Bank when appropriate. To facilitate private capital movements toward the major borrowing countries, industrialized countries have also acted to support the new Multilateral Investment Guarantee Agency, or MIGA, which should in time facilitate flows of direct investment. More particular actions can also help. For example, export credit agencies of the OECD countries, especially the U.S. Export-Import Bank, have been an important source of support for the financing of trade flows to the developing countries during this period of financial uncertainty. The interruption to debt service by the borrowers has, in some cases, caused official agencies to go "off cover" and cease new lending to the country in question. While in some cases such action may be justified, it will also have perverse incentive effects in the context of efforts to achieve constructive debit restructuring. I hope there is now more general recognition of that fact.

Another obligation we must accept is to restrain the forces of protectionism that hamper exports from developing countries to our markets. With developing countries eager to import what their resources can support, rising exports to the industrialized countries also mean more buying from us. It's not a matter of stealing jobs, but of being able to participate in, and share in the fruits of, a competitive world economy.

But none of those areas is so important to developing countries over the next several years as the prospects for sustained growth of world markets. And that unavoidedly raises a question of adjustment not just by the borrowers but by the industrialized world.

We collectively are in an expansion period that has already been sustained longer than most. The evidence is clear that it is the U.S. economy that has been the principal motor for that expansion. But in that process, serious international imbalances have developed. And, partly as a consequence, our own growth has slowed.

Some relevant statistics reflect the problem. In 1982, our current account deficit was $8 billion, while other members of the G-5 combined has a surplus of $8 billion. As I mentioned earlier, the 15 debtor countries, somewhat arbitrarily cited in the Baker initiative, had a deficit of $50 billion.

By last year, while the debtor countries had achieved rough balance, our deficit had moved to $118 billion, and to $146 billion at an annual rate by the final quarter. That is an amount equivalent to more than 15 percent of our domestic manufacturing output and explanation enough of the relative sluggishness of the manufacturing sector over the past two years. Meanwhile, the other G-5 countries achieved a current surplus of $68 billion last year, with Japan alone at $50 billion.

In effect, over the past four years, the United States, directly and indirectly, has provided a disproportionate share of the incremental demand to the world economy, and it has made room for most of the external adjustments of the debtor counties as well. In fact, Japan and Western Europe have essentially had no increase in imports from Latin America since 1982.

The resultant strains are showing. I for one do not believe there is any simple and easy solution to the imbalances in exchange rate changes alone, however important, it is that we have now achieved a more competitive exchange rate structure. Among other things, we had better not forget that we are today the world's largest debtor, dependent on a continuing large inflow of capital to finance our own budget deficit, and that capital will not flow freely without continuing confidence in our own stability.

The implication is not, of course, that we should stop growing, but that other strong countries, with little or no inflation, with excess capacity and historically high unemployment, and with super-strong external positions, assume more of the leadership in providing the impetus for world growth.

That is the essence of a coordinated strategy for growth, far more fundamental than the precise timing of recent discount rate actions by leading countries upon which there has been so much comment. In fact, coordination in the broader, more fundamental sense, will seldom imply lock-step action with respect to a single policy variable in one direction -- to the contrary, it implies that when conditions vary among nations, then different kinds of adjustments need to be made.

Such adjustments do not come easily -- our long struggle with our budget deficit is the most obvious case in point. But if the procedures for surveillance elaborated at the Summit a few days ago are to be meaningful, that is the kind of mutually complementary action that is required. And difficult as they may be, the adjustments involved do not approach in relative magnitude those required by the debtor countries.

In sum, I think we face a kind of watershed, not just with respect to international debts, but with respect to management of the world economy.

We have made great progress. The opportunities are enormous.

And we also have a lot of work to do in translating rhetoric into action, in our part of the world as well as to the south.

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