DISCUSSION OF FUND POLICY AT FOURTH JOINT SESSION[1]

STATEMENT BY THE GOVERNOR OF THE FUND FOR SOUTH AFRICA

B. J. du Plessis

Both the World Bank and the International Monetary Fund, under the distinguished leadership of Mr. Clausen and Mr. de Larosière, deserve to be congratulated on their achievements in dealing with complex economic problems over the past year. Since Mr. Clausen has just announced his intended retirement, a word of special appreciation for his dedicated and competent services to the Bank and its member countries is very appropriate.

From the evidence before us it is clear that the world economic situation improved during the past year in certain important respects. In the industrial countries, output grew on average by nearly 5 percent in 1984. At the same time inflation rates in these countries receded to an average of 3.5 percent. In addition, the rapid growth in the imports of industrial countries materially assisted the developing countries by reducing their current account deficits and cushioning the domestic impact of their austerity policies.

In spite of these improvements, clouds are gathering on the horizon. Primary commodity prices have recently been declining, and coupled with the slowing down of economic activity in the United States, the export earnings of the developing countries and hence their growth prospects are weakening. Unless there is accelerated economic expansion in the other major industrial countries, overall industrial growth countries might well slow down in the year—at a time when unemployment in developing countries is a serious problem and a threat to social stability. Add to this the growing calls for protectionism and the reluctance of banks to extend new loans to Third World countries, and we have the making of a new international debt crisis.

Governors of the Bank and the Fund should therefore not be deluded into thinking that the international debt problems are being resolved satisfactorily. They are not. The debt crisis is getting worse, not better. In the

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light of the drastically depreciated currencies of the debtor countries, the impact of foreign debt servicing on their economies is often little short of devastating. This is a matter of concern not only for the debtor countries themselves but also for the creditor banks and the monetary authorities of industrial countries. Indeed, there is no denying that the interbank market and the international banking and monetary system as a whole are now more vulnerable than they have been for some time to disruptive influences, including precipitate actions by opportunistic individual banks.

Recent developments in the South African balance of payments situation have provided further evidence of the vulnerability of and the threat to the integrity of the present international financial system. The events that led up to the forced declaration of a standstill period for the repayment of foreign debt as from September 1, 1985, however, were in many respects very different from those that created debt repayment problems for many other countries.

In brief, South Africa has for some time been applying restrictive monetary and fiscal policy measures, and as a consequence, over the past year gross domestic expenditure has decreased sharply; imports have declined; and with enhanced exports, the current account surplus has equaled some 4 percent of gross domestic product.

A relatively large net inflow of long-term capital further supplemented the current account surplus and enabled the country to reduce its foreign debt by some $2.5 billion over the past year. The debt/export ratio is less than half the average for developing countries in the Western Hemisphere, and the ratio of interest payments to exports of about 7 percent is low for a developing country.

Moreover, South Africa has not experienced any difficulty in meeting both its interest and capital redemption commitments on long-term loans. Neither has the Government or public sector experienced an outflow of short-term capital. The country was forced into the credit standstill by a sudden large withdrawal by some foreign banks of short-term credit facilities previously extended to domestic banks and other business enterprises. In accordance with this standstill arrangement the repayment of capital was suspended temporarily, while current payments such as interest, dividends, and trade settlements have not been affected.

The solution to the South African problem, therefore, also cannot be copied from those applied to other countries. In view of obvious structural and political differences, the procedure of negotiation which has to be followed already displays a unique pattern of its own. Good progress has already been made in this regard, and, as is generally known, discussions have been initiated with the major creditor banks.

South Africa has, however, one major interest in common with other countries in comparable situations and that is a keen desire to promote its exports. Indeed, its ability to meet its international financial commitments in the immediate future will, in large measure, depend on its ability to continue to expand its exports. As a country that has a firm belief in the virtues of the free market system, South Africa therefore unreservedly endorses the statement by members of the Interim Committee that:

> unless protectionist measures were resisted, the prospects for sustainable recovery in the world economy would be undermined and the management of the external position of heavily indebted countries would be severely complicated. Protectionist pressures also make more difficult the task of countries that are taking steps to reduce restrictions and open their markets.

In these circumstances, I particularly welcome the firm determination expressed by members of the Interim Committee that their governments will preserve an open trading system in which all countries will have effective access to world markets. After all, any multilateral or bilateral restrictions on trade or political interference can only exacerbate the imminent danger of an eventual breakdown of the present fragile international financial system.

In these circumstances the new approach of the Group of Five to exchange rates is to be welcomed. The official recognition that the U.S. dollar has been overvalued for some time and that concerted intervention in the foreign exchange markets is necessary to improve the alignment of exchange rates, in general, should certainly help to reduce protectionist pressures in the United States.

Concerted intervention in the foreign exchange markets will, of course, not be enough. It is also necessary to address the root causes of the distorted exchange rate relationships. In this context the Interim Committee is surely right in emphasizing the need for budget deficits to be reduced where they are still excessive. A strong case can also be made for somewhat more expansionary policies in those industrial countries outside the United States that have succeeded in eliminating overspending by means of tight fiscal and monetary policies.

Last year at the Annual Meetings, further momentum was given to the idea of a Joint Program of Action for Sub-Saharan Africa, highlighting the distressing plight of many parts of the continent. It was gratifying to note the recognition granted to the complexity of the situation and the emphasis put on the extent of external support needed to assist the economies of African countries.

South Africa supports the calls that have again been made this year for adequate flows of concessional finance within the functional ambit of the World Bank. To the extent that the Fund also can collaborate in lending a

stabilizing hand to facilitate this delicate adjustment process, the South African authorities would be only too pleased to promote the concept of a multilateral aid package encompassing integrated participation by all members of the Bretton Woods family.

At the same time, however, there can be no substitute for the initiative of private enterprise in enhancing the growth process in developing countries. One would hope, therefore, that international entrepreneurs and the authorities of such countries would find ways and means to join forces in opening up new fields of investment and development.

In Southern Africa further progress was made during the past year with the activities of the Development Bank of Southern Africa, established in 1983. The Bank's programs are aimed at improving the living conditions of the poorest people in the region by helping to identify, and by supporting, high-priority, economically sound investments in the least-developed areas of the region. During the financial year ended March 31, 1985, the Bank almost doubled its fixed commitments under its lending, technical assistance, and guarantee programs, while a large number of important additional projects were under consideration and in the pipeline at the end of the latest financial year.

If ever there was a time when man's morality should match his technology, it is now. If ever his compassion was to be equal to his skills in material goods and wealth, the time is now. The challenge to those who have lies in caring sufficiently to share their knowledge and other resources and to materially assist developing nations on the road to sustainable economic growth, with due regard to their dignity and self-respect.

In conclusion, it is a pleasure to join in welcoming the delegation of the Kingdom of Tonga to these meetings and to extend to the people of Korea great appreciation for their overwhelming kindness and hospitality. They indeed have done their country proud.

Statement by the Governor of the Fund for Denmark

Palle Simonsen

I have the honor to make this statement on behalf of the five Nordic countries—Denmark, Finland, Iceland, Norway, and Sweden. Let me first express our gratitude and appreciation to the Government and the people of the Republic of Korea for the warm hospitality extended to us here in Seoul.

In recent years, the world economy has seen a number of positive developments. Growth has picked up while inflation and nominal interest rates

have come down in most countries. However, these improvements have taken place against the background of increasing imbalances among the industrial countries. Although it is gratifying that there are signs of a more balanced pattern of growth among the major industrial countries, we are concerned about the likelihood that the growth rate in the industrial world—at a time when unemployment is still high—may go down compared with the recent past.

The slowdown in the United States this year has been stronger than anticipated, and economic activity in other industrial countries has not increased sufficiently to compensate for the lower growth in the U.S. economy. In Europe, there are no prospects for an early improvement in the unemployment situation. Faced with debt-servicing problems, many developing countries have had to undergo painful adjustment. The results achieved are still fragile. The risk that the debt situation may take a turn for the worse is still with us with all the consequences this may entail, not only for the indebted developing countries, but also for the economic and financial stability of the world economy in general.

Against this background, it is of paramount importance that the major industrial countries as a group strengthen their endeavors to secure a higher level of economic activity. We see the outcome of the Group of Five meeting in New York in September as an important step forward in this direction. A better coordination of economic policies of the major industrial countries would not only help to reduce large imbalances among industrial countries, thereby easing protectionist pressures, but would also be a major contribution in alleviating the problems of the developing countries.

We share the view presented by the Managing Director that it is of great importance—both for domestic and external reasons—that the budget deficit of the United States should be reduced faster than anticipated at present. At the same time, Japan and some European surplus countries are now in a position in which they could pursue somewhat more expansionary policies. We do not believe that such policies would be inflationary given the slack that exists in most European countries. Such measures do not obviate the need to continue to pursue supply-oriented policies, which will improve the flexibility of their economies. Japan could also make a significant contribution to global adjustment through further opening of the domestic market for imports. We note with satisfaction that, in the aftermath of the New York meeting in September, the yen has strengthened against the dollar, and we hope that the Japanese authorities will pursue policies which will be conducive to a further strengthening of the exchange rate of the yen.

An extremely worrisome feature in the present economic situation is the growth of protectionist pressures in many countries. As has been amply

documented in reports and analyses from international organizations, protectionism implies high costs and yields no benefits either in the short or in the longer term. Nevertheless, countless measures are being implemented to restrict the free flow of goods and services: administrative hurdles, quotas, bilateral arrangements, and countertrade deals, just to mention a few examples.

In our opinion, an immediate reversal of protectionist trends is called for. The Nordic countries strongly support the efforts to convene, at the earliest possible date, a new round of multilateral trade negotiations within the framework of GATT, on the basis of a balanced agenda which reflects the interests of all contracting parties, and which covers all the important issues in international trade. Such negotiations will necessarily take some time. In the meantime, it is important to create a momentum toward reversing the present protectionist trends. To this effect, previous arrangements on standstill and rollback of protectionist measures should be implemented. Furthermore, there is no doubt that a more satisfactory growth rate supplemented by a change in exchange rate relationships, particularly between the dollar and the yen, could contribute importantly to endeavors to combat protectionist tendencies.

For developing countries, free access to markets in the industrial world is of fundamental importance in their development process. As has been documented by the Fund staff, these countries will suffer the most if protectionism spreads.

Recent developments in the international debt situation give rise to serious concern, as many indebted developing countries still have a long way to go before relations with creditors are normalized. In some important cases, the difficulties have even increased.

The Nordic countries continue to endorse a solution of debt problems based on a case-by-case approach, and we appreciate the crucial role the Fund is playing and should continue to play in this process.

In addition to internal adjustments, it is equally important that the external environment be conducive to export growth and that adequate financing be made available. A high and stable rate of economic growth in the industrial countries, together with a liberal trade policy, is necessary to secure sound adjustment in both developing and developed countries. Although nominal interest rates have come down during the last year, real rates are still high by historical standards. A continued decline in international interest rates, in particular for the U.S. dollar, would not only be beneficial for the recovery in the industrial world, but would in itself make a significant contribution to the orderly solution of debt problems.

I will now turn to more specific Fund issues.

The Nordic countries find it satisfactory that the Interim Committee reached a conclusion on the modalities for a one-year extension of the enlarged access policy, even though we would have preferred unchanged limits under the present circumstances.

With respect to the future use of Trust Fund resources, we welcome the conclusion that has been reached in the Interim Committee. We think that this may form the basis for an important contribution to structural adjustment in many of the poorest member countries. It may also be instrumental in furthering closer collaboration between the Bank and the Fund, while preserving the fundamental character of the two institutions.

With respect to a new allocation of SDRs, the Nordic countries remain of the opinion that a decision on an early allocation of a moderate size would have been warranted. Nonetheless, we look forward to the discussions in the Executive Board during the next year on the more basic features of the SDR system.

The Nordic countries have studied the reports prepared by the Group of Ten and the Group of Twenty-Four on the functioning of the international monetary system with great interest, and we believe that the reports will be a most useful basis for the coming discussions on this important subject.

I shall not at this stage comment on the reports in any detail. With respect to exchange rate policies, the recent Group of Five meeting indicates an increased acceptance of the need to influence exchange rates through action by governments and central banks—in addition to the necessity of framing policies with a view to promoting internal and external stability as well as economic growth. It would seem to merit discussion as to how this changed attitude can be implemented in a more lasting way in the international monetary system. Together with a greater degree of convergence in economic developments, this would contribute to a more orderly realignment of exchange rates of major currencies.

In conclusion, I would like to emphasize that a constantly changing international economic environment creates a need for continuous adjustment, which requires flexibility on the part of the Fund. However, the necessary adaptation should not imply a change in the fundamental monetary character of the Fund.

Statement by the Governor of the Fund for Hungary

János Fekete

It is a great honor to address the joint Fortieth Annual Meetings of the Bretton Woods institutions.

I join with my fellow Governors in welcoming Tonga as a new member of the World Bank and the International Monetary Fund. I would also like to thank the host country for the excellent arrangements they have made for our Meetings. I wish to congratulate the Chairman, Mr. Touré, for his excellent opening address. And it is a pleasure to join previous speakers in expressing our thanks for the remarkable speech by Mr. Clausen. We heard with great regret that he will not be available for the next term as President of the Bank. He did an excellent job, and I think the standing ovation that he received after his speech proves that it is the general view of us all. I wish to also thank the Managing Director for his enlightening and sincere remarks and to express my gratitude that he took a bit of his precious time to visit our country. I hope he was aware of the high respect and esteem that we feel for him and for the institution he represents.

I would like to report to you first on recent developments in the Hungarian economy and then outline our position concerning some problems of the world economy and the international monetary system.

Since the early 1980s, Hungary has taken several important steps to join the international monetary system. In 1982, we joined the Bank and the Fund and, in the spring of 1985, Hungary became a member of IFC and IDA. I would like to use this forum to emphasize the close relationship and fruitful cooperation that have developed between Hungary and these international financial institutions, which was shown in practice when the policy of external and internal economic adjustment pursued by us since 1979 was seriously disturbed by the international debt crisis of 1982. Our country successfully solved its liquidity shortage with the help of both the acceleration of the adjustment already under way and the coordinated assistance given by central banks and the international financial institutions.

Hungary concluded two stand-by arrangements with the Fund in two consecutive years and completed all the undertakings we had agreed upon.

During those two years, the Hungarian economic policy aimed to achieve a sizable surplus in the convertible current account and to increase the level of foreign exchange reserves. Domestic demand has been restrained through strict fiscal, credit, and income policies. Exchange rate and price policy measures were also taken to promote transfer of resources

to the external sector. The strength of adjustment can be seen by the shift of real resources into the external sector, equivalent to 16 percent of GDP between 1978 and 1984. This, according to the Fund staff appraisal, was a "striking degree of adjustment by any standard."

As a result of these achievements, the commercial banks' voluntary lending to Hungary resumed, making possible a substantial increase in medium-term and long-term capital inflows. Our reserves are today at a higher level than before the international debt crisis, and cover about eight months of imports in hard currencies—a high level by any international standard.

Hungary progressed also in effecting structural changes and increasing efficiency in the economy. Several measures were taken to strengthen the role of market forces and improve the ability of the economy to adjust itself to the changing conditions of the external markets. New projects were implemented in the agriculture, industry, and energy sectors—projects supported by World Bank "A" loans and "B" loans and by commercial banks. During the completion of three successful cofinancing operations, we received much needed help and advice from the management and staff of the World Bank.

The Fund appraisal, under the recent Article IV consultations, stated that by early 1985, Hungary was well placed to forgo further Fund assistance on the expiration of its second stand-by arrangement. In line with Fund policy we shall make early repayments this year of our 1986 obligations to the Fund.

Our cooperation with the Fund proved to be fruitful because the aim of our Government's economic policy, launched in December 1978, to achieve external and internal equilibrium, coincided with the suggestions of the Fund. We are convinced that Fund support can only be successful if it meets with the political will of the government involved and the conditionality does not exceed the limits of the social tolerance of a given country.

The main objectives of our economic policy in 1985 and also for the five-year period are to continue our adjustment efforts, so as to achieve an enduring improvement in the current account in convertible currencies while accelerating the process of improving economic management.

However, earlier policy instruments of adjustment used up to now—reduction in real wages and investment—no longer constitute a realistic policy option, because they undermine the basis for future growth and also imply unacceptable social costs.

Therefore, the path of adjustment to be followed is to increase productivity and efficiency in order to attain a reasonable growth of investment and consumption.

This requires further restructuring of the economy. Therefore, for the medium term, Hungarian economic policy will allocate a greater share of resources in support of economic growth and the acceleration of structural changes.

At the same time, greater emphasis will be given to further improving the economic management system in order to:

(a) accelerate the elimination of consumer price subsidies;

(b) make wages correspond more to performance, thus creating the possibility of real wage differentiation;

(c) introduce with, we hope, the aid of professional advice of Fund staff, adequate personal income taxation and a VAT-type tax system, which are under consideration;

(d) introduce external convertibility for the Hungarian forint, which is envisaged in the medium term.

The changes are to be accompanied by the modernization of the institutional system of macroeconomic guidance of the economy and enterprise management. An important component of this process is the Hungarian financial system. Steps were taken to introduce more competition into the banking system and to develop a system of capital market intermediation.

Restructuring the economy is an import- and capital-intensive process; therefore, we shall also need external financial resources for the next medium-term period. Hungary intends to go ahead with its active participation in the international capital and money markets and wants to continue its cooperation with the international financial institutions by utilizing their policy recommendations and technical assistance, and, in the case of need, financial assistance.

However, achieving our economic policy objectives depends largely on external conditions. Up to now, the cooperation of international institutions, governments, central banks, and commercial banks made it possible to keep the international debt crisis under control. The moderate and uneven recovery, which peaked in 1984 in the industrial countries, alleviated to some degree the pressure on a number of indebted developing countries.

Unfortunately, there is growing evidence that this recovery and the first phase of debt rescheduling brought only temporary relief; the fear exists that the breathing space the world has gained during the past two years is vanishing.

Since the beginning of this year, we have witnessed declining growth rates mainly in the United States, which cannot be compensated by the modest improvement in some other industrial countries. Growth forecasts

are repeatedly down-scaled. Expansion of export markets is hindered by growing protectionism. The terms of trade for developing countries continue to deteriorate, and real interest rates are still very high. Official support and private lending to developing countries continue to decline. We could witness a negative transfer of resources from a number of developing countries, like a "reverse blood transfusion," whereby the healthy one gets blood from the unhealthy.

In order to avoid an outright recession, which would surely trigger a second debt crisis, it seems to be of great urgency to address energetically the severe and growing imbalances in the world economy and to share more equally the burden of adjustment.

I do not, myself, feel entitled to criticize the policy of any other member country. But I ask myself why do governments of some major shareholders object—in the face of a dangerous debt crisis—to any proposal aimed at an increase of the lending capacity of the IMF and the World Bank. This hurts the interests of many debtors—which badly need liquidity because they are unable to borrow on the market—but it also hurts, at least to a certain extent, the interests of the creditors, making it more difficult or even impossible for debtors to service their debts.

The policies followed by the international financial institutions are of considerable importance for all the member countries. The Fund must play a pivotal role in promoting international financial stability and external adjustment. The Reports of the Group of Ten and Group of Twenty-Four also came to this conclusion. We fully agree with this. We think it is necessary to strengthen the Fund's role in its surveillance function and its balance of payments assistance.

The Fund's surveillance function is most important in the case of countries that have a large impact on the world economy through their national policies. Hungary therefore supports the proposal that, in order to ensure greater symmetry of adjustment, existing surveillance procedures regarding major currency countries have to be reinforced. We should move toward a new exchange rate system which can overcome both the destabilizing uncertainties of floating exchange rates and the rigidity of the former par value system.

As for the Fund's balance of payments assistance, serious debt-service burdens in several member countries fully justify the maintenance of the Fund's enlarged access policy. Countries that have carried out a successful adjustment should receive support enabling them to enter a period of sustained economic growth. International financial institutions are frustrating this process by their delays in formulating both policy guidelines and adequate financing resources. The responsibility for this delay falls on some major members of the Bank and the Fund.

Hungary supports the continuation of the Fund's enlarged access policy and the maintenance of the present access limits for 1986 and considers the reduction of these limits untimely, as they transmit wrong signals to the financial markets.

We also support revival of SDR allocations, which would reduce the dependency on borrowed reserves. Such allocations would not be inflationary in the present economic environment. We support the use of resources arising from the reflow of loans that were made by the Trust Fund, and we highly appreciate the generous attitude of China and India to renounce the use of this facility. Hungary will make early repayment of all its debts to the IMF due in 1986.

Hungary strongly supports the strengthening of the World Bank as well. The unique role of the Bank cannot be maintained without a considerable increase of its lending. Hungary is in favor of a new general capital increase.

Our principal position on this question is that we support all reasonable and realistic proposals aiming at the increase of the lending capacities of the IMF and World Bank Group because we are convinced and afraid that debtors and creditors alike will need their help in the not-too-distant future. . . .

Some people believe we have passed the crisis; I think we have only gained time to be used to build up our defenses against a worldwide economic recession and debt crisis. We remain confident that the Bank and the Fund will play an effective role in it.

We have a heavy responsibility. We have to act now.

Statement by the Governor of the Bank for the Netherlands

H. O. Ruding

The World Economic Outlook

Real GNP of the industrial world will grow this year but less than we expected at the time of the spring meetings of the Interim and Development Committees. Unemployment is too high, and where it declines, progress is too slow. Still, the underlying macroeconomic conditions for growth have improved markedly. Inflation rates have come down and are not likely to rise this year. Monetary policy has gained credibility in recent years and it does not stand in the way of sustained economic expansion, nor does it fuel inflationary expectations. Interest rates are on the decline

though still too high. Investment and business profitability have improved. Now that the U.S. economy has slowed down, economic growth is spread more evenly across the industrial countries, giving rise to less tension. In Europe, economic expansion has been modest thus far, with exports being its driving force. Domestic expenditures were restrained by remaining supply-side rigidities and high real interest rates. But the contribution of the domestic sector to economic growth is rapidly increasing, thereby broadening the basis of the European recovery. In view of these favorable conditions, the baseline scenario envisaged at the Interim Committee meeting last April still appears within reach.

This is not to say that we can take this scenario for granted. Indeed, developments during 1985 point to increased downside risks. A first downside risk arises from protectionism. At our last Interim Committee meeting we committed ourselves to a reversal of the trend toward more protectionism. However, no action to that effect has taken place yet. Despite many pronouncements in favor of freer international trade, protectionism has gained ground. This hurts exports of developing countries, thus endangering their debt-servicing capability. Equally, it hurts the industrial countries' export performance. It is generally recognized that protectionism benefits some sectors in the economy at the expense of others, and that in the long run the costs far outstrip the benefits. Therefore, we in government must show the political courage to pursue trade liberalization more vigorously.

A second cause of downside risk that confronts us is that efforts to restore fiscal balance still are inadequate. I must strongly warn against an early relaxation of fiscal adjustment efforts at a time when in most countries budget deficits and public debt service obligations are still far from being under control. Budget deficits put upward pressure on interest rates. They thereby hamper investment growth in industrial countries and make it more difficult for developing countries to service their debts. Excessive budget deficits undermine government credibility as they endanger the medium-term oriented framework of sound positive adjustment policies. The U.S. experience demonstrates some of the dangers clearly. Exchange rate crowding-out seriously hurts the import-competing sector of the U.S. economy, while fueling protectionist tendencies, as was indeed recognized by the Group of Five in their recent communiqué. The consequent effect of the recent action by the Group of Five on the dollar exchange rate, however, cannot last without action to reduce the U.S. deficit. And that will be the more painful the longer it is postponed. In those European countries where this is necessary—including my own country—government deficits should also be reduced further by cutting expenditure. Once deficits have been brought under control, fiscal and social taxes can be lowered and governments can make room for the healthy dynamics of the private sec-

tor. Such dynamics also require the removal of existing structural rigidities in the markets for goods, labor, and capital.

This strategy is medium term. Already, signs of success can clearly be discerned in Europe. In the Netherlands, for instance, the steep increase in unemployment has been arrested and employment is rising for the first time in many years. Despite weaker demand from abroad, the European economies show a stable, sustainable, as yet modest, real economic growth. A few major countries have already raised their growth forecast for the next year.

Turning to the developing countries, I observe that the spectacular improvement in their external positions during 1983 and 1984 has not continued in 1985, owing to a loss of export opportunities and deterioration of their terms of trade. Fortunately, their current account deficits, particularly those of the debtor countries, are still at a sustainable level. They can be financed in the aggregate largely by non-debt-creating capital imports, while leaving some room for a buildup of monetary reserves.

Another cause for concern is that the internal adjustment efforts of some larger debtor countries, with the noteworthy exception of Argentina, have slackened. This may undermine the confidence of financial markets and postpone the normalization of the relations between borrowers and lenders. In that case, and even more so when countries proclaim so-called "alternative" solutions to their debt problems, less rather than more external finance will be available, thereby jeopardizing development and economic growth and making the adjustment process all the more severe.

The Role of the International Monetary Fund

Against the background of this ongoing but fragile economic recovery, the role of the Fund in promoting and financing the adjustment process remains crucial. It must continue to exercise firm surveillance over the policies of its members. The need for stability in international economic and financial relations requires an intensification both of the country-by-country approach under Article IV and of multilateral Fund surveillance.

The recent report on the functioning of the international monetary system prepared by the Deputies of the Group of Ten contains several constructive suggestions. An agreement on strengthening Fund surveillance should aim at achieving international compatibility of domestic policies. The Article IV consultations of the industrial countries should, therefore, more explicitly take the international repercussions of domestic policies, including exchange rate implications, into account. Furthermore, the scope of surveillance should include supply-side and structural economic issues. In developing countries, Fund surveillance can assist in establishing more viable balance of payments positions. In some debtor countries,

finally, enhanced surveillance can support the adjustment policies and, at the same time, contribute to keeping external financial flows at an adequate level. Enhanced surveillance should, however, by no means imply that the Fund and the creditors lose track of their specific responsibilities.

The policy of enlarged access to the Fund was temporary from the outset. It enabled the Fund to cope with the financial needs of member countries in extraordinary circumstances. Considering the development toward more sustainable balance of payments positions, there is room to proceed with the gradual reduction of access limits, so that by the time of the Ninth General Review, quotas can again be the primary source of Fund financing. This would ensure the liquidity of the claims on the Fund and underline the Fund's monetary character. I, therefore, endorse the decision by the Interim Committee, here at Seoul, to reduce the annual and cumulative access limits by a symbolic margin. Given the actual access limits experienced thus far, this decision to my mind will not impair the Fund's flexibility in addressing individual country situations to any significant degree.

The financial role of the Fund also includes the possibility of creating SDRs to meet any long-term global need to supplement existing reserve assets. The current expansion of economic activity and the expansion anticipated for the remainder of the 1980s suggest a potential need. This need can be met from various sources of reserve growth, by access to the international capital markets, and by an SDR allocation. The Netherlands is in favor of a moderate allocation that would contribute to sustaining the share of the SDR in the world's non-gold reserves. I look forward to the basic study on the role of the SDR by the Fund staff. I am confident that it will clarify the analytical underpinnings of the SDR.

I also endorse the decision of the Interim Committee to put the resources flowing back from former Trust Fund loans to use in support of low-income countries that are eligible for IDA resources and that face protracted balance of payments problems. In this respect, I highly appreciate the decision taken by India and China not to avail themselves of this new facility. Close cooperation between the Bank and the Fund in formulating adjustment programs for these new loans would, indeed, be desirable. . . .

Statement by the Governor of the Bank for Zaïre

Djamboleka Loma Okitongono

On behalf of the countries that make up the African Caucus, and personally as well, I would like to take this opportunity to express to the peo-

ple, the President, and the Government of Korea my heartiest congratulations and sincere gratitude for the warm welcome we have received and the outstanding organizational efforts made with a view to facilitating our work in this beautiful capital city of Seoul.

I wish also to congratulate the Chairman of these meetings on his selection to head our discussions.

Finally, on behalf of all the African delegates here, I would like to salute Mr. Clausen and Mr. de Larosière. In particular, I would like to express to Mr. Clausen the African countries' thanks for the sensitivity he has shown to the problems of our continent during his term of office. Under his leadership, Africa has benefited from, and continues to benefit from, a certain priority as regards the World Bank Group's assistance to developing countries. We cannot but regret Mr. Clausen's decision not to seek another term.

To the people of Mexico, recently the victims of violent earthquakes, I would like to express the complete sympathy of the African Governors. The African people have themselves been the victims of a number of natural disasters and are in a position to understand and properly appreciate the pain being endured by the Mexican people. The African Governors speak as one with the entire international community in expressing their solidarity under these trying circumstances with the Government and people of Mexico.

In examining the development of the world economic situation, some maintain that the recovery noted in a number of industrial countries over the past two years or so constitutes both the beginnings and the guarantee of economic recovery worldwide.

In large measure, however, Africa has not benefited from this recovery, because most African countries are continuing to suffer from a heavy debt service burden that imposes various restrictions even as flows of resources are continuing to dry up and all other factors reflecting the degree of our well-being are developing unfavorably.

Despite optimistic forecasts for 1985, which project a growth rate of 3.2 percent and a decline in the rate of inflation to 3.8 percent in the industrial countries, the possibility of lasting recovery is still jeopardized by the lack of policy convergence in the industrial countries.

Thus, the problems attributable to high real interest rates, fiscal deficits, external payments imbalances, and unsustainable fluctuations in exchange rates, are with us still.

The international community must resolve all these issues if it is to create the conditions for a genuine recovery benefiting all countries.

I do not believe I exaggerate in stating that the current international economic order is more favorable to the industrial countries and that, since national economies are interdependent, it is up to the major industrial countries primarily to follow policies that will promote economic growth and stability throughout the world. In this connection, reducing the real interest rates that have significantly contributed to the debt service burden of the developing countries and stabilizing the exchange markets would constitute a first step toward improving the functioning of the international monetary system, a prerequisite for world economic recovery.

In the existing international economic order, the industrial countries are the driving force behind world economic growth. It is important that these countries play this role properly. We therefore call upon them to dismantle the protectionist barriers that are preventing many developing countries from benefiting fully from their comparative advantage in international trade.

It goes without saying that the exacerbation of protectionist practices aggravates the problems of servicing the external debt, reducing the chances that adjustment programs will succeed and slowing down economic growth in the developing countries.

It is in the interest of the world economy that the industrial countries take steps now to reduce obstacles to international trade.

In view of the growing importance of the external debt problem in recent years, it must rank high on the list of obstacles to recovery and economic growth. I wish especially to stress that the solution to this problem is the responsibility of all, and only by concerted action will one be found.

The developing countries have done and are continuing to do everything that has been and is required under their adjustment programs, many of which are supported by the Bank and the Fund. These programs have entailed reductions in imports, cutbacks in capital spending, and declines over extended periods in the standard of living of the poeple. We Africans believe that the burden of adjustment ought not to be borne by the developing countries alone, not only for reasons of equity but also because international economic order and good economic sense indicate that, in view of the impact on the world economy of the economic policies of the major industrial countries, the only approach with any chance of success is that of solidarity.

For all these reasons, the industrial countries should move to restructure their economies.

In our opinion, this is the only approach that can harmonize structural adjustment, economic growth, and the fight against poverty. We are convinced that sound management amounts to more than simply reducing

balance of payments and budget deficits; it must entail special consideration of the improvement in living standards that can come only from economic growth and development and which constitutes a prerequisite for the proper application of adjustment policies.

Turning my remarks now to Africa in particular, there can be no doubt that its economic situation remains a source of serious concern. Affected by a persistent drought, some of the countries of sub-Saharan Africa are battling relentlessly for the very survival of their populations. The somber picture of conditions on the African continent can be better illustrated by a few figures: in five years, the cumulative decline in real GDP has ranged from 10 to 12 percent, while the standard of living has declined by more than 15 percent.

The African countries are conscious of the efforts of the international community in coming to their assistance and are grateful. However, they wonder if the same community is sufficiently aware of the gravity of this situation and of the political and social consequences of this crisis and the adjustments it requires.

It is not my intention to question the need for adjustments, but in view of this situation, which calls for a lasting, structural solution, our countries have doubts about the pace of execution of adjustment programs and about the general policy recommendations formulated within the context of these programs. Fund programs in particular lay too much stress on short-term aspects and on financial equilibrium while underplaying long-term restructuring. This is the consequence of an excessively narrow interpretation of the role of the Fund, which is running the risk of no longer meeting the needs of a large part of the international community, the majority of which is made up of developing countries.

What is desirable for our countries—and this view is largely shared by the other developing countries—is a better combination of adjustment programs with development efforts that involve inflows of the necessary resources from our partners.

In saying this, I am not in any way attempting to downplay the obligations of the African countries and shift all the responsibility for finding solutions onto the international community. We are fully aware of the crucial role that must be played by domestic reforms in order to turn the situation around.

But it is undeniable that the situation of the African countries makes substantial external support essential. This support must have an impact on the domestic production of essential goods and services and on the fight against poverty in order to ensure the success of domestic reforms. The countries of Africa face a situation marked by the scarcity of domestic re-

sources and by a sizable amount of outstanding external payments. While the debt service ratio in other areas of the world is expected to stabilize or decline, it is climbing in the low-income African countries, a sign that debt service obligations are increasing more rapidly than the capacity to cover them.

The conclusion to be drawn from this state of affairs is obvious: more than ever, the problems of Africa call for a coordinated and integrated approach, not only on the part of the Bank and the Fund, but of bilateral agencies as well.

This approach must be reflected in:

—increased flows of concessional development assistance and balance of payments assistance;

—an easing of the debt service burden, releasing ever larger amounts of resources for development; and

—increased investment, with net inflows of external resources.

I wish at this juncture to stress the need for institutionalizing multiyear rescheduling and for converting the public debt of the poorest countries into grant form.

The situation of our countries demands an improvement in the way our institutions, the International Monetary Fund and the World Bank group, function and contribute to promoting world economic recovery.

As regards the policy and practices of the Fund, the views of the African governments are as follows:

—the restrictions on access to Fund resources supported by some of the most powerful members are contrary to the interests of our countries, in particular the low-income countries;

—the requirement that a program be concluded with the Fund before the debt can be rescheduled or before a structural adjustment loan can be granted is unacceptable;

—it is unconscionable to limit access to the resources of the special facilities at a time when the developing countries' exports are more than ever at the mercy of exogenous factors;

—the conditionality associated with recourse to the compensatory financing facility is unfavorable to the economic recovery of our countries;

—the conditionality associated with the financing of fluctuations in the cost of imported cereals makes it impossible for the African countries suffering from food shortages to make use of this facility.

The African Governors believe that the role of the Fund must be strengthened; for this to happen it must adapt to new realities and must boldly and pragmatically modify its policies accordingly. In particular, the Fund should intensify its financial support in a medium-term perspective, especially in the case of the poorest debtor countries that have no access to the capital markets.

We are pleased with the decision to create a new facility whereby the resources made available by the liquidation of the Trust Fund will be used to help the low-income developing countries to move ahead successfully with their development efforts. The conditionality of this new facility must be similar to that of the Trust Fund.

The African Governors have three concerns with regard to the International Monetary Fund about which we cannot remain silent.

First, we refer to the difficulties that many African countries are experiencing in meeting their financial obligations to the Fund on time, this specifically because of their special situation. Although the "revolving" nature of Fund resources is of concern to us as well, we strongly urge the Fund to be understanding and flexible on this point in accordance with the spirit of Article V, Sections 7(g) and (e) of the Fund Agreement.

Second, we refer to the slight progress made with regard to the allocation of SDRs during the Fourth Basic Period. The failure to reach a decision on this issue, despite the fact that an allocation is fully justified and supported by the majority of members, shows how much the international community can be held at bay by a small number of member countries that persistently demonstrate a lack of political will to support an SDR allocation. In this connection, the African Governors are opposed to any effort aimed at making SDR allocations subject to Fund conditionality, which, in our opinion, runs counter to the spirit and objectives of the Articles of Agreement.

The third concern of the African Governors is the lack of symmetry in the surveillance exercised by the Fund over the economic policies pursued by member countries. We are all well aware of the fact that the Fund closely monitors the policies followed by the developing countries in deficit, and by those participating in Fund programs in particular, while the Fund has yet to develop an effective system of exercising surveillance over the economic policies of the major industrial countries.

For this reason, the African Governors support the efforts being made to provide for symmetrical surveillance and call upon the major countries to cooperate closely with the Fund on this important question.

The African Governors reaffirm their support for the principle of a fundamental reform of the international monetary and financial system.

They share the positions espoused by the Group of Twenty-Four and support that Group's proposal to organize an international conference at which the developing countries would be full participants. The topics to be covered by this conference would include international liquidity, the creation and allocation of reserves, the participation of the developing countries in decision making at the Fund and the World Bank, and the means of increasing the stability of the exchange system. . . .

The indebtedness problem of Africa is of particular concern because of its negative impact on the development of the region. Although Africa's debt is relatively small, the debt service burden has reached such proportions in recent years that it has simply become unbearable and seriously jeopardizes the continued pursuit of the policy reforms undertaken in several African countries. The drought and the decline in commodity prices have aggravated an already precarious situation. In view of the seriousness of the problems, we call upon the Fund, the World Bank, and the international community to reply affirmatively to the recent call of the Heads of State and Government of the Organization of African Unity for an international conference on the external debt. This conference would give international creditors and African borrowers the opportunity to discuss the problem of Africa's external indebtedness and reach agreement on appropriate emergency measures for the short, medium, and long term, thereby contributing to the solution of the problem.

Despite the adjustment efforts made in the developing countries, there has been a considerable reduction in public and private capital flows to these countries. In order to increase flows to the developing countries, we support the creation of a Multilateral Investment Guarantee Agency. The various member countries will need more time to examine the draft agreement closely, and we hope that this agency will extend its support only to economically and technically sound projects.

We encourage the multilateral institutions, in papticular the World Bank, to continue and intensify their efforts to mobilize and increase capital flows to the developing countries. . . .

It is generally acknowledged that the possibilities open to the developing countries to obtain the external capital essential to finance their adjustment policies, inter alia from the commercial banks, have been uncertain in recent years. It is therefore necessary to intensify efforts to provide the multilateral institutions with sufficient resources to enable them to better meet the pressing and growing needs of borrowing countries. Discussions on the future role of the World Bank should therefore be placed in such a context. . . .

As regards cooperation among the Bretton Woods institutions, we are concerned that such cooperation is going hand in hand with a reciprocal

strengthening and hardening of the conditionality associated with the use of the resources of the World Bank and International Monetary Fund. Once again, we wish to stress the fact that we are strongly opposed to cross-conditionality. We call upon the managements of both institutions to take the steps necessary to avoid it.

As regards the African Development Bank Group, despite the vigorous support provided by the participating states in the operations of the African Development Fund last year, the fourth replenishment of that Fund's resources fell short of the desired levels for the 1985–1987 period. This year, the African Development Bank is making preparations for a general capital increase. We hope that the international community will react favorably and thereby enable that institution more effectively to respond to the priority needs of the African countries.

In conclusion, I would like once again to stress the fact that the economic crisis now facing Africa is truly unprecedented. The problems facing the African countries are in large measure the result of difficult international conditions, the effect of which is exacerbated by the natural disasters, including, in particular, the drought and desertification that our countries are continuing to experience. We have made many efforts to find solutions to our crisis. Recently, the Heads of State and Government of our African countries met in Addis Ababa. Their deliberations at this summit were focused on the examination of economic problems and the solutions to them, in particular in the areas of food, agriculture, and the external debt.

Mr. Chairman, I have touched upon only some of the pressing problems, which, to our way of thinking in Africa, can be resolved with the assistance of the International Monetary Fund, the World Bank, and the international community as a whole. On behalf of the African Governors, I call upon the entire international community to provide the support necessary to implement measures aimed at promoting growth and stability in the most severely affected continent of all.

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

Edward Seaga

We are guests on this occasion of the Government and people of the Republic of Korea.

It is rightly said that there are few countries in the world able to host the Annual Meetings of the World Bank and the International Monetary Fund because of the demanding logistics of accommodating some 10,000 visiting

officials, financial leaders, and dignitaries with precision, attention, and care. Of those countries able to meet these demanding standards, it is understandable that developing countries are the rare exceptions. Indeed, there are only very few previous instances of these Meetings being hosted in developing countries.

It speaks volumes, therefore, for the Government and people of the Republic of Korea that these Annual Meetings have been staged here, and that the arrangements have been made with the customary precision, perfection, and care associated with the Korean people. I speak for many, I am certain, in offering not only appreciation for the warmth of the hospitality extended to us, but also in admiration of the accomplishments of the Korean people of which this is but a symbol.

I am equally certain that the pride which we of the developing world feel in these accomplishments is not restricted to the achievements of Korea but can be extended to the family of South East Asian nations, which have similarly made giant strides over the past three decades to reach a takeoff point to the achievement of sustainable economic growth and stability, the ultimate goal of all our plans and policies.

This group of newly industrialized countries, as they are known, is a pointed reminder to us all of what can be achieved by even the battered and war-torn nations among us, mostly devoid of natural resources, as, in fact, is true of the leading luminaries in this brilliant constellation.

I say "devoid of natural resources" in a pointed and specific way, because the success of these nations points to a direction which we must all examine in order to understand both the "Why" and the "How," so that we may learn from their experience and shape our future based on the wisdom of the past.

The prevailing wisdom of these institutions, particularly the Fund, emphasizes adjustment programs through tight demand management. The result is severe austerity which, in the final analysis, cuts services and reduces growth. This austere path carries social and political costs which often work counter to the final objective of achieving adjustment without sacrificing stability.

Because of these consequences, the question inevitably arises: Is there another way? Is there an alternative which could avoid the counterproductive features of adjustment—sharp reduction of services for health, education, and so on, coupled with dramatic reductions in staffing levels, increased costs of basic needs, and ultimately a reduction in living standards which is too sudden for the people to bear without demoralizing them?

It is here that the consequences to the human element in the process of adjustment turn negative in the form of protest action and other forms of nonsupport for the program of change.

Oddly enough, so important is the program of adjustment, so vital is the need for stabilization, that every force within the political and social system needs to be harnessed to ensure success, to keep the lifeline of credit open without which conditions would be incalculably worse. Yet the severity of austerity in the program design carries its own seeds of counterproductive action which limits success. It is as if the prevailing wisdom dictates that since there is no path of painless change, it matters not how painful the process may be. But it does matter—it matters to the human element which, in the final analysis, is in fact the target of the adjustment program. We do not adjust economic systems; we adjust the lives of people who make these systems work. It is shortsighted to ignore the human element.

These intense social and political costs often lead countries with Fund programs in search of an easier path to query the ultimate benefit of the program, and, in doing so, to mistakenly denounce the whole adjustment process.

Too often, it is not recognized that when economic circumstances dictate the need for Fund programs, the level of adjustment required is inevitably drastic and no moderate course of change will then suffice to restore economic health.

But at the same time, accepting the need for drastic *levels* of change does not automatically imply an equally drastic *pace* of change, and this is the essential factor overlooked in the framing of the timetable for adjustment.

The difference is one of approach and is critical to the end result, determining whether change proceeds with the meaningful support of the population because the level of austerity is more manageable in human terms, or whether the inhuman features of severe austerity eventually prejudice any positive achievements by the emergence of negative forces which are unmanageable and counterproductive.

It is here that the seeds of success or failure of Fund programs are generally sown.

The reasoning behind the need for severe austerity and drastic change is the short-term nature of Fund agreements—a maximum of three years. These short-term programs are invariably extended to two and three times the length of the initial period as a result of the inability of the countries involved to meet the targets dictated by policy prescriptions for rapid short-term change.

What is worse, every year of extension of these programs simply extends original targets set on the same course of a drastic pace of change. Inevitably, what begins as a three-year adjustment program has to struggle to accomplish the same ends over seven years or more, with a huge toll in human suffering and nonsupport for program targets. Yet, if these programs were originally designed to be achieved over seven years, they could be achieved with much greater support of the people and less social cost, producing a welcome change of goodwill for Fund programs.

Whether the current Fund policy to impose drastic short-term change, rather than gradual medium-term adjustment, is successful can readily be ascertained if we note that this policy of short-term arrangements has few real success stories to show to its credit. Something is lacking, and I repeat the observation that what is at fault is the *pace* more than the *substance* of adjustment.

What is even more disturbing is the dramatic fall in requirements for Fund resources from SDR 9.2 billion in 1983 to SDR 6.4 billion in 1984.

These arguments point to the direction of a solution: extend the maximum program period available. The three-year extended Fund facility should be extended to a seven-year program with an easier path of adjustment to enable the human element to be a more important factor in the process of change, working with the program of adjustment, not against it.

Wherever whole nations are involved in the process of achieving monumental change, it must inevitably be a timely one. The countries of South East Asia, of which Korea is but an example, grew from battered war-torn impoverished levels to the success stories of today, not in a three-year program of monumental change, but in *three decades*. The change required of countries with Fund programs today is no less monumental. But the great difference is that the period of adjustment allowed is but a fraction of the time, too short to carry the support of the people who are, after all, the real targets of change. The result is that the human element becomes a *negative force* rather than a *positive resource*.

I return to where I began: the newly industrialized countries of South East Asia together with Japan, the industrial giant of the region, have clearly established by their success what can be accomplished by economies which are virtually devoid of natural resources but which have used their *people* as a resource base. Many other countries with deep economic problems are potentially better off having both *natural and human resources*. If these two resource bases can be made to work in concert productively, not in opposition counterproductively, what greater things may they yet achieve!

I trust the Fund will not fail to recognize this lesson.

One more point must be made: To adopt an extended program of adjustment requires no extra funding since the terms of a three-year program generally allow for much longer periods of repayment of the drawings provided by the program. Indeed, because the period of the program of adjustment is much shorter than the repayment period, repayment generally continues long after the program ceases, during which the Fund no longer has any surveillance role. I say no more in regard to this particular point, which, I believe, will not be lost on the management of the Fund.

Not only are the three-year programs of the extended Fund facility too short, but the compensatory financing facility programs need similar rethinking.

At a time when the basis of the problem of so many debtor countries is the dramatic fall in export earnings resulting from the collapse in primary commodity prices and markets, it is incomprehensible that the compensatory financing facility, which was devised to deal with such cases, is, in fact, a source of little assistance, falling from SDR 3.4 billion in 1983 to a mere SDR 0.8 billion in 1984. We support the view that quotas under the compensatory financing facility should be eliminated and conditionality softened to make the resources of the compensatory financing facility more readily available.

Finally, I turn to another resource flow that is currently a *negative drain* rather than a *positive gain* in the transfer of resources from the developed to the developing world. The whole purpose of global development strategy is to increase, not decrease, these flows. Yet last year, debtor countries experienced a negative flow of resources to commercial bank creditors, and this is likely to be increasingly so as long as commercial banks restrain new lending as they now do.

I need hardly repeat here the many calls for reviews of international debt obligations. It is wrong to believe that the debt problem has really been contained. It has been contained in global accounting terms, but at a great cost to growth and to human services that is intolerable and not sustainable in the medium term.

A major step could be taken to restore a positive flow of resources to debtor countries from commercial banks, if the repayment of commercial loans were rolled over by the banks into trade credits for raw materials and capital goods imports. Furthermore, the commercial banking community would hold more secure paper against current indebtedness in the form of trade credits than is the case in the longer-term notes, which are currently prejudiced by threats of default or unilateral deferral. This program of rollovers of current debt payment and rescheduled payments would constitute invaluable additional credit support to debtor nations without a requirement for new money to be found.

Perhaps, at this critical period, when the choice exists between perpetuating intolerable levels of human suffering in order to service debt and increasing calls for unilateral limitation or cancellation of debt, the commercial banking community would be well advised to seek the goodwill which can be generated by a program of relending the proceeds of repayment, rather than being regarded as a champion of the concept of honoring *debt* over all other considerations.

This is as valuable a collateral in terms of international security as the enhanced value of gradually substituting trade credits for term loans would realize in banking security. It would be a welcome sign of recognition by the banking system that, in light of the prevailing crisis, this is no time to reduce exposure when all other players on the stage are seeking new ways to increase involvement and are themselves making new commitments. This is no time for any player to fall out if we are to ensure that the performance proceeds to a satisfying end.

In conclusion, let me voice the hope that too much reliance will not be placed on global figures of performance, whether in world trade or global growth. Experience has told us that global accounts mask serious underlying areas of weaknesses. Last year, world trade grew by an astounding 8.8 percent, up from a very weak 2.1 percent in 1983. By that account, most debtor countries should have experienced revived export earnings to enable them to better service debt. If this were so, there would have been fewer calls for unilateral debt limitation or cancellation. The fact is, of this 8.8 percent increase in world trade, most of the performance was a result of increased trade among the industrial group and a small number of developing countries.

Increased world trade by itself is no panacea. Nor, indeed, will global growth be such a panacea. What is required is to devise programs which target resources to the specific areas of need in a manner which can be utilized, case by case. It is in this light that the proposals in this presentation are made; none of them requires additional funding, only relaxation of present policies to enable the better and more meaningful utilization of what exists.

In summary, let us clearly recognize that the path forward poses no easy, painless way to restore economic health. Demand management to improve financial health must continue and austere measures cannot be avoided. But a balance must be struck so that what we *gain* in improved financial health is not *lost* in reduced growth.

The Fund has played an important role in enabling countries with severe deficits to buy time in the process of recovery, while the Bank assists in restructuring their economies to achieve sustained growth. The policy re-

forms on which these institutions base their lending programs are essential disciplinary measures, laying a surer foundation for economic health.

But the road to recovery is not a short one; for many it is a path that stretches well into the medium-term future. For this reason, the commitment of national populations is essential to the program of adjustment and recovery. No sustained march to these goals can be achieved without the prospect of total commitment and support of the human resources of the nation.

This support can be forthcoming if the programs of change adopt a more human face; if the process of change is measured in terms which people can more readily absorb, and if this process recognizes that, in the final analysis, change is not merely a process which generates a greater yield from each machine; it is, above all, the means by which we adjust and restructure the beliefs, the attitudes, and values of the man behind the machine.

Statement by the Governor of the Bank for Yugoslavia

Vlado Klemencic

It has been stated frequently over the past few days that the results of the world economy in 1985 were less favorable than expected, and that prospects for further development are uncertain. For developing countries as well, and particularly those burdened by external debts, 1985 is but one in a series of years in which they are facing stagnation in their economic development, high rates of unemployment, a decline in the standard of living, and accumulated social and political problems.

However, with enormous efforts, developing countries have achieved significant results in their economic adjustments. This particularly refers to improvements achieved in their foreign trade and current account balances, a more balanced supply and demand, and the introduction of numerous market criteria in their economies.

But developing countries can only accept adjustments conducive to overcoming crises through economic development, technological progress, increased exports, and a gradual rise in living standards. This is the only way to help solve their debt problems and accomplish a more balanced development of the world economy.

The current international financial system, including present external debt reorganization mechanisms, is not favorable for developing countries. We all know the difficulties that exports from developing to industrial countries have been facing. Less developed countries have experi-

enced net outflows of financial resources over the last few years. Interest rates are still too high and international economic developments and financial flows are strongly influenced by some overvalued currencies and by large budget deficits and slow structural adjustments in industrial countries.

Therefore, the international community should introduce changes and create new solutions, because the danger of further serious disruptions in the international monetary and financial system is gaining strength. Indebtedness not only affects normal financial flows, but may also bring into question the stability of the international financial system.

Although we are aware that problems relating to indebtedness are also caused by the economic policies of developing countries, and that these countries should resume efforts to overcome their economic difficulties, it is also important for the international community to find lasting solutions for the external debt problems of developing countries. Due to greatly needed structural changes, the introduction of multiyear reschedulings is of great importance. It will be necessary to consider solutions that would limit the level of annual repayments in proportion to export earnings. Solutions must be found for compensatory financing for some portion of high interest payments.

We repeat that obligations related to external debts are not at stake and stress the urgency of seeking solutions for debts through cooperation between debtor and creditor countries, international financial organizations, and banks. Therefore, in their recent conference in Luanda, Angola, the nonaligned countries called for a political dialogue aimed at durable solutions to the debt problem.

We support this year's Group of Twenty-Four report proposing solutions and directions of changes in the international monetary and financial system, which may significantly contribute to development financing and to the solution of the debt problem. They relate to the IMF's symmetrical surveillance, curbing of protectionism, allocation of SDRs, quota increases, replenishment of IDA funds, a special facility for the sub-Saharan Africa countries, and the World Bank general capital increase. Of special significance are the warnings relating to tightening of conditionality in the extension of financial assistance, in particular to cross-conditionalities in the IMF and the World Bank programs.

Decisions on these and other urgent matters should be taken regardless of our parallel proposal to discuss the reform of the world monetary and financial system. We support the establishment of a representative body from developing and industrial countries that would study and recommend changes in this system within the Interim and Development Committees.

Allow me to refer briefly to the efforts which Yugoslavia has been making to overcome its economic problems. The most significant result has been achieved in stabilizing our current balance of payments. Persistent current balance of payments deficits from the 1970s were converted into surpluses in the last two years. Our expectations are that 1985, for the third subsequent year, will end with a surplus. It is also significant that in both 1984 and 1985 a further rise of external debt was halted. The decline of output and its stagnation in the early 1980s was followed by a rise in the last two years. The first significant steps to strengthen financial discipline were also made. It would be erroneous, however, to underestimate the problem still to be overcome: primarily, curbing inflation and increasing productivity.

Ladies and Gentlemen, I would like to thank Mr. Clausen who has successfully conducted the World Bank in recent years. We highly appreciate his contribution to the shaping of the development policy and financing for the developing countries.

May I join in the congratulations extended to our hosts for the successful organization of the Annual Meetings, and express our gratitude for their hospitality.

Statement by the Governor of the Bank for Egypt

Kamal El-Ganzoury

It is indeed a great pleasure and honor for me to address this distinguished gathering. On behalf of the Egyptian delegation and myself, let me first extend my sincere thanks to the Government and people of Korea for their warm hospitality. I also would like to extend a warm welcome to the delegates from our new member country, Tonga.

The significant expansion of world output and international trade that took place in 1984 is giving way to more modest rates of growth in 1985. Presently, the international economic scene is clouded with many uncertainties and imbalances. The real victims of the international economic forces at work today are, as always, the weakest, that is, the developing countries, which perennially bear the heaviest burdens of adjustment. The debt burden, the high interest rates, the costly dollar, deteriorating terms of trade, and protectionism have combined to erase many of the gains made during the 1960s and 1970s. Current economic forecasts envisage a recovery in many developing countries so slow that the per capita income of 1980 will be barely regained by 1990. For sub-Saharan Africa, the World Bank foresees that, without action, per capita income in the year 2000 will actually fall below the level of 1960.

The external debt situation continues to be a major concern to a large number of developing countries, threatening their growth prospects as well as the health and integrity of the international credit system. The recent successful reschedulings have provided breathing space. It is clear, however, that such an approach does not solve a crisis that will be with us for many years to come. The situation in many of the major debtor countries is extremely critical, and elsewhere, particularly in the low-income countries, there are grave difficulties in servicing foreign debt obligations.

Developing countries continue to undertake strenuous adjustment efforts in the face of an adverse external environment. The cost of this adjustment in terms of low or negative growth, falling standard of living, and social instability has been excessively high. Such a situation may be tolerated for a short period. In the long run, it is evidently unsustainable.

International trade relations have continued to suffer from increasing protectionism in the industrial countries. It is estimated that over one third of developing country exports to the developed countries are subject to one or more kinds of measures which constrain export volumes. In some sectors where developing countries are generally acknowledged to have a comparative advantage, the value of trade subject to such measures is far higher. Moreover, nontariff measures are applied with particular force to goods originating in developing countries. Recent years have seen the emergence of new trade restrictions in markets where developing countries have been particularly successful. The deterioration in conditions of market access for exports of developing countries inhibits export-oriented strategies and damages the capacity to service external debt.

The continuing volatility in exchange rates has added to the problems of developing countries. Well over a decade's experience with the present floating exchange rate system has shown its limitations. It cannot claim to have succeeded in improving the operations of the adjustment process nor can it be said to have helped the growth of world trade and output.

These problems call for urgent remedial action by all concerned. Special responsibility falls upon the major industrial countries whose policies have far-reaching repercussions on the world economy. Without major policy changes, which will have to be coordinated and carefully planned, the world economy remains on a course that is unsustainable and financially perilous.

Let me turn now to some of the current issues under consideration by the Fund and the Bank. It is a matter of deep disappointment to my delegation that, so far, no agreement has been reached on an SDR allocation in the Fourth Basic Period. Recent trends in the state of international liquidity and the conditions of the world economy have greatly strengthened the case for a fresh allocation of SDRs. This is all the more so in view of the

greatly reduced flow of resources from the private capital markets to developing countries. Given that there is a significant underutilization of world productive resources, a substantial allocation of SDRs would promote world recovery, reduce the liquidity problems of a large number of Fund members, and contribute to an orderly adjustment without adverse inflationary consequences. We urge the few members that have not so far found it possible to agree to an allocation to reconsider their position and request the Interim Committee to develop a political consensus for the approval of a substantial SDR allocation.

In the view of my delegation, it is important to continue the policy of enlarged access and also to maintain the current access limits under the policy as well as under the special facilities. This is fully justified by the current and prospective conditions of the world economy and the strained financial position of developing countries. The uncertainties that plagued the world economy at the time this policy was introduced continue to be with us. To phase down the access limits at the present juncture would give the wrong signal and impede the adjustment process. We regret the agreement in the Interim Committee to reduce the current access limits applicable to Fund resources.

My delegation welcomes the proposal to use the Trust Fund reflows for the benefit of the poorest countries. The use of the special disbursement account should be additional to other concessional assistance. It should be provided on the same terms and conditions as the original Trust Fund loans to low-income countries. We appreciate the statements made by the representatives of China and India that they will not avail themselves of this facility in the period 1985–91.

It is recognized that the transfer of resources to developing countries is of crucial importance in facilitating adjustment and accelerating development. However, the recent record in this area has been disappointing. The transfer of resources from official sources, both multilateral and bilateral, has been inadequate. In fact, it has not made up for the unprecedented losses incurred by developing countries on account of the adverse movements in terms of trade and high interest rates. . . .

We are encouraged by recent reports on closer cooperation among the major industrial countries to bring about more realistic exchange relationships. This is a welcome development, which we applaud. Let us hope it is only the beginning of a broader and deeper cooperation that would include both industrial and developing countries and would cover not only exchange rates, but all aspects of the international monetary and financial system.

We regret indeed the announcement of Mr. Clausen that he has decided not to seek the renewal of his mandate. He assumed the leadership of the

World Bank at a very difficult time. We would like to take this opportunity to pay tribute to Mr. Clausen for his efforts in making MIGA a reality, for his leadership in mobilizing support for sub-Saharan Africa, and for expanding the role of IFC. We wish him all the best.

Finally, I would like to extend our thanks to Mr. de Larosière and Mr. Clausen for their sincere efforts in serving the two international institutions.

Statement by the Governor of the Bank for Western Samoa

Tofilau Eti Alesana

Although the Governor for Solomon Islands is addressing these Meetings on behalf of Vanuatu and Western Samoa, as Prime Minister of Western Samoa, I am particularly anxious to make a brief intervention.

First, however, I would like to express my appreciation and admiration to the President and people of the Republic of Korea: appreciation, for the generous arrangements they have made for these Meetings and all the courtesies extended; admiration, for the success in rapidly developing the nation's economy, with consequential benefits to all. The economic development attained is a remarkable demonstration of what can be achieved with careful planning, hard work, and financial and economic discipline.

I am delighted to welcome our closest South Pacific neighbor, the Kingdom of Tonga, as a member of the Bank and the Fund. I feel sure that the many tangible benefits of membership, not the least of which is rapid access to a wide variety of high caliber technical advisory services, will become increasingly apparent over the years.

Western Samoa's experience with both the Bank and the Fund over our 14 years of membership has, on balance, been overwhelmingly positive. From our experience, the Fund's endorsement of an agreed stabilization program means much more than the financing made available. It is a signal of confidence to the country's bankers and creditors.

Along with governments in other developing countries, in agreeing with the Fund on a program, my Government has received complaints that the Fund is "too harsh and insensitive" and is "dictating economic policy of the country." These charges, while they might be good for the opposition, are not really fair.

In Western Samoa's experience, the Fund will only offer financial assistance if so requested and, like any prudent bank, when lending monies in the higher tranches requires that appropriate action be taken to ensure

return of the funds borrowed, as agreed with the borrowing government. This seems reasonable in that the Fund is not directly managing international aid, but is a revolving fund.

I would suggest, however, that there is room for some flexibility on the part of the Fund in dealing with individual countries' situations within the basic parameters of appropriate financial and economic policies to achieve a required adjustment. Other than in broad terms, the economic, financial, and sociological structure of most African countries is different from most Asian countries, which structures are different again from most South Pacific countries. Thus, many developing countries have specific unique problems and circumstances that require specific solutions. Given that a basically sound package of policies is being prepared for implementation, I consider that the Fund must show a flexible approach, having regard to the specific and possibly unique circumstances of each country. . . .

Statement by the Governor of the Fund and the Bank for Sri Lanka

Ronnie de Mel

On behalf of the Sri Lankan delegation and on my own behalf, I wish to express our sincere thanks and appreciation to the people of Korea and the Government of the Republic of Korea for the excellent arrangements made for these Meetings. Next, I wish to very warmly welcome our new member, the Kingdom of Tonga.

I am glad to be able to address these Annual Meetings for the ninth consecutive year. A strong and effective World Bank and a strong and effective International Monetary Fund are necessary for the world economy, and it is the duty of all of us to do everything in our power to strengthen these two institutions, which have played such an important role in the last forty years. However, I must express some disappointment about the relatively slow progress we have made so far toward the establishment of an orderly and equitable international financial system. Although there was a modest global economic recovery in 1983 and 1984, the recession that set in since the early 1980s seems still to be lingering on, confirming our earlier position, stated last year, that the recovery was fragile. For this recovery to be sustained, it is vitally necessary to strengthen the economic base of developing countries by an adequate transfer of resources.

The world is full of challenges and opportunities. The developing countries are unable to face these challenges and seize the opportunities unless there is a deeper appreciation of their problems by the industrial countries. In the spirit of enlightened self-interest, we must learn to sacrifice short-

term gains for long-term benefits. We must learn to work together in a spirit of international cooperation for the welfare of all. This would mean that the burden of international adjustment should be more equitably shared by the industrial and developing countries alike. It is important to recognize the interdependence between industrial and developing countries and to view such a relationship as mutually beneficial. It is only by ensuring greater access to trade and capital and enhancing resource flows to the developing countries that the industrial countries themselves can expand their economies. Adoption of such an enlightened approach to correct the present malady need not await a major reform in the international monetary system. Immediate action is necessary.

Many developing countries which have embarked on bold and imaginative adjustment programs have faced difficulties owing to lack of financial assistance when needed. While conditionality has increased, there has not been a corresponding increase in the availability of financial resources to undertake medium- and long-term structural adjustment. As a result, imports have been compressed, investment has been dampened, and prospects for economic recovery and growth have been made bleaker. It is the responsibility of the major international institutions, such as the Bank and the Fund, to promote world development by the provision of additional and sufficient levels of international liquidity. The question of supplementing international liquidity by the allocation of SDRs has been debated every time we get together, and we have made no progress. As a result, the role of the SDR has diminished and our desire to make the SDR the principal reserve asset has been frustrated. Some have even challenged the *raison d'être* of the SDR. Much thought and consideration went into the establishment of an internationally created asset—the SDR—and we should be very careful not to undermine it now. That there is a clear global need for a fresh allocation of SDRs has already been recognized by Fund studies, which indicate a serious shortage of global liquidity by nearly SDR 260 billion by 1991. This is further complicated and aggravated by the sharply rising debt burden, diminishing access to commercial markets, and declining official development assistance (ODA). The minimum we can accept is that, while further studies are being made, the SDR has to be kept alive by reasonable allocations.

We are also deeply concerned by the sharp reduction in access to Fund resources since 1984. It is unfortunate that the scope of several imaginative solutions devised by the international community in the past, such as the compensatory financing facility, the Trust Fund, and the extended Fund facility, have been scaled down at a time when they are most needed. Their coverage should be considerably expanded and their terms and conditions can be suitably modified to accommodate more of the medium- and long-term requirements of the developing countries that have undertaken struc-

tural adjustment. In this regard, we welcome the recent proposals to utilize Trust Fund reflows in support of structural changes. Such approaches are indeed necessary to ensure that adjustment programs achieve the desired objectives of growth and development. Otherwise, these programs in developing countries could fall by the wayside—or wither and die before they come to fruition.

When dealing with the subject of adjustment policies, it is not possible to ignore the political risks and social costs of adjustment that developing countries have to incur in the short and medium term, mainly due to stringent demand-management policies. Therefore, every effort must be made by both funding agencies and recipient countries to safeguard the vulnerable groups in the developing countries during this process of structural adjustment.

Another crucial issue is the volatility and misalignment of exchange rates. Developing countries have been rather seriously affected by the way the exchange rate system has been functioning since the adoption of floating exchange rates. The greater uncertainty and higher risks involved in the floating system have distorted investments, discouraged investors, and disrupted trade. Hence, it should be one of our major objectives to achieve a more stable exchange rate regime, after the misalignments arising from domestic policies have been corrected.

There is also a strong link between exchange rate stability and international surveillance. It has been difficult to correct misalignment of exchange rates among industrial countries owing to the well-known asymmetry of the Fund's surveillance. In this regard, we welcome recent attempts to tighten multilateral surveillance, and we urge the industrial countries to cooperate in this endeavor. We must accept surveillance as a means of achieving the required global adjustments.

Careful consideration must also be given to the whole question of "enhanced surveillance," which must be carried out only at the specific request of the member countries concerned. Above all, there must be no deviation from the basic premise that all Fund programs are linked to financing, barring the exceptional cases where the members themselves have opted for enhanced surveillance without recourse to Fund resources. The danger of the Fund becoming a credit-rating agency must be resisted.

The recent moves to improve coordination between the Bank and the Fund can be a positive step. The needs of borrowers may be better met if the two institutions act in a mutually supportive manner. However, it is of paramount importance that such coordination does not lead to cross-conditionality. For instance, a Fund arrangement must not be a precondition for structural adjustment lending by the Bank. Coordination between the Bank and the Fund must serve to improve access to resources rather

than to further diminish resource transfers through enhanced conditionality. In the final analysis, the objective of such arrangements should be to extend a larger volume of resources to developing countries. This is very important, because the Bank has not been able to meet its lending targets and the Fund remains highly liquid at a time when there is a most regrettable net outflow of resources from the developing world. . . .

The progress made so far toward reaching a workable solution to the debt problem has not been very encouraging. While multiyear restructuring of debts could help in preventing a bunching of maturities, it alone would not offer a lasting solution to the debt problem. The resolution of the debt problem requires much greater and more positive cooperation of debtors and creditors. In this connection, we should evolve a more comprehensive and integrated approach to the debt problem, rather than adopting a case-by-case approach.

While the debt crisis certainly deserves the attention of the multilateral institutions, it should not result in a shift of emphasis away from other developing countries that have managed their economies better, but still face external difficulties owing to circumstances beyond their control. The fact that certain developing countries might have shown better results through better economic management should not constitute a reason to exclude them from concessional finance when they are undertaking strong adjustment measures. Continued assistance and encouragement to sustain their growth and development efforts must be ensured. There must always be due rewards for prudent economic management. Otherwise, those who have managed their economies better may suffer at the expense of those who have not. This is a situation we should avoid at all cost. Although we strongly support the program for sub-Saharan Africa, we wish to emphasize that this should not in any way lead to a decrease in concessional lending for the low-income countries in Asia and other parts of the world.

Before I conclude, I wish to briefly focus on the painstaking efforts that Sri Lanka has been making toward structural adjustment. We have been able to increase the per capita real growth rate threefold in the last five years, reduce unemployment by one half, bring down inflation almost to zero, and enhance investment appreciably within those years since the adoption of major economic reforms in 1977 and 1978. We are thankful to the international community and multilateral institutions for the assistance they extended to us to supplement our own effort. We have responded by enhancing our savings rate, reducing our budget deficit, improving our external reserves position, and managing our debt satisfactorily. But we are finding it increasingly difficult to cope with the adverse trends in the external economic environment. Unfavorable commodity prices, particularly since the beginning of this year, exchange rate volatility, high real interest rates, and protectionist barriers have been ex-

erting enormous pressure on our balance of payments, creating new difficulties in economic management just when we have succeeded and gotten out of our previous difficulties. Therefore, it is extremely important for Sri Lanka to receive continued assistance on concessional terms if we are to build on the success achieved so far and fulfill our task of adjustment in a satisfactory manner. In this connection, I wish to emphasize that with the sharp decline in commodity prices, it is essential that the resources of the compensatory financing facility should be extended to affected countries without conditionality, automatically.

Before I conclude, let me place on record Sri Lanka's deep appreciation of the services rendered by Mr. Clausen to the World Bank and the international community. He has shown a keen awareness of the needs of developing countries. I have had the pleasure and the privilege of working with him regarding the problems of my own country, and I thank him for his never-failing support, sympathy, and understanding. I wish him well in the future.

Statement by the Governor of the Bank for Greece

Ioannis Papantoniou

I would like first to express my appreciation for the good organization of our meeting and also welcome our new member, the Kingdom of Tonga.

In the Annual Reports of the World Bank and the International Monetary Fund, the international economic situation was adequately discussed. Thus, I intend to make only a brief reference to recent developments, and then I shall express some thoughts regarding international policy options.

In 1984 there were some encouraging signs of economic recovery. Output grew faster than it had for almost a decade, while inflation rates continued to decline. The recovery of world output was largely due to the rapid expansion of the U.S. economy during 1983 and 1984. Growth in the OECD area as a whole, however, was not sufficient for making inroads into unemployment, which remained at very high levels. Moreover, recent developments suggest that the expansion of economic activity in the United States has reverted to a considerably slower pace, pointing thus to a worsening of the global outlook for output and employment.

In late 1984 a downtrend for nominal interest rates in the United States was established. Real rates of interest, however, are still at historically high levels, reflecting the large size of the U.S. budget deficit. The persistence of high real interest rates in the United States has produced a reversal in the direction of international capital flows in favor of dollar-denominated

assets and lies at the root of the dollar's overvaluation. This, in turn, has led to a widening of the U.S. external deficit while giving rise to a considerable and worrying intensification of protectionist pressures.

In spite of the adjustment efforts made by several developing countries, insufficient progress has been realized in correcting external imbalances. Persistent balance of payments deficits, coupled with high real rates of interest in the United States, accentuate the problems of the heavily indebted countries, thus hampering their development efforts and, in some cases, leading to drastic reductions in living standards. It must be emphasized that the developing countries have limited capacity to withstand the economic and social costs associated with the pursuit of adjustment policies, especially if a new slowdown in world economic activity occurs.

Urgent action has to be taken if a new world recession and debt crisis are to be avoided. Policy coordination and closer cooperation among the industrial countries is an essential condition for achieving our objectives.

Corrective action should be taken by countries with high public sector borrowing requirements, particularly if such borrowing leads to a crowding out of the private sector. A reduction of the U.S. budget deficit will bring a fall of real interest rates in the United States which, in turn, will help to produce a more balanced and sustainable pattern of international capital flows and exchange rates while easing the developing world's burden of servicing its external debt.

Further measures should be taken toward the elimination of structural rigidities that lead to inefficient allocation of resources and undermine the efforts to reduce unemployment. These measures should be part of a program of concerted action designed to encompass both the economic and social aspects of structural change.

Clearly, pressures for the adoption of protectionist measures should be firmly resisted. Our economies have become so interdependent that no country has anything to gain by a return to trade wars.

Since the United States has currently ceased to act as the locomotive of the world economy, positive action should be taken by other major industrial countries to restore internal and external balance. They could and should lead the recovery of the world economy by cautiously implementing expansionary policies.

The measures I have just outlined will be more effective if taken as part of a wider policy at the international level, aiming at improving the structure of international liquidity and satisfying the capital needs of the developing countries. In this context, I am not satisfied with the decision of the Interim Committee not to allocate new SDRs and reduce the access limits under the enlarged access policy.

The problem of servicing external debts is particularly serious for some Third World countries. It is clear that greater cooperation and better understanding among governments, the Bank, the Fund, and the commercial banks is needed to alleviate the debt-servicing burden and to improve the foreign exchange position of these countries as part of a longer-run program of adjustment that takes due account of the structural problems of their economies. . . .

Finally, there is a need for improving the functioning of the international monetary system. Since a return to fixed exchange rates cannot be currently envisaged, there should be closer cooperation and better coordination of the economic policies of the industrial countries. The decision of the Group of Five to intervene in the foreign exchange markets to depress the value of the U.S. dollar is a necessary but not sufficient step. It put a brake on speculative expectations, but only a change in economic policy aimed at the elimination of internal imbalances and the establishment of a sustainable pattern of international capital flows is likely to prevent the emergence of similar expectations in the future.

In concluding, I would like to stress, once again, the need for a global strategy that aims at establishing the conditions for a return to durable growth. The time is ripe to build on the progress made during the last decade in adjusting our economies to the new economic conditions. We should meet the challenge by coordinating our policies and mobilizing the resources necessary for a sustained recovery of world output.