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PRIORITY ISSUES FOR 1984 - A WORLD BANK PERSPECTIVE

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The world was recovering from the worst recession in over 40 years by the beginning of 1984 and many leading international figures were expressing their views on how to repair the damage. The President of the World Bank and International Finance Corporation, A. W. Clausen addressing an influential gathering of public officials and business people at the European Management Forum in Switzerland at the end of January 1984 focussed on four issues that needed priority attention: improving economic policy and performance in the industrial countries; liberalizing trade; reviving international capital flows; and improving economic policy in the developing countries. He called on his influential audience to contribute to a revival of commercial investment in the developing countries and to foster understanding of the actions that must be taken.

As 1984 starts, the world is recovering from the worst recession in over 40 years. But the recovery is uneven, and many developing countries still confront acute economic problems. The creditworthiness of some countries has been questioned. And in most developing countries, growth in per capita income has been arrested, needed investments are being postponed, and efforts to reduce poverty have been interrupted.

Let me stress at the very outset today that it will take years to repair the damage that has been done to Third World prospects.

The current recovery will not be enough, by itself, to return the developing countries to growth rates comparable to what they achieved in the past. Concerted effort, in a number of areas and over a period of years, will be required to revive progress in the developing countries. To fail in this effort would have negative consequences for the whole world.

My intent today is, first, to provide an overview of the global economy, with particular attention to the Third World, and then to focus on four economic issues that deserve priority attention in 1984 and for some years to come. These issues are:

improving economic policy and performance in the industrial countries; liberalizing trade; reviving international capital flows; and improving economic policy in the developing countries.

The global economy

According to the Organization for Economic Co-operation and Development, the industrial countries as a group are likely to achieve economic growth of 3½ percent in 1984, up from 2½ percent in 1983 and negative growth in 1982. Most of this change is due to the dramatic recovery of the United States; Europe's economy is still expected to expand just 1½ percent in 1984.

Our World Bank estimate is that the developing countries will average growth of 3 to 3½ percent in 1984, up from less than 1 percent in 1983 and less than 2 percent in 1982. But since population is growing more than 2 percent a year in the developing countries average per capita income actually fell in 1982 and '83, and will increase only modestly in 1984.

Economic conditions vary greatly among the developing countries. In contrast to the rest of the developing world, India, and China have

maintained high rates of growth in per capita income throughout the global recession. This is partly because international commerce is less important to these Asian giants; they benefited relatively little from international commerce when the world economy was expanding, but they are also less affected by the world economy's recent dislocations.

The oil-exporting developing countries underwent a sharp drop in incomes in 1983; the decline in average growth for all the developing countries together in 1983 (from the already low level of 1982) was almost entirely due to this sharp drop for the oil-exporting countries. We expect per capita income among the oil-exporting countries, to continue declining a bit in 1984.

The headline-catching aspect of Third World difficulties has been the debt crisis, and the debt crisis has dramatically affected Latin America. After suffering a decline in per capita income of 14 percent over the last three years, we expect the oil-importing countries of Latin America to achieve at least some growth in per capita income in 1984.

The low income countries of Africa have been suffering steady declines in per capita income for 10 years. Per capita food production has been falling over the past 20 years, and the cost of food imports is now equivalent to a quarter of all the development assistance that Africa receives. Rising commodity prices may give Africa a bit of relief in 1984, but we still expect no growth in per capita income. In most African countries, political conditions are fragile, institutions and human resources are already strained, and population is expected to more than double by the end of the century.

Some developing countries in other regions also face bleak prospects. But for the most part we expect the

developing countries to move back during the rest of this decade toward the growth rates they achieved in the Sixties and Seventies.

Wide variations from this projection are quite possible. It depends mainly on how well or how poorly the nations of the world - both the industrial and developing nations - manage the thorny economic issues that confront us in 1984 and the years beyond.

Improving economic performance in industrial countries

One priority issue, clearly, is improved economic policies and performance in the industrial countries, so that they translate their present recovery into sustained, non-inflationary growth.

In the United States, economic activity has entered the new year on a vigorous note, and strong gains in employment and income in the United States will encourage growth throughout the industrial world. The OECD expects only a slight increase in inflation as unemployment falls and production rises.

Reducing budget deficits especially in the United States, is essential to maintaining the momentum of today's recovery. Real interest rates are far too high, and the prospect of annual U.S. deficits on the order of \$ 200 billion over the next few years may well keep upward pressure on interest rates and dampen business confidence.

And in order to move from recovery into a sustained period of economic expansion, the industrial countries also need to create an environment conducive to structural change. Economic progress requires change - increasing productivity through new technology, for example, or adapting to evolving patterns of comparative advantage. Some areas of activity

expand rapidly, others decline. But adaptation in the industrial countries, particularly in sectors such as steel and textiles, has failed to keep up with the need for change over the past ten years, and that has contributed to falling returns on investment and to slow growth. A new period of sustained growth will require policies in the industrial countries that permit and facilitate changes of the sort that raise productivity.

Liberalization of international trade

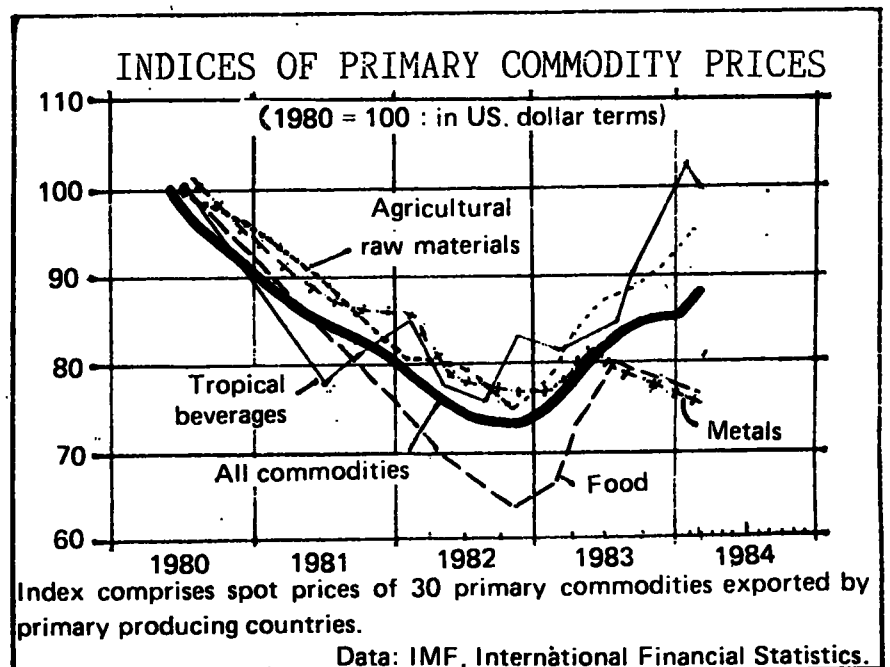
And the industrial countries will not be able to achieve sustained and rapid growth on the basis of purely domestic improvements. Sustained and rapid growth will require further liberalization of international trade, and this is another priority issue. We must reduce barriers to trade, including trade between the industrial and developing countries.

Trade barriers were gradually lowered over the last generation through successive rounds of negotiation under the aegis of GATT. Since trade barriers protect inefficient and declining

industries, more liberal trade stimulated economic growth through increased productivity. Also, international trade tended to grow faster than output, and thus tended to accelerate the growth of each national economy.

The developing countries sell 60 percent of their exports to the industrial countries. However, in regard to trade between the industrial and developing countries, the liberalization process of past decades was only a qualified success.

Most developing countries maintain higher levels of protection than do most industrial countries. For their part, the industrial countries generally impose higher-than-average tariffs on products from the developing countries. Agriculture which is important to many developing countries, has not only been left out of the liberalization process, but, in fact, barriers to trade in agriculture have increased. And recently, there has been a proliferation of non-tariff barriers such as the Multi-Fibre Arrangement, so-called "voluntary" export restraints, and so-called "orderly" marketing arrangements.



Trade with the developing countries is vitally important to the industrial countries. Exports to the developing countries account for 28 percent of the total exports and 6 percent of the national income of the industrial countries.

The debt crisis and the associated austerity programs among developing countries have resulted in lower export sales by the industrial countries. For the four quarters that began in mid-1982, the developing countries cut their imports from the industrial countries by \$43 billion compared to the previous four quarters. The businesses and workers that lost those sales in turn had less to spend, and these multiplier effects had an additional negative impact on growth. The industrial countries would have achieved growth of 3 percent in 1983, instead of the 2½ percent actually achieved, if the developing countries had been able to keep importing at the 1982 level.

And trade with the developing countries is not only important because of their significant and characteristically buoyant contribution to demand. Because the industrial and developing countries have such different comparative advantages, trade between them yields large gains. The continued expansion of North-South trade, with developing countries producing more and more traditional manufactures, offers opportunities for major improvements in efficiency on the supply side of the global economy. There are difficulties in devising successful adjustment assistance programs. But expanding North-South trade is one of the keys to higher living standards in both the industrial and developing countries over the coming decades.

For developing countries, growing exports to the industrial countries are essential for the recovery of growth and creditworthiness. To achieve economic growth of 5 to 6 percent a year, comparable to what they achieved in the Sixties and Seventies, the developing countries probably need

to expand their exports by at least 6 to 7 percent a year in real terms. Given prospects for relatively slow growth in their revenues from commodity and fuel exports, they may well need to expand their manufactured exports by some 12 percent a year.

Many developing countries can improve their export performance by reforming domestic economic policies. Countries have generally achieved faster growth in both exports and income. By entering the global market, these countries have been able to achieve economies of scale that their domestic markets wouldn't have allowed. Businessmen and other economic decision-makers in outward-oriented countries learn to adjust to market changes and to deal with international competition. Thus, outward-oriented economies have proved more resilient in dealing with adverse changes in the global economy. We are urging countries not to discriminate either for or against exports. In countries where producers have equal incentives to sell in the home and export markets, resources tend to be allocated efficiently.

An increasing number of developing countries were moving toward more open trade policies in the Sixties and Seventies. But this trend stopped in 1981, as some countries resorted to additional import restrictions to cope with balance of payments problems. The present dilemma is that more liberal trade is essential to long-term growth, but slow recovery in large parts of the world makes it difficult for many countries (both industrial and developing countries) to resist increasing barriers to trade.

For heavily indebted countries, the dilemma is acute. Some countries will have to generate a trade surplus for the foreseeable future in order to cover interest payments on their debts. Yet financial pressures are tempting these countries to impose import controls that will make their economies

less efficient and discourage exports for years to come.

International capital flows

This brings me, then to the issue of reversing today's trends in international capital flows.

The total debt of the developing countries amounted to about \$810 billion at the end of 1983. Since mid-1982, some 30 countries have renegotiated terms on as much as \$100 billion of this debt.

These reschedulings, together with arrears and lower interest rates, have slowed the growth in debt-service payments, but such payments have, nevertheless, continued to rise somewhat. At the same time, new commercial-bank lending to developing countries, especially to major borrowers, has fallen dramatically. As a result, the net transfer from commercial banks to developing countries (that is, new lending minus debt-service payments) is now negative. The developing countries are paying back more to the banks than the banks are lending.

According to the World Bank's Debtor Reporting System, the net transfer of medium- and long-term lending from private sources to developing countries was \$16 billion in 1981. But in 1982, the net transfer was a negative \$7 billion. We estimate a negative net transfer of \$21 billion for 1983.

Productive investment yields a return, and foreign investors should get back more than they invest. But it is premature for developing countries, as a group, to be transferring resources to the high-income countries on this scale. In 1983, the net transfer from the 13 major borrowers among the developing countries to private lenders was equivalent to 2 percent of their national income.

The other types of medium- and long-term capital flows have not grown to compensate for the fall in medium- and long-term lending from the commercial banks.

Because of the slump in commercial-bank lending, many developing

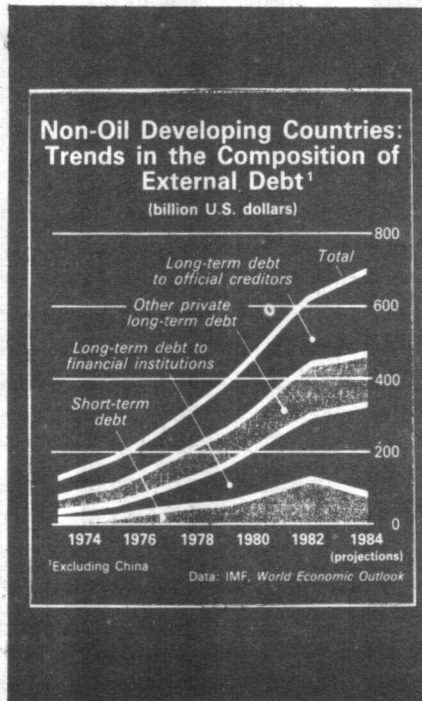
countries are making greater efforts to attract direct investment by multinational corporations. But the figures for direct investment nevertheless show a significant decline - from \$ 14 billion in 1981, to \$ 13 billion in 1982, to \$ 10 billion in 1983.

The two main types of medium- and long-term capital from official sources are non-concessional lending and development assistance. Medium- and long-term non-concessional lending comprises loans by The World Bank, the other multilateral banks, and export credit agencies; IMF resources are not included in this official-lending category. Development assistance comprises grants and highly concessional lending. IDA (the International Development Association) is the World Bank's concessional affiliate.

Official lending and development assistance can reduce the risks that are worrying commercial investors. But the net transfer of medium- and long-term lending from official sources remained roughly constant between 1981 and 1983. The World Bank, for example, helps developing countries establish a policy environment that is conducive to investment and growth. The World Bank also develops well prepared and appraised projects, and we are expanding the opportunities for commercial banks to cofinance these projects.

Given the likely trends in other capital flows and the continuing need of the developing countries for medium- and long-term finance, continued growth in lending by the World Bank and the regional development banks is essential. Official lenders raise the bulk of their resources by borrowing on a commercial basis; to expand their lending, they need capital from the governments that own them, although only a small percentage of it needs to be paid-in capital.

1/ These figures are net of reverse flows of equity, but they are not net of repatriation of profits.



The low-income developing countries that is, countries with incomes below about a dollar per person per day - depend on official development assistance for three-quarters of all the external capital they receive. Yet the total flow of development assistance (from both the industrial countries and the high-income oil-exporting countries) is also stagnant. And 70 percent of the development assistance from bilateral agencies goes to middle-income, rather than low-income, developing countries.

The nations that contribute to IDA just completed negotiating its funding level for the next several years. They agreed on \$ 9 billion for three years - a sum much lower, even in nominal terms, than that agreed in 1979 for the last IDA replenishment. This disappointing result suggests continued stagnation, or even substantial falls, in official development assistance in the years ahead.

We cannot be content with this result. For the world's low-income countries, especially Sub-Saharan Afri-

ca, effective programs of official development assistance are essential. So we will continue to urge governments to increase their IDA contributions. Strengthening IDA will be most difficult, but it is vital.

The slump in commercial-bank lending and direct investment, coupled with very slow growth in official lending and development assistance, has forced the developing countries to cut imports. They moderated the cut in 1983 by resorting to short-term commercial borrowing and drawing down reserves, including IMF resources. But by 1983, many developing countries had nearly depleted their reserves and opportunities for short-term borrowing, and were therefore forced to reduce imports drastically - chopping their current account deficit from \$ 85 billion in 1982 to \$ 48 billion in 1983.

Looking ahead, we expect most developing countries to continue to be able to import more than they export, and we expect the negative net transfers for medium- and long-term lending from private sources to decline gradually.

Concern in Europe, Japan, and North America about capital flows to the developing countries has largely focussed on the possible impact of the debt crisis on the international financial system. The financial system has weathered the storm quite well. But cutbacks in imports and government spending among the heavily indebted countries have thrown their economies into deep difficulties.

Mexico halved its public deficit in one year, and reduced its imports by two-thirds between 1981 and 1983. The Ivory Coast reduced its public investment program by nearly half, and per capita income in the Ivory Coast has dropped 20 percent in three years. Industrial employment in Brazil has fallen 20 percent since 1980, and 25 percent since 1980, and 25 percent of Brazil's manufacturing capacity is idle.

Some developing countries used foreign borrowing to finance consumption rather than investment, particularly in the few years leading up to the debt crisis of 1982. Those countries that borrowed and postponed needed adjustments must undergo more abrupt adjustments now. But some countries that generally used foreign borrowing well have also been affected by the general decline in international lending, and idle plant and workers don't help any country repay its debts.

The debt crisis has had a most damaging effect on the private sector in the developing world. Almost the entire drop in commercial lending in 1982 was suffered by private non-guaranteed borrowers. Public-sector control over private financial institutions has increased in countries such as Mexico and Chile, and thousands of enterprises throughout the developing world have gone bankrupt.

Sustained growth and resistance against protectionism in the industrial countries will help most of the developing countries with large debts to meet their debt obligations and resume growth in per capita income, but the borrowing countries will also need improvements in their domestic economic policies. Difficulties resulting from today's debt problems may be with us for as much as a decade. Some countries will have to generate a trade surplus to cover part of their interest payments, and several countries with promising medium-term prospects will face acute short-term financing problems because of uncertainty among lenders. There are likely to be more reschedulings, and we expect a "hump" in debt-service obligations between 1985 and 1987, partly due to scheduled repayments to the IMF.

Economic policies in developing countries

Improved economic policies in the developing countries themselves is a fourth area for action to restore the global economy to health - an essential

complement to sustained recovery in the industrial world, liberal trade, and increased capital flows.

The developing countries must pursue economic policy reform urgently and tenaciously, because it is absolutely fundamental to the resumption of their economic and social progress. It is not my intention to attempt a comprehensive outline of the types of policy reform that many developing countries require. Rather I want to stress, by way of a couple of illustrations, that the necessary policy reforms are complex and will take time to bear fruit.

Policy management is always difficult, and it is especially difficult in the developing countries right now, because they must tackle two problems at once. They must improve financial discipline to keep their balance-of-payments under control, and, at the same time, they must enact additional policies that will lead back to economic development and restore creditworthiness on a lasting basis.

For example, many governments must cut back on public spending, including public investment, to cope with immediate financial pressures. But, at the same time, they should improve the quality of investment by using their remaining resources only for those projects that will have the greatest, most needed impact. Improving the quality of public investment involves difficult and delicate judgments, and its full effects will not be realized for many years.

Another way for countries to encourage economic growth over the medium-term is to let prices reflect scarcity values. There is strong evidence the price distortions retard economic growth, and many price distortions favour relatively privileged groups at the expense of lower-income people. In the Sixties and Seventies, quite a few developing countries made major efforts to reduce price distor-

tions, and some of these countries sharply accelerated their economic growth. But such reform programs proved complex, politically difficult, and not without short-term costs, suggesting the importance of reproducing price distortions with determination, but gradually.

Many developing countries have already taken impressive policy measures to improve their balance-of-payments position and restructure their economies. We must be mindful that the speed of adjustment is limited by the need to maintain political cohesion and stability. The process is difficult, and specific adjustments must be tailored country-by-country; there are no simple, patent recipes.

While the International Monetary Fund uses its resources to support policies designed to address balance-of-payments problems, our responsibility at the World Bank is to help developing countries design and enact complementary reforms to foster a revival of economic and social development. Because such reforms entail difficult structural change and take time to come into effect, it is appropriate that the World Bank together with other lenders, both commercial and official, provide assistance for this purpose. Within the World Bank, we have begun an intensive process of reflection on the institution's future role. And one thing is clear: World Bank support for improved economic policies in the developing countries will be extremely important - for some countries, decisive - in the years ahead.

Summing up, then, the condition of the world economy at the outset of 1984 is more promising than a year ago. But to achieve a new era of sustained growth worldwide, the developing countries must give the highest priority to policy change, and we will need to improve economic policy and performance in industrial countries, liberalize trade, and increase both commercial and official capital flows.