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Achieving Growth in the Context of External Adjustment

I am delighted to join you on the occasion of your Annual Dinner and to have the opportunity to share a few thoughts with you on the challenge of achieving growth in the context of external adjustment. It is surely a fact that the need for adjustment and growth in the developing world remains as pressing as ever. This evening, I should like to explore some of the implications of the pursuit of these dual objectives. In the process, I want to try and dispel a number of misconceptions--both about growth-oriented adjustment itself, and about the attitude and approach to growth and adjustment of the institution that I now have the privilege to head. To this end, I shall put before you five propositions.

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Proposition number one: adjustment and growth are mutually supportive; there is no basic conflict between them.

True, there is likely--in any economy--to be some transitional loss of output as resources are shifted into strengthening the balance of payments. This, however, is unavoidable, and the longer corrective action is postponed, the more painful it is likely to be. Indeed, prompt and orderly adjustment--by avoiding the drastic austerity that a loss of external support would entail--<u>protects</u> the growth of the economy, currently and in the future.

There are, I believe, three essential aspects to the relationship between adjustment and growth. First, countries in untenable balance of payments positions will simply not be able--unless they adjust--to sustain a satisfactory rate of economic growth. But growth does not follow from just <u>any</u> measures to improve the balance of payments. It is best served by policies which promote savings, increase export capacity, and improve efficiency in resource use. It is ill served by an approach which relies on indiscriminate cuts in imports and investment, which is characterized by unilaterally-imposed measures, and which cuts a country off from international financial support. This, in turn, points up the third aspect of the relationship, which is that a stronger balance of payments position is likely to prove sustainable only if it is attained against a background of durable economic expansion. In recent years, inadequate growth has been at the root of the inability of many governments to maintain the popular support needed to persevere with adjustment. Let me therefore repeat what I frequently say: growth is just as necessary for adjustment as adjustment is for growth.

What does this mean in practical terms? Two things, above all. There can be no relaxation of current efforts by countries with debt-servicing difficulties to bring the balance between demand and supply into a more sustainable pattern. On the contrary, these efforts need to be strengthened. But such efforts need to rely more than ever on measures which will promote the expansion of supply and lessen any inescapable impact on output of measures that aim at restraining demand.

In recent years, steadily more emphasis has been given by the Fund to structural and supply-side measures in helping countries to design stabilization programs. In addition, last year the Fund opened a new lending window--the Structural Adjustment Facility--which is specifically designed to support structural policy changes undertaken by low-income countries with protracted payments problems.

There are two points that this illustrates about the Fund's approach to adjustment. The first is that it is an evolutionary one. It has responded to changing conditions in the past, and it will--I am sure--continue to do so in the future. Indeed, the Fund's Executive Board is currently embarked on a thorough review of adjustment programs and their supporting arrangements in order to ensure that they remain appropriate in the current circumstances.

The second point is that demand restraint, while an unavoidable element in adjustment programs, has never been the exclusive element. Facilitating the expansion and balanced growth of international trade, and contributing thereby to the promotion and maintenance of high levels of employment and real income, and to the development of the productive resources of all its members, has been a central purpose of the Fund's endeavors from the outset. The Fund's Articles of Agreement are clear on this, and its practice has amply demonstrated its commitment to these ends. If the Fund has come to be associated more with "adjustment" than with "growth," it is, I believe, <u>because</u> of its concern that growth will suffer unless economies in disequilibrium adjust.

To be sure, the growth attained by countries implementing Fund-supported adjustment programs may not always have been satisfactory--particularly in the recent period. In some cases, the overall compression of domestic consumption that the economic situation has required may even have been such as to lower the real incomes of the poor temporarily. But the question that needs to be asked--and is asked too seldom--is what would have happened in the <u>absence</u> of Fund-supported programs and the financial support that they provide, both directly and indirectly. What would have happened to the level of imports, output and employment; to the funds available for social services; to living standards generally, and the welfare of the lowest income groups in particular? In the overwhelming number of cases, the consequences would, I submit, have been much more difficult to bear.

It is most important that this be better understood, and that the perception in some quarters that the Fund is only peripherally concerned about growth and social conditions be seen for the myth that it is. I cannot emphasize too strongly that if it is not, the Fund will only be handicapped in its efforts to assist its members in difficulties.

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Let me turn to the second of my five propositions. This is that the specific mix of policies for promoting growth with adjustment will vary from country to country. On this, I can be brief.

Policies that can have a positive influence on output during the process of adjustment fall broadly into two groups. First are measures which can increase output by improving the efficiency with which existing resources are used. These facilitate the shift of factors of production from meeting an inappropriate pattern of domestic demand to servicing economically viable activities, including potential external demand. They encompass price reforms--including changes in exchange rates and interest rates--action to raise the quality of public sector investment, and steps to lessen the distortions caused, among other things, by monopolies, the tax system, and trade restrictions. Second are policies that aim to increase the productive potential of the economy over the longer term. Under this heading are incentives for domestic savings and investment, as well as measures aimed at promoting the inflow of foreign savings and the reflow of flight capital.

Growth-oriented adjustment, if it is to be effective, will need to address each of these broad areas, and at the same time ensure that the requisite degree of control is exercised over the development of domestic demand. But the specific content of programs will inevitably vary. The situation of each country differs from that of others, and there are differences in adjustment needs. Mirroring this reality, Fund-supported programs are highly differentiated packages of policy measures, geared to the particular circumstances of each country. The notion that there is a "standard" Fund recipe that relies on one or two policy instruments is a second myth. Case-by-case analysis, diagnosis and prescription is the only sensible approach.

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Proposition number three: measures to promote balanced growth typically involve difficult political decisions. Paradoxical though it may seem, they can be harder for governments to introduce than measures of general demand restraint.

Consider, for example, efforts to remove price distortions. These invariably imply higher prices. As such, they may run sharply counter to other objectives, especially when the prices being raised are for basic consumption goods. More generally, the very emphasis of supply-side policies on changes in relative prices means that the distribution of income among individuals, households, factors of production and socioeconomic groups will inevitably be affected if the economy is to respond. This goes to the heart of national politics. Similarly, many elements of structural adjustment--such as reducing import protection and placing greater reliance on market incentives--often threaten entrenched and powerful interests, while at the same time colliding with an ingrained aversion to change.

Wishing to grow faster is plainly not enough. Sustained growth requires enormous political commitment. Almost always it implies changes in habits and fundamental shifts in benefits and advantages.

The sensitive social and political issues that growth-promoting measures often raise are <u>not</u> matters on which an institution like the Fund can seek to take an independent position. This does not mean that it cannot render <u>advice</u>, nor that it is indifferent to the social consequences of adjustment programs. It is, I regret, too little known that all proposals that are brought to the Fund's Executive Board for assistance under the Structural Adjustment Facility contain a section that specifically examines the social impact of the proposed program. And as regards stand-by arrangements, my predecessor made it abundantly clear that, when requested by a member country, Fund missions would be willing to consider with the authorities the implications of alternative approaches to adjustment for the distribution of income. I reaffirm that willingness, for I am convinced that the more adjustment efforts are able to give proper weight to social considerations--especially the implications for the poorest--the more successful they are likely to be. My views on this matter are akin to those of the Development Committee, which in its April communique urged that in the design and implementation of policy reforms, governments and international institutions should give special attention to protecting the most vulnerable groups.

But there should be no misunderstanding. The final choice in the specification of policies bearing on issues of income distribution and resource allocation must rest with the country itself. In turn, governments must recognize such choices as their own and be steadfast in their resolve to implement adjustment programs. The success of such programs depends crucially upon public acceptance of their necessity and usefulness. This perception can be gravely impaired if governments do not live up to their responsibilities, but instead attribute the corrective measures to the imposition of external agencies, rather than to the country's own imperatives and its own initiative.

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My fourth proposition is that, in many cases, longer periods for the process of adjustment must now be envisaged than had earlier been thought necessary.

There are two realities in the current situation that we cannot overlook. First, in many countries the magnitude of imbalances and structural problems that have accumulated over the years, combined with the difficult global economic environment, makes the adjustment task particularly arduous. Second, if countries are to give greater emphasis to supply-side policies, allowance must be made for the fact that such measures generally take longer than demand-side policies to register their effect. I am not--let me be clear--suggesting that the implementation of structural reforms should be gradual; on the contrary, this should not be delayed. My point is rather that the period over which adjustment is intended to achieve its objectives may need to be longer.

This would have implications for the amount of external resources that would be required by countries implementing adjustment programs, and for the periods for which they would be made available. By facilitating a more orderly adjustment process, the availability of larger external resources ought to lead to more effective adjustment than we are now getting. Not only would it help to bridge the gap that frequently exists between the measures that are technically needed and those that are politically feasible; it should also strengthen the resolve of governments to implement the latter and could perhaps induce them to go further still.

In considering the possible sources and forms of additional financial assistance, a distinction needs to be drawn between two broad groups of borrowers. One group consists of those countries with large liabilities to official creditors, low per capita incomes, and limited scope in the foreseeable future for meeting their debt-servicing obligations. It is essential that the international community hold out hope to these countries that major efforts to strengthen their economies will be supported by increased aid and exceptional financial help on concessional terms.

Proposals now being considered by the Paris Club to ease the debt burden of the most impoverished nations in sub-Saharan Africa are a welcome move in this direction. It would also be helpful if the resources available to the Fund's Structural Adjustment Facility could be supplemented by resources provided by members. Eleven countries are already availing themselves of this facility--under which loans carry an interest rate of 1/2 percent and are to be repaid over a 5-10 year period. But the financial assistance that it can provide at present is too limited. Additional resources--on concessional terms and with long maturities--would enable the Fund to play a fuller role in supporting growth-oriented adjustment over the longer period that is often needed in low-income countries for such efforts to begin to show results.

The second group of borrowers consists of middle-income economies. For countries in this group that are prepared to undertake strong programs of adjustment and structural reform, a moderate resumption of net lending by banks is needed--both for the resources it will provide and for the signal it will give.

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My final proposition is that, to be fully effective, growth-oriented adjustment in the developing world requires reciprocal action in the industrial world. It is not only countries seeking to use the Fund's resources that need to make an effort. Robust growth of markets in the industrial countries is a vital key for export-led expansion in developing countries.

There is clearly scope at present for the industrial countries to do more--not only to sustain their rate of demand growth and maintain stable conditions in financial markets, but also to improve the access of developing countries to their markets and to reduce their competitive subsidization of agricultural exports. Where individual countries have little room in which financial policies can maneuver, they must redouble their efforts to implement structural policy changes supportive of global adjustment and growth.

It will require a concerted effort of economic statesmanship to liberalize trade at a time when protectionist pressures are on the rise. An excellent opportunity to make progress is, however, provided by the Uruguay Round of multilateral trade negotiations. It is important that it be seized.

Equally, it will require an exceptional degree of policy coordination to maintain a reasonable rate of economic growth, while bringing external payments imbalances among the major industrial countries into a more sustainable pattern. In the efforts now under way to strengthen policy coordination among the industrial countries, the Fund will have an important role to play--both in focusing the attention of national policymakers on the consequences of their actions for other countries, and in evaluating the mutual consistency of national policies with objectives endorsed by the Fund's membership as a whole. In this connection, we are giving considerable attention to developing the "indicators" approach to monitoring economic performance, and intend to apply it actively. Through an enhanced process of multilateral surveillance, it will, I hope, be possible to promote the kind of conditions in the industrial countries that are conducive to growth in the developing world.

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There should, though, be no illusions. The task of achieving satisfactory growth in the developing world will not be easy. The prime responsibility must fall to the developing countries themselves. But if growth-oriented adjustment is not to be merely a slogan, <u>all</u> parties must recognize their responsibilities. You may be assured that the Fund will not withdraw from its role of assisting countries in the formulation of effective adjustment programs, making available its own resources to promote those programs, and mobilizing additional financing from other sources. On the contrary, we intend to play our part to the fullest, both in the middle-income developing countries and in the poorest countries, where an enhanced effort can, I hope, be made.