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To: Members of the Executive Board

From: The Secretary

Subject: *Statement by the Managing Director to the Development Committee on the Revival of Growth and the Role of the Fund*

As indicated at the recent meeting of the Committee of the Whole on the Development Committee, there is attached for information the statement by the Managing Director to the Development Committee on the Revival of Growth and the Role of the Fund. This statement will also be issued as a Development Committee document.

Att: (1)

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Department Heads

Statement by the Managing Director of the International Monetary Fund to the Development Committee on the Revival of Growth and the Role of the Fund

Washington, D.C.
September 29, 1986

The agenda for this Development Committee meeting focuses on two of the most critical issues currently confronting the world economy: the need for a revival of growth, particularly in heavily-indebted countries; and the need to improve the prospects for aid and concessional assistance to the low-income countries. These are issues that pose a difficult challenge for economic policy management at the national and international levels. In this statement, I will examine this challenge from the perspective of the Fund and I will provide you with the considerations that have guided the activities of the institution in the areas of your interest. The underlying theme of my remarks will stress the critical importance of three factors for the task that lies ahead: continuity in adjustment efforts, adaptation of policies to changing circumstances, and strengthening of international cooperation. All of these will be required to consolidate the progress already made and resolve the difficult problems that still remain.

1. The global economic environment

Economic developments in the first half of 1986 have been disappointing in a number of respects. Despite lower interest rates and lower oil prices, the pace of economic activity in industrial countries appears to have slowed relative to earlier expectations. As a result, for the year as a whole, output growth in industrial countries is now forecast at about 2 3/4 percent and is expected to edge up only to about 3 percent in 1987. These growth prospects are slightly lower than those envisaged at the time of the April meeting of the Committee. The slower pace of activity in industrial countries, the intensification of protectionist and subsidy measures in these countries, and the weakening of primary commodity prices have affected export earnings in many developing countries and have rendered difficult the resumption of satisfactory growth in most of these countries.

Within the developing world, output in the group of most heavily indebted countries, which had recovered from a decline of about 3 1/2 percent in 1983 to a growth of almost the same magnitude in 1985, is now forecast to rise by about 2 1/2 percent in 1986. The outlook for a number of oil importing countries in this group has improved because of the positive impact of the oil price decline, the reduction in interest rates, and the implementation of sound adjustment policies; on the other hand, the outlook for oil exporters in the group has worsened substantially, and declines or virtual stagnation in economic activity are forecast for most of these countries. This prospect is expected to be reversed to some degree in 1987, with the rate of growth slowing down somewhat in the oil importers and reviving in a number of the oil exporting countries. For the group of highly indebted countries as a whole, growth is projected to rise in 1987 to 3 1/2 percent.

Over the past few years, the group of low-income countries have expanded at generally higher rates than the heavily indebted countries. The rate of growth of low-income countries is expected to reach about 5 percent in 1986, approximately in line with last April's forecast. The implementation of strong adjustment policies, supported by increased official development assistance, particularly in some of the African countries, have contributed to these results. For 1987 the rate of growth for the small low-income countries is expected to fall back somewhat, while growth rates in the two largest countries are projected to be maintained.

While we are now facing an outlook for growth in most developing countries which is somewhat less favorable than we had foreseen in April, the recent record and the near term outlook are considerably more favorable than the performance in the early 1980s. Perhaps more worrisome is the continued difficult balance of payments and external debt positions of many developing countries. While the debt-export ratios of oil-importing countries stabilized owing in part to the decline in interest rates in international markets, those of the oil-exporting countries reached a new peak in 1985 and seem likely to rise further in 1986.

Besides strong adjustment policies in the developing countries themselves, a revival of growth in the developing world will require a satisfactory external environment, including policies in industrial countries that result in open and expanding export markets for developing countries, and reasonable interest rate levels in international financial markets; it will also require adequate external financial support for developing countries undertaking adjustment efforts. Developments since the April meeting underscore the importance of (i) adjustment policies in borrowing countries that avoid excessive use of foreign resources and are aimed at export-led growth as a means toward the attainment of a viable external payments position; and (ii) trade and agricultural policies in industrial countries that promote balanced growth in the industrial and the developing world together.

The Fund has, and will continue to support the process of revival of growth through various channels. First, through the exercise of its surveillance responsibilities, the Fund encourages the coordination of macroeconomic policies in the major industrial countries, to promote a stable global economic environment for the pursuit of sustainable growth. Second, the Fund supports growth and adjustment through its financial and technical assistance to developing countries, in close collaboration with the World Bank. Third, it catalyzes financial resources from other sources in support of developing countries' adjustment programs. Finally, through its policy advice and provision of assistance on concessional terms under the Structural Adjustment

Facility (SAF), the Fund is assisting low-income countries that face protracted balance of payments problems, in collaboration with the World Bank.

2. An appropriate setting for the revival of growth

The international community has increasingly recognized the importance of appropriate macroeconomic policies and close cooperation among major countries to promote stable economic and financial conditions in the world economy. The benefits of such cooperation were emphasized in the Plaza Agreement of September 1985 among the five largest industrial countries and in the Tokyo Economic Declaration of May 1986.

Fund surveillance contributes to this cooperation both in the context of the Article IV consultations with individual members and in the discussions of the World Economic Outlook. Following last year's reports of the G-10 and G-24 Deputies and the discussion of surveillance in the Interim Committee last spring, efforts to increase the effectiveness of surveillance have continued, including through the development of objective indicators of policy actions and economic performance. A consensus has developed that the monitoring of domestic economic variables must be undertaken in light of both their domestic and international implications. Surveillance should appropriately focus on the need to ensure international policy consistency and compatibility of external payments positions in a medium-term framework.

Trade and structural policy issues have received increasing attention in the Fund's Article IV consultations with member countries, particularly the major trading nations, as well as in the World Economic Outlook exercise. On these occasions, members are reminded of the adverse domestic and international implications of their actions. In between Article IV consultations, the Executive Board is kept informed of important trade measures adopted by members through trade information notices which describe and assess the restrictive or liberalizing effects of the actions from the perspectives of particular interest to the Fund. The Fund, along with the World Bank, has been invited to participate in major discussions of trade issues in the international community. The most recent of such occasions was the GATT ministerial meeting in Punta del Este, where the Fund stressed that it is crucially important that the next round of multilateral trade negotiations under the GATT result in a significantly more open trading system. This is a subject of which Committee members will be fully apprised by the Director-General of the GATT.

3. Developing country policies

The Fund has always reasoned that sustained growth calls for adoption of sound policies and continuing adaptation of policies to changing circumstances. Consistent adaptation of sound policies over an extended period is important not only to allow enterprises and households to respond to the signals given by the government but also to enhance confidence in economic management and performance in the countries concerned. Confidence is central to sustained growth because in its absence, it is unlikely that productive private investment will take place on the required scale. Confidence is also important to ease the external resource constraint, particularly for major market borrowers, because it encourages the reflow of flight capital, and helps improve access to international capital markets and increase foreign direct investment.

Fund-supported adjustment programs seek durable growth in a context of balance of payments viability and low inflation. Macroeconomic and structural measures including maintenance of a realistic exchange rate and positive real interest rates are fundamental to adjustment as well as necessary for sustainable growth. These policies strengthen the prospects for development and growth by raising economic efficiency and the productivity of investment, as well as by encouraging savings that make higher levels of investment possible.

The Fund has given greater emphasis to the structural policy aspects of adjustment such as the establishment of appropriate pricing, the rationalization of tax systems and of investment programs, and the reform of public enterprises and of the exchange and trade systems. Increasingly close collaboration between the Fund and the Bank has developed to coordinate the policies supported by the two institutions in their search for improvements in economic efficiency within their respective mandates. It will be important to ensure that domestic producers are subject to competitive discipline and also have access to necessary imported inputs and upgraded levels of technology. A liberalization of the foreign trade regime and a receptive attitude toward foreign direct investment are also of importance in this respect.

Experience suggests that where effective adjustment programs have been consistently implemented, external adjustment has been accompanied by encouraging growth performance. In a number of countries with Fund-supported programs, the inclusion of actions to influence the structure of the economy in the design of adjustment has encouraged efficient use of available external financing which, in turn, was instrumental in reviving growth.

Currently, the Fund is supporting the adjustment efforts of 26 developing countries, with a total commitment of Fund resources of SDR 3.0 billion; in addition, the Executive Board has endorsed Mexico's adjustment program in support of which the Mexican authorities requested a new stand-by arrangement for an amount equivalent to SDR 1.4 billion. Discussions are currently underway with some 20 other countries with a view to arranging Fund support of their adjustment policies.

4. Coordination of external flows for heavily-indebted countries

Since the onset of the debt crisis four years ago, the Fund has followed a case-by-case approach to assist highly-indebted countries in overcoming debt-servicing difficulties so as to minimize disruptions in those countries and in the system as a whole. The Fund, in collaboration with the World Bank, has identified the financing compatible with viability in the external payments position over the medium term, as well as the policies needed to limit the needs for external financing, and mobilized resources from commercial banks, multilateral agencies, and official capital sources to ensure that the required support would be available to the countries committed to adjustment. Since then the approach has been adapted to evolving circumstances. The initiative launched by the United States a year ago reaffirmed and strengthened the approach to the resolution of debt problems. It represented a critically needed stimulus in the process of adapting the debt strategy to current events and to gear it to growth.

During the past year, both the Fund and the World Bank have been involved in fostering the strengthened debt strategy and supporting efforts of the heavily indebted countries. In addition to the case of Mexico mentioned earlier, negotiations with Nigeria and the Philippines on stand-by arrangements are close to completion, while discussions on a new stand-by arrangement with Morocco have recently started. Argentina has approached the Fund to start discussions on a new arrangement. With regard to Colombia, the Fund has contributed through an exceptional monitoring arrangement to facilitate commercial bank financing, while Venezuela and Yugoslavia have requested enhanced surveillance from the Fund, which has constituted an important factor in arranging a Multiyear Rescheduling Agreement (MYRA) with creditors.

Coordination of financing for highly-indebted countries has not been an easy task and it has often been necessary for Fund management to become directly involved to provide encouragement, particularly to commercial creditors, in meetings with bank advisory committees and through subsequent communications from management to the banking community. Even with these efforts, lending by commercial banks to developing countries has continued at a low level: indeed, it is disappointing to note that bank claims on the major heavily indebted countries have shown no increase in 1985 and have declined by US$3 billion in the first quarter of 1986. The development of more spontaneous lending for certain countries (e.g., Côte d'Ivoire, Ecuador and Uruguay) has been encouraging. However, in the absence of renewed efforts in the banking community, spontaneous lending to developing countries is unlikely to be substantial in the near future. Early restoration of spontaneous bank lending to some of the larger countries may be difficult especially when these countries are facing significant terms of trade losses.

Thus, concerted lending will continue to be necessary for some countries. It is essential that the commercial banking community provide financing necessary for countries undertaking strong growth-oriented adjustment programs in a manner that avoids excessively rigid links between the arrangements of the Fund, the World Bank, and commercial banks that could result in unwanted delays in the provision of bank financing. The Fund plans to continue to play the role of both catalyst and provider of resources.

In this context, you will be interested to know that the Fund Executive Board has reaffirmed the importance of the enlarged access policy and I will report to the Interim Committee that the majority in the Board, while acknowledging the temporary nature of the policy, has taken the view that the existing limits on access to Fund resources for 1987 should be maintained. Important considerations in this recommendation were: (i) the deterioration of the balance of payments position of capital importing developing countries; (ii) the curtailment in the availability of external financing and the difficulties standing in the way of a resumption of spontaneous lending; (iii) the need to provide countries engaging in growth-oriented adjustment programs with adequate time to implement the necessary structural measures; (iv) the ability for the Fund to coordinate concerted financing packages and to promote international adjustment; and (v) the Fund's liquidity position continues to be satisfactory. A very large majority was in favor of maintaining for 1987 the limits on access under the special facilities.

The Fund's efforts to mobilize adequate financing for countries undertaking serious adjustment programs have extended to Paris Club rescheduling as well as to export credit agencies. Paris Club creditors have increased their efforts to tailor reschedulings to individual country situations and, for countries that have made substantial progress in their adjustment efforts (Ecuador and Côte d'Ivoire), have extended multiyear rescheduling arrangements; they have also indicated their willingness to grant an extended consolidation period for Yugoslavia. Export credit agencies have demonstrated greater flexibility in taking into consideration the improvements in creditworthiness of countries in the context of adjustment programs supported by the Fund, including resumption of cover for these countries. Reflecting partly this development, officially supported export credits have grown relatively rapidly over the past two years. These are some of the favorable developments that the Fund has supported in its contacts with export credit agencies and Paris Club creditors.

5. Assistance to low-income countries

The Fund has provided assistance to low-income countries in the formulation of their growth-oriented adjustment programs as well as financial support to those countries committed to implement such policies. In addition, the Fund has participated in the mobilization of concessional resources from bilateral and multilateral donors, both in the context of aid and consultative groups and outside of these fora, and has assisted in the arrangement of debt rescheduling in the Paris Club. A number of low-income countries (e.g., Tanzania) have recently adopted an adjustment program supported by the Fund.

Here again, it has not been very easy to secure the required financing. In some cases, support from donors has fallen short of expectations, making it difficult to implement adjustment programs as envisaged. To minimize problems of this nature, greater flexibility in the procedures of donor agencies as well as improvements in aid administration in recipient countries would be necessary. To enhance the efficiency of these flows, the Fund will seek to intensify its coordination with donor agencies in close collaboration with the Bank.

The Structural Adjustment Facility (SAF) was established last March to provide resources on concessional terms to low-income countries with protracted balance of payments problems that undertake medium-term macroeconomic and structural adjustment programs as a means to strengthen their external position and set conditions for sustainable growth. SAF loans have already been approved for Burundi, The Gambia, and Mauritania, and several other cases are slated for Board consideration shortly after the Annual Meetings. SAF resources already committed and those currently under consideration amount to nearly one half of the total resources available under the facility.

Procedures on Fund-Bank collaboration envisage the preparation by the authorities of Policy Framework Papers (PFPs) with joint Fund-Bank staff assistance and the joint negotiations of PFPs. These procedures have contributed to strengthening the structural policy component in adjustment programs supported by SAF resources. The process is still evolving and we expect that the Bank's contribution to the design of structural measures will help in achieving progress toward balance of payments viability and sustainable growth through increasing the efficiency of economies.

Concerns have been raised over possible cross-conditionality in SAF operations and the absence thus far of additional resources to be associated with the SAF. With regard to cross-conditionality, members have wondered whether noncompliance with an SAF program would endanger the availability of IDA financing, or whether undertakings reached with the Bank for Structural Adjustment Lending (SALs) would be included in the conditions for the SAF arrangement. I can assure you that current procedures are geared to avoiding cross-conditionality. No specific resources from other sources have so far been directly associated with the SAF. The Fund hopes that additional concessional assistance from all sources will be made available to reinforce the support provided under the SAF.

The number of bilateral donors and multilateral agencies providing policy advice and financial assistance to low-income countries has risen considerably over the last several years. It is increasingly important that the actions of these agencies be coordinated to help ensure consistency of policy advice and to direct resources to those countries that can absorb them most efficiently. The PFPs provide a comprehensive analysis of the economic problems, identify policy priorities, and estimate financing requirements over a three-year horizon; they can, therefore, serve to link efforts of all parties concerned.

6. Concluding observations

Since the meeting of the Committee last April, prospects for growth in the world economy have worsened somewhat, and the external debt position relative to exports of a number of capital-importing developing countries has deteriorated considerably. Commercial creditors have remained hesitant to increase their exposure to developing countries, while bilateral and multilateral agencies have stepped up their lending. These developments reaffirm the need for continuous adaptation and strengthening of the debt strategy on a case-by-case basis. Indeed, differentiation among groups of developing countries, based on critical examination of the viability of the external debt position for each of the countries concerned, is of the essence for the effectiveness of the adjustment process. While concerted lending will continue to be necessary, it will be important that market assessments reflect the prospects of the country realistically, as these assessments constitute a key determinant of private capital flows.

A particularly unfavorable development since last April has been the intensification of protectionist pressures, including agricultural policies in some industrial countries. It should be recognized that as long as these practices are resorted to, developing countries will find it difficult to reduce their external indebtedness to an acceptable level and restore viability to their balance of payments, let alone attain and sustain their potential growth path. The Fund has continued to press for an open trading system, and to stress the special responsibility that major industrial countries have in this regard.

Even if the low-income countries achieve, on the whole, a satisfactory growth rate in 1986, their prospects over the medium term are uncertain, partly because of unfavorable trends in commodity prices and uncertainties about adequate official development assistance (ODA). In addition to the required increases in the aggregate amount of ODA, it would be desirable to improve coordination among aid agencies so that resources are directed to those countries that can absorb them most efficiently. Aid coordination is also important to ensure consistency of policy advice. In collaboration with the World Bank, the Fund is prepared to play a more active role in the coordination of concessional flows to support the adjustment and growth efforts of low-income countries.