DISCUSSION OF FUND POLICY AT FIFTH JOINT SESSION[1]

REPORT TO THE BOARDS OF GOVERNORS OF THE FUND AND THE BANK BY THE CHAIRMAN OF THE JOINT MINISTERIAL COMMITTEE OF THE BOARDS OF GOVERNORS ON THE TRANSFER OF REAL RESOURCES TO DEVELOPING COUNTRIES (DEVELOPMENT COMMITTEE)

Ghulam Ishaq Khan

It is my privilege to present to you the 1984 Annual Report of the Development Committee.

The long shadow of the worldwide recession which had brought misery and suffering to so many for so long began to recede in 1983. There is now increasing evidence of economic recovery in major industrial countries without acceleration of inflation. This upswing started strongly in the United States and is extending to other industrial countries. Indeed, 1984 is projected to be shaping up as the best year for economic growth in the industrial countries in the last eight years.

The impact of this recovery has been beneficial to the developing countries as a group. It has stimulated their export volume; their economic growth in 1984 is projected to rise more than three times compared with 1983, and their current account deficit has declined to about $50 billion, which is well below half the figure of three years ago.

Nevertheless, there are a number of problems which demand attention and require resolution. Many developing countries still face severe difficulties; their per capita growth rates continue to decline from an already very low level. Also, many countries face a precarious and worrisome debt situation.

The challenge, however, is how the present recovery should be sustained, strengthened, and extended in a noninflationary environment; how a liberalized trading system should be encouraged and

[1] September 26, 1984.

maintained without the impediment of protectionism; and how the obstacles of high interest rates and heavy indebtedness which threaten the growth momentum should be removed.

It was against these global economic conditions and challenges that the Development Committee in its two meetings held during this year—one in April and the other concluded in Washington this Sunday—reviewed and deliberated on important and pressing global economic issues.

There was strong support in the Committee for a $12 billion IDA-VII Replenishment, but unfortunately no agreement between the donors could be reached on a figure larger than $9 billion. This represents a sharp decline in real terms in the size of IDA Replenishment and is most disappointing. The Committee, therefore, noted with concern that recent efforts to mobilize supplementary funding arrangements had not yet been successful. The Committee requested that the situation be reviewed again next year in accordance with the Canadian proposal. This proposal enjoys wide support, and the key donors have a fresh and revived responsibility to match again their proud past record for the mobilization of much needed concessional resources for the poorest countries.

The Committee was gratified with the successful negotiations of a selective capital increase of $8.4 billion for the World Bank and a capital increase of $650 million for IFC, both of which it had strongly supported. This IFC capital increase comes at an appropriate time since the outlook for direct private investment has become more attractive as it is nondebt-generating capital, while external loans have become both scarce and costly.

During the past year, the Committee held extensive discussions on the linkages between trade and development. It agreed that progress in maintaining open access to markets for the exports of developing countries and in reinforcing the multilateral rules and disciplines for trade was an essential support to their current adjustment efforts and to the long-term solution to the debt problem. The Committee encouraged the immediate adoption of concrete measures to combat protectionism. It noted the progress being made in the implementation of the GATT's ongoing work program and welcomed the consideration being given to the role that could be played in liberalizing and strengthening the trading system by a new GATT round of multilateral trade negotiations in which all countries—developed and developing alike—could participate and from which all could benefit. Members also emphasized the contribution private investment could make to trade and development.

Another subject of great interest to Governors will be the current ongoing work in the Bank, with which your Committee has remained in touch, concerning the future role of the Bank. It has now embarked upon an extensive analysis on the role it should play in the coming years. This analysis will also be a basis for consideration of its longer-term capital requirements. This is a crucial exercise that will determine whether this premier development institution, which has served the cause of development so admirably in the past, will continue to do so in the difficult circumstances of the decade ahead. The Committee continues to give this subject due importance and priority, and we look forward to the study to be ready by the spring of 1985.

Another important and substantive item on the Committee's agenda during the year was the critical economic situation in sub-Saharan Africa. The subject was last taken up by us at our Sunday meeting when a comprehensive report from the Bank was given full consideration. The Committee, while sharing the Bank's analysis, expressed strong support for the Bank's new action plan and urged that expeditious efforts be made to implement it. We believe that a firm base has now been set for moving forward with actions, initiatives, and with prospects of financial support that will, over time, distinctly improve the development prospects of sub-Saharan Africa.

One very important matter which needs to be brought to your special attention was taken up at our meeting last Sunday. It was decided in the Development Committee to initiate discussions on a number of interrelated issues concerning the revival of growth and trade in the developing world. In doing so, the members of the Committee were responding to the converging suggestions made at the London summit of industrial nations, by a group of Latin countries in the Cartagena conference, by the Commonwealth Finance Ministers at their meeting in Toronto, and by Mr. Regan, the U.S. Secretary of the Treasury, in his address to the Committee. It was agreed that the Committee will have an extended meeting in the spring of 1985 when it will discuss, within the context of a medium- to long-term framework and the current approaches toward resolving debt problems, the structural and development aspects of the problems of developing countries in their efforts to achieve sound economic growth. These include, inter alia, external indebtedness, protectionism, commodity prices, interest rates, the structure of capital flows, and obstacles to direct investment and equity capital flows.

The interdependence of the world has grown immensely during the last ten years, creating a strong mutuality of interests among various groups of countries. This growing interdependence makes it imperative that we should place much greater emphasis on multilateral cooperative

endeavors. National states and even regional entities can no longer solve their problems in isolation.

The Committee has now been in existence for ten years. An important advance has been made in the general perception regarding its effectiveness and role. There is now a growing recognition of its potential as an appropriate and effective forum for mobilizing the political will to find practical solutions to difficult global economic development issues which threaten and impede our progress.

STATEMENT BY THE GOVERNOR OF THE FUND FOR ST. LUCIA

John G. M. Compton

I have the honor to address these Annual Meetings on behalf of the English-speaking Caribbean States, namely, Antigua and Barbuda, the Commonwealth of the Bahamas, Barbados, the Commonwealth of Dominica, Grenada, Jamaica, St. Christopher and Nevis, St. Lucia, and St. Vincent and the Grenadines.

Since our last meetings, the number of countries in this grouping has been increased with the admission of St. Christopher and Nevis to membership in both the Fund and the Bank and I would like to extend a sincere welcome to the delegation from that country, which has joined the Caribbean constituency, and also to the People's Republic of Mozambique, which has recently gained admission to these institutions.

The group of countries on whose behalf I speak have had a close and sometimes traumatic relationship with the Fund, and while only four of our constituent members had Fund programs, the objective circumstances of all of our respective economies dictate that not only should we cooperate very closely with this institution, but many of us should have availed ourselves of its financial and technical resources to ensure economic recovery, progress, and stability. But several members of our constituency have shied away from the Fund's chilly embrace fearing that adjustment programs would be imposed upon them that could push their societies beyond the limits of social and political tolerance.

Since we last met a year ago, there have been definite signs that the world economy is recovering from its longest and deepest recession since the 1930s, and the mood of the two previous years has changed from one of doom and gloom to one of cautious optimism.

There is, however, still great cause for concern, as the recovery, while encouraging, has been very uneven. Among the industrial countries, the United States has experienced very strong growth, but the recovery in Europe is still lagging and European economies continue to be plagued by very high levels of unemployment. Among developing countries, despite some evidence of improvement—mainly among the countries of the Pacific rim—most other developing countries, particularly those in sub-Saharan Africa and the highly indebted countries of Latin America, are still in very serious difficulties. The fragile and open economies of the Caribbean Group have yet to feel the effects of the North American recovery and find themselves still under severe economic pressure.

The dangers facing the recovery stem from a number of sources, among them being high interest rates, protectionism, and the fear of return of inflation. High interest rates, which were employed as one of the weapons in the battle against the virulent inflation of the late 1970s, still persist. In the industrial countries inflation is in full retreat, yet interest rates have not been lowered to acceptable levels. These high interest rates are not only encouraging the flight of capital from the developing countries, but are also having a negative effect on domestic investment in these countries. Their worst effect, however, is on the debt servicing capacity of countries which are already under severe economic strain. With inflation at its lowest level in years and with interest rates so high, the real rate of return on loans to lending countries can be described as nothing short of exploitative.

In the immediate past, many countries have responded to the battering effects of recession by retreating behind the drawbridges of protectionism. The storms of recession have now largely abated, but in many cases the protectionist drawbridges have not been lowered, thus hampering the free flow of trade so necessary to convert the early and fragile recovery into a robust engine of growth, strong enough to pull the entire world economy out of recession.

Many developing countries have consequently been forced to adopt adjustment policies so harsh as to strain their very social and political fabric, reducing their demand for the manufactured goods of industrial countries, and thus delaying the very recovery for which we so ardently hope. This clearly illustrates the interdependence of the world economy and the need for measures to ensure that the recovery is more widely spread if it is to be sustained.

Let me turn now to the situation in the English-speaking Caribbean. For several years we have been advocating with special fervor the need for particular attention to be paid to countries of our size and circumstances. Our persistence has met with some degree of success:

a paper on small island developing economies has been presented during the past year to the Executive Board of the Fund for discussion. Although the discussion has been somewhat inconclusive, we nevertheless continue to press for a special recognition of our circumstances at the highest levels and feel sure that we will eventually succeed in this quest.

The process of adjustment would by implication differ from country to country, but in our region, in the circumstances described above, adjustment is an extremely difficult and painful process.

The current economic wisdom seems to suggest that the world recession is over but the scars left upon the Caribbean economies will be deep and long lasting. The fall in demand for such primary products as bauxite and the depressed tourist market have had a debilitating effect on the Caribbean economies. The regional integration movement which produced substantial economic growth in the 1970s and early 1980s has faltered and our own payments mechanisms have been suspended.

One area of positive significance, however, has been the opportunities for export-led growth presented by the Caribbean Basin Initiative. This mechanism offers substantial benefits if Caribbean economies can be effectively restructured to place them on a competitive footing.

To come to grips with the opportunities, as well as the difficulties, the Caribbean Governments commissioned a study of the process of structural adjustment in the region which was presented to our summit in Nassau this year. All the countries in the region are now committed to programs of broad structural adjustment and have started to move in this direction.

We hope in this way to provide our own solutions to our pressing economic problems. We, however, operate within an increasingly interdependent international economy and the success of our venture will largely depend on the transformation of the world economy. Our Caribbean economies are too small and vulnerable to have any significant impact upon the world economic system so that while we must proceed with our own structural adjustment and transformation processes, our successes in these endeavors will depend largely upon a favorable international environment. Some essential features of this environment are: an increase in concessional funds to the region, as we have been advocating for years at our Caribbean Group Meetings; the dismantling of protectionist barriers leading to unrestricted access to markets for our exports; and substantial increases in the inflow of private capital and technology. In summary, it is only in a more liberalized world economy, supported by low interest rates, the removal

of trade barriers, and the free flow of capital that small countries such as ours can have any chance at all of economic progress.

Today, at our Annual Meetings, two specific issues have come in for special attention: access limits and a new SDR allocation. These issues are critical to the future role of the Fund in creating the new, stable, and prosperous international economy which we all seek. One hopeful sign at these meetings has been the general recognition of the need for change, by the developing countries, and for accommodation, by the industrial countries. The address by the Secretary of the U.S. Treasury, the recommendation of the Group of Twenty-Four, and the intervention of the Finance Minister of Canada on behalf of the Commonwealth Ministers of Finance all point to a consensus on the need for progress in establishing a new economic order.

The deliberations of both the Interim Committee and the Development Committee bear witness to the desire for dialogue and discussions, and this sentiment has been echoed in the speeches to the Annual Meetings and in that of our distinguished guest, the President of the United States.

In this situation, the work of the Fund is extremely critical and if its efforts are to succeed it cannot now be circumscribed by reducing access limits or not allowing an increase in SDRs in the fourth basic period. The work of the Managing Director is to be commended and a positive response on these two issues can be taken as a vote of confidence in the institution.

In conclusion, we look forward to our next joint Annual Meetings in Seoul in the firm conviction that a process of reform has started, which will gather momentum in the spring of 1985 and come to fruition by the time we come again to our annual deliberations.

STATEMENT BY THE GOVERNOR OF THE BANK FOR THAILAND

Sommai Hoontrakool

Allow me, Mr. Chairman, first of all, to join my fellow Governors in congratulating you on your election as Chairman of the Boards of Governors. I am confident that your extensive experience in international economic and financial cooperation will guide the deliberations of this assembly to a fruitful and constructive conclusion.

The 1984 Annual Meetings culminate another year of successful operations of the International Monetary Fund and the World Bank as is outlined in their Annual Reports. I should like to congratulate the Executive Boards, management, and staff for their highly devoted and valuable services under the able leadership of Mr. de Larosière and Mr. Clausen.

While it is heartening to note that signs of economic recovery have emerged in a number of industrial economies, the prospect for sustained worldwide economic progress remains uncertain. The slowdown in general economic activities has led to heightened pressures toward protectionism, and the debt problem remains critical in the context of high real interest rates and foreign exchange volatility.

Many developing countries have undertaken drastic measures to restructure their economies, but it is clear that the serious problems of the world economy cannot be solved without the cooperation of the major industrial countries. It is, therefore, imperative that these countries accept the responsibility of leadership by adopting responsible and constructive fiscal, monetary, and trade policies. This leadership role is particularly critical now because, after years of austerity, many developing countries are finding it increasingly difficult to further intensify restrictive adjustment measures that could seriously impair their social and political stability.

This need for greater symmetry means that the Fund will have to play a greater role in its surveillance and advisory activities and to adhere strictly to the uniformity of treatment of all members, developing and industrial countries alike. Under current highly sensitive and volatile international economic conditions, there is an urgent need for a reappraisal of the Fund policies to cope with emergent problems which had not been foreseen when the Fund was founded. The typical economic adjustment package favored by the Fund may put too much weight on short-term results without adequately taking into account the impact on medium-term and long-term growth as well as social and political stability.

Another issue that must be seriously considered in this context relates to the maximum access limits to Fund resources. While tighter conditionality rules are applied, there has recently been a trend to reduce further the maximum access limits and a tendency to shorten the duration of Fund assistance. A realistic approach to this problem, which has emerged mainly from exogenous factors such as the prolonged recession, high real interest rates, and exchange volatility, would be a complete reversal of this trend.

The downward trend in growth rates and the stagnation in world trade, coupled with the maturing of the $250 billion external debt of

developing countries, will, if left unresolved, be the root cause of a new financial crisis in the coming years. It is clear that traditional approaches will not be adequate to deal with these pressing problems. The Fund, like all other international agencies, will have to rethink its role if it is to be in a position to help member countries in an effective and timely manner. . . .

Statement by the Governor of the Fund for Egypt

Mahmoud Salah el din Hamed

Let me first express the appreciation of my delegation for your address, Mr. Chairman, at the opening session, as well as for those of Mr. de Larosière and Mr. Clausen. They provide a sober assessment of prospects and risks in the present state of the world economy and single out the most important issues of the day. I would like also to welcome, on behalf of the Egyptian delegation, the membership of Mozambique, and St. Christopher and Nevis to the Bretton Woods institutions.

Despite definite improvements in the economic performance of the industrial countries, developing countries continue to face the severe crisis that has afflicted them for several years. Output has hardly increased in 1983. In large parts of the developing world, levels of per capita output fell for the third consecutive year and were below those recorded in 1979. The impact of this continuous economic erosion is being felt increasingly in the social as well as in the economic sphere. Unemployment, underemployment, and poverty are on the rise in many of these countries. The developing countries have spared no effort in adjusting to an inhospitable external environment, but the price in terms of growth and development has been onerous indeed. Failing a change of policies on the part of the major industrial countries, it is doubtful that the present burden is socially and politically sustainable in the long run.

Transmission of recovery to developing countries is mainly hampered by the level of indebtedness of many of them as well as by protectionism. The increase in interest rates during recent months is a strongly negative factor. The combination of high interest rates and declining capital flows has drastically reduced net financial transfer to developing countries. Non-oil developing countries are in fact estimated to have

made net payments to banks of at least $13 billion in 1983. The adverse effects of these reverse flows in the present crisis could hardly be exaggerated.

Unfortunately, given the stance of monetary policy and the size of budget deficits of many industrial countries, particularly the United States, there seem scant prospects of an early decrease in interest rates. For countries with significant amounts of outstanding debt contracted at variable interest rates, higher interest payments will offset a large part of the higher export earnings resulting from recovery in the industrial countries.

The problem of developing countries has been exacerbated by the upsurge of protectionism. The trend toward increased use of nontariff barriers has been particularly damaging to the export prospects of developing countries. Such measures like the Multifiber Arrangement and the so-called voluntary export restraints may involve derogations from GATT rules. The impact of these measures has been to deprive developing countries of export potential in precisely those products where they enjoy a decided comparative advantage. A continuation of these trends would have ominous implications for both developed and developing countries whose sustained growth can only be based on a fuller exploitation of their dynamic comparative advantage.

The complexity and multiplicity of the trade issues facing developed and developing countries in the 1980s suggest that piecemeal approaches are unlikely to succeed, and that such issues could be addressed most effectively in a new round of multilateral negotiations under the aegis of the GATT. Such negotiations would help stem the tide of protectionism and roll back existing restrictions. My Government is prepared to lend its support to, and full participation in, a new round of trade negotiations.

The Bretton Woods institutions could play an effective role, not only in furthering trade liberalization, but also in extricating developing countries from the grip of the current crisis. They are constrained, however, by the limitations of their resources. The Eighth General Review of Quotas served no doubt to improve the liquidity of and ease the resource constraint on the Fund. However, the increase of quotas was far below what is warranted by the requirements of growth and adjustment. The ratio of quotas to world trade has fallen significantly since the mid-1960s. The Interim Committee, in its last meeting, agreed that enlarged access limits should be maintained in 1985. We welcome this, but feel sorry for reducing the limits, and hope that they should be maintained while reviewing the enlarged access policy itself before the end of 1985. The same is true of access to the special

facilities. The recent tightening of conditionality associated with the compensatory financing facility and reduction in access limits are unwarranted. There is an urgent need for reversing these trends.

My delegation regrets that so far there has been no agreement on an SDR allocation in the fourth basic period. Recent developments have greatly strengthened the case for a sizable allocation of SDRs. The continuing expansion of world trade implies a growing long-term global need for reserves. Appropriate SDR allocations could play a useful role in meeting a part of this growing need and help the functioning of the international economy. It would contribute toward easing an excessively harsh adjustment burden that has been imposed on developing countries by the global recession. No less important is the fact that an allocation would strengthen the SDR as a financial instrument and would be in line with the requirement of the Articles of Agreement that it become the principal international reserve asset.

My delegation supports the Managing Director in his efforts to achieve a consensus on a substantial allocation of SDRs in the fourth basic period, and urges member countries to make it possible for the Managing Director to come forward with a positive recommendation on this important issue. . . .

We in Egypt have realized very good results in the field of development and reduced the balance of payments and budget deficits and are working toward the rectification and adjustment of the economic situation despite the unfavorable international economic climate. We urge the world community to continue its efforts and action in order to provide an international climate where we can cooperate to make it possible to achieve steps toward progress and prosperity.

Statement by the Governor of the Bank for Austria

Franz Vranitzky

It is indeed a great pleasure and honor for me to address this distinguished gathering for the first time. On behalf of the Austrian delegation and myself let me first extend my sincere thanks to the U.S. Government for its warm hospitality. At the same time, I wish to thank the management and staff of the Fund and the Bank for the efficient arrangements made for this meeting. I also should like to extend a very warm welcome to the two new members—St. Christopher and Nevis, and Mozambique.

Recovery in the industrial world has been the most salient feature of economic developments over the last 18 months. While this recovery continues to be dominated by the strong pace of expansion in the United States, other industrial countries also seem to participate more and more in improving the situation.

However, this highly positive assessment has to be seen in contrast to a number of developments which are worrisome. Let me briefly enumerate the problems we are confronted with in the medium term.

First, unemployment still remains a very serious problem. While the strong recovery in the United States has created many jobs in this country, unemployment is still bothering a large number of countries, particularly in Europe. Second, there is cause for concern about the high level of budget deficits and the high level of real interest rates. Third, the international debt situation continues to be a crucial challenge to the financial community worldwide. Fourth, the protectionist tendencies which have been proliferating over the past few years have seriously compromised the functioning of the international economic system.

Let me dwell briefly on these issues, starting with unemployment. I believe that in this area we are confronted with a phenomenon, namely, with a secular rise in joblessness, particularly in the OECD countries. This structural unemployment can hardly be overcome with conventional policy instruments at hand. Moreover, employment should not be taken as a residual variable, the trends of which are affected by decisions taken elsewhere. We have to find new ways and means to cope effectively with this pressing problem which, if we cannot succeed, could have far-reaching consequences for the fabric of our societies in the longer run.

In view of the dominant role of public finance in modern societies, we have of course to pay due attention to budget deficits; these deficits bear the danger of increasing interest rates, rekindling inflation, and, above all, reducing the room for maneuver for political action. This has to be put clearly in an international context.

High dollar exchange rates lead to large outflows of capital from the other industrial countries, exerting upward pressures on their domestic interest rates and keeping them from adopting more expansionary monetary policies of their own.

Turning briefly to the explosive expansion of the payments difficulties of the developing and newly industrialized countries, which poses the greatest challenge yet faced by the international financial community. Within a very short time, it has however been possible to establish an

effective cooperation between the Fund, under the outstanding leadership of its Managing Director, the central banks via the Bank for International Settlements, and the commercial banks. It would be dangerous, however, to consider the mastering of this phase as a definitive solution of the problem.

Let me therefore briefly outline what I consider necessary. First, there is no common mold to the debt problem. What we need is a case-by-case approach. Second, so far, we have taken a rather technical and short-term view. What we do need is a comprehensive and longer-term strategy. Third, this is an area which can only be properly addressed in the very end by the policymakers through international cooperation among governments. Fourth, we have to take into consideration the political consequences of financial austerity measures. Therefore, I am very pleased that the Interim Committee will convene next spring to discuss these particular issues in a global context. . . .

International cooperation depends heavily on the large members of the community. However, full strength can only be achieved if all members, especially the small ones, play their role. Therefore, I am particularly pleased to tell you that Austria is in an adequate position to take her share.

For 1984, the economic forecasts are not unfavorable. While GDP growth in OECD countries is lower than forecast, Austria will experience an economic expansion of approximately 2.5 percent in real terms, with unemployment slightly decreasing to 4.4 percent. The inflation rate reached the peak in August with 6.0 percent and is expected to decline by 1985. The current account will remain in balance.

In concluding, let me express my sincere hope that our institutions, which have to play a decisive part in sustaining the worldwide recovery process, will be endowed with the necessary funds so as to enable them to fulfill their mandate. I wish to assure you that the Austrian Government is prepared to give to the Fund and the Bank its continued support.

Statement by the Governor of the Bank for Bangladesh

M. Syeduz-Zaman

Before I start, I would like to join other Governors in welcoming St. Christopher and Nevis, and the People's Republic of Mozambique as members of our two institutions.

This year, our Annual Meetings happen to be taking place in the wake of a recent rise in the growth forecast for industrial countries as a group and a downward revision of the estimate of the combined current account deficit of the developing countries. This, along with the somewhat improved growth forecast for developing countries as a group over the extremely depressed levels of the last two years, and debt rescheduling programs put together in the recent past, may help create a feeling of well-being in a world that has been starved for good news for some time now. It would indeed be tragic if such a feeling of well-being, therapeutic though it is, were allowed to blur the very real ambiguities and uncertainties underlying these and some other composite indices, or—more importantly—to divert our attention from the loss of development momentum in the low-income developing countries, especially the least developed countries. The development of the productive resources of all member countries, including specifically, the less developed countries, is a major common purpose shared by the Fund and the Bank, enshrined in their Articles of Agreement, and it should not be possible for us to relegate this purpose to the background. It is to the credit of our two institutions that in their surveys and reports released to the world this year, they have not done so. They have remained resolutely professional, as in the past, and have projected, with varying degrees of emphasis reflecting the division of their respective domains, the awesome challenges we are facing. Mr. Clausen deserves our special appreciation for the fact that, as in all the extremely difficult years since he assumed the responsibilities of his high office in 1981, he boldly underlined the urgency for intensified multilateral cooperation in his speech to these meetings last Monday addressing the problems of development. And Mr. de Larosière has continued to demonstrate the vital role of multilateral collaboration in the international adjustment process.

The documents admirably put together by the professional staff of our two institutions for consideration by the Interim and Development Committees, the Boards of Governors, and, in a larger sense, by the international community, deal with a number of broad policy themes as well as action-oriented issues. Taken together, they delineate the challenges facing us fairly well, though not perhaps quite exhaustively. Allow me to extract from this complex fabric two broad policy strands repeatedly visible in its total texture:

—One of these two themes is that if the recovery of output in the industrial countries, now dominated by recovery in the United States, is sustained and broadened with a sound adjustment of fiscal and monetary policies; and if market rigidities are corrected where they exist and protectionism is rolled back, there will be a

turnabout in development momentum in the rest of the world through a cascading influence on exports, terms of trade, interest rates, capital flows, and other determinants of growth and development.

—There is a more strongly articulated theme centering on market-based, efficiency-oriented policy reforms in the developing countries as an indispensable prerequisite for the resumption of their development momentum.

The common feature of these two themes bridging the developed and developing worlds is the guiding role accorded to macroeconomic policy. It is important to remind ourselves of some vital facts surrounding these two parallel themes of policy adjustments and reforms in the industrial and developing countries.

With reference to policy adjustments in the industrial countries, the facts are:

—Historical experience suggests that while a sound expansion in the industrial countries is a necessary condition for meaningful growth in the developing countries, it is by no means a sufficient condition. The essential additional element necessary for this purpose is the discretionary, deliberate provision of capital flows in all varieties, including concessional flows, to the developing countries, with special emphasis on the least developed countries. This point is not absent from the documents before us or various speeches at this forum, but it is necessary to restate it, and to guard against the temptation to put excessive trust in an automatic transmission of growth impulses.

—The current round of economic recovery in the industrial countries will have to deal not only with cyclical factors but also with deep, long-term structural changes in comparative advantage and with the development of technology affecting a wide range of goods and services.

It is neither feasible nor desirable that these structural changes in industrial countries, involving as they do vast shifts in resources and the redesigning of the productive apparatus as well as human skills and capabilities, should take place in a short-term or even medium-term perspective in all industrial countries. On the whole, these changes will constitute a process rather than an event and, during this process and after, vast sections of the developing world will not only continue their progress as natural and efficient bases of production for a growing number of goods and services, they will also constitute the only market for many of the traditional types of capital goods and associated skills that are central to development and growth. There is, thus, a positive relationship between stable structural changes in the industrial world

and the provision of all varieties of medium- and long-term capital flows to the developing countries. This provides further immediate relevance to the interdependence that is the basis of policy-directed capital flows from industrial to developing countries.

This mutuality of interests infuses the entire field of financial and real flows between the developed and the developing worlds, involving the whole range of bilateral and multilateral assistance, concessional as well as nonconcessional, direct private investment, and even commercial lending. The Fund and Bank documents released in connection with our Annual Meetings carry this reminder, but not, I am afraid, articulately enough in all cases.

It is thus essential that, because of the inherent inadequacy of the spontaneous transmission mechanism between the industrial and developing countries and the mutuality of interests binding them together, we take discretionary, deliberate measures to reactivate capital flows to the developing countries for the sake of a genuinely sustainable world recovery and the "soundly expanding world economy" envisioned at Bretton Woods 40 years ago as a necessary precondition for the realization of "mankind's hopes for the future."

The well-known but often underplayed facts surrounding the theme of policy reform in developing countries to which I would like to invite your attention are these:

—Market-based, efficiency-oriented policy adjustments in most developing countries call for an adequate level of appropriate financing. It has been demonstrated that multilateral institutions are extremely efficient channels for such financing and this underlines the importance of extending strong support to their resource base and capital structure. In the absence of adequate and appropriate financing to support the supply-side activities of the economy, adjustment measures initially seen to be market based and efficiency oriented soon generate their own distortions and become simply unsustainable through the operation of the laws of the market itself. What is bound to follow then in most cases is a compelling, though often unconscious, reversion to methods and principles closely resembling those of a command economy. This takes us back to somewhere behind square one. Sometimes, in specially weak political and social structures, the consequences of policy reform unsupported by appropriate financing can be even worse: a decline of political and social cohesion and the emergence of an environment totally hostile to economic management and policymaking.

—Because of the overwhelming weight of the unskilled, the unequipped, the unemployed, the poor and, yes, the impoverished in

the vast majority of developing economies, many adjustment measures often begin, in effect, with new burdens on the poor and the weak—burdens that are often misperceived by large sections of society as the very objectives of public policy. The ultimate success of such measures depends upon the speed with which they—the poor and the weak—can adjust themselves to these initial burdens through a rise of their real income. In a capital- and skill-starved, resource-poor country, this second round of adjustments in response to the first round of policy reforms naturally tends to be much slower than in a developed economy. If the design of policy reforms does not take account of this reality, the reforms ultimately break down.

—A large number of developing countries are specially disaster prone, which causes unpredictable random shocks to the development process. In my own country, just when the benefits of severe adjustment measures and policy reforms were taking root with improved growth prospects, this year's unprecedented floods have destroyed a large part of our agricultural production. This has made sudden and heavy demands on resources that were otherwise available for development and investment.

The design and implementation of policy-based programs will, therefore, demand a high degree of skill, imagination, and compassion, and a mastery of the art of the possible, touched upon with insight and understanding in Mr. Clausen's speech last Monday. This will also inevitably require, as I said before, adequate levels of financing, at the right time, in the right country, and on the right terms.

The professional staffs of the Fund and the Bank are conscious of these matters and, of course, policymakers and managers in the developing countries are constantly grappling with them. But all of us, nevertheless, need to remind ourselves of these facts constantly while dealing with new initiatives in policy reform in the context of multilateral and bilateral assistance.

These reminders are specially relevant this year, which has, I am afraid, been a sad landmark in the decline of the industrial countries' overall perception of the link between financial flows to developing countries and the shared interests of all countries. The resulting catalog of negatives includes the moth-eaten IDA-VII that has emerged from months of agonizing deliberations; the obstacles faced by the World Bank management in their courageous striving for a modest supplementary funding to regain the nominal size of IDA-VI; a World Bank selective capital increase only half as large as that warranted by well-established principles; a regrettable absence of consensus on an SDR

issue for the fourth basic period despite fulfillment of all objective criteria; and two rounds of reduction in access limits under the Fund's enlarged access policy. There are only three limited areas in which there appears to be some perception of interdependence. These include, first, what has come to be known as the debt problem of heavily indebted countries, and, second, the development problems of sub-Saharan Africa. The third area is that of direct private investment.

The first two of these three areas appear to be perceived as crisis areas signaling visible threats to existing institutions and interests, while the third area—that of direct private investment—appears to induce positive attitudes because of the most transparent trends in the financial and real sectors of several industrial economies. Support for the Action Program for sub-Saharan Africa is specially encouraging. We only hope and desire that this program may not meet the fate of the substantial new program of action adopted for the least developed countries only three years back.

Welcome as these limited and fragmentary perceptions are, they may distract attention from some very obvious and real issues, such as the decline of multilateralism as the basis of the international monetary system and the alarmingly growing debt burden of the low-income and least developed countries as a share of their GNP. The Expert Group of the Commonwealth on the world debt crisis has eloquently and with sound statistics drawn the attention of the international community to these issues.

Wider perceptions of interdependence cannot, and will not, take place spontaneously, without conscious cooperation in a collectively agreed forum. The time has come, in our opinion, for new initiatives, such as an international monetary conference. The latest deliberations at the Interim and Development Committees give only some faint hints of possible progress in that direction. . . .

We have always been justifiably proud of the urbane, rational business style and performance of the Fund and the Bank, historically dependent on producing a workable consensus. The managements of both institutions have been courageously innovative in the stormy financial environments of our troubled times. Let us all today give a renewed pledge of our strong and continued support to the Managing Director of the Fund and to the President of the World Bank, and, through them, the dedicated professional staffs of both our institutions, in their increasingly difficult task of furthering fruitful multilateral economic cooperation in a world that needs it more than ever before.

STATEMENT BY THE GOVERNOR OF THE BANK FOR NEPAL

Prakash Chandra Lohani

It is indeed a great honor and pleasure for me to address this distinguished gathering. I wish to express our sincere appreciation and gratitude to President Reagan for his address and eloquent support for international cooperation and for the cause of prosperity and peace in the world at large.

Since the last Annual Meetings, it is encouraging to note that the economic recovery in the industrial countries is underway. While the developed countries are emerging from what has been the worst recession of the postwar period, in many developing countries the effects of recovery are being felt only gradually. While aggregate gross national product of the industrial countries is estimated to have risen by 2¼ percent in 1983, real gross domestic product of non-oil developing countries taken as a group is estimated to have increased by only 1½ percent. The levels of per capita output of these countries have actually declined for the third consecutive year. High real interest rates, inadequate capital flows, and protectionist tendencies continue to aggravate the problems faced by the developing countries. Despite a more promising world economic situation, many developing countries find their positions deteriorating even in this recovery phase.

Historically high real interest rates, persistent disequilibrium, and instability in exchange rates have, however, cast doubts on the sustainability of the economic recovery. While the momentum of recovery is expected to be maintained in the coming years, with growth rates in the industrial countries projected at 3.9 percent in 1984, imbalances in the monetary and fiscal policies, and the protectionist measures could threaten continued world economic recovery.

High real interest rates, the strengthening U.S. dollar, and artificial barriers to trade have further aggravated the alarming international debt situation. Protectionist measures, especially nontariff barriers adopted by the industrial countries, have made it more difficult for the developing countries to increase their export earnings. This has adversely affected their economic growth and their capacity to repay external debts. Although the current account deficit of non-oil developing countries has been reduced to about $56 billion in 1983 from $82 billion in 1982, this has been possible not because of improved export performance but because of drastic curtailment in the imports by these countries, leading to slow economic growth.

Reduced international bank lending, stagnant or declining official capital flows, and heavy debt-servicing burdens have resulted in diminishing net financial transfers to the developing countries at a time when the need of these countries for capital is even more urgent. The high level of both official and private financial flows is of paramount importance for the developing countries. In this context the roles that the Fund and the World Bank can play assume vital importance.

The Fund has been playing a constructive role in the adjustment process of a number of indebted developing countries. We welcome the improvement in the Fund's liquidity position following the replenishment of resources under the Eighth General Review of Quotas and the securement of credit lines from other official sources. However, the increased stringency of limits on members' access to Fund resources is a cause of concern to us. It is disheartening to note that in actual practice the access limits have fallen well short of the guidelines for maximum access adopted at the Interim Committee meeting of September 1983. At present, the developing countries are faced with a disproportionately high burden of economic adjustment and are greatly in need of help. We would therefore like to see some easing of the conditionality rules adopted by the Fund.

An allocation of SDRs in the remainder of the fourth basic period could have ensured appropriate financing flows to the developing countries. We are disappointed to note that the Interim Committee has not yet been able to reach an agreement despite a clear and convincing case for such allocations. . . .

In the context of special needs of low-income developing countries, I would also like to refer to the substantial new action program adopted by the United Nations Conference on the Least Developed Countries held in Paris in 1980. I urge that the substantial new action program, which aims at alleviating the equally difficult problems of development faced by these least developed countries, some of which are also geographically handicapped small economies, should be supported by the international donor agencies. I would like to urge that, at the extended meeting to be held in spring 1985, the Development Committee should also take into account the need for external assistance to implement this substantial new action program for the least developed countries.

At this point, I would like to briefly go over Nepal's economic performance during 1983/84. Prudent policy measures undertaken by the Government at the beginning of the year and favorable weather conditions have helped in achieving a 7.4 percent growth in GDP. In the previous year, serious drought had precipitated a negative growth

rate of 1.4 percent. Increased output contributed to lowering the inflation rate substantially. Improved export performance led to a significantly reduced balance of payments deficit. Recognizing the vital role the private sector can play in the economic development of the country, the Government's economic policy has been designed to create and foster a competitive environment for the development of the private sector. Financial as well as other incentives are to be provided on the basis of achievement and excellence, both to the private sector and to projects implemented by the Government. In this context, the private banks, finance companies, and export-import companies with majority share of the private sector are to be encouraged. To enhance the participation of people in development activities, shares of public as well as private companies are being floated in public. The prospects for fiscal year 1984/85 look promising and the Government remains committed to pursue appropriate stabilization measures.

Nepal embarks on its seventh Five-Year Plan next year. The Plan objectives, which are largely guided by the "basic needs" approach, are to accelerate production, increase opportunities for productive employment, and fulfill the minimum basic needs of the people. The plan aims to secure an average annual growth rate of 4.5 percent. In spite of increasing efforts toward domestic resources mobilization, about 70 percent of the aggregate development outlay will have to be met from external sources. . . .

While concurring that the recovery in the industrial countries would undoubtedly favorably affect the growth of developing countries, this would not by itself ensure a satisfactory growth rate. For such growth, an appreciable increase in investment is imperative. While domestic resource mobilization should be enhanced, capital flows to the developing countries, both concessional and nonconcessional, public as well as private, must be stepped up. We believe that the Fund and the Bank can play a more effective and meaningful role in this respect. For this, these institutions need, and deserve, support in augmenting their resources by all member countries who have the capacity to do so.

Finally, institutions like the World Bank reflect a willingness on the part of mankind to look at the world as one entity in a meaningful fashion, at least on questions of economic progress and development over time. If this attitude is to be an integral part of our thinking for future international institutions, these institutions must be made more effective and functional in meeting the needs and aspirations of member countries. To achieve these objectives with support by developed countries in the form of increased flow of resources and the establish-

ment of an efficient mechanism to transmit recovery in the developed countries to the developing countries is vitally important. The Fund and the Bank must also be sensitive to both the short- and long-term country-specific needs and peculiarities of its members who are in differing stages of development. Viewed with this perspective, what is at stake is not just the effectiveness of the Fund or the Bank but the ability of nations to cooperate in making our planet a better place for all human beings.

STATEMENT BY THE GOVERNOR OF THE FUND AND THE BANK FOR GREECE

Gerasimos Arsenis

In his address to these meetings, my colleague, Mr. Dukes, Minister for Finance of Ireland, gave the collective position of the European Community countries on matters regarding the International Monetary Fund and the World Bank.

Therefore, I shall not cover the same ground. Nor will I deal with our adjustment program which has started yielding results in the form of higher output and reduced inflationary pressures. This program, together with our medium-term plan for restructuring the economy, lays the foundations for noninflationary and sustainable growth. The success of national policies, however, should not be the exclusive focus of discussions in this forum. I think that we should address ourselves, instead, to our collective responsibilities. In this respect, I would like to share some thoughts regarding recent developments and international policy options.

Previous speakers have already emphasized the main developments during this year:

—the strengthening of economic activity in industrial and developing countries alike, most notably in the United States;

—continued moderation of inflationary pressures in the OECD area;

—persistence of high unemployment rates in most countries, especially in Europe;

—resurgence of upward pressures on real interest rates and the concommitant increase in the value of the dollar; and

—the burdensome adjustment on the part of developing countries to meet debt service obligations.

These developments, however mixed, can be surely taken as signs of a long-sought upward swing in worldwide economic activity that

follows years of virtual stagnation. But a proper evaluation of the situation needs to go beyond a superficial analysis of aggregate economic indicators.

There are four issues that need be explicitly addressed before useful lessons can be drawn from our past experiences:

(1) origin of recent developments and the lack of symmetry in their effects;

(2) sustainability of recovery;

(3) implications for international coordination; and

(4) gap between realizations and aspirations.

Let me briefly comment on these issues.

As far as recent developments are concerned, the worldwide level of economic activity has improved, world trade has increased, and significant progress in curbing inflation has been achieved in most countries. If anything, this experience has shown that determination and activist policies on the part of national governments do, in fact, work, especially after periods of low capacity utilization. It should not be surprising, therefore, that in the United States, a dominant player in the international economic scene, an expansionary fiscal policy stance resulting in large government borrowing requirements coupled with severe monetary restraint and concerted efforts to curb inflationary expectations have given rise simultaneously to output growth and high real interest rates. In a world of integrated financial markets and in the absence of countervailing policy measures by other governments, the direct consequence of this policy mix has been an appreciating dollar. This trend will continue till such time as this policy is reversed, either as a result of internal pressures or lack of confidence in the sustainability of financing arrangements.

For several industrial countries, an appreciating dollar has meant greater competitiveness for their exports, but for other countries, however, especially those with diversified export earnings and dollar-denominated imports, the appreciation of the dollar has resulted in increased import payments without comparable increases in export receipts. Similarly the persistence of high interest rates has meant that, in the case of many debtor countries, a sizable portion of real output has had to be diverted to meet interest payments.

The asymmetrical effects of recent developments is a point that needs to be emphasized. Asymmetry in repercussions leads to mixed policy responses as some countries strive to curb the inflationary

pressures or meet external payments without jeopardizing the prospects of recovery.

To be sure, demand and trade are expanding with the usual multiplier effects in the international economy but the sources of growth remain both geographically and compositionally unsatisfactory.

The persistence of high real interest rates and contractionary policies followed by several governments have delayed or dampened the recovery in many parts of the world. At the same time, high real interest rates coupled with existing rigidities have acted as disincentives to private investment. It is worth noting that underinvestment in business plant and equipment continues in most countries. Since 1974, none of the major industrial countries has experienced growth rates of real investment comparable to the period up to 1973. In some countries, real investment has actually declined since 1980. Capital constraints already begin to impinge on the expansion of output as recovery proceeds.

These factors intensify uncertainty as to future prospects and increase the probability that we might experience a new downturn in the business cycle before being able to take advantage of the beneficiary effects of the present expansion.

If policy in the rest of the world, especially in other industrial countries, continues to be deflationary as countries ride on an export-led upward trend, then an abrupt shift in financial market behavior may result in renewed stagnation and even greater unemployment. This becomes a distinct possibility in view of the fragility of financing arrangements. There is a growing awareness that a situation in which a major industrial country becomes a major debtor in international financial markets can only be transitional. Thus, the second point that must be stressed has to do with the breadth and the sustainability of the recovery. Looking over the next couple of years, the central issue that will determine economic developments may well be the readjustment of exchange rate parities to a more realistic level.

It is the pace and time profile of adjustment in financial markets that would be of utmost importance to policymakers as financial developments give rise to real effects at home.

It is for this reason that we must work out now a strategy for solving the fundamental imbalances that have given rise to an unsustainable financial environment. In this task, not only the direction of policy but also its timing and worldwide repercussions should be considered.

Uncertainty as to the future course of events and the fragility of the economic situation make it imperative that we should seek better

coordination of efforts to work out a medium-term strategy that has as its principal components:

(1) gradual reduction of the imbalances arising from policies or structural problems in industrial and developing countries alike;

(2) commitment to long-run growth; and

(3) support and financial assistance to developing countries.

In order to succeed, coordination has to be credible. And this brings me to the last point I wish to raise: the gap between realizations and aspirations, a gap which I feel is growing increasingly wider.

This may be attributed by some either to unrealistic expectations or to insufficient efforts. Whatever the case, the fact remains that the credibility of policymakers is being questioned increasingly all over the world. Since 1974, governments and international organizations have asked for support and consent in pushing through painful adjustment programs. Patience and hardship were to be rewarded in the long run by a lasting recovery and improved standards of living with full employment. During these ten years, the fulfillment of promises that were given was postponed over and over again pointing to unexpected changes in the economic environment.

People begin to suspect that short-run adjustment programs were not of a transitory nature but an implicit long-run policy. What we must understand is that makeshift solutions are less and less likely to be politically acceptable. Consecutive adjustment policies that are not accompanied by *a clear program of concerted action* run the danger of being politically rejected. I need not, of course, dwell upon the incalculable political, social, and economic consequences that such a rejection may entail.

I conclude that, from now on in our Annual Meetings, it will not suffice to reassert our commitment to national adjustment policies. We must also consider policies to support a program for employment creation and sustainable growth. And this task will be infinitely easier if we all consider it together in the context of a global strategy.

Statement by the Governor of the Fund and the Bank for Romania

Petre Gigea

The 1984 Joint Annual Meetings of the Boards of Governors of the International Monetary Fund and the World Bank are taking place

during a period in which the world economy is presenting some encouraging signs of relaxation and recovery. Nevertheless, it is still far from a firm and general recovery.

Last year's recovery was followed by certain grave problems that confronted developing countries. I have in mind, first of all, the difficulties linked to debt servicing that has become a problem for more and more countries.

The essential feature that characterizes the period to which I am referring, and which was mentioned in the Annual Reports presented to us, is the maintenance of excessively high interest rates that have practically diminished the economic readjustment efforts of debtor countries.

To these difficulties is added the intensification of all kinds of protectionist measures on foreign trade. We have, unfortunately, the picture of a critical situation in the developing countries, which does not allow them to go forward with the implementation of their priority plans for economic development, thus, widening the gap between industrial and developing countries.

The main efforts to improve their economies should be made by the developing countries themselves, and they are already doing this. But it is inconceivable that these efforts should be wiped out by certain financial and trade practices which determine that most of their national income must go abroad instead of being used for their own economic growth—growth which these countries badly need.

Taking into consideration the present economic situation in the world, Romania and its President, Nicolae Ceauşescu, believe that this is the time in which developed countries should forge ahead with constructive negotiations in order to solve these particularly complex problems.

In this respect, Romania believes, in principle, that this is necessary in order to achieve a global solution in a new manner, with regard to the debt burden which is affecting developing countries. It should be taken into consideration that it is necessary that their debts should be rescheduled on a long-term basis with low interest rates; the external debts of the poorest countries should be canceled, and a substantial reduction should be made in interest rates that favor other countries. At the same time, credits for developing countries, in order to support their efforts toward economic and social progress, should be granted on terms with lower interest rates.

One such measure which could improve the economic situation of debtor countries would be to consider interest payments already made

at rates in excess of, let us say 7–8 percent, as payment on the principal. At the same time, we are considering that a basic solution to the world's economic problems cannot be achieved without considering the establishment of a new economic order which is confronting countries all over the world, and an adequate reform of the international monetary system.

Romania, as a member of the international community, is strongly anchored by its policy of consistent cooperation with all countries of the world, regardless of their economic and social systems, and it could not avoid the impact of the economic and financial recession. But by taking strong measures, for instance, stimulating labor productivity, production growth, savings in energy and raw materials, redirecting investments according to our greatest priority, we have gradually reduced the effects of this impact. Last year we achieved an industrial growth rate of 4.8 percent and 5.9 percent for the eight months of this year. In agriculture, this year's harvest will be very good; we should reach one ton of grain per capita. This year investments are oriented with priority, as in previous years, to make better use of new reserves in mineral and energy resources, expanded land irrigation, industrial modernization, and completion of ongoing projects.

In the field of foreign trade, we achieved an increase over last year's level both with respect to imports and exports, allowing us to continue to obtain surpluses, both in our trade balances and in our current account. This has resulted in a reduction in recent years of the total of our foreign debt by $2 billion and an update of interest rate payments, as well as other external commitments.

Our programs for the 1986–90 period are aimed at consolidating the good results we have been able to obtain during the actual five-year plan, stressing further development and modernization of the existing technical material basis in the Romanian economy by increased efficiency in all sectors.

The achievement of these programs will provide us the opportunities to further decrease our foreign debt and consolidate our hard currency reserves.

Romania, as an active participant in international life, has developed and will continue to widen our cooperation with all countries within the well-known principles advocated by Romania. Within this framework, we have cooperation and fruitful relations with the International Monetary Fund and the World Bank.

We positively appreciate the activity and the efforts of these two international organizations, headed by Mr. de Larosière and

Mr. Clausen, respectively, and I am expressing my conviction that the Fund and the World Bank will do their best through more flexible loan policies to assist the developing countries' efforts to a greater extent to solve the problems with which they are confronted, as well as to support their economic and social development.

Statement by the Governor of the Bank for Western Samoa

Tofilau Eti Alesana

Speaking on behalf of Solomon Islands, Vanuatu, and Western Samoa, it is a pleasure to welcome the island countries of St. Christopher and Nevis and Mozambique to membership in the Fund and the Bank. When we gathered here one year ago, there was some hope and optimism that the international economic environment was improving, and that the slowdown or recession, the longest in 50 years, was abating.

On one side of the coin, the world economy took a decided turn for the better in 1983. World output increased. Consumer price rises in the major industrial countries, which had exceeded 12 percent in 1980, fell to under 5 percent for the first time in more than a decade. And the balance of payments of the non-oil developing countries returned to more moderate levels.

On the other side, satisfactory economic growth remains concentrated in relatively few countries; economies of many continue to be sluggish and few remain unscathed from the severe slowdown in activity; unemployment continues at historically high levels, and the debt problems of many developing countries remain precarious and require more durable solutions and a strengthened international financing system.

Solomon Islands, Vanuatu, and Western Samoa—we are all small geographically isolated developing countries situated in the South Pacific Ocean. Along with most other small geographically isolated developing countries, we share common problems such as a low-income base and remoteness. Economies are often supported by only one or two crops. Industrial development is little better than rudimentary, and infrastructure, in the real as well as the financial sector, is often modest.

Against this background, economic viability is understandably a serious problem. We are often criticized for the goals and objectives

we seek. Expectations are set too high. "Doing too much too soon" is an often used quotation. To some extent, expectations of improved living standards established in the 1950s and 1960s were carried on into the 1970s although conditions had changed. Even so, material and technological developments over the last decade have brought the backwardness, human suffering, and difficult circumstances in the developing world into sharp focus in contrast to the wealth and affluence of the industrial countries—and it appears that it will take decades before the gap begins to narrow significantly or, indeed, even stops widening.

In this context, the Fund and the Bank have responded to the situation on a number of fronts, and their continued study of particular problems confronting developing countries in the period ahead is to be applauded. The very recent decision to allow enlarged access to the Fund when members' circumstances warrant, and the Bank's increasing use of cofinancing techniques, are both good examples of the continued flexibility and innovation of approach of these organizations. . . .

Against this background, we continue to require understanding and assistance from the international community and the major international institutions. Our domestic savings will not easily sustain an adequate amount of domestic investment. Concessional financing from both bilateral and multilateral sources must be a major ingredient of financing for our development efforts if the burden of debt service is not to prove crippling in the future. And there is an important role for foreign direct investment as well in the transfer of technology and the opening up of new opportunities for capital formation as part of any overall development package.

On our part as smaller countries, we must also be prepared to accept the discipline of adjustment programs so that there is a better balance between supply and demand, goals, and what is achievable. "To bite the bullet" is a very apt phrase. It is in this context that we commend Mr. de Larosière and his staff's sustained and untiring efforts to tailor financial programs to individual needs and to maintain an adequate flow of finance so that adjustment efforts can proceed. We were particularly struck with the frankness and concern shown by the Managing Director in his statement concerning the implications and impact of Fund policies.

Clearly the Fund has emphasized for some time the need for more disciplined financing and for much more flexibility in the management of prices, notably interest rates and exchange rates, and wages. In Western Samoa, we are presently implementing such a program,

successfully I believe, to achieve better internal and external balance. But from my own experience, it is not always easy to maintain a cohesive and rigorous strategy which allows adjustment to occur at the pace required. And at times, the severity of measures may reach the upper limits of social cost which prove too harsh to endure. I am certain that the Fund is conscious of such dilemmas faced by member countries.

However, I want to emphasize that small developing countries are able to do only so much. The major industrial countries must also provide the necessary leadership and mix of policies which allow progress along the road to recovery. Actual and real interest rates in some major financial markets seem unnecessarily high. Closely related to these questions is the pattern of exchange rates. We do not stand alone in saying that some important relativities of the exchange rate to the foreign exchange markets have been distorted for too long and that budget deficits whether for a small or large country must be contained and, where excessive, reduced to more manageable levels.

A second element at the international level relates to broader ranging policies and measures. With recovery under way, trade needs to be liberalized and the tide toward new forms of protectionism must be arrested. Regrettably, increased pressures for protectionism in countries with overvalued currencies are not offset by more liberal measures in countries with undervalued currencies. And liberalism runs out of steam as economies start to falter. Trade, in particular, will be vital to solving the debt crisis and additional trade barriers can only pose severe problems for those heavily indebted. With expanding export markets, developing countries, for one, will be better situated to service their debt obligations and to resume growth.

Finance is of equal importance. Adequate liquidity including appropriate allocations of SDRs is crucial to maintain an efficient and effective international monetary system. The Fund's resources have recently been reinforced to finance a substantial growth in adjustment programs, and members must ensure that its resources remain more than sufficient to finance the needs of countries for some years ahead. . . .

The world is in a somewhat improved economic and financial condition today than a year ago. Recovery and adjustment measures have removed the threat of an international financial crisis. However, we must not be lulled into a sense of complacency. For if recovery falters or is inadequate, many developing countries will be forced to make further adjustment which will only lengthen the severity of their plight. We must seek a more satisfactory outcome and hope that it can be achieved.

All countries, and particularly those of the developing world, have much at stake and must try to ensure that the current international economic recovery is sustained.

We remain confident that the Fund and the Bank will play their necessary roles in working toward this goal.

Statement by the Governor of the Fund for Spain

Mariano Rubio Jiménez

The positive elements that inspired our confidence in a recovery of the world economy a year ago have been considerably strengthened over the past 12 months. In the course of that period we have, on several occasions, revised upward the forecasts for this year for the growth of the industrial countries and the rate of expansion of world trade and, as a consequence, we have observed an improvement better than that initially expected in the developing economies.

These causes for satisfaction cannot hide, however, the difficult problems we are still faced with: the disparity in the cyclical situations of the various industrial countries, the difficulties that the present recovery will have to overcome for the way to be clear for a period of sustained expansion and, finally, the serious problems that continue to beset the present and future of the developing countries, and, particularly, of those with high external debts.

All these problems are conditioned—at least partially—by the development of the U.S. economy. This economy was the source of the impulses that have dominated the present recovery phase of the world economy and brought about the successive upward revisions of our forecasts for the immediate future, but it also carries in it, in part, the origin of certain of our fears regarding continuation of the expansion in the medium term, regarding the rate at which other countries—especially the developing countries—will be able to share in this expansion, and regarding the makeup of international financing and trade flows in the near future.

I do not, of course, propose to start making specific comments about the national economic policies of other countries, as that would be improper. I believe, however, that there is a general consensus, inside and outside the United States, on the need to reduce its public deficit, if the perpetuation of high interest rates and the absorption of savings from less wealthy countries, and the effects of this on domestic demand in the United States, on the pace of recovery in other industrial

countries, and on the problems of the heavily indebted developing nations are to be prevented.

We must not, however, seek the sole source of our difficulties in the U.S. economy; on the contrary, that economy has demonstrated a flexibility in recent times which should give cause for thought to other economies that are more rigid and therefore slower to make the adjustments needed for them to participate in a process of sustained expansion that will enable a steady rate of employment creation to be resumed.

The fact is that a good number of industrial economies are still encountering serious difficulties in eliminating their monetary disequilibria and overcoming numerous inflexibilities that hinder needed adjustments of real resources, swell public deficits, have a negative impact on incentives and returns and, ultimately, erode the capacity for growth and employment generation. These economies must continue their efforts to combat their disequilibria and the rigidities that obstruct their adjustments, since only in this way will they be able to maintain higher rates of expansion of domestic demand that can take the place of the external stimulus from the U.S. economy when it slackens in the near future.

The strategies for dealing with these problems are unquestionably unpalatable, but they are essential if the aim is to truly set the world's economies on a sound footing. This is why the Spanish Government has been focusing its efforts in this direction, with positive results that have already begun to be apparent in an appreciable reduction in the rate of inflation, which now appears to be at an annual rate below two digits; in the elimination of the current account deficit of the balance of payments and its replacement by a sizable surplus this year; in containing the growth of the public deficit, within the context of policies designed to remove the causes that fuel it and, finally, in a substantial increase in the real growth rate of the economy, up to 2.5 or 3 percent this year, spurred by a significant rise in exports that promises to link up with a resurgence of domestic demand through the improvement in returns and the reorganization of the financial structure of enterprises in various sectors and a fall in interest rates. As in all countries, correction of the disequilibria is a prerequisite for moving into sustained growth that will generate employment, the last variable to recover in an economic cycle.

In light of the difficulty of our efforts, the need becomes fully evident for the major industrial economies to implement their policies in such a way that those which take the initiative in the present recovery will ensure that it is consolidated in a phase of sound expansion, for those

which remain less far advanced to be able to speed the rates of growth of their domestic demand, for international capital movements to regain a structure more consistent with the relative shortages of factors in the world economy, for international trade no longer to be threatened by a tide of protectionism and, in sum, for the clouds that have been obscuring the prospects of the world economy for more than a decade to be swept away.

The formulation and application of appropriate economic policies by the industrial countries assumes all the more significance from the viewpoint of the developing countries. The International Monetary Fund has revised appreciably upward the growth rate foreseen for this group of countries in the present year and now places it at 3.75 percent, as a result of the stimulus their exports have received from the rapid recovery of world trade. However, the different countries in this group are not all starting from the same position; neither have they all shared equally in the general upturn. Many poorer African countries and a number of Latin American countries are still posting falls in their living standards; and, as shown by the "scenarios" outlined by our institutions for the years ahead, the recent easing in the situation of the developing countries with high external indebtedness—an easing due, to a large extent, to a compression of their economies that would be unsustainable for an extended period—does not exclude the persistence of very serious problems for some considerable time to come. Hence we trust that painstaking preparation for the Interim Committee and Development Committee spring meetings will lead to a fruitful discussion of the problems of the indebted countries.

These countries must, of course, be asked to apply responsible economic policies consistent with a gradual improvement in the problems currently besetting them; but we must make this request with an awareness of the internal limits of these policies and of the fact that they cannot ultimately prove successful if they are not implemented in a favorable and dynamic world economic context. Here, again, a major factor will be the policies of the industrial countries for ensuring consolidation of expansion and normalization of world financial conditions.

In the delicate circumstances today characterizing those economies and, with them, the functioning of the international economy, the activity of the Fund assumes special importance. I would accordingly like to express Spain's views regarding the criteria that ought to guide the policy of enlarged access to the Fund's resources and the desirability of renewed SDR allocations.

The enlarged access policy has been an instrument of great value to the Fund and to the international community in this turbulent period

our economies have been passing through. It has been one of the chief mechanisms that have contributed to increasing and improving the composition of the financing of the adjustment processes carried out by the economies with a high level of external debt. This policy has been applied with the flexibility and prudence called for by the circumstances of each case, and I would accordingly like to offer our special congratulations to the Managing Director, Mr. de Larosière. We believe that the way in which this policy has been implemented, and the difficulties and uncertainties which still hang over the adjustment process of the main developing economies, are grounds for delaying review of it until our next annual meeting.

Regarding SDRs, we repeat that, in our view, the present conditions of the international economy meet the requirements laid down by the Fund's Articles of Agreement for resuming allocations. Accordingly, and notwithstanding the position adopted last Saturday by the Interim Committee, we still believe that a moderate SDR allocation in the present basic period is advisable and would help to resolve the after-effects of a crisis as intense as that which the international community has suffered from. . . .

I would like to close by referring to one of the most serious problems facing the world economy today: the intensification of protectionism. Periods of contraction favor the extending of trade protection measures, the more so when these are combined with significant variations in the structures of relative costs and prices and of international comparative advantages. What is certain, however, is that protectionism is now on the rise and shows no signs of abating. Nontariff protection measures are continuing to proliferate over a wide range, running from import quotas to administrative barriers, voluntary export restriction agreements and recourse to measures presented as means to offset dumping or unfair competition; all with clear features of discretionality, discrimination, and a tendency toward bilateralism coupled with generation of considerable uncertainty that is prejudicial to trade flows and investment decisions.

This development is most certainly contrary to the opening of markets to goods from the developing countries that we should be interested in encouraging; however, the problem goes beyond the interest of the developing nations alone to affect the entire international community. Recent experience shows, once again, that protectionism engenders protectionism.

It would appear urgent that all countries should become aware of the threats posed by this process and that we should react energetically,

tackling the problem efficaciously within the framework of the existing institutions and expanding the sphere of the GATT to include the protectionist measures that have sprung up in the recent past.

STATEMENT BY THE GOVERNOR OF THE FUND FOR THE ISLAMIC REPUBLIC OF IRAN

Mohammad J. Vahaji

In the Name of God, Most Gracious, Most Merciful

> "The Evil One threatens you with poverty and bids you to conduct unseemly. God promiseth you His blessings and bounties. And God careth for all and He knoweth all things." Holy Quran 2:268

It is a pleasure to be part of these Thirty-Ninth Joint Annual Meetings of the International Monetary Fund and the World Bank, and I would like to express my gratitude to the organizers of these meetings. I also wish to welcome the two newest members of our two sister institutions.

On the verge of the fifth decade of the existence of these institutions, these meetings provide us with an opportunity to gauge the successes and failures of our endeavors in fulfilling the great expectations of masses of poor and underprivileged people, the improvement of whose life conditions is supposed to be the main concern of these international bodies. Looking back, it seems to be obvious now that what was established 40 years ago at the Bretton Woods Monetary and Financial Conference provided a congenial foundation for the rapid growth of major industrial countries. But the system also embodied an inherent imbalance and asymmetry in the world financial relationships manifestly based on the dominance of one currency and one country. Even after the failure of what was considered to be the foundation of the Bretton Woods arrangements, the opportunity to base these relationships on a balanced basis, less inimical to the position of the poor countries, was regretfully missed. This, again, has emanated from the continuation of the preponderant presence of the major industrial countries in these institutions. The story of the last 40 years depicts a pathetic experience in which any egoistic policymaking of a superpower has been allowed to make the weaker and vulnerable members of the international community suffer from the subsequent economic upheaval, while these two august organizations are supposed to act as a shield and shock absorber to protect and give the much-needed help to the needy and the oppressed.

We are now almost in the middle of a decade which started with a year of a drastic decline in the output growth of nearly all countries, followed by profound stagnation and an actual decline in the level of output, which was only moderately reversed last year. Even the much-heralded recovery of the last year, if added to the best of expectations for this year, can bring the average output growth of the first five years of this decade to almost one half of the average for the second half of the last decade. Once again, it has been the poor who have borne the brunt of these adverse developments. The average growth rate of the developing countries during the last four years declined to almost one fourth of the corresponding figure for the preceding four years. Among the developing countries, the real price was paid by the oil exporting countries, whose output actually declined by an appalling figure approaching 12 percent for the last four years. Even this disturbing picture is not a true reflection of what actually happened to the needy in the oil exporting countries if income disparity between a few wealthy oil exporters and larger countries among this group is taken into account.

This backward movement of income for nearly all the groups of developing countries has a different meaning for their poor population, compared with the slackening rate of growth in countries where personal income is already at comfortable levels. The luxury of a high per capita income affords the major industrial countries the liberty of tackling their problems through nationalistic policies, without taking heed of the plight of human beings living beyond their well-protected political and economic boundaries. Year after year there is talk about huge surpluses of a large variety of agricultural products in the Western industrial countries in the face of starvation and malnutrition in many developing countries. The possibility of producing all these products at a cost below the current cost of production in industrial countries does exist if the badly needed means and incentives are given to the people of the so-called South. The incentives are lacking and the protectionistic walls are being raised even higher, hence the inability of acquiring much-needed foreign exchange at a time when mounting foreign debts of developing countries are approaching the frightening figure of $850 billion and the value of their exports has been declining in each year during the last three years. The purchasing power of their exports is now less than it was in 1979.

The charters of the International Monetary Fund and the World Bank were supposed to be the sources of inspiration for remedies for these problems. However, in practice, the major industrial countries have successfully shaped policies in these two institutions which have practically aggravated the existing problems. In particular, the burden

of any kind of adjustment to the economic fluctuations has been put on the shoulders of the poorer members of the international community. The conditionalities imposed by the IMF and the terms attached to the World Bank lendings effectively pave the way for social and economic instability in the borrowing countries by putting too much emphasis on policies like wage restraint and government budget cuts. Ironically the U.S. Government can easily have a budget deficit of gigantic proportions, driving the international interest rates to unbearable levels and making the interest payments for the debtors a painful impossibility. On the one hand, the discussion about a harmless and much-needed new round of SDR allocation has been blocked at the IMF, and, on the other hand, the growth of the world liquidity has been allowed to become captive to U.S. economic policies. The asymmetries are shocking and no remedy can be expected to be offered by the IMF and the World Bank as long as the decision-making machinery within these institutions is geared to the interests of the industrial countries. The answer, inevitably, will be greater self-reliance and less dependence on major economies and less expectation about their generosity, either directly through official channels or indirectly through the international commercial banks.

In my own country, the Islamic Republic of Iran, we have put this solution successfully into practice. We are in the fourth year of a devastating war ruthlessly imposed upon us by the superpowers. In spite of this, we have been successful to set the stage for a major economic recovery over the past two years. This has been made possible through an enhanced foreign exchange position, a deceleration in the pace of price inflation, together with an extended effort to introduce fundamental and far-reaching social and economic reforms. Though the agricultural sector of the economy has faced problems mainly emanating from the structural changes taking place in that sector, the achievements of the industrial sector have been considerable as a result of a sharp increase in investments both by the public and private sectors, with the latter doubling its investment efforts last year. The imposed war has continued, as expected, to place a claim on both the Government's budget and the country's foreign exchange resources. Therefore, the main emphasis throughout has been on the careful management of the country's foreign exchange resources with a view to accommodating the economy's import needs. As a result, in addition to the prepayment of most of our foreign debt obligations, we have been able to accommodate all our foreign obligations without any recourse to new borrowings. Even the attacks instigated by superpowers on our nonmilitary cargoes failed to achieve any disruption in our international transactions and we have been able to fully meet our foreign commitments. In fact, the valuable lessons learned by living

through economic sanctions, sabotage, and the war against our country have made our people ready to refrain from wasteful consumerism. This, we believe, is bringing about economic and social rejuvenation in our society which is being helped and fostered by the social reforms now under way in our country.

Perhaps the most important area of policymaking and a major step toward the introduction of socioeconomic reforms based on the principles of Islam has been the inauguration of the interest-free banking system in March 1984. This, undoubtedly, is the first systematic modern attempt to revolutionize the entire banking system of a country and base it on the Islamic principles.

This is an altogether new experience, worthy of much research and evaluation, and we are gladly ready to share our ideas and experiences with other nations of the world in an effort to seek ways and means to alleviate the problems of today's international banking relationships. Much of the present international banking crisis and the debt problem have their geneses in the blind borrowing spree during the last two decades from the commercial banks, whose main occupation was to ensure that they would get back the principal and interest of their money without bothering about the inimical effects of such loan servicing on the borrower. This has undoubtedly been aggravated by the upsurge in the level of international interest rates. Any kind of direct involvement and participation by the lenders in the projects for which the borrowed money was supposed to be used would have precluded the banks from unjustified lending in the hope of collecting more interest. The new banking law in our country not only replaces the traditional interest charges with a series of profit-loss sharing arrangements, but also encourages the banks to play a far more active role in the selection, financing, and implementation of investment projects. We very much expect that this kind of risk sharing effectively enhances efficiency.

While it is still too early for a final assessment, all current signs point to a very warm reception of the new system by the depositors. In fact, some 20 percent of the former savings and time deposits were changed into new investment deposits within only the first three months of the new system, even in the absence of any obligatory regulations to change the status of the old deposits before March 1985. At the same time, the main challenge remains the extent to which these newly mobilized funds could successfully be channeled into productive projects, which, God willing, can smoothly be undertaken considering the present very promising investment opportunities in our economy. We believe the new system is compatible with today's economic and financial needs of the countries and the idea deserves extended studies

and debates in international forums organized by the International Monetary Fund and the World Bank. In our own country, we are closely monitoring the outcome of the implementation of the new system, which has not been faced with any difficulty or unresolvable problems. Hopefully by the next Annual Meetings we would have gained sufficient perspective to comment on these matters.

Fellow Governors, what we are observing nowadays as happening to the majority of human beings living in miserable conditions over large, underdeveloped areas of our planet clearly points to a coming crisis, which, we strongly believe, will take the opportunity of discussing our problems out of tranquil meeting places like this and move it to the battlegrounds with an annihilating outcome for the well-being of mankind. Only by restraining the tyrannical economic and political hegemony of superpowers, altering the foundation of the present world economic relationships, and allowing the underprivileged and the poor to have a larger say in the affairs of today's world shall we be able to avoid a bleak future. May God's teachings and guidance illuminate our path and enable us to search for just and lasting solutions to the many problems still besetting the world economy.