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To: Members of the Committee of the Whole for the Development Committee

From: The Acting Secretary

Subject: Background Paper on Fund-Related Issues for the Development Committee

The attached background paper on Fund-related issues for the Development Committee has been tentatively scheduled for discussion by the Committee of the Whole on Friday, April 5, 1985.

If Executive Directors have technical or factual questions relating to this paper prior to the discussion by the Committee, they should contact Mr. Allen, ext. 8381.

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INTERNATIONAL MONETARY FUND

Background Paper on Fund-Related Issues for the Development Committee

Prepared by the Exchange and Trade Relations Department

(In collaboration with other departments)

Approved by C. David Finch

March 29, 1985

I. Introduction

At its September 1984 meeting, the Development Committee decided to hold an extended meeting in Spring 1985, at which an informal dialogue could be conducted on the structural and developmental aspects of certain problems facing member countries. Specifically, the September 1984 Communique provided that, at its Spring meeting, the Committee would:

> ... discuss, within the context of a medium- to long-term framework and the current approaches toward resolving debt problems, the structural and development aspects of the problems of developing countries in their efforts to achieve sound economic growth. These include, inter alia, external indebtedness, protectionism, commodity prices, interest rates, the structure of capital flows and obstacles to direct investment and equity capital flows. In this connection, it called on the Managing Director of the Fund and the President of the World Bank to prepare in close collaboration, contributing from the perspective of their respective mandates and competences, background papers for submission, after consideration by their respective Executive Boards, to the next meeting of the Committee.

This paper treats those aspects of the above terms of reference that are related to the activities of the Fund. It draws on a series of discussions on these and other issues by Executive Directors during the course of March and early April 1985. 1/ After being considered by the Committee of the Whole for the Development Committee, the paper will be revised.

1/ See also the "Report of the Managing Director to the Interim Committee" (forthcoming) and the annexed Summings Up of the Executive Board discussions on trade, debt, and Fund surveillance.

II. The Current Situation and Outlook

The prospects for the world economy are now more encouraging than they have been for several years. While some countries remain in a most difficult situation and while there are many problems yet to be tackled, the improvement in the world economy during 1984 stands in sharp contrast to the crisis atmosphere of the period following the immediate outbreak of widespread payments difficulties and to some of the gloomier forecasts.

The economic recovery in the industrial countries continued and spread throughout 1984; growth in these countries, though uneven, averaged 4 3/4 percent. Inflation rates continued downward and employment rose. The recovery had a marked effect on developing countries, whose average growth rate rose to 3 3/4 percent, a level which, while low in historical terms, is the best achieved for some years. The rapid adjustment pursued by many developing countries in recent years, and in particular by most of the major borrowers among them, has resulted in a dramatic improvement in their combined current account position, which has now in aggregate terms reached a level financeable by official and non-debt-creating flows. In contrast to developments in 1982 and 1983, the improvement in their current account position in 1984 was in large measure achieved by growing exports, which rose by 8 percent in volume terms. This progress has allowed some major borrowers who had restructured their debt to progress toward more normal financial relations with international banks, and for developing countries as a whole to increase international reserves by some US$22 billion.

There remain nevertheless several major problem areas within this relatively encouraging picture. Among the industrial countries, fiscal and payments imbalances remain large, real interest rates, while lower than the recent peak, are still at high levels, rigidities in labor markets, particularly in Europe, continue to constitute obstacles to employment and growth, and a drift toward protectionism still characterizes policies. Amongst the developing countries, the situation remains serious in much of Africa, where growth of 1.5 percent in 1984 for sub-Saharan Africa (excluding Nigeria and South Africa) was not sufficient to reverse several years of declining per capita incomes. While most major debtors have now adopted comprehensive programs of economic adjustment, some other countries which have in the past relied heavily on commercial borrowings have not yet succeeded in stabilizing their financial situations.

The prospects for 1985 and 1986 are generally for continued progress in the world economy as a whole, although there are uncertainties attached to the outcome. In the industrial countries growth is projected to continue at the somewhat slower but more sustainable level of 3 percent per annum, and this growth is expected to be more balanced between countries. Developing countries are expected to experience rather faster growth, which would allow an increase in per capita incomes in all major regions for the first time for several years.

The progress already made in reducing current account deficits to sustainable levels will mean that a greater proportion of the additional resources generated by this growth can be used for domestic purposes rather than improving the balance of payments. Projections indicate only a small widening of the current account deficits of the developing countries, as many countries are taking steps to reduce their indebtedness and as international banks only gradually restore more normal financial relations with creditworthy countries.

Fund staff projections for the remainder of the decade indicate that the trends now apparent can be continued provided appropriate policies are followed. The baseline scenario envisages growth in the industrial countries continuing over the period to 1990 at just over 3 percent a year, accompanied by a slight fall in unemployment, some decline in real interest rates, and no rise in inflation rates. Against such a background, developing countries' export volume is projected to grow by 5-6 percent a year. Import growth should broadly match that of exports, and this in turn would permit GDP growth of about 4 3/4 percent per annum, although the performance of various groups of developing countries is expected to differ. Countries whose exports consist predominantly of manufactures are expected to grow rather faster than this figure, although this growth will be slower than that achieved in the period 1967-76. This performance would allow major borrowers to improve their debt indicators substantially. Many countries relying principally on primary commodity exports and official financing will remain in a more difficult position, with growth rates expected to stay below the average, and no overall improvement in the ratio of debt to exports.

This baseline scenario, while only barely corresponding to the aspirations of many countries, will nonetheless require considerable effort if it is to be realized. The scenario assumes that the United States will succeed in reducing the rate of growth of government expenditures, while other industrial countries continue to reduce their deficits broadly as planned. Monetary policies in the industrial countries will continue to be nonaccommodating. Those developing countries with adjustment programs in place are assumed to implement them as planned, while other developing countries are generally assumed to maintain the broad thrust of current policies.

Slippage in policies by either developed or developing countries could result in considerably less favorable outcomes. Thus, if industrial countries failed to achieve the stronger fiscal positions projected, and if structural change was less effective, industrial country growth could be reduced to only about 2 percent a year. At the same time, higher interest rates and additional uncertainties with regard to the pattern of current account deficits and exchange rates could have further adverse consequences for developing countries, cutting their growth rates by up to 2 1/2 percentage points per annum, and reducing the availability of external financing. Similarly, worse policies in the developing countries themselves, associated with reduced commitment to the process of orderly adjustment, would further hinder their recovery.

On the other hand, there is scope for better policies within each group of countries, which could feasibly raise growth rates in industrial countries by a further 1/2 percent per annum and in developing countries by up to 2 percent. The main effects of these improvements would be felt in the major borrowers and those developing countries primarily exporting manufactures, but for the smaller low-income countries, particularly those in Africa, such policy improvements would also be important in determining the extent of increases in per capita incomes over the remainder of the decade.

The achievement of the baseline scenario, and even more the scope for better outcomes, will depend crucially on the continued pursuit of policies that facilitate structural change in both industrial and developing countries. The rest of this background paper is concerned with the nature of the structural adjustment policies that need to be applied over the longer term, and the possibilities for improving the policy stance in this area.

III. Adjustment and Growth

The achievement of higher growth rates and greater prosperity in industrial and developing countries alike depends on their ability and willingness to achieve the right kind of structural change in their economies. Such change is required if countries are to adapt to technological progress and shifts in relative scarcities in factor and product markets and are thus to use their available resources efficiently and competitively and to create the conditions for growing prosperity. This change can nonetheless be a socially painful and politically demanding process: current patterns of production and consumption have generated important vested interests and dislocations will be resisted. Furthermore, such change is more arduous the longer it has been postponed.

Adjustment is frequently perceived as entailing substantial costs in terms of foregone production, foregone consumption, and of reduced flows of income to particular social and economic groups. These costs are genuine and may be heavy in human and social terms, but it is essential to be clear about their real source and nature. Costs are entailed because imbalances are allowed to develop, and first among these costs is the gap between actual output and that which could have been produced had the imbalances not emerged. These costs are spread broadly over society, and the voice of those that have to bear them is likely to be less focused than that of the beneficiaries of current distortions. Correction of structural disproportions involves a relative redistribution of income away from these latter as steps are taken to return the economy to its longer-run equilibrium path. This redistribution is of course less painful when it can be done in a rapidly growing economy than at a time of economic retrenchment.

The reallocation of factors of production and the change in their remuneration may affect output in the short run by causing previously employed workers to be laid off or capital and land to be idled. Nevertheless, the adjustment process is the only way to restore the economy to its sustainable growth path. The temporary cost in terms of foregone output depends on the severity of the imbalances facing the country, but the sooner these imbalances are corrected, the sooner the benefits associated with successful adjustment can be enjoyed.

The considerable progress made recently by industrial countries in reducing inflation and by developing countries in stabilizing their external payments presents both with an opportunity to treat the more intractable problems of longer-term adjustment in a determined fashion. The present period of rapid technological change and the relatively low growth rates of the last few years imply the existence of increasing opportunities for accelerated growth. Thus the rewards expected over the long run from adjustment in the current period may be very substantial. On the other hand, the costs in terms of technological retardation and low productivity of not adjusting to this changed environment may be severe.

As the interdependence of countries has increased, so has the impact of one country's policies on another. Of course, as a group the policy stance of the industrial countries has the predominant influence on the environment in which developing countries must conduct their policies, and within the group of industrial countries it is the largest that bear the greatest responsibility for determining conditions. Nevertheless, the effort of all countries to place their economies on a sound footing and to adjust, not only contributes to their own welfare, but also helps others achieve soundly-based growth.

IV. Adjustment in Industrial Countries

With the current recovery from recession, the outlook for the industrial countries is now better than for several years. Most encouraging is that the recovery is taking place at a time when the industrial countries are tackling some of the more deep-seated structural problems of their economies. One aspect of this has been the continued pursuit of longer-term strategies for financial stability within the framework of nonaccommodative monetary policies. This has provided a major contribution to the success of the industrial countries in bringing about a recovery of output without additional upward pressure on prices. A second aspect of the attempt to deal with structural problems has been the reduction in administrative regulation of markets and the reduction in some countries in the scope of the public sector. These measures are contributing to the development of more competitive economies, and are now being reflected in a recovery in investment activity in a number of countries, albeit from a low base.

The steps that have been taken, however, are only the first in what must inevitably be an extended process. Structural rigidities continue to characterize certain markets, particularly those for labor in Europe. These hinder the movement of factors of production into more productive areas and thus act as a brake on output growth and employment. Additional flexibility of markets is particularly important to accommodate the rapid technological change that is taking place throughout the world.

Another major structural issue is the need to overcome serious fiscal imbalances. The growth of the United States' fiscal deficit and its size in relation to available savings is a major source of concern given the weight of the U.S. economy and its impact on the rest of the world, but other industrial countries are also incurring deficits that are even larger in terms of GDP than that of the United States. These imbalances stem from the inflexibility of expenditure patterns, combined with limits on the possibilities for raising revenues without distorting the pattern of incentives in the economy. Current disparities in fiscal stance have introduced an element of potential instability into the system, contributing to high interest rates and an unsustainable pattern of exchange rates and current account deficits. The claims on available savings by the public sector in certain industrial countries have also led to unusually high real interest rates and thus hindered the channeling of funds to productive investment in both industrial and developing countries. Measures to restore fiscal equilibrium are vital if the underlying conditions necessary for stability in exchange rates, interest rates, and international payments are to be created over the longer run.

These market and fiscal rigidities have served to increase the degree of uncertainty attached to economic conditions. This has a pervasive effect in both industrial and developing countries, in making otherwise justified investment for both domestic and foreign markets more risky, and hampering flows of capital and direct foreign investment.

One of the most serious consequences of these rigidities is the protectionism to which they give rise in a number of ways. Hopes that recovery from the recession would by itself lead to a reduction in protectionist pressures have been disappointed. It can now be seen more clearly that the roots of protectionism lie in the same structural rigidities described above. Pressures for protectionism come largely from those sectors and groups which have lost or are losing their comparative advantage to other producers. The persistently high levels of unemployment in Europe, themselves engendered by the structural problems referred to above, have made some governments less resolved to resist protectionist pressures. In the United States, where the fiscal imbalance has contributed to an unprecedented current account deficit and a very sharp rise in imports, foreign competition has been felt most severely and calls for protection have been loudest in traditional sectors where structural adjustment has been weak or insufficient. Protectionist measures, however, tend to exacerbate the very structural problems that gave rise to the problem in the first place. Furthermore, as a means of saving jobs, protectionism imposes disproportionate costs on other sectors and consumers, thus making the economy as a whole less efficient.

The form that protectionist measures are taking is also disturbing. They are increasingly applied as nontariff barriers of various sorts which, unlike tariffs, severely hamper the transmission of market signals and thus serve to reduce the degree of interdependence of the world economy. A second feature is that such measures are increasingly escaping the scrutiny of the multilateral trade system based on the GATT. Insofar as GATT disciplines are ignored, or measures tailored so as to fall outside the scope, if not the spirit, of the GATT, the multilateral trading system itself tends to come into disrepute, a development which can only make the achievement of an open and prosperous world trade system more difficult. Finally, it should be noted that recent protectionist measures are increasingly assuming a bilateral character which, besides undermining the multilateral nature of the system, tends to create groups in both the importing and exporting countries which have a vested interest in the maintenance of the measures. Not only is there an economically unwarranted transfer of resources from consumers to producers in the protecting country, but resources are transferred from potential exporters to those who managed to establish an early position in the market.

The opening of markets to both domestic and international competition will frequently cause dislocation, and Governments are inevitably subject to pressure to mitigate it. The measures chosen to do this, however, should not be such as to inhibit the desirable underlying change in the use of resources or to create new, if less clearly defined, adjustment problems elsewhere in the economy. The economic costs of protectionist responses, both to consumers and in terms of foregone growth, are well documented, but not sufficiently well known to the public at large.

The determined pursuit of long-term structural adjustment policies by the industrial countries would have very beneficial effects on the prospects of the developing countries. First and foremost such policies would allow the industrial countries to regain that path of sound and sustained growth which is the most important single contribution to improved growth prospects of the developing countries. But in addition to these general benefits to developing countries flowing from the growth of their trading partners, there are more specific benefits: their access to these markets would become more secure, they would be able to exploit growing trade opportunities as industrial economies adjust to changes in technology and factor scarcities, and these in turn would lead to increasing investment opportunities. Developing countries would also benefit from the reduction in the instability of currency markets and the lower real interest rates that would follow from more stable underlying economic conditions. At the same time, increased confidence in the fundamental stability of the international financial system would serve to make investment in developing countries more attractive. Finally, once budgets are restored to a more sustainable position, a better climate should be created for the increases in official development assistance that the poorest countries so badly need, and which is discussed further below.

V. Adjustment in Developing Countries

Developing countries can expect to benefit, not only from structural adjustment policies of the industrial countries, but also from their own efforts to adapt the structure of their economies. As already mentioned, many developing countries have adopted major and courageous adjustment programs in the recent past. If persevered with, these programs will undoubtedly bring benefits in terms of increased economic dynamism, an enhanced ability to benefit from the progress of trading partners, and greater resilience in the face of adverse external developments. Nevertheless, the adjustment process is a difficult one which can strain the political and social fabric, and it is essential that the international community afford the needed external support for such programs.

In considering how to strengthen the growth process in developing countries over the longer term, two key elements can be distinguished: the efficiency of resource use, and the mobilization of resources for development. Before considering these two elements directly, however, it is appropriate to discuss the medium-term adjustment framework in which longer-term measures can be effective.

A stable financial and economic environment is essential if governments are to be able to persevere with structural adjustment measures. As stated above, an important factor in creating this environment is the policy stance of the industrial countries. Industrial country policies have a major influence on, inter alia, the growth of export markets, security of market access, commodity prices, conditions in international financial and foreign exchange markets, and the flow of official development assistance. The steps that industrial countries can take to promote more stable conditions in many of these areas have been discussed in the previous section. Nevertheless, it is the domestic economic and financial policies of developing countries themselves that determine the effectiveness with which the external economic environment can be exploited to promote growth and development.

Of primary importance in this regard is domestic economic stability. A stable economic policy environment requires above all the orderly matching of claims on resources with their availability and the maintenance of a realistic rate of exchange. Failure to do this can directly result in inflation, increased uncertainty, distorted relative prices, and reduced confidence in the value of the currency, leading in turn to capital flight, the deterioration of the balance of payments, and ultimately arrears and serious disruptions in international payments.

Such external financing crises can impair capital inflows and normal trade credits, causing severe contraction in economic activity and a hiatus in the development process.

The experience of many developing countries in recent years shows that development is not possible in an atmosphere of financial crisis. Furthermore, several countries at all levels of development, particularly in Asia, have shown how quickly growth can become self-sustaining if fiscal imbalances and distortions are avoided. As discussed in the section above on the current outlook, the major adjustment programs put in place with great effort in many countries are now beginning to bear fruit in terms of normalizing international financial relationships and resumed growth. Over the next period the continuation of macroeconomic stability is needed if these countries are to return to their long-run sustainable growth path.

In many countries this will require first and foremost sustained fiscal restraint, which should in turn facilitate a stable monetary environment. Foreign borrowing policies will have to remain cautious, in order to bring about the establishment of more sustainable debt service positions. At the same time it is essential to avoid allowing major prices to become misaligned, in particular real exchange rates, interest rates, and the prices of important crops and export products.

Within this framework, further measures to improve the efficiency of resource use over the longer term can be pursued. In many developing countries there is a need for a review and rationalization of fiscal expenditures. Current expenditures are frequently too high and absorb scarce resources. Another major component of such a review is the public investment program, which should provide only for good quality projects with sufficiently high rates of return. A further important element is the management of parastatal enterprises, which in a number of countries are a major drain on the budget and need fundamental rehabilitation and reform, if they are to generate or use resources efficiently.

A second element in ensuring greater efficiency of resource use is the removal of other distortions in the economy. Among these are highly protective and often irrational systems of border restrictions, which go well beyond the "infant industry" rationale, and do not even serve fiscal objectives efficiently. The rationalization and liberalization of protective systems, combined with realistic exchange rate policies, can promote an outward-looking export-oriented development strategy, under which countries can take fuller advantage of international markets for their products. Of course, the success of such a strategy will be dependent on the availability of markets for exportables, and in this connection successful resistance to protectionism in the industrial countries can provide vital support. The success of developing countries following such a strategy as exporters is matched by their substantially enhanced import capacity, another valuable element for the industrial countries to balance against the pressures for protectionism. It should also be noted that developing countries pursuing an outward-looking strategy in general coped more resiliently with the difficulties of recent years than those with more closed economic systems.

The liberalization of developing countries' trade regimes has also another side, that of providing markets for the exports of other developing countries. As the pattern of comparative advantage is shifting for certain goods between industrial and developing countries, some goods can now be produced most efficiently in the lowest-income developing countries. It is in the interests of efficient resource use in both poorer and relatively well-off developing countries if conditions are created whereby the former are allowed to compete as suppliers. Liberalization can also promote advantageous specialization of production between developing countries at the similar levels of development.

The removal of distortions extends beyond the trade regime. If the government administers prices or allows parastatal enterprises to do so, it must take steps to ensure that the price-formation policies are such that these prices are not allowed to get out of line and encourage the inefficient use of resources. Other distortions that need to be tackled include the overregulation of private economic activity through unnecessarily cumbersome registration systems or regulations that prohibit or effectively suppress foreign direct investment or various productive activities.

These measures to improve the efficiency of resource use may be complicated, politically sensitive, and take time to introduce. In some of the poorest countries considerable concessional assistance may be required to formulate and support the implementation of these policies. In others these reforms also need to be complemented by access to external capital in appropriate forms. In any case, the prompt introduction and sustained application of such measures is a matter of urgency. Not only will they provide a direct contribution to sustained growth, but they will be instrumental in ensuring that adequate flows of resources are available to support the development process.

By dint of their adjustment efforts the developing countries have succeeded in reducing their current account deficits to a level equivalent to regular official and non-debt-creating flows. Over the next two years, aggregate current account deficits of these countries are not likely to increase substantially. Total flows are unlikely to reach the levels of a few years ago for quite some time. This is both because suppliers of some forms of finance are now more cautious about such lending and because many developing countries are trying to reduce their external debt or improve its profile so as to reduce their vulnerability to external developments, including financial market conditions. Nevertheless, there is both scope and need for an increase in the flow of resources on appropriate terms in support of development.

Commercial bank flows to developing countries have been severely affected by the events of the last few years. Following a decade of massive growth, spontaneous commercial bank lending to developing countries has declined continuously since 1982, after a number of major borrowers found themselves unable to service their debt. The massive and successful adjustment effort undertaken by many of these countries was linked to financial packages involving debt reschedulings and concerted commercial bank financing arranged in close collaboration with the national authorities of creditors' countries and the Fund. Such efforts have put several of these countries in a position to re-establish normal financial relationships with the commercial banks, and this environment favors the resumption of spontaneous commercial lending to countries that have experienced payments difficulties. This normalization of financial relations is of the utmost importance, and where multiyear reschedulings are required to bring this about, all parties--the country, private creditors, official agencies, and international financial organizations--should devote their efforts to this end.

While some more advanced developing countries can expect to use such flows as an important means of attracting foreign savings, the prospects for others remain limited. While it seems reasonable to suppose that commercial lending to finance imports by developing countries will grow broadly in line with the value of the imports being financed, the indications are that commercial banks will seek to curtail the share of their overall portfolios represented by non-trade-related lending to indebted countries. Commercial banks may be expected to give greater weight than before to evidence that trade- and project-related credits are being used effectively. Both bank regulators and international banks see advantages in gradually re-establishing earlier relationships between the banks' assets in indebted developing countries and their capital and reserves: this factor could also constrain the growth of such lending for some years. From the side of the borrowing countries, the attraction of large-scale borrowings at variable market-related interest rates is now greatly reduced, and efforts to improve their debt profiles may lead many to reduce reliance on such borrowings.

Official development assistance (ODA) is subject to a somewhat different set of considerations. Although the ratios of debt to GDP and exports of countries which rely on official assistance are generally the highest and fastest rising, and these countries face rising, albeit still concessional, real interest costs, the need for increased flows of official assistance to low-income countries remains pressing. While commercial bank flows to developing countries have fallen sharply in the last few years, aggregate ODA flows have only been broadly maintained in real terms.

To some extent, the failure of ODA to increase may reflect a shortage of development projects to finance at the present time. This in turn could have been caused by the reappraisal of certain investment projects which now no longer have sufficiently high rates of return, or by governments' decisions to cut capital rather than current expenditures in order to improve their fiscal positions. However, the absence of real increases in ODA also reflects donors' unwillingness to expand commitments. While it is clear that there are pressures in the industrial countries to restrain official development assistance at a time when major efforts are underway to reduce domestic fiscal deficits, this has unfortunate consequences. The need for such assistance, especially in Africa, is greater than ever, and it could significantly reduce the strains that the current resource shortage is inflicting on these countries. Furthermore, the conditions for a more efficient use of such assistance may have improved with the structural adjustment and the reduction in distortions now underway in some of these countries.

The priority for aid programs must be maintained while fiscal deficits are reduced. It should be clear that reducing the commitment to giving external assistance cannot contribute in an important way to the re-establishment of fiscal equilibrium in industrial countries. At the same time there are steps industrial countries can take to improve the quality of their official development assistance by better coordination and ensuring the efficiency of the projects it finances. Here, though, the recipient countries have also to make a major effort to unlock such flows by reappraising investment programs and to taking other measures to ensure that resources, whether foreign or domestic, are used efficiently.

Steps to improve the efficiency of resource use and to reassess investment programs can also contribute to increased inflows of other forms of resources. The maintenance and expansion of export credit flows will increasingly depend not only on a good payments record and satisfactory debt management policies, but on ensuring the flows go to support high quality projects. Cover policies for export credits have on occasion accentuated payments difficulties, with continued cover for export credit flows as difficulties mounted, and delays in restoring such cover after the adoption of comprehensive adjustment policies. Efforts need to be made to ensure that such flows are more responsive to economic conditions and that such credit is available to those who show they can use it efficiently.

During the 1970s, the relative importance of direct foreign investment in capital flows to developing countries declined. Such flows are attractive, in that they do not create a debt to be serviced on schedule, they can be an important vehicle for the transfer of technology and management methods, and they can help in securing access for their products in the market of the investor. These beneficial effects can only be realized if regulations unnecessarily hampering such investment are removed, and profitable and stable investment opportunities are created by eliminating distortions and adopting an outward-looking development strategy.

As discussed above, while there is scope for increasing the amount of foreign savings flowing to developing countries, in the immediate future such scope is limited. The improvement in the current account of developing countries over the last few years has furthermore come from cuts in investment to a much greater extent than from higher savings. Thus, if additional resources are to be invested in the development process, it is crucial that domestic savings rates be raised. Three interdependent issues can be distinguished in this context: the generation of domestic savings, the retention of such savings, and the use made of them.

The generation of savings lies at the heart of the adjustment programs now being pursued or contemplated throughout the developing world. Private savings can be encouraged by price stability, sufficiently attractive real interest rates, and by ensuring that profitable and efficient investment opportunities exist. Even more important, though, are steps to raise public savings by tackling the fiscal imbalances that have pre-empted a major part of national savings. Reduction and rationalization of expenditures and, to some extent, revenue increases are required to restore fiscal balance. Changes in the pattern of expenditure may require altering the structure of relative prices. One important complement to improving the fiscal balance is the rehabilitation of public enterprises, a task in which the World Bank has particular expertise, so that, when appropriate, such enterprises generate public savings rather than absorb them.

Measures to ensure that domestically generated savings stay at home are broadly those that will encourage the domestic investment of foreign savings. These include setting real interest rates at remunerative and competitive levels and ensuring that the exchange rate is not allowed to become overvalued. These must be accompanied by two aspects of particular importance, i.e., that investors and savers, both domestic and foreign, have confidence that economic policies are such as to promote financial stability and that the authorities will not allow policies to deteriorate or change rapidly in such a way as to impair unduly the value of their assets. If conditions for retaining savings at home are created by establishing needed confidence in domestic currency assets, in many countries this may create the conditions for a repatriation of flight capital, which could be an important supplementary source of development funds.

In increasing the incentives for savings and the attractiveness of holding such savings domestically, the efficient use of such savings is a vital element. If the country is to forego current consumption, there must be an assurance that savings will be used well and bring an appropriate return in the future. In this the quality of investment and its conformity with the country's comparative advantage are paramount considerations. Reassessing public investment programs and removing the distortions that inhibit efficient use of resources, such as maladjusted prices and excessively restrictive trade regimes, not only gives confidence in the strength of policies, but lays the basis for a high rate of return on investments. In countries with relatively underdeveloped systems of financial intermediation, the improvement in investment opportunities can in itself raise the rate of savings.

VI. The Scope for Multilateral Action

This background paper has stressed the contribution that each country can make individually to establishing the conditions for sustained growth and long-term development. By so doing, each country not only lays the foundation for its own progress but assists in creating an environment in which others can move more readily toward greater prosperity. While the main contribution must be made by each country's individual efforts, there is also a contribution that the multilateral institutions can make with the support of their membership to facilitating this process.

This is seen clearly in the need for a strong multilateral trading system. A clearer, more orderly, and properly observed set of rights and obligations in international trade would add immeasurably to the security of countries and facilitate that structural change which leads to a more efficient use of resources. Yet the GATT system has been partly undermined by increasing resort to measures taken outside it and by the failure of countries to make adequate use of its dispute settlement machinery. These actions have increasingly been taken by countries which can themselves benefit most from a strong multilateral trade system.

A number of major trading countries appear to be converging on a proposal for a new round of multilateral trade negotiations. That the results of such negotiations can hardly be expected to lead to liberalization before the early 1990s is no reason to postpone its consideration, but it nonetheless raises questions about what can be done to strengthen the international trade system and bring about a reduction in the spread of protection in the interim. In particular, there is an urgent need to reduce barriers to the exports of developing countries, if they are to be encouraged to persevere with the outward-looking development strategy that offers the greatest benefits to all.

The Fund also has an important part to play in helping its members re-establish the conditions for longer-run growth and prosperity. In Article IV consultations, increasing attention is being paid to the fundamental structural problems that are impeding longer-term adjustment and could destabilize the international monetary system. In particular, more critical attention is being devoted to the structural fiscal problems of certain industrial countries, and the problems of market rigidities in others. In consultations with developing countries, increasing efforts are made to identify the policy changes needed over the medium term to secure the more efficient long-term use of resources and appropriate flows of foreign savings that can ensure longer-run balance of payments viability. In this work, the Fund relies heavily on the judgment of the World Bank, whose expertise and activities are predominant in the area of countries' development strategies. The Fund also has an important contribution to make in assisting longer-run structural adjustment, through its support of members' macroeconomic adjustment efforts. Here the Fund tries to help members design a stable macroeconomic policy framework in which measures of structural change can be taken effectively and promptly, together with a system of prices that correctly guides resource allocation. Thus by working with its members to put such policies in place, the Fund contributes importantly to structural change.

The promotion of structural adaptation and development in developing countries lies at the heart of the World Bank's activities. This work involves not only the financing of good projects and assisting members in drawing up investment plans and development strategies, but in communicating to the donor community the opportunities available and the progress being made in particular developing countries. Over the next few years, capital flows to developing countries will increasingly depend on the providers of official development assistance and other concessional flows, as well as on commercial banks and the business community, having confidence in the quality of the investment programs and development strategies of recipient countries. The World Bank, with its expertise in the assessment of such programs, stands in a unique position to encourage international investment and capital flows.

The activities of the Fund and the Bank are of central importance in sub-Saharan Africa. Fund staff projections indicate that if African governments pursue effective policies and there are no major adverse exogenous developments, per capita income should on average grow slowly during the remainder of the decade. This growth is unlikely to restore the levels of per capita income prevailing at the start of the decade, and there are countries where the decline in living standards is expected to continue. Policy slippage in Africa, such as a weakening in efforts to maintain appropriate real exchange rates, could have disastrous effects. The severity of the crisis through which many African countries are now passing can only be exacerbated if inadequate external resources on appropriate terms are provided. Both the Fund and the Bank, by helping ensure that appropriate adjustment policies are and remain in place, can promote such flows. In this context, the initiative of the Bank to establish a Special Facility for Africa to support policy reform and structural adjustment efforts, and the contributions already pledged, will also play an important role. Nevertheless, a Special Facility of its present size can only fill a small fraction of the continent's needs. The international community needs to consider how further resources can be provided to assist Africa in overcoming its current difficulties in an orderly way and in resuming the growth and development process.

More generally, the multilateral financial institutions and their members acting individually and in other multilateral fora have a responsibility not only to encourage the pursuit of needed adjustment strategies, but also to ensure that adequate financing is available.

Countries which have taken measures to ensure that additional capital can be used efficiently should have access to such capital. Issues relating to debt rescheduling and export credits are to be treated primarily in the Interim Committee, but are clearly relevant in this context. Normal financial relations with debtors pursuing adjustment policies must be restored as soon as possible, and as adjustment proceeds this may require a more active promotion of multiyear reschedulings and modifications in export credit policies. The multilateral organizations can facilitate this process, by developing mechanisms to monitor adjustment and to certify that foreign savings will be used efficiently. If these conditions are met, developing countries must be given access to the credit, the trade, and the technology that will allow them to make the investments on which their growth depends.