Remarks by the Managing Director of the International Monetary Fund, at the Meeting of the United Nations Administrative Committee on Coordination (ACC)

Rome, April 22, 1987

Let me first thank you, Mr. Secretary-General, for your words of welcome. My predecessor valued his participation in the ACC meetings and the opportunity for the exchange of views that they represent. I also look forward to participating in your deliberations and in getting to know and working with each of you.

You have asked me to review the international economic and financial situation. I shall first describe how we in the Fund see the current situation and prospects; second, outline the main concerns expressed by policymakers at the recent meetings of the Interim and Development Committees; and, third, say a few words on international cooperation and the role of the Fund.

1. World Economic Outlook

The world economy is still adapting to the large changes in exchange rates and relative prices of the past two years. The short-term costs associated with these changes have been larger than anticipated and the momentum of output growth has not been as strong as expected.

This shortfall in growth mainly reflects development in the industrial countries where growth slowed from 3 percent in 1985 to below 2 1/2 percent in 1986, and is expected to slow further to about 2 1/4 percent this year. These results are especially disappointing in relation to the prospects that had seemed to follow from the decline in oil and commodity prices. The main reason seems to be that the pass-through of the terms of trade gains in industrial countries has been unexpectedly slow while the corresponding real adjustment in developing countries has been unexpectedly rapid. Overall, therefore, the changes in relative prices shifted income from individuals and enterprises with relatively high spending propensities to entities with relatively low ones, to the detriment of global activity.

These effects of global income shifts have been compounded in the case of industrial countries with appreciating currencies, by the weakness in their net exports stemming from the changes in real exchange rates. This weakness has undermined investor confidence and led to cutbacks in investment spending. The growth of aggregate demand has also weakened in the United States, partly as a reaction to the high

levels of indebtedness and to recent changes in tax laws. Given the expected improvement in the fiscal situation of the United States and the cautious cast of financial policies generally, we expect the growth of output in the industrial countries to slow to 2 1/4 percent in 1987, before firming somewhat in 1988.

The other disappointing feature of industrial country developments is the continued worsening of the imbalance on current account of the three largest countries. Despite large adjustments in exchange rates and a convergence of growth rates, the imbalances widened further in 1986--a widening that has unsettled foreign exchange markets, aggravated trade tensions, and undermined investor confidence in countries with appreciating currencies. Looking forward, we expect the imbalances to diminish significantly over the next few years. Nevertheless, given the current constellation of policies and exchange rates, prospective imbalances remain sufficiently large to pose significant risks for the outlook.

Turning to developments in the developing countries, these are very mixed. Overall, the growth of output averaged some 3 1/2 percent in 1986, in part because of strong net exports to the industrial countries and progress toward greater financial stability. Experiences of individual countries varied widely, however. The fuel exporters experienced a drop in output, increased price pressures, and a shift from surplus to deficit in their external accounts. Several of the heavily indebted countries registered strong rates of economic growth and a marked decline in inflation, but a larger weakening of their combined external position than for developing countries as a group. Small low-income countries recorded an increase in output of 4 percent, and inflationary pressures were contained, but their external accounts remained vulnerable. Output figures, however, mask the extent of the real adjustment in terms of living standards that is going on in developing countries. For such purposes, a better measure is real demand per capita, which for the group as a whole declined in 1986, to a level of some 2-3 percent below that reached in 1981.

Financing constraints have severely limited the capacity of developing countries to permit a deterioration in their current account balances. As a result, imports have been declining, or rising only modestly, in most developing countries. Despite the very low levels of borrowing, however, debt ratios have continued to increase (to 183 percent of exports of goods and services in 1986, compared with 156 percent in 1982) because of the declines in export earnings and the valuation effects of the realignment of industrial country exchange rates. Under these circumstances, prospects for the developing world are for an only gradual improvement in living standards, with growth in 1987 expected to average 3 percent.

A positive development of 1986 was the further easing of inflation. In the industrial countries, inflation rates fell to their lowest level in 20 years. They also eased in the developing countries, especially

in several high-inflation countries. More recently, however, inflation rates have increased, moderately in industrial countries, but more markedly in some developing countries.

2. Policy Concerns of the Interim and Development Committees

Let me turn now to the three policy issues that dominated the recent meetings of the Interim Committee.

The first was how to correct current account imbalances among industrial countries while achieving sustained noninflationary growth. There were, of course, significant differences in points of view, especially as regards the appropriate policy responses. Nevertheless, following up on the agreements reached at the Louvre, there was a strong consensus in favor of coordinating policies among the major industrial countries and fostering stability in exchange markets. It was accepted that actions to correct imbalances on current account need to place more emphasis on adjustments in financial policies and less on adjustments in exchange rates. The United States, in particular, needs to take more decisive action to correct its fiscal deficit; by the same token, surplus countries ought to orient budgetary policies so as to ensure a satisfactory growth of domestic demand. Structural policies should be geared to removing artificial impediments to the allocation of resources in a range of markets, including those for labor, agricultural products, financial services, and foreign trade.

The second major issue at the meeting was how to restore the momentum of growth and development in the developing world. In this respect, attention focused on the debt strategy and concern that the drying up of commercial lending to developing countries was undermining investment and growth in those countries. While there was general agreement that progress had not been as rapid as expected, the Committee reaffirmed the need for persistence in the implementation of the main features of the debt strategy. These features include: tenacious pursuit of growth-oriented adjustment policies in developing countries; sustained growth and resistance to protectionism in industrial countries; and the provision on a case-by-case basis of adequate financing at appropriate terms. In particular, banks were urged to move swiftly to support sound economic policies in debtor countries. Creditors were also encouraged to experiment with a wider range of financing techniques to expedite the mobilization of financial support for developing countries.

Third, a great deal of concern was expressed that the trade tensions generated by current trade imbalances and sharp changes in relative prices would lead to an escalation of protectionism. The Committee was unanimous in calling on members to resist such pressures and to maintain an open trading system in order to enhance global prospects and facilitate the management of the debt situation. In this respect, I should also note the concern expressed about the role of agricultural policies and especially agricultural subsidies in the current depressed state of commodity prices.

The Development Committee also focused attention on growth, specifically on the relationship between Fund programs and growth.

There was agreement that a key factor to achieving adjustment with growth is the strength and quality of macroeconomic and structural policies in developing countries themselves. It was stressed, however, that such efforts must be supported by better policies in industrial countries (including more open trade policies) and by larger capital flows.

Both Committees expressed special concern about the bleak outlook for low-income countries including, of course, those in sub-Saharan Africa. The present flow of concessional aid to these countries is clearly inadequate to support the far-reaching structural reforms needed in many of these countries. In the case of the highly indebted low-income countries, there is growing recognition that debt rescheduling on commercial terms is not a realistic response and that exceptional support for the efforts of these countries is needed. For its part, the Fund is already providing resources on concessional terms under the structural adjustment facility (SAF) in support of macroeconomic and structural adjustment programs to foster growth and balance of payments viability. The resources available under the SAF are limited, however, and additional concessional assistance is therefore needed from multilateral as well as bilateral sources. In this general context, creditor governments were urged as a matter of priority to consider ways of granting exceptional financial relief to highly indebted low-income countries, particularly in sub-Saharan Africa, where this is needed to support far-reaching economic reforms.

3. International Cooperation

Let me conclude with a word on the need for international cooperation. Difficult challenges lie ahead in making a transition to a more favorable world economic environment and in dealing with the debt crisis. There is no assurance that the transition will be smooth. Nevertheless, I have been impressed by governments' recognition of the need for international cooperation in addressing these problems. The surveillance function of the Fund has been reaffirmed. The use of "indicators" provides a mechanism for strengthening the ability of the larger industrial countries to coordinate their policies in a manner that takes proper account of other countries in the world economy. Similarly, it is encouraging that all partners in the debt strategy--industrial countries, debtor countries themselves, and financial institutions, including the Fund--clearly recognize the need for a cooperative solution and are actively working toward that end. Within this context, the Fund, in collaboration with the World Bank will continue to play a central role in assisting countries in the formulation of growth-oriented adjustment programs, in the provision of its own finance and in assisting countries to mobilize finance from private and official sources. As a critical supplement to its activities in the adjustment front, the Fund will strengthen its exercise of surveillance to ensure that industrial country policies contribute to a more favorable economic environment.