DISCUSSION OF FUND POLICY AT SECOND JOINT SESSION[1]

REPORT TO THE BOARD OF GOVERNORS OF THE INTERNATIONAL MONETARY FUND BY THE CHAIRMAN OF THE INTERIM COMMITTEE OF THE BOARD OF GOVERNORS ON THE INTERNATIONAL MONETARY SYSTEM

Allan J. MacEachen

The Interim Committee has held two meetings since last September—the eighteenth at Helsinki on May 12–13 earlier this year and the nineteenth, here in Toronto, on the day before yesterday. Both meetings were held against the background of a very difficult world economic situation, characterized by slow growth, high unemployment rates, persistent inflation, stagnation in international trade, and high payments imbalances for the non-oil developing countries. Internationally, high levels of interest rates and exchange rate fluctuations among the major currencies have also been matters for concern. In fact, because of the tardiness of the long-awaited economic recovery, the outlook for 1982 appears now to be even less favorable than it did in the spring at the time of the Committee's meeting in Helsinki. Real GNP in the industrial world is now expected, according to the most recent forecast by the Fund staff, to remain virtually unchanged from 1981 to 1982 instead of the moderate growth of about three fourths of 1 per cent that was predicted in the forecast prepared prior to the spring meeting. The projections for real economic growth in the developing countries have also been scaled down significantly.

However, some favorable signs are beginning to emerge. The battle against inflation is by no means won, but encouraging progress has clearly been made. Partly as a consequence of this progress, there has been a sharp reduction in interest rates in recent weeks. The softening in international interest rates has already had some favorable effects, including a welcome relief to the external debt service burden of the developing countries. And as for 1983, the prospects are clearly for the beginning of an economic recovery—though, because of the many uncertainties involved, there may be differences of judgment regarding the pace at which the recovery will take place.

[1] September 6, 1982.

In its discussion of policies to deal with the current economic situation, the Committee emphasized that the problems were deep-rooted in character and called for continued sustained efforts to promote the adjustment of domestic as well as external imbalances. There was agreement that, despite the progress achieved, inflation remained unacceptably high in most countries and the objective of ushering in a soundly based expansion of output and employment could be achieved only if the reduction in inflation and inflationary expectations, and in nominal and real interest rates, could be sustained. The Committee also recognized the important complementary role of structural adjustment policies and special programs designed to encourage production and employment. In its assessment of progress already achieved and still needed in the fight against inflation, the Committee stressed the contribution of resolute monetary policies and the desirability of more supportive fiscal policies. Attention was drawn to the emergence in several industrial countries during the 1970s of fiscal deficits of a structural character. The Committee agreed that sustained efforts were needed to reduce these deficits in order to lessen the adverse consequences for output and employment of the anti-inflationary effort.

The Committee was gravely concerned by the difficult predicament of the non-oil developing countries. Their economic growth had slowed down to a rate not experienced in the postwar period and that resulted in a reduction of per capita real incomes in several of them. While the current account imbalances of the industrial and oil exporting countries had adjusted significantly, the non-oil developing countries continued to experience a large aggregate deficit. The Committee observed that unfavorable external developments had contributed greatly to this, noting in particular the effect of the international recession on the volume of exports, the squeeze on resources resulting from a large adverse movement in the terms of trade, and the increase in the debt service burden from high interest rates. However, the Committee also pointed out that unduly expansionary domestic financial policies had contributed in many countries to the financial imbalances. Two other features of the external environment facing the developing countries were noted; namely, the need for an enlarged flow of developmental assistance to low-income countries with limited access to international financial markets and, for other countries who had better access, the historically high level of external debt that had now been accumulated. The Committee stressed the importance for these countries of adopting policies for ensuring an orderly adjustment to the prevailing conditions.

The Committee reiterated that close international cooperation was essential to surmounting the present economic difficulties. The danger from protectionist pressures had to be vigilantly guarded against at a time

when unemployment and excess capacity were ubiquitous. The Committee warned that protectionist policies, by obstructing international trade, were ultimately destructive of employment, and, by undermining efficiency, they exacerbated inflation.

The Committee agreed that the Fund had a crucial role to play in ensuring a coordinated international effort to deal with the current difficult situation. Firm and evenhanded implementation by the Fund of its surveillance function was critical to the promotion of balance of payments adjustment and greater exchange rate stability. In this connection, the Committee was pleased to note the policy declaration in the Versailles communiqué, issued at the end of the summit meeting last June, in which the participants promised full support to the Fund's efforts to foster monetary stability.

Both at Helsinki and here, in Toronto, the Committee deliberated on various issues relating to the Eighth General Review of Quotas. Considerable progress has been made on a number of aspects of this work, including completion of the review of the method of calculating quotas that it had been agreed would be made following the Seventh General Review. During the more recent meeting, the Committee's deliberations were focused on the main issues of the overall increase in total quotas and its distribution among individual members. On the first of these issues, there was widespread support in the Committee for a substantial increase in total quotas. The principle that quotas should remain the primary source of the Fund's financial resources was reiterated. Several members of the Committee stressed that a strong Fund with adequate financial resources would be better able to play its role in promoting balance of payments adjustment. As regards distribution of the overall increase, the Committee reiterated the need for bringing quotas of members more in line with their relative positions in the world economy, taking account of the case for maintaining a proper balance among different groups of countries. The necessary work on the Eighth General Review of Quotas is to be pursued by the Executive Board as a matter of high priority so that the remaining issues on the size and distribution of the quota increase could be resolved by April 1983. The Committee also asked the Executive Board to assess the adequacy of existing arrangements to deal with major strains in the international financial system.

At both of its meetings, the Committee, in considering the question of allocations of SDRs in the fourth basic period, noted the Managing Director's statement that he had not been able to make a proposal for such allocations because of the absence of sufficiently broad support. The Committee has asked the Executive Board to continue its efforts to bring about a consensus that would enable the Managing Director to submit a

proposal for SDR allocations in the current basic period, in accordance with the Fund's Articles.

Finally, I should like to mention that the Committee has agreed to hold its next meeting in Washington, D.C., on April 27–28, 1983.

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

Allan J. MacEachen

It is heartening to see so many countries participate in a cooperative effort to discuss our economic problems and find solutions to them. I join Prime Minister Trudeau in extending my warmest welcome to all of you and especially to Antigua and Barbuda, Belize, and Hungary, which are participating in these Annual Meetings for the first time.

Cold realities confront us in the world economy but there has recently been a glimmer of hope. The more pronounced downward trend in inflation rates and the consequent lowering of historically high interest rates are encouraging. Nevertheless, the ravages of a prolonged world recession remain with us. Growth everywhere has stalled or declined. Unemployment has risen to distressingly high levels. World trade, so often a powerful driving force for growth and development, is stagnant, and many countries face serious balance of payments problems. The developing countries, with their urgent need for growth, have borne a particularly heavy burden. None of us, however, have been able to insulate ourselves. The social and economic costs to our societies have been tremendous and continue to mount, inevitably inflicting pain and suffering on those least able to protect themselves.

The foundation of recovery must be the will and determination of those present here today to follow a wise course in the management of our economies. I believe the Interim Committee's prescription that we must persist in our efforts at reducing inflation in order to achieve sustainable economic growth and lower unemployment is the right one.

The world recession has by no means ignored Canada. With its highly open economy, Canada has been particularly vulnerable to the effects of international inflationary pressures, high and volatile interest rates, and the depressed state of world commodity markets. As a result, output since last summer has dropped sharply, with severe declines in primary and secondary industries. The squeeze in profit margins has contributed to a regrettable decline in job-creating investment. Nonetheless, inflationary

expectations remain deeply entrenched. Inflation, while somewhat lower than its peak at 13 per cent a little over a year ago, continues to be the main obstacle to recovery. The inflationary expectations that permeate our society, revealing themselves at every turn in demands that are greater than can be accommodated by what is being produced, must abate if we are to win our battle against inflation. It is a battle that we cannot afford to lose.

Unemployment has risen dramatically in most of the industrial countries, with over 30 million unemployed in the OECD area. Over the past year, unemployment in Canada has risen dramatically from 7½ per cent a year ago to nearly 12 per cent or 1.4 million people at the present time. As for most industrial countries, the prospects for absorbing these unemployed rapidly are not promising. And yet we remain firm in our resolve to bring about renewed economic growth and create more jobs by dealing with the source of the problem—inflation.

Earlier this summer, I introduced a new budget which demonstrates a clear and strong commitment by the Government of Canada to speed the process of adjustment to lower levels of inflation. The maintenance of an anti-inflationary monetary and fiscal policy stance is being reinforced by a number of creative policy initiatives to build a new social consensus. Our goal is to move from a 12 per cent world of recession to a 6 per cent world of recovery.

Since the introduction of this budget, I have been encouraged by the response of many Canadians who have joined in the cooperative struggle against the obstacles to recovery. The Canadian Government has provided leadership by implementing firm wage restraint in the federal public sector, keeping wage increases to 6 per cent this year and 5 per cent in the next year. The Government has also subscribed to similar objectives in the area of administered prices under its jurisdiction. Given the national character of this effort, the Government has called upon provincial and municipal authorities to endorse this program. Our consultations in recent months with the private sector, including labor, have been fruitful and productive. The consensus that is being built through these efforts forms the cornerstone for an acceptable and lasting solution to the seemingly intractable problem of inflation in our economy. It is our view that these efforts must be voluntary in nature if they are to be truly effective.

The need to alter inflationary behavior through a broad social consensus internationally is also vital. Each country individually cannot hope to succeed in restoring growth and economic well-being without the diligent efforts of others. The performance of the U.S. economy in the next few months will be a key determinant of the nature and extent of world economic recovery.

The Fund and the Bank have continued to play a pivotal role in assisting the world economy through this difficult time. Of particular importance has been the Fund's dynamic and innovative support of adjustment efforts of countries facing balance of payments difficulties. Such assistance must continue to involve an appropriate blend of adjustment and financing.

If it is to help promote effective adjustment in deficit countries, the Fund must have access to sufficient resources. Currently, the Fund is supplementing its own resources with short-term and medium-term borrowing from member countries. Although I fully support this borrowing program, it is important that it be viewed as a temporary phenomenon and that over the long run the Fund's own resources provide the major source of financing. It is in this context that the Eighth General Review of Quotas must be carried out.

It is widely recognized that a substantial increase in quotas is in order. I share this view, and I wish to reiterate that Canada can support an increase in the range that has been discussed lately which would bring the total size of the Fund to SDR 100–125 billion. I also consider that it is essential that economic criteria play an important role in the distribution of any overall quota increase among individual members. An appropriate balance must be struck between the quota increases of potential debtor and creditor countries if the Fund's liquidity situation is to be improved. A certain realignment in the relative quotas of individual countries is necessary and will help ensure that the Fund continues to fulfill its key role in the international adjustment process.

I have been encouraged in our discussions at this meeting by the increased sense of urgency to reach agreement on all these issues before the deadline.

Earlier I referred to the particular burden which has been borne by the developing world. Last year's World Development Report emphasized the importance of economic growth in this decade if we are to reduce the number of people living in absolute and desperate poverty. The performance of the world economy over the past year gives no cause to be sanguine about our ability to achieve this reduction. This year's Report offers some hope that over time we will be able to roll back further the number of people living on the margin of survival. However, the past year or two have been particularly difficult and have undermined some of the earlier gains made by the developing countries. It is all the more urgent that those of us in the more developed countries stand firmly behind our aid programs and multilateral institutions like the Bank and IDA. Of equal importance is that the developing countries themselves set policies which will foster sound development and which will inspire the confidence of private and official lenders. This will help overcome any fears and

apprehensions of international lenders and restore the dynamic thrust that international capital markets can give to development....

The problems facing all of us are taxing and complex but not insoluble. Persistence in our economic policies and responsible adjustment to the economic realities will set the stage for a sound and more prosperous world economy. Hopefully, as we leave this meeting three days hence, we will carry with us a renewed sense of will and determination to see a world recovery blossom.

Statement by the Governor of the Fund for Denmark

Ivar Nørgaard

I have the honor of addressing this meeting on behalf of the Member States of the European Communities.

Since the last Annual Meetings there seems to have developed a deeper understanding of the gravity of the world economic situation. The Community hopes that this will provide a broader basis for overcoming the present severe economic difficulties for developed and developing countries alike.

The fact that strong price increases are still in evidence in many developed as well as developing countries is a worrisome feature in the situation. However, several countries have made important progress in the fight against inflation and the overall picture for the industrial countries points to a continued slight reduction in the rate of price increases. However, these steps forward should not be a reason for diminishing the struggle against inflation.

Since 1980, hopes of a revival in growth have been repeatedly disappointed and at present the growth performance of the world economy is still discouraging. Despite the improved price and cost performance in several important countries and some recent decline in interest rates, nominal and real interest rates remain unacceptably high—partly as a consequence of high budget deficits—providing an important obstacle to productive investment. We are therefore witnessing a delay in the resumption of sustainable growth of the world economy. Both the development in oil prices in 1981 and 1982 and the sustained adjustment efforts by many countries have contributed to a distinct improvement in the global balance of payments pattern. However, the deficit of the non-oil developing countries as a group remains at a high level, and the high international rates of interest are particularly burdensome for this group of countries.

So far as the European Community is concerned, output is developing in a more satisfactory way than was the case when we met last year. However, the rate of expansion in output is modest indeed and could easily come to a halt in the event of only minor unfavorable external developments. The present and prospective growth rates for 1983 in the Community are clearly inadequate to stop unemployment from rising further from its already far too high level.

Against this background, the European Council at its meetings in March and June stressed the importance of a coordinated policy for combating unemployment by promoting productive investment, increasing competitiveness and productivity as well as the development of a Community industrial strategy based on a policy of technology and innovation.

Over the last two years, the Community has been increasingly worried by the international economic situation. We have, in particular, witnessed high and volatile interest rates which, along with other factors, have played an important part in producing sharp exchange rate movements between the major currencies, often unrelated to the underlying fundamentals.

The European Council, therefore, in March called for increased cooperation between the major industrial countries, aimed particularly at encouraging a reduction in interest rates and at making exchange rates less volatile.

In this respect, we are encouraged by the reductions in U.S. interest rates in recent weeks. It is important that this trend should be strengthened and made durable in order to pave the way for a more general reduction of interest rates internationally.

The Community welcomes the undertakings that were agreed upon at the economic summit meeting in Versailles in June. At its meeting late in June, the European Council confirmed its intention for its part to adhere to the lines of policy agreed by the participants at Versailles to the full.

We hope that the agreement reached in Versailles will improve international economic cooperation. A development toward lower interest rates and more stable exchange rates hopefully can create the basis for sustainable growth and an improved employment situation. Last but not least, we believe that an improvement in the international economic situation will support our endeavors to maintain free world trade.

The Community strongly supports the efforts of the International Monetary Fund and the World Bank. We agree that it is important that the Fund's special responsibility in the field of surveillance be strengthened.

Generally, the recycling process has been functioning smoothly during the past two or three years. However, it must be recognized that an increasing number of developing countries have run into financial difficulties.

The experience since 1973 has clearly demonstrated the importance of preserving the duties and competencies of the Bretton Woods institutions. In order for the Fund and the Bank to be able to fulfill their functions, we are prepared to support proposals to secure that these institutions have adequate financial resources at their command.

In order to assist developing countries in their longer-term development and in their adjustment policies, the Community is concerned that sizable amounts of aid should continue to flow from the industrial countries and the better placed of the OPEC countries. . . .

For the Fund, the most important task at hand is the Eighth General Review of Quotas.

In our view quotas of member countries must remain the main source of finance available to the Fund and the Eighth Quota Review must ensure that the Fund has sufficient usable resources, both to ensure the liquidity of its liabilities and to give financial backing for appropriate adjustment programs of members.

We look forward to progress at these meetings toward reaching agreement on a substantial increase in the size of the Fund, as a result of the ongoing review, which should also result in an appropriate restructuring of Fund quotas on the basis of the general principles adopted for the Seventh Review in December 1978, namely, with a view to adjusting quota shares better to reflect members' relative economic positions while having regard to the desirability of an appropriate balance in the composition of the Executive Board.

We strongly support the conclusion reached at the Helsinki meeting of the Interim Committee that this review should be completed within the agreed timetable.

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

Kyong-Shik Kang

First of all, on behalf of the Korean delegation, I would like to express our gratitude to the people and the Government of Canada for hosting the Thirty-Seventh Annual Meeting in this beautiful city of Toronto and for providing such warm hospitality to all participants at the Meeting.

At the same time, I want to welcome Belize, Antigua and Barbuda, and the Hungarian People's Republic as new members of the International Monetary Fund, and Belize, the Hungarian People's Republic, and St. Vincent as new members of the World Bank.

I would also like to take this opportunity to convey our Government's sincere thanks to all the member states for supporting Korea's bid to host the.Fortieth Annual Meeting in Seoul in 1985. We will do our best to make the meeting a most successful one.

As you all know very well, the world economy is currently going through one of the most difficult periods in recent economic history. The industrial economies have practically stopped growing since 1979, and unemployment rates in some of these economies have reached the highest levels since the Great Depression. The growth rates of most developing countries have also dropped sharply from the levels achieved in the 1960s and the 1970s, and the increasingly large current account deficits are causing serious concern in many of these countries.

The problems facing non-oil developing countries are particularly acute, because of their high vulnerability to changes in external conditions. The second oil shock nearly trebled their oil import bill, and the consequent worldwide recession has sharply reduced the demand for their products from the industrial countries. In addition, exceptionally high interest rates in advanced countries have further eroded their balance of payments positions.

Although these non-oil developing countries are trying hard these days to adjust to a changed world economic environment, the prospect for an early economic recovery and an improvement in their balance of payments position is not bright, because of continuing weak demand in the industrial countries and the prospect of lingering high interest rates.

As the World Economic Outlook has correctly noted, the cause of the current worldwide recession is more deep-rooted than appears on the surface, thus any quick or easy recovery is not expected. In other words, the current recession is more of a structural character than of a cyclical one, thus the remedy called for is also of a fundamental nature, requiring considerable time and sacrifice to correct the structural imbalances and rigidities in the economic system.

Thus, policies of structural adjustment which many advanced and developing countries are pursuing at the moment are unusually difficult and painful, and international cooperation is needed now more than ever to restore the health of the world economy.

An uncertain and grim economic prospect, however, tends to breed protectionism and economic nationalism. But nationalistic policies that

disregard their impact on the economies of other nations will not be able to achieve their objectives because of defensive adjustments from other countries.

Only constant efforts to remove rigidities in the economic system and prudent demand management at the domestic level, and strong and spontaneous cooperation at the international level, will pull us out of the current recession.

In fact, the Korean Government's adjustment efforts during the past couple of years have been largely along similar lines. The Korean Government, in recognition of the urgent need to remove rigidities in the economic system, has been promoting structural reforms in various sectors of the economy.

First, to remove inefficiencies created by comprehensive government intervention in the management of the economy, liberalization has been pursued with respect to government price control, commercial bank operations, and the exchange rate system.

Second, in order to promote a more harmonious development of industries along the lines dictated by the law of international comparative advantage, the industrial incentive system is currently being overhauled with substantial import liberalization, relaxation of foreign investment regulations, and reduction of preferential financing or tax treatment.

And third, various anti-inflationary measures have been taken to enhance the competitiveness of Korean products and to change the deep-seated inflationary expectations of the Korean people, who have grown accustomed to double-digit inflation over the past three decades.

Helped in part by these structural changes, the Korean economy recovered in 1981, achieving 7 per cent growth from the negative growth of 6 per cent in 1980, and is expected to grow about 6 per cent this year. More significant than these macroeconomic growth figures was the realization of price stability and a considerable improvement in its balance of payments position.

The annual rate of increase in consumer prices is currently less than 5 per cent, compared with 23 per cent in 1981 and 29 per cent in 1980, and the current account deficit is also expected to drop considerably this year to around $2 billion, down from $4.5 billion in 1981 and $5.3 billion in 1980.

With such improvement in price stability and the balance of payments, and with enhanced efficiency realized through the various reform efforts, the Korean economy is expected to achieve another healthy, sustained

growth as the world economy gradually recovers from the current recession.

The recovery of the world economy would depend, in large measure, on increased cooperation among countries, as I have noted earlier. And, in this respect, the role of multilateral organizations like the IMF and the World Bank should be further strengthened, particularly to help member countries carry out necessary adjustments more smoothly.

First and foremost, the Fund's capital base needs to be further strengthened, in view of mounting difficulties with the balance of payments in many member countries during the 1980s. Thus, the Korean Government strongly supports the position of the Fund's management on the scale of the Eighth General Review of Quotas.

The maximum possible increase of the quota is desirable, especially in view of the fact that balance of payments problems of many developing member countries have become structural in character, and that it will require considerable time for them to make necessary adjustments.

A related point concerns the distribution of the quotas. Adjustment of the Fund's quotas has been very slow to reflect changes in individual members' positions in the world economy. This point has been raised by many Governors in various meetings but has not received due consideration. I earnestly hope that the relative economic size of member states will be properly represented this time through the selective increase of the quotas in the forthcoming review.

As to the issue of an additional allocation of SDRs, I understand that some advanced member countries are opposed to any sizable additional allocation for fear of a possible inflationary impact. It should be noted, however, that international liquidity is not evenly distributed among countries and that the balance of payments difficulties of many member states are expected to worsen in the 1980s, while the Fund's own resources will become increasingly insufficient.

Thus, the issue of additional allocation of SDRs should also be carefully reviewed, taking into consideration the probable scale of the Eighth General Review of Quotas and the need to strengthen the role of the SDR as the principal reserve asset.

Another point I wish to make is related to the recent reinforcement of conditionality in providing financing. Although we fully understand the Fund's efforts to use its limited resources more effectively, terms of conditionality should be applied more flexibly and should depend upon the nature of structural adjustment needed and on the different capabilities of member countries to design and implement appropriate adjustment programs.

Application of too stringent conditionality across the board may reduce the level of the Fund's activities, render proper adjustment more difficult for many developing countries, and weaken the role of the Fund as a major source of balance of payments support.

The role of the World Bank should similarly be strengthened in view of the escalating difficulty in financing the development needs of many developing member countries. The World Development Report has correctly noted that, during the 1970s, developing countries, in general, have weathered the unfavorable international environment better than most advanced countries. This observation, nevertheless, should not be the basis of undue optimism for their continuous successful performance in the 1980s.

We should note that the relatively fast growth of developing countries during the 1970s was based on favorable international financial market conditions and consistent expansion of world trade volume during the decade.

During the 1980s, however, external conditions are expected to worsen because of mounting difficulties in servicing debts and rising protectionism in advanced countries....

In closing, I would like to express the Korean Government's deep appreciation to the staffs of both the IMF and the World Bank, for their continuous efforts to meet the changing financial needs of member countries in this difficult international economic environment. I sincerely hope that, through the concerted goodwill and determination of all member countries, this meeting in Toronto will be remembered as the first moment in a new era of international cooperation.

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

Ernane Galvêas

I am greatly honored to address this important international gathering on behalf of Argentina, Bolivia, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Spain, Suriname, Trinidad and Tobago, Uruguay, Venezuela, and my own country, Brazil.

Our thanks are due to the Government of Canada, to the Province of Ontario, and to the city of Toronto for the cordial hospitality they are affording us. The fact that the Prime Minister of Canada has addressed the

inaugural session is particularly welcome and his message has reflected the understanding that Canada has always shown for the problems of developing countries. I should like also to extend our congratulations to our Chairman, Mr. Abdlatif Y. Al-Hamad, the Governor for Kuwait, and warm greetings to Mr. Jacques de Larosière and to Mr. A.W. Clausen, and to all Governors and delegates attending these Meetings. Finally, I should like to welcome the new members who have joined the Fund during the past year.

The economic outlook at this time presents little encouragement. Recently, short-term interest rates have fallen some percentage points. Unless lower rates can be sustained, the stagnation of the industrial countries will, as in 1981, condemn the developing countries as a group to practical recession in per capita income and into a widening gap between all developing countries and the industrial economies.

The pattern of economic policy in the industrial countries with a continuous pressure on interest rates and increasing protectionism that characterize it, painfully afflicts the developing countries. In the face of this dismal picture the industrial countries, who determine the economic fate of the world, sit as if paralyzed. How long can the social fabric resist?

High and variable interest rates have led to a greater variability of exchange rates, which has created serious problems for LDCs. High interest rates have encouraged the reduction of inventories, adding to the direct impact of the stagnation of the industrial world on the growth of our volume of exports. At the same time, our terms of trade will further deteriorate, for the fifth year in a row, pulling down our imports, with repercussions on the industrial countries themselves. Thus, the budget deficits of major industrial countries have become the most devastating single factor in the world economy. Their destructive effects persist for an already long period of time; they depress the prices of all groups of products exportable by the developing countries, including manufactured items: thus, developing countries find themselves lagging farther behind the developed economies and ever more deeply indebted.

Another deleterious aspect of the policies pursued by the industrial countries is a resurgence of protectionism, which is assuming particularly vicious forms. The Generalized System of Preferences is being weakened progressively, in part as a corollary and a direct consequence of the thesis of graduation. In addition to duties and quotas, the LDCs are the victims of the abuse of antidumping and countervailing duties, of licensing and certification procedures, as well as systematic policies of subsidies which are not warranted by any natural comparative advantage and produce serious market disruption for the products involved. "Countertrade" or reciprocal trade is being increasingly imposed upon us, pushing the world

back not just to bilateralism but to bilateralism by categories and subcategories of merchandise, something worse than anything that existed during the immediate postwar period.

Yet the developed countries cannot expect to maintain outmoded industrial structures in the face of changes in comparative advantage; what they save by protection, they will unavoidably lose by their inability to export to countries whom they inhibit from earning their way.

The developing countries have reacted as best they can. They are courageously facing the need for adjustment. They must not and will not falter in this purpose. They are fully conscious of their responsibilities. But the success of adjustment requires appropriate financing so that the burden should not become intolerable.

The situation is, of course, grimmest for the developing countries that depend on official transfers. Official transfers accounted for a smaller share of current deficit financing in the second than in the first oil shock. No relief is in prospect. Considering the minuscule proportion of their gross domestic product represented by official assistance, the reluctance of donor countries to increase their official assistance is hard to understand. This is the more so as the resources made available to LDCs will return to the industrial countries immediately in the form of demand for their exports.

In any case, once again, while governments have faltered, the international private banking system has responsibly performed its tasks, and we are confident it will continue to do so. We are grateful also to the central banks who have in recent months called on the banking community to continue to perform their expanding intermediary functions. This attitude contrasts with other exhortations against international lending. It is obvious that official regulatory agencies must maintain the responsible stand that they have now adopted to prevent any abrupt changes in the flow of private capital, which could only enhance payments difficulties and thereby threaten the stability of the international financial system, as well as exert a cumulative depressive effect on the world economy.

Under present circumstances, an increased responsibility must unavoidably fall upon the Fund. This responsibility has several aspects. All countries are well advised to consult with it on their adjustment programs, irrespective of whether they elect to obtain financial assistance from the Fund, or are countries in balance of payments deficit, or else in balance of payments surplus. The asymmetry prevailing between the weight likely to be given to this advice by countries in deficit and countries in surplus is probably unavoidable, but the effects of this asymmetry can be mitigated to the extent that the Fund can offer financial assistance to a country in deficit.

Thus, it had been accepted that it is appropriate for the Fund to finance a program which will help to bring about adjustment in the context of an increase in investment rather than simply or mainly by demand restraint. However, Fund policy in general has come under attack. The Fund has an obligation, in this exceptionally difficult world situation, to resist these attacks. It must not reduce but should rather enlarge the scope of its financial activities, including compensatory facilities. The present maximum access under the enlarged access policy is inadequate. Appropriate financing must be made available, within the limit set by the Fund's resources and its borrowing capability, to allow members the necessary time for adjustment. The Fund must not be encouraged to swing from gradualism to shock treatment or even from three-year to one-year arrangements. The Fund has also suffered attacks for assisting countries with access to the private international capital markets.

In other words, there may be here an attempt to reduce the Fund to the function of a lender of last resort, a role that it has always rejected as detrimental to its ability to maintain an open trade and payments system, or if one likes, to apply a principle of "graduation" also to the Fund and not only to the Bank. This makes even less sense than at the Bank.

There is also a disappointing trend in Fund conditionality which contradicts the general agreement we thought had been reached at the Belgrade Meeting. The structural adjustment problems that afflict our countries, including particularly the smaller ones, demand an imaginative conditionality approach.

The role of the Fund in these unprecedentedly difficult and dangerous times may range from support for adjustment programs to as far as becoming a safety net for the worldwide financial system.

The Fund cannot live up to its unprecedented responsibilities without adequate resources. Pending the quota increase, the Fund may at least have to engage in additional borrowing from official sources. The refusal of some major industrial countries to allow the Fund to establish itself, even on a modest scale, as a borrower in the private market, may prove to have been a major mistake. It should be corrected as soon as possible. Above all, however, it is urgent that the Eighth General Review of Quotas should be accelerated; even the present deadline of April 1983 for the conclusion of the work of the Executive Board is a belated concession to reality.

Even an increase in quotas of not less than 100 per cent would be insufficient to re-establish the relationship prevailing between imports and quotas at the beginning of the 1970s. It should also be mentioned that even on moderate assumptions about volume growth and inflation (say, 3 per cent and 5 per cent, respectively, for the years after 1982), the

comparative value of Fund quotas is bound to deteriorate by about one third before the end of the 1980s. Because of the development of the international capital markets, the relevance of mechanical rules to determine the proper size of the Fund—such as the relationship between the value of imports and quotas—may be questioned. Yet, in view of the unprecedented responsibilities faced by the Fund, the old quota-world imports relationship can by no means be considered excessive, but may be quite inadequate.

As far as the distribution of quotas is concerned, may I recall that the Interim Committee has stated that it wanted quotas to be brought more in line with the relative position of members in the world economy but also wanted to maintain a proper balance between the shares of different groups of countries. In that respect and particularly regarding the voting power of the LDCs, we reject the idea of depriving the developing countries of this hemisphere of their shares, which are already inadequate, in quotas or votes. We support the allocation of quota shares to major groups so as to preserve the present status, using formulas only for allocating quota increases within each group.

The delegations on whose behalf I am speaking consider it of paramount importance that the Managing Director continue to pursue new allocations of SDRs. It seems obvious that there is not the slightest danger that the modest range of SDR allocations, which was proposed a year ago, would either directly contribute to inflation or give an inflationary signal to the world.

In reality, it would under present circumstances be wiser and without danger to create a large volume of SDRs. A time of worldwide stagnation, when global reserves are falling, is not the proper time to deprive the world of growth in nonborrowed reserves. It would also be wise to resume the study of a redesigned substitution account on as wide a basis as may be necessary to deal with the present disturbed situation of the international financial system.

In the event of a major financial crisis, in which central banks fail to step in fast enough or on a sufficient scale, the SDR mechanism may have to play a major role. The Fund cannot quickly increase quotas or borrowing from official sources, as already mentioned; both, in important member countries, require legislative approval. Nor can the Fund expect to raise quickly important sums from private sources, at least until it has made an entry into the markets. On the other hand, the legislation of major industrial countries permits them to approve an allocation of SDRs up to a generous limit, without legislative approval. A large allocation of SDRs could, therefore, be decided quickly. And means could, moreover, be found to direct it to the needy members.

As the present circumstances require:

We call upon the major industrial countries to review the stance of their fiscal policies and to retreat from policies of financial and commercial protectionism, which is assuming a particularly vicious form and threatens to destroy the trading system that has been so painfully constructed over the postwar period. By contrast, our trade policies are designed to develop infant rather than preserve senescent industries, to stimulate the continuous diversification of our export structures, or are simply the necessary reactions to the restrictions imposed upon world trade by the industrial countries.

We call upon the Fund urgently to review its enlarged access policy to enable it to assist its members on an appropriate scale.

To supply the necessary resources, we call upon all member countries to commit themselves to approve an increase of at least 100 per cent in total Fund quotas, and to conclude the Eighth General Review of Quotas not later than the time of the next meeting of the Interim Committee. We wish to stress that the establishment of a "crisis fund" could not replace a quota increase. The latter would still be needed to supply the Fund with resources for adjustment programs not involving an international crisis.

We call upon the Governors to encourage the Fund to increase its borrowing from official sources, since its liquidity on a commitment basis at April 30, 1983 may be exhausted.

We also call upon the Governors to encourage the Fund immediately to make an experimental approach to the private capital markets so that these markets can be prepared to supply additional resources to the Fund in the event of need.

We call upon the Governors to approve immediately a major allocation of SDRs, which is fully justified in terms of the Articles of Agreement (Article XVIII, Section 1). Moreover, we call upon the Governors to resume the study of a redesigned substitution account on as wide a basis as may be necessary to deal with the present disturbed situation of the international financial system.

Statement by the Governor of the Fund and the Bank for the United States

Donald T. Regan

I am happy to be here today, enjoying the hospitality of a neighbor with whom we share the world's longest unfortified border. I am delighted to

be with you and to join in welcoming three new members to this Meeting—Antigua and Barbuda, Belize, and Hungary.

Last year, President Reagan met with this group in Washington and said: "We need to recognize our progress and talk about it more...with one another. This in no way denies the immense problems we face. But without some sense of what we have achieved...we will succumb to defeatism or surrender to ill-advised solutions...."

During the past year, there have been major economic achievements, both in my country and in the international arena, and we would do well to recognize them. But first let me put these accomplishments in perspective.

At these meetings last year in Washington, at Helsinki, and again at the economic summit in Versailles, we were told that the U.S. budget deficit and high interest rates were the major economic problems for every other country in the world. In recognition of widespread concern and uncertainty in financial markets over the projected size of future U.S. budget deficits, we acted. In an atmosphere made difficult by domestic economic and political pressures—and despite our own unwavering commitment to incentive-oriented tax rate reductions—we asked the Congress to reduce budget deficits over the next three years by $380 billion, including the $99 billion in revenue increases which just passed the Congress. Although there are complaints about inadequate U.S. control of government expenditures, we have cut $270 billion from nondefense expenditures since taking office, in addition to the $280 billion in further cuts we are now asking for. President Reagan is personally committed to seeing these cuts through.

We are already seeing tangible results from our economic program. We have been predicting a decline in interest rates. This prediction met with entrenched skepticism, both at home and abroad. But the fact is that interest rates have been dropping for some time now. And while they are still much higher than we would like, they are far, far below their peaks.

The three-month treasury bill rate, which peaked at 16.7 per cent at the beginning of 1981, is now at 8.6 per cent. The prime rate was over 20 per cent then. Today it is 13½ per cent. The federal funds rate has moved in the same period from 15 per cent to 9 per cent. These are major declines. With continued progress on inflation, we should see more in the months ahead.

The decline in long-term rates has lagged behind short-term rates. Historically, this has been the pattern, and the transition we are presently moving through is no exception. However, even long-term rates have now started downward.

In our first budget, we anticipated that the rate of consumer price increase in the United States would drop from the double-digit rates prevailing before we took office to about 8½ per cent this year and a little over 6 per cent in 1983.

Our critics, back then, scoffed at such projections. But in fact we have done even better. Consumer price inflation in the first half of this year ran at a 5.1 per cent annual rate, and we expect it to be only a bit higher than that for the year as a whole. Wage increases in the United States have averaged only about 6 per cent in the first six months of 1982. Wholesale prices are up only 2.5 per cent in the same period, and one of our major automobile manufacturers has increased prices for the 1983 models by a mere 1.9 per cent—a clear indication of weakened price pressures.

At last year's Annual Meeting, President Reagan said that "...each of our societies has a destiny to pursue. We have chosen ours in light of our experience, our strength, and our faith."

The theme of the United States under the Reagan Administration is by now very familiar to you: we have faith in the market mechanism. Economic decision making through private market activity simply produces more efficient results than decisions imposed by governments. And experience has demonstrated time and again that this is the case, both domestically and internationally.

In the United States, we have worked to put in place an economic program that embodies this approach. We have set our goals high—but they are attainable goals.

The declines in interest rates and inflation that I have mentioned are welcome. But they provide only the first inkling of the real benefits that the U.S. and world economies will realize from the President's economic program.

The stage has been set for a strong recovery that is becoming more probable and more imminent with each passing day. Our index of leading indicators for July rose 1.3 per cent—the fourth consecutive monthly increase. The turnaround in U.S. real GNP, which began with modestly positive growth in the second quarter, will give us stronger growth later this year, before settling back into a sustained recovery with growth in the 4 per cent range.

While countries differ greatly in culture, traditions, and present economic circumstance, we believe that there is a broad blueprint for sound economic policy which is applicable to all. A stable and noninflationary macroeconomic policy, formulated with a long-term planning horizon and implemented steadfastly despite short-run pressures, is necessary for sustainable economic growth.

This type of macroeconomic policy must in our view be reinforced by a free-market orientation. When we allow market forces continually to adapt our economies to changing economic circumstances, adjustment is less abrupt. Governments can sometimes delay adjustment for a short time by using subsidies, protectionist measures, and capital controls—but sooner or later the adjustment has to be made.

These, then, are the components of our approach to both domestic and international economic issues: an emphasis on noninflationary, market-oriented domestic economic policies and on effective international cooperation. This is the philosophical framework that shapes our attitude toward the Fund and the Bank.

The Fund continues to be the key institution of the international monetary system. In the current environment the only acceptable approach is the one the Fund is taking—an approach designed to foster economic and balance of payments adjustment.

The types of problems our nations face have not changed in character. They still include excessive inflation, high unemployment, substantial payments imbalances, and the daily burden of poverty and hunger. But in the past 12 months there has been fundamental improvement on a number of fronts.

First and foremost, there has been broad—although not universal—improvement in the areas of inflation and payments imbalances. But we have only to look about us, or to listen to our citizens, to know that we still have a long way to go. A lasting world economic recovery, with significant reductions in unemployment, is now within our reach. But it will require continued diligence and perseverance to attain. From a worldwide perspective, the fires of inflation, while not as white-hot as they were a year or two ago, are still uncomfortably warm. In some countries, they continue to rage virtually unchecked.

Second, the experience of the past few months underscores the basic strength and resilience of the international financial system. The system is sound. It has coped with some difficult liquidity and debt problems, and I am confident that it will do so in the future.

At the same time, it is clear that the rapid growth of international debt has placed strains on the world banking system. Ironically, many current problems stem from government policies designed to stimulate rapid growth but which—because of their excesses and reliance on controls—have produced little or no growth and have greatly damaged economic performance in all respects.

All too often, governments have tried to follow overly ambitious national economic plans that exceed the real and financial resources of

their nations. Confronted with the gap between aspirations and resources, the temptation is great to spend beyond one's means—a problem not unheard of in Washington. There are pressures for massive government deficit spending and temptations to monetize budget deficits, thus fueling inflation. And there are heavy pressures to borrow excessively abroad—to the point that a nation loses access to foreign credit markets altogether.

The results are inevitable: too little growth, too much inflation, too much debt. Confidence in the borrower's economy becomes shaken and money flees to other countries and to other currencies.

The lessons here for all of us—creditors and debtors—are plain. The international financial system is tough and resilient, but its resources are not inexhaustible. Societies cannot grow faster than their resources will allow. Attempts to promote unrealistic growth rates lead only to inflation.

The real solution to the problems we all face is to be found through a series of courageous and concerted steps toward adjustment.

As President Clausen said this morning: "...sustained growth in the developing countries inevitably depends on their own sound domestic policies...." The same applies to all.

Without sound national economic policies, both domestic and international resources—real and financial—are misallocated, and economic and social disruptions can only increase. With sound policies, the basis is laid for reconciling the necessary prudence in lending by the private sector with the need for continued financing during the period of adjustment.

Reluctance to tackle difficult economic decisions, coupled with recent sluggishness of the world economy, has made it all the more difficult to resist the political pressures for protectionism. But one of the lessons of history is that protectionism does not pay. Free-flowing trade and investment are part of the engine that drives economic growth.

For this reason it is essential that we maintain forward momentum on trade liberalization, rather than slipping back into politically motivated protectionism. While liberalization of international trade and investment, in itself, is no panacea for our economic difficulties, it is an essential component of any sustainable long-run recovery. We have been working hard to keep up momentum for such liberalization, and that will be the central focus of our efforts at this fall's GATT ministerial meetings.

As the major international monetary institution, the IMF has a central role to play in promoting greater discipline in national economies. One obvious way it can accomplish this is through its surveillance activities.

In this context, I am pleased to note that, with the assistance of the Managing Director, we have begun the process of enhanced international

economic and monetary cooperation that was agreed upon at the Versailles summit. We are hopeful that this effort will make an important contribution to greater convergence and stability in the policies of the major trading nations, and thereby to greater exchange market stability.

Another important area of the Fund's adjustment-related activities is its role in extending conditional balance of payments financing. For the Fund to have an effective role, this financing must remain temporary; and it must be directed toward support of sound adjustment programs.

The United States has urged that IMF support be directed to cases of genuine need, in order to conserve scarce financial resources; and that great care be given to the design and implementation of IMF-supported programs, to maximize the IMF's contribution to effective adjustment. We are pleased with progress in both of these areas: the Fund's current financial position is strong, as is its reputation for supporting sound economic programs on the part of its borrowers.

For the future, we must assure that the Fund maintains the capacity to respond to genuine needs for temporary financing and to cope with situations that place strains on the system as a whole. The increase in IMF quotas now under discussion in the Fund must be adequate to meet temporary balance of payments financing requirements under normal circumstances. We believe also that consideration should be given to establishment of an additional permanent borrowing arrangement, which would be available to the IMF on a contingency basis for use in extraordinary circumstances.

The United States is prepared to work closely with others in elaborating and considering this suggestion and believes that basic decisions both on it and on the quota review itself should be a realistic aim for next spring's meeting of the Interim Committee....

A year ago, when I first addressed this body, I urged a return to the types of economic policies that gave the world such an excellent record on growth and development during the first decades after World War II—market-oriented policies to mobilize private economic activity.

The events of the intervening year have served to remind us that, while such policies will lead us to lasting economic recovery and vigorous growth, the process is not quick. Nor is it easy. We are making solid progress toward reducing inflationary pressures and restoring the basis for growth—but much more remains to be done.

The International Monetary Fund and the World Bank continue to embody sound principles. They continue to make very important contributions to world economic progress. The United States remains an energetic supporter of both the Fund and the Bank. It is clear, I am sure,

that this Administration holds fast to certain principles and to certain policies. At the same time, I hope it is evident that dialogue and cooperation are also bywords of this Administration. We listen. We discuss. And thus we all have a continuing opportunity to learn from one another.

Thirty-eight years ago at Bretton Woods, another American Treasury Secretary, Henry Morgenthau, said: "We can accomplish our task only if we approach it not as bargainers but as partners—not as rivals but as men who recognize that their common welfare depends on...mutual trust and joint endeavor." And with that view still in mind, we look forward to effective cooperation with these institutions and their members in the future.

Statement by the Governor of the Fund for New Zealand

R.D. Muldoon

The world economy is in a critical situation. We have heard, and will continue to hear, speakers elaborating on the themes of high inflation, world recession, massive unemployment, unstable exchange rates, excessive interest rates, widespread protectionism, and financial crises. The situation has been aggravated by the behavior of the major exchange rates which have taken on a speculative life of their own that is not consistent with relative costs or trading performance. This has distorted competitive positions and trading shares and has triggered further trade barriers distinguished in some cases by the grimly humorous pseudonym "voluntary." The situation is for many countries, especially the poorer ones, desperate. The policies of the major countries, necessary though they may be if inflation is to be reduced, have forced on the less developed countries declining commodity prices, lower demand for their exports, and reduced access for their products to international markets. Their attempts to diversify from primary products into textiles and other manufactured goods have been obstructed by trade barriers.

The balance of payments and debt problems of many developing countries have reached critical levels. On the capital account, these countries need to supplement domestic savings with inflows of aid and borrowed funds if they are to finance economic development and at the same time maintain basic living standards. The very high cost of servicing external debt, in conjunction with a static level of aid, has brought the development process close to a halt and forced many countries into financial crisis and political instability.

The reduced significance of the Fund and the increased size and number of national deficits have forced developing countries to turn to private banks. The situation has now been reached where growing numbers of countries and some private banks are clearly at risk.

This combination of difficulties is without precedent in the postwar period. The world has, of course, survived such crises before, as in the 1930s, but only at enormous cost. That last crisis, and the lessons that were drawn from it, led to the Bretton Woods Conference and to the establishment of the Fund and the Bank. Further negotiations led to the compromise of GATT. These institutions were founded as the centerpiece of a system of exchange rate stability, freedom of trade and payments, orderly adjustment of balance of payments deficits *and* surpluses, and international economic cooperation in the widest sense.

This system served us well for a quarter of a century until the 1970s when the fixed exchange rate system collapsed, economic activity slowed, and there emerged balance of payments deficits and surpluses of a persistent rather than a cyclical character.

The response to these developments by the international community has been limited and can now, I believe, be clearly seen as inadequate. As for the Fund itself, the Second Amendment of its Articles ratified the floating exchange rate system and reduced the role of gold, but incorporated very little of the work on monetary reform by the Committee of Twenty. New facilities were established: the oil facility, the supplementary financing facility, and, most recently, the enlarged access policy. On the other hand the total of Fund quotas has failed to keep pace with the expansion of international trade and payments, while the role of SDRs has, if anything, declined.

There are steps that we can take to arrest the decline in the role of the Fund and make it better able to deal with the problems facing us. New Zealand favors a doubling of quotas to help restore the relative position of the Fund and to cope with expected requirements up to the mid-1980s. Quota increases must remain the principal source of Fund financing, given the substantial cost of borrowed funds and the uncertainties of relying on this form of financing. Access to the Fund should also be reviewed in the light of increased quotas. While, however, strongly supporting expanded resources for the Fund, I do not believe that today's problems will be solved by this means alone. A more comprehensive approach is needed.

New Zealand also considers that there should be more vigorous efforts to establish a more meaningful role for the SDR. Further issues of SDRs will be required and indeed are justified by such considerations as the lack of growth in world trade and the recent contraction in international

liquidity. In present circumstances, the risk of higher inflation flowing from SDR issues seems to be minimal.

To complement these steps we need a more flexible and sympathetic approach to conditionality to ensure that the deficit countries are positively encouraged to turn to the IMF. I would not want there to be any misunderstanding as to what I mean by this.

We must, of course, take domestic measures to adjust to external deficits. The Fund clearly cannot lend without agreeing with the member a set of appropriate conditions to facilitate this adjustment. It must also ensure an eventual ability to repurchase the amounts drawn under its facilities. The point is that conditionality has to be administered in a manner acceptable to both lender and borrower. Something is wrong when, in a world beset with widespread and persistent deficits, so many countries feel unwilling or unable to approach the Fund or utilize its services, or do so only when it is almost too late.

We simply have to acknowledge that for many of the poorer countries, balance of payments deficits are not of the transitory or cyclical character originally envisaged by the Fund's rules. The deficits are often semipermanent, chronic, and intractable. The period required for their resolution can be lengthy. Where existing standards of living are already abjectly low, conditionality that is too harsh or oriented excessively to the short term will simply push these standards down to levels that would be quite unacceptable to any reasonable person and that will inevitably create political instability.

The essence of the matter is that the world needs both adjustment and conditionality, but it has to be better balanced between deficit and surplus countries, between the rich and the poor, between short and long terms, and between demand and supply considerations. We need symmetrical surveillance in the broadest sense. The industrial nations cannot afford to see the international financial system further impaired by the collapse of sovereign borrowers. They must also become more conscious of the impact their own domestic policies can have on other nations, especially on the poorer ones, and seek ways to alleviate these adverse effects.

I cannot avoid the conclusion that on the whole the approach to the question of international economic cooperation needs to be reviewed, but I question whether the present calendar of international meetings is adequate for this purpose. The economic summits are too exclusive and, in any event, have shown little evidence of an ability to make progress on difficult issues. It is noticeable, for example, how little has been done since the Versailles summit on the Fund's surveillance of the major economies. As for the Interim Committee, it is regrettable that its discussions have taken on the character of formal exchanges that change

nobody's opinions. Since the Committee negotiated the Second Amendment it has achieved very little.

In the same vein, I do not support ad hoc solutions to emerging financial problems. The continual resort to partial measures to deal with problems shows that we have failed to adequately strengthen and develop the central institutions.

Few countries can be satisfied with the present approach. Indeed there is widespread recognition of the need for a fundamental reappraisal. This was overwhelmingly clear at the Commonwealth Finance Ministers' Conference in London last week and also emerges in the communiqué of the Group of Twenty-Four following their meeting here last Friday.

Comprehensive solutions are needed. If we do not start out to seek solutions, however, I can only be pessimistic for the future of the world economy. If we do not start on this soon we will only be forced to do so later, in even less propitious circumstances.

I, therefore, conclude that we should meet again, as we did at Bretton Woods, in a full-scale conference to review the state of the international financial system and the role of the Fund and the Bank in managing that system. We should also re-examine GATT. We must, I believe, address these matters with a sense of urgency.

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

Michio Watanabe

Let me begin my address by expressing my sincere gratitude for the favors given by the Government of Canada and the city of Toronto and their great efforts devoted to organizing these joint Annual Meetings.

I would also like to give my warmest welcome to Antigua and Barbuda, Belize, and the Hungarian People's Republic, which have joined us as our newest members.

The Recent Japanese Economy

First, I would like to evaluate the present state of the Japanese economy and explain our economic policies.

In fiscal year 1981 ended this March, Japan's gross national product amounted to $1.1 trillion, an increase of 5.2 per cent in nominal terms or 2.7 per cent in real terms from the previous fiscal year. As for the balance of payments, while the current account recorded a surplus of $5.9 billion,

the net long-term capital outflow amounted to $14.8 billion, far exceeding the current account surplus. During the fiscal year, prices were exceptionally stable with an annual increase of 4 per cent in consumer prices and only 1.4 per cent in wholesale prices. The unemployment rate remained at 2.2 per cent.

The major reasons why the Japanese economy could attain such a relatively favorable performance despite serious recession and inflation worldwide are as follows.

To cope with the virulent inflation due to the second oil crisis, we placed the highest priority on stabilizing prices, and took prompt action to moderate aggregate demand by implementing appropriate fiscal and monetary policies. We also promoted resource and energy savings by organizing a national campaign. As a result, while the economy grew, our oil consumption dropped by 18 per cent during the last two years to almost the same level as ten years ago. Meanwhile, private enterprises made every effort to increase productivity by thoroughly rationalizing production. Owing to cooperative labor-management relations, labor secured stable employment, while restraining from demanding an excessive wage increase.

On the other hand, growth in personal income remained moderate, and consumption and housing investments stagnated. More recently, exports have started to decline. The recovery of the economy slowed, and as a result, an unexpected budgetary revenue shortage arose, further expanding the already huge budget deficit.

Fiscal Policy

As economic recovery slowed, the actual tax revenue fell short of an initially estimated amount by approximately 10 per cent with the total budget deficit reaching some $66 billion or 6 per cent of GNP. Government bonds outstanding reached an enormous $350 billion or 33 per cent of GNP. If this situation is left uncorrected, the government deficit will have serious adverse effects on private economic activities. The reduction of the budget deficit as well as the further recovery of the economy are the Government's most important political goals. With the Government's best effort to reduce budget expenditures, an annual increase in general expenditures excluding automatic transfers to local governments and public debt-service payments were kept to 4.3 per cent in fiscal 1981 and 1.8 per cent in fiscal 1982. As for fiscal 1983, a 1.4 per cent ceiling was set on the budget requests by ministries.

However, some people are now calling for prompt stimulation of domestic demand by expanding public works, even at a risk of a temporary increase in the budget deficit. They maintain that present

economic trends would lead to a recession and thus further aggravate fiscal difficulties. On the other hand, others insist that a larger budget deficit would not only jeopardize the important government goal to restore fiscal soundness but would also raise the general level of interest rates, including those of government bonds, thus hindering our economic recovery. Which view prevails remains yet to be seen. However, since our economy has been basically recovering and consumer expenditures have started increasing in real terms due to price stability, we consider that we can reasonably rely upon an expectation of steady and stable economic growth.

Structural Reform of Administration and Budget

Until the early 1970s Japan enjoyed a high economic growth that took advantage of the availability of abundant low-priced oil. Accordingly, public finance could afford rapidly growing public expenditures for social security, education, and public works, which had lagged behind the country's economic development, but which were essential to higher living standards for the Japanese people.

Because of the drastic oil price hikes in the 1970s, economic growth was sharply reduced and the situation in public finance was seriously aggravated. However, once any given measure is publicly financed, it is not easy to stop budgetary support, even after it has accomplished its initial purpose; as a consequence, people's sense of self-help and self-control has been weakened. The most important and essential task for our country today is to review those systems premised on high economic growth. The level of public services and their cost-sharing should be fundamentally reviewed.

For this reason, the Government has decided to thoroughly simplify and rationalize government organizations and economize on administrative expenses and subsidies. We have also decided to limit the role played by the central and local governments and to promote the transfer of public organizations to the private sector as much as possible, even if the organizations in question are proud of their long history in the public sector. For example, both the Japanese National Railways, well known for its famous "bullet train" but recording a deficit of about $6 billion a year, and the Nippon Telegraph and Telephone Public Corporation, which is being urged to accommodate further technical innovation through organizational reform, are to be examined for possible transfer to the private sector.

Our fundamental principle on administrative reform is to relax administrative regulations and to diminish protectionism as much as we can. We aim to promote free competition and self-help efforts in the

private sector and thus create an environment where the dynamics of our society can be further vitalized.

Monetary Policy

Next, I would like to address monetary and exchange rate policy. At present the official discount rate in Japan is 5.5 per cent and the long-term prime rate is 8.9 per cent. As the recent price performance remains extremely stable, some people argue for lowering interest rates in order to improve business conditions. However, in light of the present appreciation of the dollar and the consequent depreciation of the yen, we are not now in a position to lower interest rates and thereby widen international interest rate differentials.

On the other hand, I recognize that there are other people abroad who support a tighter monetary policy and higher interest rates in order to strengthen the yen. Increased interest rates would, however, discourage private investment and prevent the recovery of domestic private demand.

Under these circumstances, we will maintain free financial markets and respect the market mechanism as much as possible.

The Yen Rate

There is also criticism abroad that Japanese policies are oriented in favor of depreciation of the yen. Such charges are totally groundless. Japan imports many kinds of resources, and depreciation of the yen, with its adverse effects on imported prices, is absolutely contradictory to the fundamental concept behind our economic policies, which is to achieve economic growth based on price stability. On the contrary, a stronger yen would lower the cost of imported resources and promote stable economic growth. It would also prevent higher interest rates and thus enable us to adopt the most desirable economic policies for stable conditions.

Broad exchange rate trends, in principle, reflect the performances of home and foreign economies, and inter alia, the differential in inflation rates among different countries. Although the yen rate has been so far heavily influenced by international interest rate differentials, I believe that our improved economic performance, including stable prices, should lead to the appreciation of the yen in due course.

International Economic Policy Cooperation

The achievement of stable currencies is the dearest wish of all nations. However, with the world economy still troubled by instability, it would not be realistic to adopt any exchange rate system other than floating rates. The currency stabilization should be based on the restoration of fiscal and monetary disciplines and realization of continuing noninflationary growth

over the medium and long term. In order to realize the above objectives, both the efforts of individual countries and cooperation among different countries in making economic policies are of the utmost importance.

In this sense we sincerely hope that the United States will endeavor further to reduce its budget deficit with expenditure cuts and tax increases, thereby moderating inflationary expectations and enabling a further decline in interest rates.

Means of Intervention

However, actual exchange rate movements are extremely volatile in the short run due to interest rate fluctuations and speculation. Generally speaking, it is difficult to guide exchange rates in a certain direction or to fix them at a given level through intervention, but intervention would be effective to correct excessive short-term fluctuations. Especially when exchange rates change drastically, due to disorderly market conditions, I strongly hope that every country concerned will take mutually coordinated action to cope with the situation.

Eighth General Review of Quotas

Turning to the present international financial situation, it is estimated that huge balance of payments deficits will continue in many countries, particularly the non-oil producing developing countries. The credit requirements of these countries to finance their balance of payments deficits will therefore remain strong. However, private financial institutions are taking a more cautious and selective attitude toward borrowing countries that will continue to suffer from the accumulation of huge debts, sharp increases in interest payments, and shorter maturity structures.

Under these circumstances, the borrowing countries must restore economic discipline to stabilize the international financial situation. It is an important role of the Fund to promote economic adjustment by the borrowing countries, and the active contribution of the Fund in this area is strongly sought. For this purpose, the Fund should implement an adequate eighth quota increase to mobilize the necessary funds. I would like to emphasize that an extensive adjustment of quota shares among member countries would be an indispensable precondition in implementing the eighth quota increase, in order that member countries shall cooperate with the Fund in accordance with their relative economic positions in the world economy and thus allow the Fund to function smoothly.

Japan's Economic Cooperation Policy

Regarding official development assistance, in spite of the financial difficulties we are faced with, we intend to steadily expand our economic

cooperation, paying due attention to the effective implementation of official development assistance. To extend a total package of economic assistance programs would, however, discourage recipient countries from making self-help efforts. Our economic cooperation policy will, therefore, be based on a thorough, basic survey of each project, on a case-by-case basis, so that it will be the most efficient and effective for a recipient country in terms of the size, timing, area, and form. It is important to note that economic cooperation is supposed to assist self-help efforts of recipient countries. In other words, loans should not be extended where there would be no repayment, and aid should not be forthcoming on a permanent basis. No one would endlessly prime a pump that would never bring forth water. I stress that aid can be effective only when there is a strenuous effort to bring up water in response to the pump priming....

Concluding Remarks

Discussions and arguments abound on the causes of the present worldwide inflation and economic stagnation. They include the following: first, the loose control on public finance and the relaxation of monetary discipline by many governments; second, the people's own inadequate self-help efforts and their excessive dependence on their governments; third, trade union demands for wage increases exceeding productivity growth and a lack of persuasiveness on the part of management; and fourth, excessive protection of ailing industries.

Many other causes have also been cited. They include the stagnation of investment and the accumulation of debts attributable to high interest rates worldwide. There are temporary measures to cope with balance of payments deficits by depending heavily on exchange rate depreciation under the floating exchange rate system. There are sharp oil price increases that can not be absorbed by productivity increases. There is the outflow of key currencies caused by prolonged wars. There is, in some cases, expansion of military expenditures preventing adequate funds from being invested in the productive private sector.

We may yet find a number of other causes, and the views on the relative importance of these factors are sure to differ from person to person and country to country. However, in essence they do not seem so different. What we now must do is to study deeply how the present difficulties in the world economy came about. We must consider countermeasures and together solve the problems through cooperation.

It is impossible for any single nation to maintain its present living standards in an autarkic economy. Under the free economic system the world is bound together like the links in a chain. Production cannot mobilize an economy without adequate demands; demands cannot be

created without purchasing power; and purchasing power does not come about without production.

Some items we do not have ourselves are owned by others, and items others do not have are surely owned by us. When every country offers what it has, the chain is linked and rotates. If the chain rotates, goods are mobilized, production encouraged, and employment increased.

The rising tide of protectionism worldwide is thus a matter of the greatest concern. In order to strengthen the chain, we must uphold the free trade system and make every effort to increase productivity in every country. At the same time we need to keep financial markets as free as possible to ensure the smooth flows of international capital.

I have said nothing here today that you did not already know. However, I fear that fundamental principles are being forgotten. There are too many professional arguments that stick to minor points. We should return to the fundamental points once more, scrutinize seriously the real causes of the present worldwide inflation and economic stagnation, and reflect on what is to be done.

I would like to close with my favorite expression in Oriental philosophy: "What is emptiness, that is form." As "emptiness" also means "sky" in Japanese, it symbolizes what is infinite and intangible, such as the heart. On the other hand, as "form" means "color" in Japanese, it symbolizes what is finite and visible, such as human behavior. Thus the literal translation of the phrase would simply be, "Sky is color." In other words, it can be interpreted thus: the heart, which extends infinitely within ourselves, can only be expressed through our daily visible behavior.

Our policies to cope with the fundamental problems facing the world economy may prove unpopular. However, if we persuade people by demonstrating our ideas with action and a sincere heart, I am confident that our policies will be understood and will bear invaluable fruit.

Statement by the Alternate Governor of the Fund for the Federal Republic of Germany

Manfred Lahnstein

We are gathering in critical circumstances. All over the world continuing economic stagnation is a severe test of our patience and tenacity as citizens and policymakers. All over the world we detect signs of a growing loss of confidence in the efficiency of our common economic and financial system, and also a loss of confidence in our ability to master the crisis. Our policy choices remain narrowly constrained and we are

facing tremendous difficulties in trying to make these choices understood by large sectors of our public opinion.

Sharply rising unemployment has reached intolerable levels in industrial countries. Underemployment and hunger plague millions and millions of people in developing countries.

The advocates of impatience are getting the upper hand in many countries. Protectionism, beggar-my-neighbor policies, and inward-looking policies are the dangerous and unacceptable answers.

For all of us, our total capabilities are put to the test. During these days at Toronto we have to give clear, common, and political answers.

First of all, governments, rightly or wrongly, will be judged by their ability to maintain a sufficiently high level of employment. This ability hinges on restoring investment-led, noninflationary growth. Such growth is a necessary prerequisite for mastering the adjustment task of industrial and developing countries alike. For the latter this task is being enormously amplified by the prevailing slack in the world economy. Developing countries have indeed "had to run harder merely to stay in place."

Let us be aware of a simple truth: responsibility for economic revival begins at home. That is a major theme of the Fund's policy advice.

Responsible policies include a monetary policy that is firm enough to be credible but flexible enough to avoid unsettling swings of interest and exchange rates; success in this respect has been limited.

Correction is also called for in the conduct of fiscal policy. Inevitably, budget structures still bear the imprints of the good old days when economic growth was taken for granted; when business slowdowns were relatively mild and responsive to traditional demand management; and when rising expectations could be accommodated by increasing revenues.

In the Federal Republic we have contained inflation in the face of strong cost pressures from abroad. We have improved the competitiveness of our industry and restored equilibrium to our current account. My Government is firmly committed to cut back growth in public expenditure and the size of our budget deficits; this is not a once-and-for-all task but a medium-term challenge.

However, in an interdependent world small-sized and medium-sized countries have come up against the limits of what they can achieve on their own. This leads me to another major theme of Fund policies: the need for a maximum degree of international cooperation. Cooperation is a matter of shared responsibilities and benefits. The world's largest economy and leading reserve center has a special responsibility in this respect.

Policies in the United States profoundly affect what statisticians like to refer to as the "rest of the world." Its policy has a decisive impact on the functioning of the international monetary system and the course of the two organizations whose work we are reviewing today. Its readiness to help others, and especially the countries of the Third World, is a yardstick for all of us.

The recent easing of U.S. interest rates could become a major turning point. To some degree this easing is attributable to the success of the Administration in containing the fiscal deficit through higher tax revenues. I wish to congratulate Secretary Regan on this success, which we all find extremely gratifying.

We should not, however, blame all economic troubles on interest rates. In particular, monetary policy must remain geared to the need to improve inflationary expectations, which, in many countries, remain very much alive. But the extended period of unacceptably high and volatile interest rates our economies have been going through has contributed to the worsened world economic and financial environment. These rates have depressed investment, strained the balance sheets of corporate and sovereign borrowers, and triggered recurrent spells of exchange market unrest.

This period is not yet finished. Therefore, we have to add: the key to a lasting normalization of U.S. interest rates is to convince markets that the U.S. budget deficit will be reduced to, and held at, sustainable levels and that inflation can be firmly contained.

Commitment to international cooperation includes commitment to free world trade. Here the European Community, together with the United States and Japan, bears a special responsibility. This responsibility relates not only to trade among industrial countries but perhaps even more so to trade with those developing countries that follow outward-looking policies and that have succeeded in broadening their external markets for their own products. The access of developing nations to industrial countries' markets must be kept open. You can count on the Federal Republic to remain a staunch advocate of free trade. We will resist protectionism in all its forms, overt or hidden, including the monetary variant.

Over the past year, financial markets have become increasingly aware of the potential risks of international lending. Bankers have reduced the volume of net new lending, at least to certain debtor countries. This in itself is not unwelcome; in the wake of the second oil shock, international credit had been growing at an unsustainable pace. We need indeed an appropriate balance between financing and adjustment that keeps the transfer of financial resources to deficit countries within the limits of their

debt servicing capacity. If these limits are not respected it will be of no use whatsoever to devise new financial safety nets and to pile debt upon debt.

So far, individual payments problems have been kept from spilling over into the financial system at large. The network of cooperation between financial intermediaries, central banks, and governments has proved effective in containing damage. But increased prudence by banks, increased attention by banking supervisors, and, of course, stepped-up adjustment efforts by borrowing countries are clearly required.

Commitment to the cause of international cooperation implies commitment to a strong and effective Fund.

In this spirit, the governments participating in the economic summit conference in Versailles have undertaken to strengthen their cooperation with the Fund in its work of surveillance. The competence conferred upon the Fund to exercise surveillance over members' exchange rate policies enables the Fund to work toward sound, internationally compatible policies by all its members, deficit and surplus countries alike. Firm exercise of that function is critical in order to ensure that the process of structural economic adjustment proceeds in a symmetrical way and that the burden of adjustment is equitably shared.

The Fund remains the centerpiece of international monetary cooperation and its role may become even more important than in the past. The Fund must remain equipped to assist its members in a meaningful way in meeting their needs for external finance. But it is essential that the finance provided by the Fund remain linked to effective though flexible conditionality aimed at restoring a viable balance of payments over the medium term.

To strengthen conditionality is to strengthen the Fund. Conditionality, however, cannot be a set of rigid, doctrinaire rules. It must be tailored to the varied situations of members. For us, conditionality is a matter of pragmatism, not of ideology.

But with all pragmatism, conditionality must be effective. In this respect, the record is mixed. Under almost half of the programs concluded over a recent period, there has not been much progress toward balance of payments viability. This is not good enough.

My country remains firmly committed to a substantial increase in Fund quotas. In our view, it is essential that the review of Fund quotas be completed within the agreed timetable; indeed, it is highly desirable that it be completed as soon as possible. In this context, we should not lose sight of the need to adjust quota shares sufficiently in order to better reflect members' positions in the world economy.

For some of the developing countries the outlook is bleak indeed. But generalized pessimism is inappropriate. As the OECD Secretariat recently put it: "There is not one developing world but many." Developing countries starting from roughly comparable conditions have evolved quite differently. Some of them have definitely "taken off." They, too, were handicapped by poor natural resource endowment and other constraints. They, too, had to cope with external shocks. But they have managed to emerge as a major force in the world economy. This highlights the crucial difference that domestic policies can make.

But developing countries—and in particular the poorest among them—need continued support by the industrial world. This support cannot be granted through monetary relief only. It is therefore essential that industrial countries do not solve their fiscal problems by slashing away at development aid budgets. Germany will continue to increase its aid expenditure at a rate that exceeds markedly the overall rate of growth of public expenditure....

Let me conclude on a guardedly optimistic note.

Adjustment to changing economic structures has been gathering pace. On the whole, the network of international cooperation has held up under considerable strain. If progress toward policy coordination remains slow, we have at least prevented a general relapse into the kind of inward-looking policies that wrecked the world economy in the 1930s. We must do better, however.

The Fund and the World Bank must and will continue to catalyze economic progress and growth. No other institutions can accomplish this task more efficiently.

These are elements of strength on which we can build. But saying so is not enough. We must put our political will behind our well-meant intentions. We are with all those who share this conviction.

Statement by the Governor of the Fund for Turkey

Adnan Baser Kafaoglu

As the new Minister for Finance of Turkey, I would like to express on behalf of my Delegation our sincere appreciation to our host country for its warm hospitality and efficient arrangements. I would also like to extend our congratulations to Mr. de Larosière, Managing Director of the International Monetary Fund; Mr. Clausen, President of the World Bank;

the Executive Directors, and the staffs of the two organizations as well as their affiliates for their dedication to our cause and for their accomplishments in the past year.

I take great pleasure in welcoming among us the new members, Antigua and Barbuda, Belize, Hungary, and St. Vincent and the Grenadines. I am particularly pleased to have Hungary in our constituency.

The problems with which we were concerned at the last Annual Meeting are still with us. Although some progress has been made in fighting global inflation, it nevertheless remains at a high level; economic growth is slow or negligible; and unemployment is rising, becoming a major problem. The Annual Reports of the International Monetary Fund and of the World Bank, and the *World Development Report 1982* all indicate that the international economic situation continues to remain precarious, particularly for developing countries. The present conditions in the global economic environment and immediate prospects for a great number of member countries continue to be very unfavorable. Against this bleak picture, the recent slowdown in inflation and the decrease in external imbalances in developed countries are indeed encouraging signs. However, these improvements have been achieved at the cost of slower economic growth, higher unemployment, a lower volume of international trade, and more protectionism.

Middle-income developing countries, like the low-income ones, are faced with less than acceptable rates of growth, substantial chronic deficits on their current accounts, and a rapidly rising external debt burden. Now more than ever, an unproportionately large part of the adjustment burden of the world economy falls upon the oil importing developing countries. This holds true despite the fact that developing countries generally pursued more successful adjustment policies in the 1970s compared with developed countries. This fact is duly acknowledged in the World Development Report. Although developing countries suffer from lagging development aid, reduced exports possibilities, worsening terms of trade, and the increased cost of interest rates on their external debt, they have so far achieved a successful adjustment.

I believe that the actual volume of long-term and concessional capital flows to the developing countries must be increased in order to speed up their adjustment process and alleviate their difficulties. Therefore, I would ask especially that the large donor countries make every effort to raise their bilateral official development assistance so as to reach the internationally agreed upon target. Besides aid, the other and perhaps more important condition for a successful adjustment for developing countries is the need for urgent progress in the area of international trade. World

trade stagnated in 1981. The Bank and the Fund both share a common concern over rapidly expanding protectionism. Its removal is not only a means of promoting the developing nations' exports but also of bringing about a more efficient global pattern of industrial division of labor. It is now vitally important to further our efforts to ensure the most efficient allocation of our limited resources. The protectionist measures that have been adopted by the industrial countries must be discontinued. We believe this is an integral part of global adjustment efforts. In this context we attach great importance to the forthcoming GATT ministerial meeting. We sincerely hope that firm results will be achieved at this meeting.

In particular, I want to stress the need for the policies of the industrial countries to be supportive of and compatible with adjustment policies of developing countries. The best contribution the industrial countries can make is to reverse their sluggish growth performance, without stimulating inflation, and to move toward sustainable high growth levels that will create the external environment conducive to the "high-case" scenario developed in the World Development Report.

In this context, the industrial countries must follow liberal and open trading policies. They will themselves benefit from these policies through efficient trading and by enhancing the potential of the developing countries in an increasingly interdependent world economy. These countries must also design a balanced monetary and fiscal policy mix to attain low inflation rates while allowing interest rates to decline to more reasonable levels. This has a vital bearing on bringing down especially the debt burden of non-oil developing countries to a less pressing level. Without these major policy measures the cost of even successful adjustment efforts of the developing countries will reach unbearable levels.

Turning to the international monetary issues, we believe it is essential that the resources of the Fund should grow in line with the increase in financing requirements of member countries, particularly developing countries. It is satisfying to note that the Fund has been able to provide support for member countries in a larger volume than in the recent past. In our view, quotas should be the primary source of Fund resources. Thus, there is a need for a substantial increase in quotas under the Eighth General Review of Quotas. The Eighth General Review should also ensure a more balanced representation on the Fund's Executive Board. With regard to the SDR allocations, we will endorse another SDR allocation taking into account the long-term global liquidity needs. We support the establishment of a direct link between SDR allocations and development assistance. It is gratifying for me to observe that the resources of the Bretton Woods institutions are actively and satisfactorily

augmented by the oil exporting Islamic countries, in addition to their support for developing countries through their own agencies and regional banks. . . .

Turkey, as a middle-income non-oil developing country, has been undertaking vigorous adjustment measures since January 1980 against the background of extremely adverse world economic conditions. Despite the enormous difficulties and sacrifices inherent in such programs, we are convinced that we have made very important progress in the process of adjustment, as indicated in the *World Development Report 1982*. We are determined to maintain this program in its entirety. There will be no retreat from its fundamental premises. We are equally determined to take all the necessary steps which international cooperation requires. The most successful aspects of our stabilization measures are related to the areas of balance of payments and inflation. At present, we plan to activate other policy instruments that will be complementary to and supportive of monetary policy. In this respect, we intend to develop on the one hand a comprehensive fiscal program and on the other to put emphasis on the improvement of the institutional efficiency of both the public and private sectors.

In conclusion, I should express our conviction that the Bretton Woods institutions are a clear recognition of the growing interdependence among nations. These institutions must be further strengthened, for they serve the interests of all our nations. It is our hope that through our cooperation in these institutions the world community will ultimately succeed in overcoming present difficulties and continue its march toward greater prosperity and peace.