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PHILADELPHIA MONETARY CONFERENCE: ADVISORY COMMITTEE STATEMENT ON MEXICO

1. TEXT OF STATEMENT REFERRED TO IN MIPT FOLLOWS:
QUOTE SENIOR REPRESENTATIVES OF THE COMMERCIAL BANKS FORMING THE ADVISORY COMMITTEE FOR MEXICO MET YESTERDAY IN PHILADELPHIA TO RECEIVE A REPORT FROM THE MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND, COVERING MEXICO'S PERFORMANCE IN THE SECOND YEAR OF ITS PROGRAM WITH THE FUND. ON THE BASIS OF THE SUBSTANTIAL PROGRESS MEXICO HAS MADE UNDER ITS ADJUSTMENT PROGRAM, THE ADVISORY COMMITTEE HAS AGREED TO NEGOTIATE WITH THE PERTINENT MEXICAN AUTHORITIES SPECIFIC ARRANGEMENTS FOR A RESCHEDULING OF ITS PUBLIC SECTOR DEBT ON A MULTI-YEAR BASIS COMPATIBLE WITH ITS MEDIUM-TERM FINANCIAL OUTLOOK. THIS MULTI-YEAR APPROACH SHOULD FACILITATE MEXICO'S PLANS FOR AN EARLY RETURN TO NORMAL MARKET ACCESS. UNQUOTE

2. FCO PLEASE ADVANCE TO PS/CHANCELLOR, LITTLER, LAVELLE (FOR WICKS) AND DIGGLE (HMT), PS/GOVERNOR, LOEHNIS AND GILCHRIST (BOE) AND TAIT (ERD).

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Remarks by J. de Larosière
Managing Director of the International Monetary Fund
before the International Monetary Conference
Philadelphia, June 4, 1984

I greatly welcome the opportunity to participate in this year's International Monetary Conference. The theme of this session--the Role of the Commercial Banks in the Prospective World Environment--is a broad and important one. I shall begin my remarks by taking stock of the progress--the very considerable progress--that has been achieved over the past year and a half in managing the debt problems. Next, I shall explain why the resolution of these problems can be viewed today with greater confidence than a year ago, in spite of some important difficulties which need to be tackled. Finally, I want to draw the lessons of recent experience for future policies and action on the part of governments and the commercial banks.

I. Managing the debt problems: progress to date

I need hardly remind this audience that the debt crises that erupted less than two years ago posed a real threat to the integrity of the international financial and trading system. There was a great deal of pessimism at that time. Some people felt that the burden of debt servicing facing a number of countries--including some of the largest debtors--simply could not be managed in a world marked by deep recession, historically high interest rates, and a sharp curtailment of commercial lending.

But the skeptics have been proved wrong. Developments over the past eighteen months have been encouraging. The various authorities and institutions responsible for international finance responded swiftly and decisively to the crisis. A cooperative strategy was set in place comprising two essential elements:

- concrete steps on the part of indebted countries to address the root causes of their financial difficulties by means of what we call "adjustment programs,"

- and concerted action on the part of the international financiers to maintain financial flows in support of those adjustment efforts.

The strategy has worked well. Let me give you the highlights.

1. Adjustment

Nearly all of the problem countries have sought the assistance of the Fund in drawing up and helping to finance adjustment programs. These programs are designed to correct the weaknesses in demand management and to remove or reduce the rigidities and distortions that have contributed to the problems. They have to be carefully tailored to the specific circumstances of each case. But they have one objective in common: that is, to restore a viable external payments position within a few years.

The external adjustment that has taken place has been dramatic. Take the Latin American countries, for example, where much of the attention and concern has been directed: countries in that region with Fund-supported programs saw their combined external current account deficit coming down from $41 billion in 1981 to $11 billion last year while their trade accounts shifted from a deficit of $7 billion to a surplus of $24 billion. More generally, all the non-oil developing countries taken together cut their combined external deficit by half during those two years--from a record high of nearly $110 billion in 1981 to $56 billion last year. It is true that much of this external adjustment involved sharp cuts in imports and growth for many countries that are not sustainable. But a much more severe adjustment would have been inevitable in the absence of the Fund's programs; and the actions of the governments concerned with the Fund's support have helped to bring about the reduction in external deficits to more viable levels in a much more orderly manner than would otherwise have been possible. And it has been achieved without a further increase in trade restrictions which would have been detrimental to the prospects for growth in these countries. In fact, in some cases such restrictions have begun to be scaled down and these countries are now in a better position to resume growth.

2. Financing

The second element has been to keep financial flows moving. The greatly increased activity of the Fund in negotiating adjustment programs has involved a substantial growth in its financing. Since the middle of 1982, the Fund has lent some $22 billion in support of adjustment in 66 member countries. A further $8 billion of commitments are outstanding in support of the 34 programs that are presently in place. Because they have been linked to adjustment, these amounts have catalyzed additional financing on a much larger scale as well as rescheduling.

Rescheduling of official and commercial debt has had to be arranged for an unprecedented number of countries and on an unparalleled scale. In all, during 1983 alone, some 30 developing countries including 11 of the 25 largest borrowers completed or were engaged in debt rescheduling with official or commercial creditors. We estimate that debt restructuring arrangements eased the cash flow situation of the non-oil LDCs by some $40 billion in 1983, equivalent to 8 percent of their exports of goods and services. In virtually all cases the agreements were anchored to a Fund-supported adjustment program.

It has also been possible to muster the essential commercial bank lending to support countries' efforts to adjust--a prospect that was in real jeopardy in late 1982. The indications are that commercial bank exposure in non-oil developing countries increased by some $25 billion in 1983. That amount was broadly consistent with an orderly scaling down of bank lending as well as with manageable adjustment in deficit countries. New bank financing commitments were closely integrated with rescheduling agreements, particularly in the case of the major borrowers.

Net new lending, together with restructuring, has helped to bring about a considerable improvement in the maturity profile of outstanding debt. The share of short-term debt in total external debt for the non-oil developing countries declined to some 15 percent at the end of 1983 from almost 20 percent at the end of 1982. As a result, we have seen the debt service ratio of the non-oil developing countries fall from 24 1/2 percent in 1982 to 21 1/2 percent in 1983. For the Latin American countries the debt service ratio fell from 54 percent to 44 percent over the same period.

II. The debt problems can be viewed with greater confidence today than a year ago

Thus, the strategy has been working, and working well. Better indeed than many had thought possible. And a number of encouraging developments have taken place that are helping to sustain this progress.

1. The Fund's resources have been reinforced

As you know, a number of steps have recently been taken to increase the resources of the Fund. At the end of last year member countries completed action to bring into effect an increase of nearly 50 percent in the Fund's basic capital resources. Agreement has also been reached on a threefold increase in the resources available to the Fund under the General Arrangements to Borrow (GAB), which is a line of credit with the major industrial countries; also, Saudi Arabia has agreed to lend to the Fund under an associated arrangement with the GAB. What is more, the GAB may now be used by the Fund not only for the benefit of Fund members among the Group of Ten major industrial countries but, under certain circumstances, for the benefit of any member country. Finally, the Executive Board has very recently approved other borrowing arrangements, totalling $6.3 billion, with the Saudi Arabian Monetary Agency and a number of industrial countries with the assistance of the BIS. These steps have strengthened the Fund's financial position considerably and thereby its capacity to carry on its role as the agent of orderly and cooperative adjustment in the system. These important decisions were not easy to reach given the difficulties of the time. They are an expression of confidence in the IMF and of commitment to a liberal and open world economy.

2. Other institutional mechanisms have functioned well

The commercial banks, with the assistance of central banks, have developed and expanded their cooperation through advisory committees and their regional groupings in an exemplary manner. As for the Paris Club, it has demonstrated remarkable efficiency in handling the reschedulings of loans from official sources.

3. The world economic setting has significantly improved

With the strong performance of the U.S. economy, the recovery has proved to be stronger than many had anticipated. Growth in the industrial countries in 1983 turned out to be higher than expected and, even on the higher base, the Fund staff now expects a stronger expansion of economic activity in the industrial countries in 1984 than it did last fall. For the industrial countries as a group, we estimate that real output expanded by about 2 1/4 percent in 1983 (on a year-on-year basis) and should grow by 3 1/2 percent this year. Growth in the European countries in 1984, at about 2 percent, would still be behind that of North America and Japan, though it would represent a considerable improvement over last year. The international trade aspects of the picture are also encouraging. According to our projections, world trade will expand quite strongly this year--by over 5 percent in volume terms--after four years of stagnation.

4. Growth is picking up in the debtor countries in the developing world

Higher levels of activity and trade are not limited to the industrial world. The adjustment efforts of the developing countries are now beginning to pay off. Many of these countries are already experiencing a resumption of growth with activity in some sectors accelerating sharply. This is true not only of some of the smaller countries but of large countries too, like Mexico and Brazil, both of which are likely to record positive growth rates this year after a period of stagnant or falling output. In line with these trends, a resurgence of imports is projected for the great majority of countries implementing Fund-supported programs. For the nine largest program countries, the value of imports is projected to increase by 12 percent in 1984, compared with a decline of 9 percent last year. This amounts to a turnaround of nearly \$25 billion--an impressive potential stimulus for world trade.

5. The paradox of the present situation

It is therefore somewhat paradoxical that, in spite of the encouraging developments I have just outlined, some observers are showing renewed pessimism as to the manageability of the debt problems. I think that one of the reasons for this paradox is to be found in the lags that always exist between action being taken by debtor countries and positive results becoming known and recognized. The rigor of adjustment which has just taken place still tends to divert attention from the underlying improvements that are being brought about. Another factor has been the recent increase in interest rates. Clearly that is a troubling development. We all know that every additional percentage point on interest rates adds \$3 1/2 - 4 billion a year to the interest bill of developing countries. But this turn of events, which is hardly surprising in current conditions, has to be seen in perspective. The stronger-than-expected recovery and the large U.S. trade deficit have meant that many program countries are reaping unanticipated gains in export earnings. And the countries are reaping unanticipated gains in export earnings. And the projections underlying most of our programs had left room for some increase in interest rates in 1984. The external position of debtor countries must be evaluated in the light of all of these elements. In our view, their balance of payments position is, on the whole, better today than our assessment of only six or eight months ago upon which the programs being drawn up at that time were based. What is of concern, however, is the uncertainty regarding the future evolution of interest rates. I shall have more to say on that subject in a moment.

III. What are the lessons to be drawn?

I have outlined the progress that has been made and I have noted that recent developments and the outlook are, on balance, encouraging. All this is not to say that there is any room for complacency: quite the opposite. What is needed now is vigilance and determination to consolidate and extend the progress to date. There are difficult issues that still confront us and uncertainties that will pose new challenges in the period ahead. I now want to draw the lessons of recent experience for future action.

1. We must avoid pessimism and wishful thinking

We are clearly going to have to avoid pessimism and wishful thinking. I have said it before and I shall say it again: there are no magical solutions to the problems we have been facing. Proposals have been made for panaceas such as writing off part of the debts or transferring them wholly or in part to official institutions, for official guarantees, or for techniques for linking debt servicing to one economic variable or another. But these proposals have attracted little support. One reason for this is that each country's debt situation has its own specific features that cannot adequately be taken into account in generalized approaches. Another reason is that these proposals involve financial support, subsidies, or losses to be assumed or provided by entities which the proponents have no power to control. In some ways such ideas tend to raise unjustified expectations and can, therefore, complicate the adjustment process. Also they could well cause certain lenders to turn away from the cooperative process and make it more difficult to maintain the cohesion that is needed to organize new financial packages. Indeed, these techniques must each be judged by their effectiveness and their capacity to keep the various financiers actively involved in the task of strengthening the international financial system.

I am confident that the most productive strategy--which does not preclude imagination and improvements--lies in the present country-by-country approach of the Fund, in collaboration with all the interested parties--governments, central banks, the BIS, commercial banks, and the World Bank--directed toward putting together realistic financial packages linked to adjustment programs that are both forceful and adapted to each country's situation.

2. More needs to be done by all parties

The second lesson is that a lot more needs to be done by all parties--debtor countries, the commercial banks, and the industrial countries--to consolidate the progress made so far and to bring about a lasting solution to the problems.

a. Debtor countries

The implementation of adjustment programs by debtor countries will have to continue. This is obviously a first and paramount necessity. The impressive gains that have been realized in bringing down external deficits to more viable levels need to be followed up by more vigorous and determined efforts to remove the obstacles to domestic growth. There is considerable scope for developing countries to do more in the way of tackling rigidities in their economies that have for years been stifling growth and increasing their vulnerability to external shocks. Though progress has been made, much more flexibility is needed in prices, particularly interest rates and exchange rates, and wages. It is only through such policies, backed by counter-inflationary demand management, that we can expect to see debtor countries achieve the expanded savings, investment, and exports they need to generate productive employment and to fuel their growth and development.

It is also very much in the interest of debtor countries to do more to attract foreign capital especially in the form of direct investment. Clearly, better domestic economic policies are an important step in this direction. But many countries also need to dismantle or relax administrative controls on such flows. Expanded flows of direct investment to the developing countries are in everybody's interest. From the point of view of potential investors, it opens up new opportunities for investment in areas frequently offering high commercial rates of return. From the standpoint of the recipient countries, direct investment represents a more secure form of external finance, and one that does not involve the accumulation of external debt. Also, it carries the advantage of being tied to productive capital formation as well as forming part of a package that includes the transfer of technology and skills. Thus, the developing countries should be encouraged to remove obstacles to such flows and to place greater emphasis on policies designed to attract foreign direct investment as part of their development strategy.

b. The commercial banks

There is also a crucial role for the commercial banks in the future, as in the past, in helping to cope with debt problems and in the provision of new finance. While fully consistent with the basic framework of a country-by-country approach, their role involves a new stage of the effort with a medium-term perspective.

(i) Reschedulings

A longer perspective may be particularly desirable in cases where heavy amortization payments due by some debtor countries over the next few years--countries that otherwise are performing well--impede a return to more normal market conditions. If problems are to be avoided and if we are to foster the conditions for a return to more spontaneous financing, restructuring will need to be looked at more closely in a medium-term context in the light of the resources that individual debtor countries might reasonably be expected to devote to debt servicing. Mexico, for example, faces repayments of principal that average about $12 billion a year over the period 1985-90. Those amounts represent close to a third of its exports of goods and services, not to mention the very heavy interest burden.

In my view, a longer time frame for bank rescheduling arrangements for countries that have made or are making substantial progress towards adjustment would have several advantages. It would be a way in which to reward good performers, while avoiding the necessity for repeated annual rescheduling: it would also help to restore the conditions needed for a return to market access and serve to rebuild confidence in the system. Given the outstanding performance of Mexico, I believe that it would be an ideal time to start tackling this case in a multi-year framework. Other countries, like Brazil whose performance is improving steadily could also qualify if progress is sustained. The periods of consolidation as well as grace would have to be long enough and tailored according to each case.

(ii) New money

In the period ahead the commercial banks will also have a vital role to play in channeling new money to debtor countries implementing adjustment policies. Projections in the Fund's World Economic Outlook envisage a rate of growth of such lending that is much lower than in the years leading up to the 1982 crisis, and one which is consistent with a gradual decrease in the proportion of banks' assets committed to developing countries and a significant decline in their capital exposure to those countries. In addition, reliance on "non-spontaneous" flows will decline as the adjustment process continues in debtor countries. Again, Mexico provides a striking example of how a country making impressive progress toward adjustment is paving the way back to normal access to financial markets. This is reflected in its reduced reliance on organized bank financing: this year's financial package arranged with Mexico's bank creditors amounts to $3.8 billion, compared with a package of $5.0 billion that had to be put together in 1983. Progress is expected to continue and I am hopeful that Mexico will have to raise little or no new money from banks next year, and will be able to look forward to resuming normal market borrowing for what limited amounts may be necessary thereafter--assuming existing debt can be restructured.

Until such time as borrowing countries can regain access to the markets, it is important that all the banks--whether large or small and whether or not their foreign exposure is large-- participate in the provision of new financing justified by sound adjustment programs; this was managed successfully in 1983. The very integrity of the system depends on such cohesion. This is not to ask the banks to cast prudence aside. Quite the contrary. For sure, prudence involves covering risks and maintaining a solid capital base. But it also consists of helping to strengthen one's clients by giving them time to adapt to new circumstances and tackle their balance of payments problems. It would be highly illogical and harmful to the stability of the system if some banks sought to evade the obligations of solidarity at the very time when the strategy adopted in 1982-83 is beginning to bear fruit, as revealed by the progress of the major debtor countries in strengthening their economies and their external positions as well as by the medium-term prospects for a far-reaching improvement in their debt situation.

To achieve the broadest possible participation in the new financing packages, the time may well have come to increase the options open to the banks. One of the approaches that has been suggested deserves careful consideration. That is to allow greater scope for increased trade finance or other medium-term lending to the private sector. Provided that this could be handled in such a way that it would not frustrate the efforts to assure enough new financing to meet the requirements of the public sector that are not directly related to projects, this approach could well be a useful one.

(iii) Terms

It will also be important to see that the terms and conditions of restructuring and new lending are such that a self-defeating impact on the balance of payments and debt service capacity of debtor countries is avoided. Obviously, the demonstrated performance of countries under adjustment programs should be a key factor in the determination of terms. Indeed, there is an underlying logic to this: risk is reduced to the extent that countries perform well, and this should be reflected in appropriately improved terms. We have already seen encouraging moves in that direction with the recently concluded Mexican financial package.

Beyond that, there is the more difficult matter of the uncertainty surrounding the future course of the world economy in general and interest rates in particular. The interest burden is already very heavy indeed, and the banks will have to continue to show flexibility, realism, and pragmatism as the situation evolves.

3. The industrial countries

There is also an indispensable role for the industrial countries in the resolution of the current problems.

(a) Reduce structural budget deficits

In the first place, these countries need to strengthen their financial policies in order to bring about a lowering of interest rates on a non-inflationary basis. Essentially this means keeping a firm rein over monetary policy combined with action, now long overdue, to reduce structural fiscal deficits in a number of cases. Large budget deficits are contributing to keeping interest rates at abnormally high levels, and the most recent trends indicate that the clash between public and private credit demands is intensifying. Over time, this can pose a threat to investment and, hence, to sustained growth. From the standpoint of most of the developing countries, a faltering in the world recovery combined with the direct impact of higher interest rates on their debt service would make the task of adjustment significantly more difficult. Action to deal with budget deficits must, therefore, be taken as a matter of urgency, especially in the United States where the present fiscal situation is of special significance for the entire world economy.

(b) Roll back trade restrictions

Protectionism has been creeping up everywhere particularly over the past two years. The time has come to act to reverse these tendencies. In the present environment of rising growth rates, the industrial countries are now better placed to make good on their commitment to roll back protectionist barriers. At the same time, the developing countries have to be able to export more if they are to meet their debt service payments and to increase their imports. If their imports are to start rising again, debtor countries, many of which are still traumatized by the debt crisis, need a change in the trading environment. They must have a more secure future for their exports to encourage them to persevere with outward-looking adjustment strategies.

In my view, the time is ripe for action in the trade field. A new round of trade negotiations in the framework of the GATT would offer a promising avenue for securing the benefits of trade liberalization on a lasting basis. However, such negotiations are sure to require extensive preparation and complex trade-offs. In the meanwhile, we must get early action to roll back trade barriers as undertaken at Williamsburg and on pragmatic measures to open up access to industrial markets for LDC exports.

(c) Industrial countries must provide the necessary financial backing for adjustment

Governments of industrial countries must also provide the necessary financial backing for adjustment efforts, particularly in the form of guaranteed export credits and long-term capital either bilaterally or channeled through the multilateral development agencies like the World Bank. During the 1970s, too much emphasis was placed on commercial bank borrowing to cover the external payments gaps of developing countries. It is essential that official flows play their role in contributing to the stability of the system and, where possible, to support programs arranged with the Fund. This is essential to facilitate the handling of structural adjustment in a medium-term context. I am convinced that the balance of payments adjustment programs that are being implemented, often at high social cost, must receive greater backing by long-term capital in order to tackle the fundamental obstacles to growth. To this end, continued close cooperation between the Fund and the World Bank is essential.

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In the Fund, we have made a careful assessment of the evolution of the debt problems in a medium-term context. That analysis demonstrates that with the right policies, the problems are manageable in the aggregate and in a manner that is consistent with strengthening the international financing and trading system. The prescription is to press ahead with the strategy now in place. That strategy has been working: it must be reinforced. This is not to say that the mechanisms cannot be improved by innovations that are acceptable to the interested parties. Creditors have shown a sense of flexibility and adaptation to changing circumstances. I am confident that they will continue to rise to the challenges with a broad and constructive vision. But let us not forget that it was weaknesses in national policies and undisciplined financing, by borrowers as much as by creditors, that produced the problems. And it is only by continuing to grapple with those fundamentals that we can look forward to re-establishing the underlying conditions for renewed financial stability and a more dynamic and prosperous world economy.