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I am delighted that the Austrian National Bank and the IMF are cooperating to sponsor this seminar, and would like to thank Dr. Schaumayer, the President of the National Bank, for her enthusiastic support. This seminar provides a timely opportunity to stand back and assess together the experience so far with the systemic reforms that the five countries of Eastern and Central Europe are implementing. We are fortunate, also, to have Dr. Winckler of the University of Vienna as our moderator.

You will discuss in some detail, over the next couple of days, the difficult choices that the governments and peoples of these countries are facing, and their options for the period ahead. All of us in the IMF expect to benefit from this discussion, as we don't want to propose to governments, whether in Eastern Europe or anywhere else in the world, any kind of abstract blueprint. Rather, it is our aim to offer them the benefit of the Fund's experience that stems from involvement in policy formation in many countries, and from a frank and open exchange of views about that experience with a broad range of interlocutors.

My colleagues will discuss with you in detail the IMF's role in supporting the economic reforms in each of these countries. I kept for myself a less exciting task: to give you a picture of the broader context in which the reform process is taking place--the global economic environment, and the fundamental shift in economic philosophy that is such a marked feature of the present time--and then, in order not to step back for too long from the agenda of this seminar, I will discuss briefly the prospects for international support of the reform process.

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Let me start with the global economic environment. This will be far short of the promised land they might have dreamed about and into which we would have liked to welcome them when they embarked on this momentous transition. Instead, I'm afraid, the world will be characterized for some time ahead by a scarcity of savings, relatively low growth, and the risk of a resurgence of inflation. This being said as a reminder of the probable key features of the beginning of the nineties, the reforming countries will

nevertheless be operating in a climate that is possibly more favorable than we all expected only recently, although the outlook is still difficult. Various shocks and adverse developments during the second half of 1990 all tended to make us worry about the prospects for sustained healthy growth of output and world trade. Consider briefly the six main areas of concern in 1990, and how they look now.

- First, the conflict in the Middle East. This was a major source of political and economic disruption and uncertainty, and brought with it much tragic loss of life and human suffering. The conflict, and the related disruption to the oil trade and consequent sharp rise (albeit a relatively brief one) in oil prices, also had a significant impact on the world economy. The most obvious harm was done to the countries directly affected by the war, and others in the region. They can expect at best a gradual recovery of output, as they undertake the reconstruction of their economies.

- Second, the conflict also had adverse consequences for the many developing countries, including those in Europe, that are heavily dependent on imported oil, or have important trade links with the Middle East. Reflecting this, and the slowdown in the industrial countries which are the main outlet for their exports, the developing countries showed a very disappointing performance in 1990. They can expect to see only a gradual and piecemeal recovery in 1991, followed, hopefully, by a stronger recovery next year.

- Third, the industrial countries also suffered adverse economic damage from the Middle East crisis, although not as much as had been initially feared. The main feature was the slipping into recession of the USA and the United Kingdom, and a deeper recession in Canada. This slowdown was, however, counterbalanced by the continued growth in Germany and Japan, helping to avert the danger of a global recession.

On present indications, we expect activity in the industrial countries to begin to recover in the course of 1991, and to be stronger in 1992, while their inflation rate should moderate somewhat. I would say in passing that, in these circumstances, the appropriate policy stance for these countries is to ensure that the next expansion phase is healthy and sustainable, and not marred by a flare-up of inflation or re-emergence of excessive balance of payments difficulties. That is why I have welcomed the progress toward fiscal consolidation in several industrial countries, while recommending further improvements, and why I have been advocating a cautious and gradual approach to any easing of monetary policy. I expect that this cautious approach will allow a moderate but sustained expansion in the industrial countries, which are the most important export markets for the reforming countries of Eastern and Central Europe.

- Fourth, the countries of Eastern and Central Europe themselves experienced substantial losses of output and employment in 1990, due in some cases to the transitional costs of adjustment. They were also adversely affected by the external factors already mentioned, and by other

developments, in particular the extremely difficult economic situation in the Soviet Union, which has been for many years an important trade partner. The prospects there are most worrying, and we should not count on an early recovery of this trade.

- Fifth, some developments in world financial markets showed a continuation of recent disquieting trends, in particular the growing evidence of a shortage of global savings, which is causing more intense competition for scarce resources.

- And sixth, a crucial development in 1990 was the failure of the Uruguay Round to come to a satisfactory conclusion by the agreed deadline. The suspension of these crucial negotiations was a severe setback. It will be important for the world economy, and not least for the reforming countries of Eastern and Central Europe, that the GATT negotiations result in a meaningful measure of trade liberalization. This would be to the benefit of all countries, of course, but I am particularly mindful of the boost it would give to the countries undertaking systemic reforms. In each case, the reform strategy includes a greater opening of the economy to participation in world trade. I do not see how these economies can achieve sustained growth, or be modernized and made more productive, without a substantial increase in their imports and exports. It would be tragic if the countries of Eastern Europe, after abandoning a "bloc" mentality because they recognized that it leads to inefficiency and a lack of progress, should now be forced back into thinking defensively by a failure of the industrial countries to observe market principles.

These six points together suggest a global environment that is only moderately supportive for the countries of Eastern and Central Europe. But they could perhaps find some additional hope and inspiration from the fact that their own revolution in economic thinking, and their formidable effort to transform their economies, are part of a worldwide phenomenon. Let me put it in another way. The countries in transition are not joining a very exciting world, but at least a world which knows now much better than a few years ago which policies work and which don't.

This brings me to my second topic.

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I am impressed by what I like to call the "silent revolution", this widespread acceptance of a set of general propositions about the most effective way of achieving sustainable economic growth--the kind of vigorous growth that allows societies to achieve a genuine improvement in living standards. What are the main elements of such a deep change? Let me sketch out just three.

- First, better economic policies are seen as part of the response to a growing demand for "good governance." This demand takes many forms, depending on the country, and is giving rise to a corresponding change in

people's expectations of what constitutes effective and acceptable political leadership. A very demanding task indeed!

--to create a vision and devise a coherent strategy to achieve ambitious yet realistic objectives;

--to put aside political differences, if necessary, for the sake of sustaining a national effort at adjustment; and

--to persevere with sound policies despite occasional setbacks and the recurrent demand for quick results.

So, let us refuse to take the side of those who suggest that democracy has a price in terms of quality of policies, that only authoritarian governments can be strong enough in promoting strong policies. Quite the contrary! Only democracy is strong enough to muster through open dialogue the necessary consensus in favor of strategies that invariably require major adjustments--and equitably shared sacrifices. Only democracy is strong enough to eschew the "easy" solutions offered by so-called alternative strategies; and to face up to vested interests, and corruption. This is true in Eastern Europe, this is true in Africa, this is true everywhere in the world.

All this calls for imaginative leadership at the political level, and dedicated competence at all levels of government. This is what "good governance" means.

- Second, a more specific aspect of "good governance" concerns a shift in thinking about the role of the State in a modern market-oriented economy.

I would draw the following proposition out of the rich array of practical experiences we have accumulated in so many countries in recent years. The main responsibility of the State in the domain of economics is not only to streamline itself, is not only to go to less government, but first to achieve better government--a matter I am sorry not to be able to dwell on today--and, second, the indispensable establishment and maintenance of a stable and equitable economic framework within which the other economic actors--the enterprises, the workers, households, and foreign partners--are allowed and encouraged to work as efficiently as possible to contribute to what I like to call high quality growth, namely sustainable growth respectful of common goods, such as the environment, and contributing particularly to the alleviation of the plight of the most vulnerable.

- Third: the components of this economic framework. We see of course a variety of experience from country to country, but one can easily identify the key elements of a workable strategy, applicable everywhere but particularly in the countries of Eastern Europe. Since there are seven, I shall merely outline them!

--a medium term approach, that establishes realistic objectives in the light of the country's potential;

--a dynamic enterprise sector, that becomes the principal source of initiatives and productive change in the economy;

--sound public finances.

--a central bank with sufficient independence from the political authorities for it to conduct a monetary policy that is firmly aligned to avoiding inflation. I am sure that Dr. Schaumayer will not disagree!

--a wide array of structural reforms to improve productivity in all sectors of the economy.

--a greater openness to trade and financial relations with the outside world.

--and last, but by no means the least important, the provision of adequate safety nets to the most vulnerable members of society.

These seven elements constitute, I believe, the basic agenda for sound economic policies.

What these experiences show is that the type of thinking that is responsible for the present intellectual ferment in Eastern and Central Europe has produced tangible successes in every kind of economy, all over the globe. But they also show most clearly that, even if there is a close convergence of ideas about the right economic policies, it is hard to translate this consensus into action. And it reminds us of the need for far-sighted leadership, and a political willingness to take some hard decisions.

But whatever the quality and commitment of the leadership, durable success cannot be achieved in isolation. International support is essential and in a longer-term perspective is mutually profitable for donors and recipients: obviously enough in a small global village where every country benefits from every other's success.

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What can I say now about the prospects for support of the reform efforts of the five countries?

Clearly, the whole world is impressed by the fundamental transformation that the governments and people of these countries are bringing about, and the tremendous sacrifices that are required. I think this is reflected in the substantial support by the industrial countries for the structural reform programs and stabilization policies of these five countries. Allow me to give you some data. The Fund itself is extending some \$5 billion of



assistance in 1991, and thus catalyzing more than \$17 billion of assistance from other sources, including probably about \$2.7 billion from the World Bank and parallel financing from other sources, an estimated \$3.6 billion from the G24 and E.C., some \$6.2 billion of official debt relief through the Paris Club, and the rest composed of private capital flows. This support should cover the full financing requirements of these countries for 1991 as set out in our financial arrangements. This amount of more than \$22 billion, for only one calendar year, which is well above what many expected not long ago, is a remarkable illustration of the capacity of nations to mobilize assistance, in a spirit of solidarity. Indeed, it has been most encouraging for the IMF, in its capacity as the central international institution with the responsibility to foster this kind of monetary cooperation. But I must tell you in the same breath that already I detect threats to the future of this cooperative effort. Threats or temptations, on both sides. These include, in the reforming countries themselves, the nostalgia that is felt in some quarters for the illusory "security" of the old system; or the wishful thinking that leads to a belief in short cuts to growth, or easy options, or to letting inflation solve all the pressing problems, or to thinking that the rest of the world can be persuaded to contribute more if the reforming countries just do less... and so on. And there are other illusions that may seem seductive to some of the donors and creditors. Some may think they can afford to hold back their assistance, and so shift their share of the burden to other donors. Others may think that a greater adjustment effort, or more speedy reforms, will be undertaken by the Eastern countries, if the creditors extend less assistance.

Such illusions can be entertained by people--on both sides--who have very good intentions but are unwilling to face up to the consequences of the inescapable fact that the old economic system, and substantial parts of the productive capacity that is its legacy, are simply not viable.

These illusions are dangerous. They threaten to undermine the process of international cooperation in support of systemic reforms, just when we are entering a critical phase; just when we are discovering that the period of transition will be longer, and the sacrifices heavier, than expected, between these countries gaining political freedom and realizing their full economic potential.

Ladies and Gentlemen, we all have to face the truth, and not try to escape the inevitable consequences. We in the IMF have to try to help both sides, who are at present united in a remarkable endeavor, to accept that they both need to persevere with far-reaching reforms and support for such reforms. Indeed, perseverance is the key; perseverance not for six months or a year, but for several years to come. For our own part, we in the IMF are prepared to enter now into 3- or 4-year extended arrangements, if needed, to support growth-oriented structural adjustment in these countries, after completion of the stand-by arrangements which have just been launched and which are especially suitable to meet the immediate needs of macro-economic stabilization. However, I fully expect that, after the initial

stabilization phase, there will be a greater emphasis on development, and hence a growing role for the World Bank, EIB, and the EBRD, whose inauguration we have just celebrated in London, and whose contribution we await with high expectations. Even with such multilateral support, and even if private foreign investment takes on a more important role, we must expect that bilateral public assistance will continue to be needed for several years. I believe this will be forthcoming, through the cooperative structure of the G-24, in which the EC Commission has tirelessly played an invaluable role of management and leadership. I cannot promise for the years to come that as much of the ex-ante balance of payments gaps of these countries will be financed from abroad as in 1991. Rather, I would expect a greater degree of responsibility to fall on the countries themselves. Nevertheless, I expect that assistance will continue to be extended to them, in accordance with the underlying principle of monetary cooperation, namely that the stronger the effort by countries to address their own problems, the stronger will be the support from the international community.

