

# 3

## *Opportunities for growth*

As growth slows, governments turn their attention to reviving it—and to addressing the problems that slower growth creates. Developing countries have taken many steps to improve their economic performance and to adjust to the changing international economic environment. But as they look ahead to the rest of this decade and beyond, they recognize that there is room for further improvement. Better policies are especially needed because the international environment is fraught with uncertainty. Commodity prices are depressed, real interest rates are still above historical levels, and the debt service burden imposes serious constraints on many countries' long-term prospects for growth.

As the economies of the world become increasingly interdependent, future prospects for the world economy depend upon the policies that both the industrial and developing countries adopt. This chapter describes two possible paths for the world economy during the next ten years and the policies that might bring them about. Both High and Low cases presuppose the same moderate improvements in the economic policies of developing countries. However, if the pace of reform were to quicken, or if more countries were to implement corrective policies, the average growth rates for developing countries would exceed our estimates in each case. As the recent success of countries as diverse as Turkey and China illustrates, it is the developing countries' own policies that determine how much they can take advantage of, or offset, changes in the world economy.

Developing countries cannot assume a stable or favorable external environment. It is, therefore, important to outline the kinds of policy which would improve their ability to adapt to unpredictable circumstances and to use capital flows most

productively to sustain growth over the medium term.

### **Policies for growth in developing countries**

A useful way to approach this issue is to consider the distinction between stabilization policies and structural adjustment policies. Stabilization policies include the monetary, fiscal, exchange rate, and incomes policies that governments use to maintain macroeconomic balance. Structural adjustment policies concern those things which influence production, trade, and distribution decisions: changes in incentives, government institutions, and the rules governing property rights, liability, and information. Obviously, the two sets of policies overlap and can complement each other. An exchange rate adjustment not only stabilizes the current account but also will increase the share of exports in domestic output. Similarly, restructuring a public enterprise may improve its efficiency and also reduce the public sector deficit.

Sometimes the two policies work against each other. A rapid reduction in distortionary trade taxes can, if there are no new revenue-raising measures, increase the budget deficit in the short run. Unless macroeconomic policy is consistent with longer-term structural aims, governments run the risk of having to reverse or abandon policy reforms for the wrong reasons. The Philippines is a case in point (see Box 2.3 in Chapter 2).

While the exact mix of appropriate policies varies from country to country, the overall aim is to restore and maintain economic stability while simultaneously improving the incentive and institutional structure to encourage domestic savings and the efficient allocation of resources. Whether the initial problems are caused by unsustainable do-

mestic policies (for example, a large fiscal deficit), sudden changes in the external environment (such as a drop in the price of oil), or a combination of both, the sooner the economy can be stabilized, taking due account of adjustment costs, the greater its ability to deal with subsequent shocks. If budget deficits or external imbalances are allowed to continue unchecked, the country will be forced to run down its foreign exchange reserves and exhaust its access to foreign borrowing. Once this happens, domestic demand can no longer be maintained above income. Given such a situation, governments have only two options: to address the fundamental policy issues or to further constrain growth. And they must do something without delay. The flexibility provided by access to foreign borrowing will have been lost because of past policy errors.

An example is provided by those countries in sub-Saharan Africa and elsewhere that failed to adjust spending after the commodity price boom in the mid-1970s. They continued to maintain exchange rates and spending (especially public investment) at levels which were sustainable only if export prices quickly returned to previous peak levels. But commodity prices did not rise, and, moreover, these countries soon had to cope with the second oil shock, high real interest rates, and a worldwide recession. This would have been a burden under any circumstances, but many countries had already exhausted their access to short-term capital and depleted their foreign exchange reserves.

Other countries have demonstrated the longer-term benefits of implementing policies which quickly restore macroeconomic stability. Indonesia faced the prospect of sharply declining income in the early 1980s. Oil prices began to weaken, world growth slowed, and capital flight began to put pressure on the current account. The government quickly cut subsidies to oil consumers, canceled or postponed nearly fifty import-intensive investment projects, devalued the currency, and shifted to a managed float. Zero real GDP growth in 1982 was followed by a 3.3 percent growth rate in 1983 and growth rates of 6.6 percent in 1984 and 1985. The current account deficit as a proportion of GDP declined from 8.5 percent in 1982 to 2.5 percent in 1984.

Turkey provides an example of a country where domestic policies, as opposed to a sudden change in external circumstances, created an unsustainable macroeconomic position that slowed growth until corrective action was taken. Throughout the

1970s the government pursued expansionary monetary and fiscal policies, financed the current account deficits with heavy foreign borrowing, and protected domestic industry with high import barriers. When it could no longer borrow abroad, the government implemented a comprehensive policy package designed to both restore domestic stability and restructure the economy over the medium term. Exchange rate adjustment accompanied by tighter monetary and fiscal policies restored stability. This created the conditions needed to support the structural adjustment policies, the objectives of which were to open up the economy, increase efficiency, and stimulate growth. As a result, between 1980 and 1984, Turkey increased the dollar value of its merchandise exports by 120 percent at a time when world non-oil exports rose by only about 5 percent. The average annual real GDP growth increased to 4.6 percent during this period.

This example illustrates the point that stabilization is not an end in itself. Rather, stabilization policies should be thought of as facilitating measures in the transition toward a new framework which permits a higher, but sustainable, rate of economic growth. Once domestic stability is restored, growth needs to be stimulated by policies that encourage increased savings and investment, greater efficiency, and higher productivity.

Structural adjustment policies focus on changing institutions and incentives. The main objectives should be (a) to mobilize resources by raising the domestic savings rate, attracting foreign capital, and, if necessary, reversing capital flight; (b) to allocate resources more efficiently and raise the productivity of the existing capital stock; and (c) to create employment and income in areas where the economy has a comparative advantage.

#### *Domestic savings*

If investment is to be restored to the level required to sustain growth while debt obligations are met, many developing countries will have to increase domestic savings. Ultimately, an increase in domestic savings depends on the government's commitment to adopt the policies needed to establish a stable macroeconomic environment. Reduced budget deficits, an appropriate rate of monetary growth, and stable real exchange rates will do much to stimulate savings. Such policies would also deter and, it is hoped, reverse the transfer of domestic savings abroad. Capital flight has become endemic in many economies with inappropriate exchange and interest rates. A reversal of

this process will provide a clear and important signal to foreign investors and commercial banks that the nationals within a country have had their confidence in the economy restored by credible government policies.

With respect to public savings, governments have two fundamental options: they can either reduce expenditures or raise revenues. Many developing countries could reduce public spending without slowing economic growth or adversely affecting the poor. This would entail such measures as reducing military spending, improving public sector wage and pricing policies, reducing and reallocating current expenditures, and improving the efficiency of the public sector. For example, many developing countries would benefit if they increased public utility (electricity, water, gas) and transport charges to reflect the long-term opportunity costs and rationalized their agricultural support programs. A higher level of efficiency in the public sector could be attained by management and institutional reforms designed to improve the planning and budgeting process and to strengthen the degree of public sector accountability.

An important potential source of public sector savings is reduced expenditures on loss-making and inefficient public enterprises. For example, in Argentina the 353 state-owned enterprises lose an estimated \$2 billion annually and hold about \$11 billion of the country's \$46 billion foreign debt. Many countries in sub-Saharan Africa could also gain by eliminating the deficits associated with parastatals; they should close down the worst and introduce reforms to increase the efficiency and accountability of the remainder. There is also considerable scope for rationalizing the public sector through divestiture. This would provide a one-time increase in public savings and improve resource allocation over the medium term.

Governments can also raise public savings by increased taxation (including the inflation tax). Increased taxation, where unavoidable, needs to be formulated in such a way as to minimize the efficiency losses and tax evasion effects discussed earlier. Furthermore, the decline in per capita consumption levels in many Latin American and African countries means that the positive effect that an increase in taxation may have on the budget deficit must be weighed against the negative effect it will have on real income levels. There is, however, scope for raising revenues by reforming and improving the tax administration. This includes measures designed to simplify the tax system—with fewer exemptions or allowances and

increased penalties for evasion—and broaden the tax base.

Private savings could also be encouraged by tax reform. By limiting the taxation of interest payments to inflation-adjusted receipts and by reducing marginal tax rates, personal savings can be increased. This should be supported by the removal of distortions in credit markets, particularly through proper interest rate policies on deposits. A recent World Bank review of financial sector policies in Bangladesh, Kenya, Nigeria, Peru, Thailand, Turkey, and Uruguay suggested that in many cases the elimination of government control of interest rates and bank fees and increased competition among financial institutions would improve financial intermediation and increase private financial savings. These measures would also limit the outflow of capital. But, to return to our opening point, the restoration of private sector confidence is crucial to raising domestic savings rates.

#### *The level and efficiency of investment*

The method by which many developing countries adjusted to the changing external environment of the early 1980s led to a considerable fall in domestic investment. Policies designed to reverse this trend and, more important, to increase the efficient allocation and utilization of investment are necessary to sustain growth over the medium term.

With respect to public investment, those cuts that have scaled down or eliminated low-return projects (such as the Majes irrigation scheme in Peru or the extension of the metro systems in Chile and Colombia) have clearly been beneficial to the economies involved. Before the 1980s, the quality of public investments in many developing countries was at best mixed. Some governments, however, are unable or unwilling to make selective cuts. Public investment programs have often been reduced by damaging across-the-board cuts. There would, therefore, be considerable efficiency gains from creating the institutional capability to systematically evaluate projects at the planning stage and to allocate adequate resources toward maintenance and rehabilitation after the projects are completed.

Adjustment to a lower level of (more efficient) public investment could also be achieved by having government draw a clearer distinction between what is, and what is not, appropriate for public sector involvement. Many developing countries stand to gain from reducing and preventing fur-

ther public sector investment in activities where the private sector has a comparative advantage (for example, production and marketing activities in industry, energy, and agriculture). Public investment should be directed toward activities with externalities and long payback periods (for example, human resource development and physical infrastructure).

Governments can contribute further to increasing the efficiency of investment—and to reducing unemployment and alleviating poverty—by creating a policy environment which will encourage foreign and domestic private investment. For private investment to be efficient, governments need to provide a set of clear and nondiscriminatory policies over an extended time period. This would include many of the policies discussed earlier: trade policy reform, reduced administrative controls, a less distortionary tax system, removal of distortions in labor and capital markets, changes and clarification of foreign investment codes, and so forth. Furthermore, in many heavily indebted countries, such as Argentina, Brazil, Chile, and Mexico, a major disincentive to new private investment has been the record level of real interest rates in recent years. These high rates reflect both inflationary expectations and the pressure exerted on credit markets by the need to finance large budget deficits and preferential credit programs for sectors such as agriculture. Breaking inflationary expectations and reducing government borrowing will contribute greatly to a lowering of real interest rates and will thereby stimulate private investment. The recent monetary and fiscal reforms adopted in Argentina and Brazil represent serious attempts to tackle this problem.

#### *Policies to stimulate exports*

There is a strong link between an economy's international trade and exchange rate regime and the flexibility required to maintain growth. A competitive exchange rate and a fairly neutral trade and tax system tend to limit excessive foreign borrowing and encourage exports and efficient import substitution. Countries which sell on world markets can exploit economies of specialization, size, and scale. This helps to create efficient producers who are competitive both at home and abroad. In inward-oriented economies, producers are limited to selling their goods in small, highly protected domestic markets. The level of public investment in inward-oriented economies tends to be higher to compen-

sate for a somnolent private sector—and much of that public investment is misallocated because of the distorted incentive system. Finally, the more efficient investment in outward-oriented economies encourages domestic savings, with foreign borrowing or direct investment playing a complementary role. In inward-looking economies, foreign borrowing often acts as a substitute for domestic savings.

For example, Korea, Thailand, and, more recently, Turkey have countered adverse external shocks primarily by undertaking domestic policy reforms. By allowing their exchange rates to adjust, controlling public expenditures, and adopting export promotion measures, they boosted exports, reduced the need for foreign borrowing, and dampened inflation. In contrast, countries as diverse as Argentina, Jamaica, Mexico, and Tanzania have attempted to finance their increased current account deficits with more foreign borrowing or increased aid. This enabled them to maintain existing exchange rates, which discouraged import substitution and exports, which, in turn, increased their dependence on foreign borrowing. When the accumulation of debt denied them access to new funds, they were forced to deflate in order to lower real incomes and import demand.

The adoption of policies designed to stabilize and restructure the economy will stimulate growth, even in an adverse world environment. But for the most heavily indebted developing countries, the debt overhang is so constraining that corrective domestic policies alone will not provide a viable solution to their problems. The domestic adjustment effort will have to be supported by additional capital inflows and growing export markets. For these countries, as discussed later, future trends in the external environment have the potential to undermine domestic adjustment efforts.

These trends are illustrated in our High case and Low case scenarios. The future stability and growth of the world economy depend on the economic policies adopted by both industrial and developing countries—especially policies related to international trade—and on the behavior of world capital markets which interact with these policies. The two scenarios provide illustrations of a consistent set of outcomes for a range of possible policies. They are not intended as forecasts and do not allow for any exogenous shocks to the world economy, such as major disruptions in commodity or capital markets. They show what is achievable, rather than what is likely to be achieved.

## A decade of opportunity, 1985–95

Policies in developing countries are expected to improve moderately, along the lines discussed in the previous section, in both scenarios. Even with these improvements, however, the Low case scenario will pose serious problems for many countries. But without policy improvements, the situation of some developing countries is likely to be untenable under any scenario.

The recent declines in oil prices and real interest rates could provide a useful stimulus to most developing countries in the second half of the 1980s. Both our High and Low cases reflect the beneficial effects that these developments, if sustained for three to five years, would have on inflation and growth. For many oil exporters, however, the lower oil price presents severe difficulties. How successful governments are in building upon this stimulus, or in coping with their problems, will be determined by the policies they adopt.

The favorable results illustrated in the High case are based on the assumption that there would be a steady reduction in the fraction of world credit absorbed by government deficits in industrial countries. This would lead to a higher rate of growth of investment in productive assets. Increased capital stock would, in turn, lead to higher output and

employment, which would ease social tensions and help reduce barriers to trade. The end result would be accelerated growth.

Under these circumstances, growth in industrial countries would increase to an average of about 4.3 percent a year. This is more than the average for 1973–80, but is below the rapid annual growth of 4.7 percent between 1965 and 1973. Industrial countries, particularly those in Europe, would enjoy lower unemployment than has prevailed in the past five years, and inflation would remain at a moderate rate. If the United States and other industrial countries with large public deficits were to gradually eliminate the structural part of their budget deficits, the world's demand for credit would fall and nominal interest rates would decline to an average of about 5.6 percent. Real interest rates would then return to around 2.6 percent, their historic average.

Under these conditions most developing countries would find it easier to service their debts through more rapid export growth and lower rates of interest. Annual rates of real GDP growth in developing countries would increase to 5.9 percent, or 3.9 percent in per capita terms. Furthermore, the international debt burden would be lightened by increased export earnings, a revival in commercial bank lending, and higher direct invest-

**Table 3.1 Average performance of industrial and developing countries, 1965–95**  
(average annual percentage change)

Country group	1965–73	1973–80	1980–85	1985–95	
				High	Low
<i>Industrial countries</i>					
GDP growth	4.7	2.8	2.2	4.3	2.5
Inflation rate <sup>a</sup>	5.1	8.3	-0.3	4.8	7.0
Real interest rate <sup>b,c</sup>	2.5	0.7	6.7	2.6	4.5
Nominal lending rate <sup>c</sup>	5.8	8.4	12.0	5.6	10.2
<i>Developing countries</i>					
GDP growth	6.6	5.4	3.3	5.9	4.0
Low-income countries					
Africa	3.9	2.7	0.9	4.0	3.2
Asia	5.9	5.0	7.8	6.4	4.4
Middle-income oil exporters	7.1	5.8	1.4	4.8	3.4
Middle-income oil importers					
Major exporters of manufactures	7.6	5.9	2.1	6.4	4.0
Other oil-importing countries	5.4	4.5	1.7	5.5	3.8
Export growth					
Manufactures	11.6	13.8	7.9	9.8	5.0
Primary goods	3.8	1.1	1.4	4.3	1.5
Import growth	5.8	5.9	0.9	7.7	3.4

Note: Projected growth rates are based on a sample of ninety developing countries.

a. Industrial countries' weighted GDP deflator expressed in U.S. dollars. Inflation in the United States is 3.0 percent per year in the High case and 5.7 percent in the Low case. But for the industrial countries as a whole, it is higher in dollars because of an assumed depreciation of the dollar between 1985 and 1990.

b. Average for six-month U.S. dollar Eurocurrency rates deflated by the rate of change in the GDP deflator of the United States.

c. Average annual rate.

**Table 3.2 Growth of GDP per capita, 1965–95**  
(average annual percentage change)

Country group	1965–73	1973–80	1980–85	1985–95	
				High	Low
Industrial countries	3.7	2.1	1.7	3.8	2.0
Developing countries	4.0	3.2	1.3	3.9	2.0
Low-income countries	3.0	2.7	5.2	4.4	2.5
Africa	1.2	–0.1	–2.0	0.8	0.0
Asia	3.2	3.0	5.9	4.8	2.8
Middle-income oil exporters	4.5	3.1	–1.1	2.3	0.9
Middle-income oil importers	4.5	3.2	–0.1	4.1	1.9
Major exporters of manufactures	5.2	3.7	0.2	4.6	2.2
Other oil-importing countries	2.8	2.1	–0.8	3.1	1.4

Note: Projected growth rates are based on a sample of ninety developing countries.

ment in developing countries. This favorable overall result conceals some variability, however. Even in the High case, a number of sub-Saharan African countries and some heavily indebted oil exporters would find it very difficult to adjust and grow. If they are to share in an expanding world economy, additional measures—over and above those underlying our High case—would have to be taken.

The Low case illustrates what would happen if industrial countries were to abandon the tentative policy reforms adopted in the early 1980s. It reflects unchecked budget deficits, particularly in the United States. Even if lax fiscal policy were combined initially with restrictive monetary policies, it is likely that, under the cumulative pressure of debts and deficits, monetary discipline would be relaxed. This would lead to increasing real interest rates because financial markets, expecting that the deficits would sooner or later be monetized, would demand an inflation premium. These high rates would tend to reduce commercial bank lending to developing countries. At the same time, growing trade account deficits in industrial countries would exacerbate the demands for increased protection, which would, in turn, lead to reduced demand for developing-country exports and to lower commodity prices.

The consequences for industrial countries would be growth rates similar to, or even less than, those of the uncertain 1970s. Annual GDP growth would average 2.5 percent between 1985 and 1995. Real interest rates would remain high—around 4.5 percent—and inflation would rise to around 5–7 percent.

The consequences for developing countries would range from awkward to grim. For developing countries as a whole, average annual GDP growth rates would be 4.0 percent in the years to 1995 (see Table 3.1). Per capita growth would be a

precariously low 2.0 percent a year.

Under these circumstances some of the more outward-oriented middle-income exporters of manufactures could sustain growth, albeit at comparatively low rates. But for others the Low case would mean another decade of low or negative growth. Middle-income oil exporters would be unlikely to achieve any significant increase in real income, and the low-income African countries would suffer another decade of stagnation (see Table 3.2).

In the Low case, even those countries that implement domestic reforms may find it difficult to earn or borrow the resources required for growth. The consequences of slow industrial-country growth and limited additional financing for heavily indebted middle-income countries would be severe. Following five years of stagnation and declining per capita incomes, these countries would face the hard choice of how much of their resources to channel to service existing debt and how much to allocate to current consumption and investment. It is impossible even to sketch the consequences of such choices. Here, only the tensions, not the outcomes, can be illustrated.

#### Policy requirements for the High case

Assuming that moderate policy reforms continue in developing countries, the High case also requires improved performance in industrial countries. That, in turn, depends upon:

- *Monetary and fiscal policy.* Continued large budget deficits in the major industrial countries would make it very difficult to sustain a higher rate of growth in the world economy. Higher real rates of interest would eventually be accompanied by an accelerating rate of inflation and increased protection. The resulting stop-go policy mix that would

be adopted by governments as they attempted to control inflation, unemployment, or the trade deficit would slow world growth to the disappointing rate obtained in the 1970s. Therefore, a primary policy requirement of the High case is that those economies with persistently large deficits reduce them. As argued in Chapter 2, this should be achieved primarily by cutting public expenditures. Where tax increases are unavoidable, care needs to be taken to minimize the distortionary effects and efficiency losses created by high marginal taxes. This combination of monetary and fiscal policies

needs to be reinforced by lowering targets for monetary growth to cut inflation and reduce long-term nominal interest rates. Such an adjustment in the aggregate deficits of industrial countries could be achieved in a less disruptive manner if the largest economies coordinate their macroeconomic policies. The recent success in reducing interest rates and the value of the dollar illustrates the potential usefulness of such cooperation.

• *Labor markets.* Chapter 2 argued that rigid and high real wages contribute to increases in unemployment. To create jobs, therefore, policies to en-

### Box 3.1 Multilateral trade negotiations and the GATT

Throughout the post-World War II era, multilateral trade negotiations under the aegis of the GATT have proved effective in stemming the tide of protectionism and in achieving broad-scale reductions in tariff barriers to trade. Partly as a consequence of the limited participation of developing countries, reductions in tariff barriers have been less substantial on their exports. Developing countries have, however, benefited from the extension to them, on a "most favored nation" basis, of tariff reductions negotiated among industrial countries.

In the past several years, protectionism in industrial countries on average has intensified, and nontariff barriers to trade (as opposed to tariffs) have proliferated in markets that are of present or potential interest to developing countries—such as textiles and clothing, steel, and agricultural products. Nontariff barriers to trade across a wide range of product categories have also continued to play a significant role in the trade regimes of developing countries.

Following extensive discussions in the past two years, the GATT is now preparing for a new round of multilateral negotiations. A preparatory committee is expected to produce a report on the substance and modalities of the new round in July 1986. To produce meaningful results, this round should focus on nontariff barriers more than it has in the past, because they are the most important impediments to trade today. The new round should also promote institutional reforms in the GATT that would strengthen the international trading system and help prevent the growth of protectionism. An important unresolved issue on which views differ is whether trade in services should be included in the negotiations—and if so, in what manner.

The developing countries have an important stake in these negotiations. Liberalization and rationalization of their own trade regimes are likely to bring them important economic gains through increased efficiency

and the reduction of the distortions that bias production against exports. The reciprocal and multilateral nature of the negotiations implies that developing countries have an opportunity to obtain greater access to markets in industrial countries in exchange for their own liberalization efforts. Strengthening of the GATT system could also serve the developing countries' own trading interests, especially if the result is a reduction of the arbitrary and discriminatory protection practices of industrial countries against their exports.

Issues of access to markets in industrial countries are critical to the success of multilateral negotiations from the standpoint of developing countries. Such issues arise with respect to both manufacturing and agricultural products. In the case of agricultural products, the key issues are nontariff barriers and the subsidization by many industrial countries of temperate-zone agricultural products.

The developing countries will not be able to reap significant benefits unless they participate actively in these multilateral negotiations. Active participation implies a willingness to offer some reciprocal concessions to industrial countries in the form of rationalization and liberalization of their own regimes. Certain import controls which developing countries often maintain create problems for export interests in the industrial countries, and the support of these export interests may well be critical to the industrial countries' ability to reduce import barriers on products of interest to the developing countries.

If the more developed of the developing countries are unwilling to provide reciprocal reductions in trade barriers as part of the negotiations, they face another danger: industrial countries interested in pursuing trade liberalization through multilateral negotiations—especially the United States—will engage in negotiations that exclude the developing countries. Such an outcome would be detrimental both to developing countries and to the international trading system:

courage flexibility and reduce marginal labor costs are needed. This means encouraging training and mobility, lowering unemployment insurance and welfare benefits, and keeping wage settlements in line with productivity increases. It also entails reducing the protection afforded certain industries, so as to encourage the movement of labor into more efficient and competitive activities.

- *Trade liberalization.* While governments in industrial countries have started to correct some of the distortions caused by fiscal and monetary policies and labor rigidities, their trade policies have

often gone the other way: toward protectionism. By adopting the type of policies discussed above (in particular, lower fiscal deficits), the industrial countries could create the conditions for strong sustained growth. This would increase import demand among industrial countries and boost both exports and imports of developing countries. It would also create the conditions needed to reduce international trade restrictions. That would, in turn, increase the volume of world trade over and above that resulting directly from higher growth. A new round of trade liberalization for manufac-

trade barriers would tend to be reduced primarily on items of interest to industrial countries, and, at the same time, the multilateral nature of the trade system would be undermined by the spread of bilateral arrangements.

The degree of reciprocity in negotiations should take into account the varying stages of economic development. The enabling clause of the GATT states that there is the "expectation of the developing countries that they will be able to participate more fully in the framework of rights and obligations under the GATT with the progressive development of their economies and improvement in their trade situation." In keeping with this principle, those developing countries that have already made significant strides in economic development and that offer promise of further growth in the future may be expected to shoulder increasing obligations in a new round of multilateral negotiations.

While many institutional changes may be desirable, perhaps the most important is the establishment of an effective system of safeguards. Such a system is needed to ensure that the reductions in protection that the negotiations secure are not arbitrarily and unilaterally reversed and that temporary protection is provided for specific industries that need it. Thus, to promote longer-term adjustment, a safeguard system should be uniform, temporary, and reduced progressively over time.

The effective application of a safeguard system would also require strengthening the system for settlement of trade disputes in the framework of the GATT. Institutional strengthening of the GATT would be helpful to developing countries insofar as it is they, as the weaker trading partners, that have the most to gain from the greater adherence of nations to rules governing international trade.

The process of trade liberalization through multilateral negotiations has been, and is likely to remain, slow. Not only do the actual negotiations typically re-

quire several years to complete, but the trade liberalization agreed to is normally implemented in stages in subsequent years. As a result, significant trade liberalization from a new multilateral round cannot be expected to take place before the end of this decade. However, many developing countries, especially the heavily indebted ones, need to increase their export earnings within a much shorter time span. Increasing their exports requires the reduction of the disincentives to efficient exports created by their own highly protectionist trade regimes and improved access to markets in the industrial countries. Every encouragement should be given to both industrial and developing countries so that they undertake the needed trade rationalization and liberalization now.

The current preparations for a multilateral trade negotiation may, however, prompt many countries to consider delaying trade liberalization in order to preserve their bargaining power for the multilateral negotiations. It would be truly unfortunate if the negotiation process undermined the prospects for critical structural change as a result of the adoption of such a negotiation strategy.

One possible way to address this issue could be the provision, within the framework of the multilateral negotiations, of appropriate "credit" for the adoption of such prior reforms by developing countries. There are precedents for credit being extended in negotiations between industrial and developing countries during the earlier Kennedy Round. Industrial countries might wish to agree in principle at the beginning of the negotiations that credit would be given for liberalization or other trade reforms undertaken by developing countries after a certain date. Such an action may encourage developing countries to liberalize their trade regimes when it appears desirable to effect the structural transformation they want rather than to wait until the round has been completed.



tures and agricultural imports of industrial nations would be needed for the growth rates of the High case to be achieved. In addition, by 1995 the tariff equivalents of major nontariff barriers would have to be significantly lower than they were in 1984 (see Box 3.1).

### Developing-country prospects

The 5.9 percent growth rate of GDP in the High case illustrates how fast developing countries can grow, given continued domestic reforms and a favorable external environment. It implies a healthy 3.9 percent growth rate in per capita income. In contrast, per capita income would grow at only 2.0 percent in the Low case.

As both High and Low cases presuppose similar improvements in developing-country policies, the difference between the two cases for a particular group of countries provides a rough estimate of the extent to which changes in the world economy affect the performance of that group. In low-income Asia, the growth rate in per capita income shown in the High case is a strong 4.8 percent; in the Low case the rate is 2.8 percent. For the major exporters of manufactures, the High case leads to a per capita growth rate of 4.6 percent and the Low case only 2.2 percent. But in low-income African countries, the corresponding rate is 0.8 percent in the High case, and in the Low case per capita incomes would not increase at all.

The large differences between the High and Low cases for low-income Asia and for middle-income major exporters of manufactures (2.0 and 2.4 percentage points, respectively), as compared with the narrow gap for low-income Africa (0.8 percentage point), reflect the greater integration of the

newly industrialized countries into the world economy. Changes in export markets and interest rates would cause the performance of these economies to fluctuate more than that of the more inward-looking and agriculture-based African economies. But this does not mean that the newly industrialized countries are worse off. Indeed, their Low case growth rate exceeds the High case growth rate for low-income Africa. Developing countries that attempt to insulate themselves from the world economy may reduce the impact of international cycles, but they pay the high price of lower growth rates under any world scenario.

The higher per capita growth rate in low-income Asia is also due to the lower rate of population growth as compared with the rate in Africa. This reflects the relative success, particularly in China, that low-income Asia has had with population control programs.

### The High case

If OECD growth is strong, low-income Asia and major exporters of manufactures would attain the highest growth rate. Both groups would expand their exports of goods by more than 8.0 percent a year (see Table 3.3). Much of the growth in per capita income levels in low-income Asia reflects the performance of China and India. Their strong performance results from continued domestic policy reforms and an increased level of foreign borrowing. The further opening up of these two important economies to international trade would lead to increased efficiency in domestic production and a higher rate of export growth. This, coupled with a greater reliance on international capital markets (debt indicators for this country group in-

**Table 3.3 Change in trade in developing countries, 1965–95**  
(average annual percentage change)

Country group	Exports of goods					Exports of manufactures				
	1965–73	1973–80	1980–85	1985–95		1965–73	1973–80	1980–85	1985–95	
				High	Low				High	Low
Developing countries	5.0	4.6	4.1	7.1	3.2	11.6	13.8	7.9	9.8	5.0
Low-income countries	1.9	5.4	5.0	8.0	4.3	2.3	8.3	7.4	11.1	6.5
Africa	4.6	1.3	–1.5	5.3	2.6	5.4	2.0	–2.1	9.3	4.6
Asia	0.6	6.8	6.6	8.4	4.6	2.0	8.7	7.8	11.1	6.5
Middle-income oil exporters	4.3	0.0	1.2	5.1	1.5	10.7	8.0	15.4	11.5	5.9
Middle-income oil importers	7.1	9.0	5.6	7.8	3.8	15.5	15.3	7.4	9.4	4.7
Major exporters of manufactures	9.2	10.6	5.9	8.1	3.9	15.6	15.9	7.0	9.3	4.6
Other oil-importing countries	2.4	3.5	4.3	6.6	3.4	14.8	9.1	13.0	10.6	6.5

Note: Historical growth rates of volume of international trade reflect revisions in the nominal trade figures, as well as revisions in the methodology of calculating trade deflators.

crease), supports the stronger growth shown in our High case.

For major exporters of manufactures, such as Korea and Brazil, stronger growth in industrial countries plus the accompanying reduction in protection would provide the growing markets they need to expand production and exports. Export growth, plus an increase in private capital inflows from abroad, would raise their capacity to import by close to 9 percent a year. As a result, these economies could sustain a faster rate of growth over the next ten-year period.

Even if our High case growth rates are achieved, the prospects for middle- and high-income oil exporters will be lower than they were last year. For middle-income oil exporters (for example, Egypt, Indonesia, and Malaysia), the recent drop in the price of oil has led commercial banks to lower their assessment of how much debt they can carry. For those oil exporters that have had debt-servicing difficulties (for example, Mexico and Nigeria), the oil price decline exacerbates an already difficult situation. As a consequence, significant steps need to be taken to moderate the decline in their real incomes. Of primary importance will be policy measures designed to increase domestic savings and to allocate and utilize resources more efficiently. A reduction of the disincentives to new export activities will be particularly important, as will the reduction of trade barriers in industrial economies. As argued later, for the heavily indebted middle-income oil-exporting countries, this domestic adjustment effort needs to be supported by continued and increased access to external capital flows. Under these conditions, middle-income oil exporters as a group will be able to finance a sustainable expansion in imports. Furthermore, in the

longer term, the oil price can be expected to strengthen as the faster growth in the world demand for oil begins to press against existing supply capacity. As a consequence, in a stronger world economy oil exporters could regain an annual per capita growth rate of 2.3 percent over the decade 1985–95 (see Box 3.2).

Middle-income countries that are not major exporters of manufactures could also attain a significant improvement in their export growth, to 6.6 percent a year. However, as this larger group of countries depends more on commodity exports, the boost from higher world demand would be less relative to that for exporters of manufactures. Demand for primary commodities is comparatively income inelastic—that is, does not rise proportionately to people's income—and substitutes are becoming increasingly competitive. Nevertheless, strong OECD growth would provide those middle-income economies undertaking reforms (such as Côte d'Ivoire, Mauritius, Morocco, and Senegal) with the growing world markets they require to realize the largest growth gains from their reforms. Foreign exchange earnings would increase, and, given access to adequate foreign capital, these countries would be able to increase imports as well as service their debt (see "Capital flows and debt" below).

In low-income Africa, the negative per capita income growth rates of the recent past would be reversed in the High case. Low-income African countries would gain significantly from the lower oil price. But if the world economy were to grow at the rates indicated by our High case, they would also gain from the assumed reduced protection of agricultural markets, particularly in Europe. But even under these favorable conditions, per capita

<i>Exports of primary goods</i>					<i>Imports of goods</i>					<i>Country group</i>
<i>1965–73</i>	<i>1973–80</i>	<i>1980–85</i>	<i>1985–95</i>		<i>1965–73</i>	<i>1973–80</i>	<i>1980–85</i>	<i>1985–95</i>		
			<i>High</i>	<i>Low</i>				<i>High</i>	<i>Low</i>	
3.8	1.1	1.4	4.3	1.5	5.8	5.9	0.9	7.7	3.4	Developing countries
1.6	3.6	3.1	4.6	2.0	0.8	6.1	5.9	6.0	1.7	Low-income countries
4.5	1.2	–1.5	4.9	2.4	3.4	2.1	–3.0	3.9	1.2	Africa
–0.6	5.2	5.4	4.4	1.9	–0.5	7.7	8.2	6.4	1.8	Asia
4.2	–0.4	–0.1	4.0	0.8	3.7	9.1	–2.0	7.0	1.6	Middle-income oil exporters
3.8	3.3	2.8	4.5	2.1	8.0	4.7	0.9	8.3	4.4	Middle-income oil importers
										Major exporters of
5.5	3.8	3.6	4.7	2.2	9.6	4.8	1.1	8.9	4.9	manufacturers
1.2	2.4	1.4	4.3	1.7	3.6	4.3	0.0	5.6	2.1	Other oil-importing countries

### Box 3.2 How a drop in the price of oil affects developing countries

Does the developing world gain from cheaper oil? All things considered the answer is yes. If the price of oil fell from around \$20-22 a barrel to \$10-12 a barrel and stayed there for the next five years, the direct loss for oil-exporting developing countries (lost oil revenue) would outweigh the direct benefits for oil importers. But for developing countries as a group, the indirect effects of a \$10-a-barrel price fall would more than offset the direct impact.

The crucial indirect benefits for developing countries derive from the impact of an oil price decline on the industrial countries. Developing countries would benefit from the boost to export demand and lower interest rates that cheaper oil is likely to create in industrial countries. Under the oil price fall postulated above, GDP growth in industrial countries would increase by at least 0.4 percentage points a year from 1986 to 1990 according to our estimates.<sup>1</sup> This would lead to a greater demand for exports from developing countries. However, some developing countries would experience an offsetting negative indirect effect because of lower remittances from migrant workers employed in high- and middle-income oil-exporting countries.

In industrial countries, the drop in the price of oil would cause both inflation and interest rates to fall in

the short term. Because oil has a greater weight in the price deflators for the United States than in those for European countries, price levels and interest rates can be expected to fall more in the United States than in Europe; as a consequence, the dollar would also tend to depreciate.

Although the total value of developing countries' exports would fall (because of lower worldwide inflation), the volume of their exports would rise. The value of exports from the non-oil-exporting regions would also fall, partly because of the drop in the rate of inflation and partly because each region exports some oil. Box tables 3.2A and 3.2B provide conservative estimates of the effect of a \$10-a-barrel decline in the price of oil on developing countries. The first table shows the effect on the nominal value of exports, interest payments, and lending, and the second table shows the effect on export and import volumes.

While the data in these tables show that oil-importing developing countries would gain, they also show the magnitude of the negative impact on oil-exporting developing countries. For the middle-income oil exporters, export revenues would fall by 24 to 28 percent between 1986 and 1990 (see Box table 3.2A). As a consequence, it is likely that these countries would be less able to obtain new capital inflows and thus would have to reduce their domestic expenditures in order to lower their real imports. The magnitude of the reduction needed in real imports could be as much as \$20 billion to \$30 billion a year. This could

1. Other estimates tend to exceed this figure. To the extent that OECD growth is higher than postulated here, the net positive effect of the oil price decline on developing countries will also exceed the estimates shown here.

**Box table 3.2A Estimated effects of a drop in the price of oil of \$10 per barrel on export revenues, interest payments, and medium- and long-term private lending to developing countries, 1986, 1987, and 1990**

Country group	Export revenues						Interest payments on medium- and long-term debt					
	Difference in billions of dollars			Percentage difference			Difference in billions of dollars			Percentage difference		
	1986	1987	1990	1986	1987	1990	1986	1987	1990	1986	1987	1990
Developing countries	-42.8	-49.7	-54.4	-8.3	-8.6	-6.4	-0.7	-4.7	-3.6	-1.1	-7.0	-5.1
Low-income countries	-3.2	-3.7	-3.2	-5.2	-5.4	-3.1	0.0	-0.4	-0.3	0.0	-7.3	-3.2
Africa	-0.3	-0.4	-0.5	-2.9	-3.9	-3.1	0.0	-0.1	0.0	0.0	-4.9	0.0
Asia	-2.9	-3.3	-2.8	-5.6	-5.7	-3.1	0.0	-0.3	-0.3	0.0	-8.3	-3.4
Middle-income oil exporters	-32.3	-36.1	-44.0	-27.9	-27.7	-24.0	-0.2	-1.5	-1.0	-1.1	-7.1	-5.0
Middle-income oil importers	-7.3	-9.8	-7.2	-2.2	-2.6	-1.3	-0.4	-2.7	-2.3	-1.1	-7.0	-5.5
Major exporters of manufactures	-5.8	-7.5	-4.9	-2.1	-2.4	-1.1	-0.3	-2.2	-2.0	-1.1	-7.4	-6.4
Other oil-importing countries	-1.5	-2.3	-2.3	-2.5	-3.4	-2.3	-0.1	-0.5	-0.3	-0.9	-5.6	-2.9

Note: Data are based on the difference between the base line price per barrel of oil—\$20 in 1986, \$22 in 1987, and \$23 in 1990—and the scenario price of \$10 less.

Source: Fleisig (background paper).

**Box table 3.2B Estimated effects of a drop in the price of oil of \$10 per barrel on developing countries' trade, 1986, 1987, and 1990**

Country group	Exports						Imports					
	Difference in billions of 1980 dollars			Percentage difference			Difference in billions of 1980 dollars			Percentage difference		
	1986	1987	1990	1986	1987	1990	1986	1987	1990	1986	1987	1990
Developing countries	2.4	9.2	17.6	0.5	1.8	3.0	8.7	11.2	5.9	1.6	2.0	0.9
Low-income countries	0.2	1.0	2.2	0.4	1.7	3.1	2.8	3.8	4.8	3.1	4.2	4.8
Africa	0.0	0.1	0.2	0.3	1.0	1.8	0.6	0.8	0.8	3.7	5.7	5.1
Asia	0.2	0.9	2.0	0.5	1.8	3.4	2.2	3.0	4.0	3.0	4.0	4.7
Middle-income oil exporters	0.6	2.4	4.6	0.4	1.7	2.7	-19.0	-23.8	-31.3	-16.9	-21.7	-24.5
Middle-income oil importers	1.5	5.8	10.8	0.5	2.0	3.1	24.9	31.2	32.4	7.1	8.4	7.0
Major exporters of manufactures	1.3	5.2	9.6	0.6	2.1	3.3	19.5	24.4	24.9	7.1	8.2	6.7
Other oil-importing countries	0.2	0.6	1.2	0.3	1.2	2.1	5.4	6.8	7.5	7.2	8.9	8.6

Note: Data are based on the difference between the base line price per barrel of oil—\$20 in 1986, \$22 in 1987, and \$23 in 1990—and the scenario price of \$10 less.

Source: Fleisig (background paper).

be achieved by reducing real GDP through increased taxes, reduced government spending, and tighter monetary policy. If the oil exporters reduced imports by these measures, their GDP levels could fall by as much as 6 to 12 percent below what they would have been otherwise. That would cut their average rates of growth by roughly four percentage points annually during the period of adjustment. The same price decline would also adversely affect the growth prospects of high-income oil-exporting countries. It is estimated that a \$10 decline in the price of oil would reduce their

export revenues by about \$60 billion in aggregate.

Some of the pressure to reduce output could be offset if oil-exporting developing countries undertook substantial devaluations. The rise in the price of traded goods relative to nontradables could raise exports, lower imports, and thereby assist the economy to adjust. This would offset some of the loss of output that might otherwise occur. But while such adjustment would be necessary, the supply response of exports may take time, and some output loss in the short term would be unavoidable.

*Medium- and long-term private lending*

Difference in billions of dollars			Percentage difference			Country group
1986	1987	1990	1986	1987	1990	
-1.4	-4.1	-15.9	-5.5	-16.6	—	Developing countries
0.0	-0.1	-0.4	-0.2	-0.7	-3.9	Low-income countries
0.0	0.0	0.0	0.0	0.0	0.0	Africa
0.0	-0.1	-0.4	0.0	-0.7	-3.4	Asia
-0.4	-1.3	-4.6	—	—	—	Middle-income oil exporters
-1.0	-2.7	-11.0	-7.7	-24.0	—	Middle-income oil importers
-0.9	-2.6	-10.5	-10.0	-29.6	—	Major exporters of manufactures
0.0	-0.1	-0.5	0.0	-5.0	20.4	Other oil-importing countries

### Box 3.3 The sub-Saharan Africa debt problem

Although the absolute size of sub-Saharan Africa's debt is relatively small, the cost of servicing it is not. Total long- and short-term liabilities increased from \$38.5 billion in 1978 to approximately \$80.0 billion in 1984, or from 30 percent of the region's combined GNP to 50 percent. Although much of low-income Africa's loans come from bilateral and multilateral sources on concessional terms, debt service obligations as a percentage of exports of goods and nonfactor services have still risen to unsustainable levels.

Box figure 3.3 shows the latest available data on the cost of servicing long-term debt in sub-Saharan Africa as a whole and in two subgroups, low-income IDA countries and others. The data for 1979-84 are what countries actually paid out in principal and interest, those for 1985 and onward are what they were scheduled to repay based on existing debt. Clearly, scheduled debt service payments greatly exceed the payments actually made. Total debt service was \$6.4 billion in 1983 and \$7.9 billion in 1984, whereas scheduled payments are about \$12.0 billion in 1985 and 1986. The debt service ratio, which had been 21.6 percent in 1984, is scheduled to rise to a projected 33.2 percent in 1985 for the continent as a whole. For IDA countries, the increase is even larger, rising from 18.5 percent to 39.6 percent.

Though debt payments have not been the fundamental cause of Africa's low growth, the debt problem is becoming more acute for three principal reasons: First, the proportion of debt payments that are not eligible for rescheduling (mainly repayments on loans from multilateral organizations) is rising rapidly. Second, the process by which high scheduled debt repayments are translated into lower manageable actual payments is proving very costly. It has created an atmosphere of uncertainty, which reduces confidence and discourages private investment. Third, net financial flows to sub-Saharan Africa have fallen substantially. As the data in Box table 3.3 show, the small

increase in net capital flows from multilateral sources in 1984 was outweighed by the decline in net bilateral flows. When the precipitous drop in net private flows is also taken into account (they fell from a peak of \$4.3 billion in 1982 to a negative \$0.3 billion in 1984), the magnitude of the problem becomes apparent.

Moreover, the debt burden is not distributed equally. In some countries, including Botswana, Cameroon, and Lesotho, the debt service ratio is less than 15 percent; in others, it is more than 50 percent. And, while some countries' debt is primarily from commercial sources (for example, Côte d'Ivoire, Nigeria, and Zimbabwe), for others it is largely official (for example, Tanzania, Zaire, and Zambia).

A total of ten countries in the region rescheduled debt at the Paris Club in 1985, matching the record of 1983 and 1984. But a potentially more serious problem emerged in 1985. Several sub-Saharan countries did not reschedule at the Paris Club primarily because they were unable to reach agreement with their creditors on adjustment programs. Most of these countries are additionally hampered by arrears to the IMF, which technically prohibits rescheduling negotiations.

Can African countries grow fast enough to meet existing debt obligations and maintain adequate domestic investment? The prospects are poor. Although it may be possible to manage the debt obligations of the non-IDA countries through domestic policy reforms and rescheduling (given strong economic growth in the world economy), this will not be enough for a group of approximately twelve IDA countries. Even in the High case, these countries could not generate the export earnings they need to finance debt obligations and the investment required to support growth. This would be true even if a large portion of the debt were rescheduled.

This year's World Bank report on sub-Saharan Africa (1986a) argues that it is possible to achieve a lasting solution to the region's debt problem. But this will

**Box table 3.3 Sub-Saharan Africa's net public flows, 1978-84**

(millions of dollars)

Type of flow	1978	1979	1980	1981	1982	1983	1984
Total net flows	5,861.4	6,372.3	7,158.4	7,091.3	8,185.4	7,650.3	2,753.0
Official creditors	2,512.5	3,527.5	3,788.0	3,944.7	3,846.5	4,034.9	3,062.2
Multilateral	1,347.5	1,281.0	1,799.7	1,649.8	1,890.9	1,782.5	1,834.1
Bilateral	1,164.9	2,246.5	1,988.3	2,294.9	1,955.6	2,252.4	1,228.1
Private creditors	3,348.9	2,844.8	3,370.4	3,146.7	4,338.9	3,615.4	-309.2
Suppliers	341.2	87.5	409.0	140.7	122.0	41.8	170.7
Financial markets	3,007.7	2,757.3	2,961.4	3,005.9	4,216.8	3,573.6	-479.9

Source: World Bank *World Debt Tables*, 1985-86 edition.

require a coordinated effort by official agencies, commercial banks, and the African countries.

The first step must be a commitment to the type of domestic reforms recently implemented by Ghana, Togo, and Zambia. The report argues that the key areas on which governments should focus are the incentive framework, public investment, and domestic savings. The aim should be to correct the bias against agriculture and exports, which often favors urban wage earners. A greater reliance on prices and markets is essential if the level and efficiency of investment are to rise. This would mean redefining the role of the government to free resources for the private sector and to create an environment where the profits from investment would once again become commensurate with the risks.

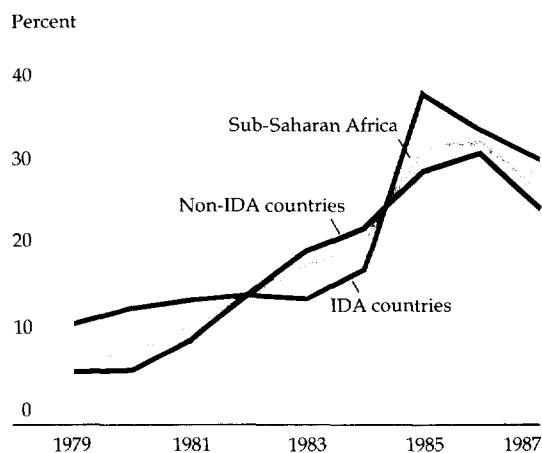
This is particularly important if foreign direct investment is to be encouraged so as to provide badly needed resources over and above domestic savings plus foreign lending. In the past, many sub-Saharan countries actively discouraged overseas investment. But it can play a useful role. It directs foreign capital toward investments with potential returns that exceed interest rates; it is often associated with transfers of technology; and, more important, it keeps the risks of the investment firmly with those who provide the capital. If the investment fails to yield an adequate return, the investor takes the loss, whereas if a publicly guaranteed loan is misspent, the repayment obligations continue.

A narrower definition of the activities that properly belong to government would also help to focus public resources (including the time of overstretched officials) on essential public goods and services. Many countries could achieve substantial gains in efficiency by ensuring that public investment programs are prioritized according to their rates of return and by keeping investment spending consistent with resource availability, after allowing for crucial recurrent and maintenance expenditures.

Policies to increase domestic savings are also required to ensure that domestic investment is not unduly constrained by the reduced flow of foreign savings. Increasing public savings implies a renewed effort to reduce budget deficits, particularly the operating losses of inefficient government-owned parastatals. Private savings could be raised through tax reform and by allowing domestic interest rates to reflect the inflation-adjusted market value of capital.

If these microeconomic reforms are to work, they must be supported by consistent fiscal, monetary, and exchange rate policies. As demonstrated in Part II of this Report, inappropriate exchange rates, large fiscal

**Box figure 3.3 Long-term public debt service as a percentage of exports in sub-Saharan Africa, 1979-87**



Note: Data for 1984 are estimated; data for 1985-87 are projected.

deficits, and inflationary monetary policies in sub-Saharan Africa have created major distortions in incentives. Neither savings nor investment will increase unless people are confident that policy-induced macroeconomic instability will not penalize those that forgo current consumption.

Since the reduced flow in nonconcessional lending is appropriate, given the weak creditworthiness of many African countries, domestic reforms will have to be supported by increased bilateral and multilateral concessional loans, at least in the immediate future. This is particularly so for IDA countries, where conventional debt rescheduling will merely postpone, and not solve, the debt problem.

But, if Africa's decline is to be reversed, such concessional lending must go hand in hand with policy reforms. This year's sub-Saharan Africa report recommends that for low-income Africa the mandate of the consultative groups of donors, which meet under the World Bank's auspices, be adapted to provide a more comprehensive assessment of resource needs and policy reform. While donors should be expected to make decisions on resource transfers with reference to the medium-term financial needs of the country, recipient governments should, for their part, clearly outline the program of adjustment that they intend to follow. Institutions such as the Bank and the IMF will have an important role in monitoring the policy reforms and in helping direct the loans and grants to the most productive purpose.

growth is a low 0.8 percent. Sub-Saharan Africa could exceed this level of performance only by pushing even more strongly ahead with the policy changes that some countries have begun to implement. This domestic adjustment effort should be assisted by a coordinated international effort to increase the level of external resources available and the efficiency with which they are used. The types of domestic policies and supportive international actions required are discussed in Box 3.3.

#### *The Low case*

The repercussions of the Low case scenario vary widely among country groups. For low-income Asia a downturn in world growth would slow the

expansion in exports to below what has recently been achieved (see Table 3.3). Since China is a net oil exporter, a greater effort to stimulate alternative export activities via trade policy reform would be necessary to offset a marked decline in its export earnings. While some low-income Asian countries have the capacity to increase their current external debt obligations, lower export growth would ultimately limit their ability to increase imports and would thereby restrict growth.

Those high-growth middle-income East Asian countries which carry modest debt burdens and have flexible economies could still attain annual per capita GDP growth rates of close to 3 percent under the Low case. Other middle-income oil importers would suffer from continued low commod-

### **Box 3.4 The debt overhang and the heavily indebted middle-income countries**

In 1985 it became widely accepted that the debt-servicing problems of some developing countries would last longer than had earlier been thought and that their solution depends critically on the restoration of sustained growth.

The scale of the problem can be gauged from the adjustments made in the early 1980s. The bulk of the adjustment has been undertaken through lower demand, which has meant, in practice, reducing imports and investment. The volume of imports for the heavily indebted middle-income countries in 1985 was 32 percent below its 1981 level. The ratio of investment to GDP fell from 25 percent in 1981 to 18 percent in 1985. GDP has stagnated since 1980, and per capita incomes have declined substantially. The reduction in demand has pushed the collective trade balance of these countries into a large surplus, which has brought their current account into rough balance. Yet, the main indicators of debt at the end of 1985 were close to their previous peaks. Despite their adjustment efforts, these countries seem to be as far as they ever were from reconciling growth and creditworthiness.

The problem is so intractable that for the biggest debtors sound policies and world growth, though essential, will not be enough to restore growth. Because debt-servicing obligations absorb 5 to 7 percent of GNP in many countries, domestic savings are not enough to service debt and maintain the level of investment needed to permit adequate growth. Thus, a significant amount of new private and official lending is required. But how much?

According to World Bank estimates, the growth rate of real GDP in seventeen heavily indebted countries needs to average at least 4 percent a year for the next ten years. This permits a per capita growth rate of consumption of 1 percent annually. Per capita consump-

tion over the next decade needs to increase by at least that much. Otherwise, it may not be politically possible to maintain the course of adjustment.

To achieve even this modest rate of growth, the heavily indebted countries must aim to reduce external debt relative to total output and export earnings. The efficiency of investment would need to increase, and domestic savings would have to rise from its present average rate of about 21 percent to about 26 percent over the next five years. Export growth, boosted not only by improved policies in developing countries but also by sustained recovery in industrial countries and trade liberalization policies, would have to average about 5 percent a year in volume terms. And interest payments need to be moderated by lower real interest rates, though the impact of this depends on the size and makeup of each country's debt.

Even with such significant adjustments, restoration of growth and creditworthiness in the heavily indebted group would require satisfactory growth in industrial countries and net flows of capital of the order of \$14 billion to \$21 billion a year over the next five years. This net capital inflow would have to come from loans from commercial banks, export credit agencies, and multilateral lenders, as well as equity investment and repatriated capital.

Despite the size of these projected flows, however, the debt of these countries would still be growing more slowly than their GDP, so that the debt-to-GDP ratio would decline significantly, as would the aggregate debt service ratio.

*Note:* All data in this box refer to seventeen countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Côte d'Ivoire, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, the Philippines, Uruguay, Venezuela, and Yugoslavia.

ity prices, high interest rates, and reduced capital flows. Their imports would be unlikely to rise at much more than a slow 2.1 percent a year, and investment would be contained at present depressed levels. That would, in turn, hold per capita growth down to a low 1.4 percent a year on average. Access to foreign capital would be a critical factor in determining how much these middle-income economies are led to squeeze domestic demand because of slower growth in industrial countries (see Box 3.4).

Because of the fall in oil prices, the prospects for oil exporters have deteriorated sharply from the Low case presented in the 1985 *World Development Report*. Under the conditions prevailing in the world economy last year, the GDP per capita growth estimated for middle-income oil-exporting countries in the Low case was 2.0 percent during the period 1985–95; this year the estimate has been revised downward to less than 1.0 percent. Cheaper oil would reduce oil exporters' growth rates under any circumstances, but the Low case reflects the additional effects of significantly reduced capital inflows and lower demand. As discussed in the following section on capital flows and in Box 3.2, this combination seriously curtails the import capacity of both middle- and high-income oil exporters just as sluggish world demand makes a shift to alternative export activities more difficult.

The implications for low-income Africa are even more serious. Depressed demand for primary commodities and continued protection in industrial countries would result in a slow increase in export earnings from the current low level. Even those countries currently engaged in serious policy reform efforts (for example, Guinea, Kenya, and Malawi) would have difficulty maintaining growth. Aid would not increase enough to offset the continued decline in net private capital inflows from abroad. As a result, imports would barely increase beyond their already depressed levels. Without resources to increase investment, many low-income African countries would suffer another ten years of declining per capita incomes. Private investors would remain hesitant, and many countries would risk sliding further into a vicious cycle of economic deterioration and political instability.

### **Capital flows and debt**

How efficiently developing countries use their resources largely determines their rate of economic

growth. But the level of those resources is still important. Foreign capital flows are one such resource: they supplement domestic savings and can compensate temporarily for foreign exchange shortages. Tables 3.4 and 3.5 provide a powerful illustration of the way the availability of these resources changes between the High and Low cases. In the High case, increased demand for developing-country exports, lower interest rates, and a resumption of voluntary capital flows to a large group of countries would encourage growth. This, in turn, would gradually ease the debt burden of the developing countries. But in the Low case, a reversal of these external circumstances—particularly lower exports and restricted capital flows—would seriously test the ability of developing countries to adjust. That, in turn, might precipitate a sweeping restructuring of international financial obligations.

#### *The High case*

In the High case, lower interest rates would reduce the interest costs on medium- and long-term debt from \$58.5 billion in 1985 to \$47.3 billion by 1995 (in constant prices, see Table 3.4). Sustained growth in real export earnings during the same period would result in a sharp reduction in debt service as a percentage of exports, from 21.9 percent in 1985 to 13.4 percent in 1995. In the long term this would make developing countries more creditworthy. Additional borrowing would increase the debt outstanding and disbursed from \$723 billion in 1985 to \$864 billion in 1995 and thus provide the additional financing required to sustain increased current account deficits. More than one-half of the current account deficit by 1995 is attributable to the rapidly growing economies within two country groups, low-income Asia (particularly India and China) and major exporters of manufactures. Indeed, some of the economies in low-income Asia have the capacity to increase their debt service ratios in the High case. Oil exporters would also be able to sustain larger current account deficits as the strengthening of the oil market in the early 1990s and the growth of other export activities reestablish their capacity to carry additional debt.

In the High case, the improved creditworthiness of many developing countries would lead to a reversal of the recent decline in net financing flows (see Table 3.5). In constant prices, total net flows would increase from a low \$62.3 billion in 1985 to \$97.0 billion by 1995. This represents a steady



**Table 3.4 Current account balance and its financing in developing countries, 1985 and 1995**  
(billions of constant 1980 dollars)

Item	All developing countries			Low-income Africa			Low-income Asia		
	1985 <sup>a</sup>	1995		1985 <sup>a</sup>	1995		1985 <sup>a</sup>	1995	
		High	Low		High	Low		High	Low
Net exports of goods and nonfactor services	-4.1	-87.0	-24.0	-4.2	-4.3	-3.4	-23.0	-22.4	-9.0
Interest on medium- and long-term debt	-58.5	-47.3	-49.4	-1.3	-0.8	-0.8	-2.2	-7.3	-5.6
Official	-13.1	-15.9	-16.1	-0.8	-0.8	-0.8	-1.2	-2.5	-2.3
Private	-45.4	-31.4	-33.3	-0.4	0.0	0.0	-1.0	-4.8	-3.3
Current account balance <sup>b</sup>	-41.3	105.4	-50.3	-5.2	-4.3	-3.7	-17.1	-22.4	-7.8
Net official transfers	15.2	19.8	17.2	2.3	2.8	2.4	2.0	2.5	2.2
Medium- and long-term loans <sup>c</sup>	36.1	58.1	18.6	1.4	1.7	1.5	6.8	18.7	4.9
Official	21.2	28.8	15.5	0.5	1.9	1.6	4.8	7.4	5.0
Private	15.0	29.3	3.1	0.9	-0.2	-0.2	2.0	11.4	-0.1
Debt outstanding and disbursed	722.9	864.2	560.9	28.9	28.6	23.4	60.1	167.4	92.7
As a percentage of GNP	33.0	22.3	17.2	58.6	38.5	33.9	10.2	15.5	10.3
As a percentage of exports	135.7	88.5	86.7	318.5	174.7	206.3	120.7	156.7	129.8
Debt service as a percentage of exports	21.9	13.4	16.7	35.8	13.5	17.2	11.9	18.0	18.0

Note: The table is based on a sample of ninety developing countries. The GDP deflator for industrial countries was used to deflate all items. Details may not add to totals because of rounding. Net exports in this table exclude factor services and thus differ from those in Table 3.5. Net exports plus interest does not equal the current account balance because of the omission of net workers' remittances, private transfers, and investment income. The current account balance not financed by official transfers and loans is covered by direct foreign investment, other capital (including short-term credit and errors and omissions), and changes in reserves. Ratios are calculated using current price data.

**Table 3.5 Net financing flows to developing countries in selected years, 1980-95**

Type of flow	Amount (billions of dollars at constant prices)					Growth rate (percent) <sup>a</sup>		
	1980	1984	1985	1995		1970-80	1985-95	
				High	Low		High	Low
Official development assistance <sup>b</sup>	23.4	21.6	22.4	29.6	25.7	5.9	2.8	1.4
Nonconcessional loans	47.1	33.4	28.9	48.3	10.1	12.6	5.3	-10.0
Official	8.7	13.9	14.0	19.0	7.0	12.6	3.1	-6.7
Private	38.4	19.5	15.0	29.3	3.1	12.6	7.0	-14.7
Direct investment	10.6	10.8	11.0	19.1	14.2	5.8	5.7	2.6
Total	81.1	65.9	62.3	97.0	49.9	9.2	4.5	-2.2
<i>Memo items</i>								
Net export of goods and nonfactor services <sup>c</sup>	-92.8	-61.9	-66.5	-135.2	-76.5	8.9	7.4	1.4
Current account balance <sup>d</sup>	-67.8	-35.3	-41.3	-105.4	-50.3	7.5	9.8	2.0
ODA from DAC countries as a percentage of their GNP	0.38	0.38	0.37	0.37	0.37	—	—	—

Note: All items are net of repayments. Data are for a sample of ninety countries.

a. Average annual percentage change.

b. Includes ODA grants (official transfers). DAC reporting includes, and the World Bank Debtor Reporting System excludes, ODA flows from nonmarket economies and the technical assistance component of grants. There are no differences in coverage of recipient countries in the two data sources.

c. Net exports of goods and nonfactor services plus net investment receipts minus interest on medium- and long-term debt.

d. Excludes official transfers.

Middle-income countries									
Oil-exporting countries			Major exporters of manufactures			Other oil-importing countries			Item
1985 <sup>a</sup>	1995		1985 <sup>a</sup>	1995		1985 <sup>a</sup>	1995		
	High	Low		High	Low		High	Low	
15.2	-12.8	6.5	19.8	-35.1	-14.0	-12.0	-12.4	-4.2	Net exports of goods and nonfactor services
-21.1	-13.0	-10.5	-25.5	-20.3	-26.5	-8.4	-5.9	-6.0	Interest on medium- and long-term debt
-3.3	-4.4	-4.4	-4.7	-4.1	-4.3	-3.0	-4.2	-4.4	Official
-17.8	-8.6	-6.1	-20.8	-16.2	-22.2	-5.4	-1.7	-1.6	Private
5.6	-25.8	-4.9	-0.2	-43.8	-31.2	-13.1	-9.0	-2.7	Current account balance <sup>b</sup>
2.0	3.4	2.9	5.4	6.9	6.0	3.5	4.3	3.7	Net official transfers
1.8	12.7	-2.4	19.3	21.6	16.5	6.7	3.3	-1.8	Medium- and long-term loans <sup>c</sup>
4.4	7.8	3.7	5.7	4.4	1.9	5.8	7.3	3.2	Official
-2.6	4.9	-6.1	13.7	17.3	14.5	1.0	-4.0	-5.1	Private
230.2	227.5	111.4	288.9	329.6	263.6	114.8	111.1	69.8	Debt outstanding and disbursed
39.4	24.6	13.6	37.9	22.9	22.9	54.5	30.4	22.2	As a percentage of GNP
160.8	116.4	90.5	108.2	60.5	72.9	180.1	98.5	87.5	As a percentage of exports
31.6	17.4	17.8	17.2	10.7	15.9	26.1	14.7	17.2	Debt service as a percentage of exports

a. Estimated.

b. Excludes official transfers.

c. Net disbursements.

growth rate of 4.5 percent a year. As ODA is assumed to remain at a constant 0.37 percent of DAC countries' GNP, it moves in line with their economic performance. Thus, an expanding world economy not only would provide improved export markets for developing countries but also would lead to a real increase in the level of concessional finance. This is crucial for sub-Saharan Africa, where even the higher level of ODA assumed in our High case would be insufficient to avoid future debt repayment problems in a dozen or more countries. Appropriate domestic policies, particularly in newly industrialized countries, would attract more foreign investment. Thus, private direct investment could increase at about 5.7 percent a year, as rapid growth in industrial countries produces more investment-seeking capital and positive real rates of interest make equity finance more attractive to developing countries.

If a concerted effort is made by developing countries to adjust and support from bilateral and multilateral agencies is increased, total nonconcessional capital flows would also grow. Under the High case, they would increase at a moderate 5.3 percent a year, primarily as a result of the restora-

tion of private lending. As commercial banks respond to the improved creditworthiness of developing countries, within a more stable and growing world economy, private lending would increase from the low 1985 level of \$15.0 billion to \$29.3 billion by 1995, a growth rate of 7.0 percent a year over the next ten years. This is, quite appropriately, much lower than the 12.6 percent rate of growth in private lending that occurred during the 1970-80 period, when economies adjusted to the two oil price increases. Official nonconcessional lending is also anticipated to increase at about 3.1 percent a year. The resulting net flow of official nonconcessional lending of \$19.0 billion in real terms by 1995, up from \$14.0 billion in 1985, reflects the third leg of a combined effort by bilateral, multilateral, and private financiers to assist developing countries in adjusting.

The increase in total net capital inflows and the corresponding larger current account deficit in the High case are sustainable because export earnings increase faster than debt service payments. A higher rate of growth in the world economy and freer trade create the conditions for this to occur. For developing countries as a whole, total debt

would decline as a proportion of GNP from 33.0 percent in 1985 to 22.3 percent in 1995. As a proportion of exports the figures would be 135.7 percent and 88.5 percent, respectively. These broad measures indicate the improvement in creditworthiness as most of the developing countries grow out of the debt problem. Before this could happen, however, additional international initiatives would be required in the near term to address the pressing debt problems of some heavily indebted countries and a group of low-income sub-Saharan countries. The type of initiatives required are discussed in the last section of this chapter.

#### *The Low case*

In the Low case, total interest payments would decline not because of lower interest rates (as in the High case) but because of a decline in capital flows to developing countries. Total debt outstanding and disbursed would decline from \$723 billion in 1985 to \$561 billion in 1995 (see Table 3.4). This decline in the real level of outstanding debt would entail a much lower current account deficit than the one implied in the High case. Given slow export growth, the level of imports and investment would be constrained below the level attained in the High case, which would inevitably result in slower growth.

As developing countries become less creditworthy and growth in industrial countries slows in the Low case, total net capital flows to developing countries would fall from \$62.3 billion in 1985 to \$49.9 billion in 1995 (see Table 3.5). The Low case assumes, perhaps optimistically, that industrial countries would maintain development assistance at 0.37 percent of their GDP. But the slower growth of industrial countries' GNP in the Low case would mean that by 1995 ODA would be \$3.9 billion less than in the High case. As commercial banks reduce their exposure in uncreditworthy countries, net private lending would also fall from the already low level of \$15.0 billion in 1985 to \$3.1 billion in 1995. This low figure reflects very limited rescheduling as commercial banks gradually reduce their portfolio in noncreditworthy developing countries. Under these conditions the developing countries would have to make very painful adjustments to a sluggish world economy with diminished capital inflows.

To maintain creditworthiness, developing countries would have to improve their trade balances, mainly by increasing exports and not by cutting imports further. With slow growth in world trade,

however, only the most efficient developing countries could achieve this—mainly by increasing their share of export markets. In aggregate this situation is untenable. Squeezed between higher debt servicing and reduced capital flows, many developing countries would face an unenviable choice: cut imports yet further by reducing investment and lowering consumption—which will reduce growth and exacerbate social tensions—or reschedule debt, if possible. Without growth, creditworthiness cannot be restored.

#### **International initiatives and the role of the Bank**

The duration and magnitude of the economic and financial crises which many developing countries have experienced over the past half decade have heightened recognition of the longer-term, rather than temporary, nature of the debt problem. A consensus is evolving that the restoration of economic growth in these countries is critical to achieving a lasting and effective solution. The pursuit of this adjustment with growth objective will require close collaboration among the governments of the developing countries, the governments of the industrial countries, the multilateral institutions, and, in many cases, the commercial banks.

Recently, attention has focused on the heavily indebted middle-income developing countries, primarily because of the potential impact that action or inaction in addressing their problems could have on the international economy. In the fall of 1985, U.S. Secretary of the Treasury James A. Baker III suggested a plan of action to address the problems of these countries. It emphasized the critical importance of an adjustment with growth strategy and supported the proposal for a collaborative international effort by debtors and creditors alike. Restoring growth is no less important for low-income countries in sub-Saharan Africa. The impact that these economies have on the world economy is smaller, but the costs of a further decline in their per capita incomes is very high in terms of its impact on the poor.

#### *Increased private and official net flows*

Mobilizing additional capital flows from private and official sources will be a crucial factor in establishing the conditions required for growth. On the private side, Baker's initial proposal envisioned an increase in the net exposure of commercial banks during the next three years. One estimate of the

increase in net flows required to help the heavily indebted middle-income countries adjust is provided in Box 3.4. To attain this transfer it will be necessary to strengthen the link between private bank debt restructuring, the provision of additional new financing, and comprehensive growth-oriented policy reforms by recipient countries. In some cases this collaborative effort needs to include a strengthening of the links between the commercial banks and institutions such as the World Bank that are capable of assisting in the development and monitoring of policy reform programs. This effort will, over time, help mobilize private flows by reducing the private banks' perception of risk. On the official side, a comparable effort needs to be made to increase flows from export credit agencies.

The increased economic stability provided by corrective domestic reforms, coupled with renewed access to external capital flows, will also help restore foreign private investors' confidence. Aside from providing an additional source of finance, direct private foreign investment has another advantage: it keeps the risks associated with investments that require foreign finance firmly in the hands of foreign investors and does not, as is the case for guaranteed loans, increase the obligations of the government.

An adjustment with growth strategy is no less important for the low-income countries of sub-Saharan Africa. While some progress has been made in pursuing structural adjustment, much more remains to be done to correct the accumulated policy distortions of the past. As in the heavily indebted middle-income countries, the prime responsibility rests with the domestic policymakers. They must implement reforms to reduce distortions, improve the allocation of resources, and increase domestic savings. Additional external resources will ease adjustment toward growth. But unlike the middle-income countries, most of these countries have very limited creditworthiness and debt-servicing capacity—a dozen or so are facing acute debt difficulties. This means that external private nonconcessional lending is likely to remain limited for at least the remainder of the decade. This implies the need for significant increases in official concessional flows to support countries committed to reform. Bilateral increases could involve both additional aid flows and more extensive debt relief actions.

The bulk of the multilateral flows will come from the International Monetary Fund and the International Bank for Reconstruction and Development.

The IMF has recently established a structural adjustment facility which is expected to lend a total of SDR 2.7 billion on concessional terms over the next five years to low-income countries undertaking macroeconomic and structural adjustment. The other major source of additional multilateral flows is likely to be the International Development Association (IDA). The negotiation of the Eighth Replenishment of IDA (IDA-8) is now under way. The critical need of all low-income countries, especially those in sub-Saharan Africa, coupled with the role which the World Bank will have to play in the designing and financing of adjustment programs in these countries, argues strongly for a substantial replenishment. Virtually all ministers at the April 1986 Development Committee meeting expressed the strong hope that an IDA-8 replenishment of \$12 billion will be achieved. This would maintain in real terms the concessionary resources now available through IDA-7 and the Special Facility for Sub-Saharan Africa.

#### *The role of international trade*

Increased export earnings for developing countries is the second linchpin in the effort to reestablish sustainable growth and creditworthiness. This requires the reduction of the disincentives to exports created by the developing countries' own policy regimes in both industry and agriculture (see Chapters 4 and 5). It is therefore important that many of these countries undertake a rationalization and liberalization of their trade regimes in order to develop the export potential of their economies.

Developing-country exports are also affected by the trade policies of the industrial countries. The 1980s have been marked by a rise in protectionist pressures in both manufacturing and agriculture. Particularly worrisome is the increasing use of nontariff measures to restrict trade. Industrial-country tariff and nontariff barriers are often more restrictive on those products of specific interest to the developing countries than on others. This is seen most dramatically in the restrictions on agricultural and textile trade. Agricultural trade policy issues have, however, been largely excluded from earlier multilateral trade negotiations. While resistance remains strong, preliminary discussions within the GATT have pointed to an increased willingness to open the agricultural trade issue to international discussion.

Experience has shown that a multilateral approach can be effective in stemming the tide of

protectionist action and achieving broad-scale reductions in trade barriers. The GATT is now preparing for a new round of multilateral negotiations. As argued in Box 3.1, it is important that developing countries in general, and middle-income countries in particular, participate in the negotiations. Because of the potential benefit to industrial and developing countries alike, particularly for agricultural commodities, this trade liberalization effort deserves strong international support.

#### *The role of the World Bank*

There are four dimensions to the World Bank's expanded role in undertaking initiatives to revive growth in developing countries:

- To assist in the development, implementation, and monitoring of medium-term adjustment programs in pursuit of the objectives of member countries committed to policy reform.
- To expand greatly its own lending in support of such programs.
- To extend its catalytic role and, consistent with its role as preferred creditor, help establish a process for coordinated mobilization of private and official support of developing countries' efforts.
- To strengthen coordination with the IMF.

To play this expanded role effectively, the Bank would also need to use its own human and financial resources in an even more efficient way.

Since the introduction of its structural adjustment lending program in 1980, the World Bank has been involved in designing and monitoring adjustment programs to maintain or restore growth. As a result, an increased proportion of its lending has been in the form of fast-disbursing policy-based loans and loans in support of maintenance and rehabilitation projects. The Bank's involvement in this adjustment effort is needed not only to help resolve the difficulties involved in developing and implementing such medium-term programs, but also to generate increased confidence of private and public creditors. In addition to its work on policy reform, the World Bank is supporting the acceleration of foreign private direct investment through an expanded role of the International Finance Corporation (IFC) and through the establishment of the Multilateral Investment Guarantee Agency (MIGA), which is designed to promote increased investment by providing noncommercial risk insurance to investors and a wide range of advisory and technical assistance.

The larger role played by donors in providing finance to low-income countries also increases the need for coordination among donors to improve effectiveness. Individual donors at times have pursued their own agenda, which can sharply reduce the benefit derived from their assistance. Some recipient governments have also had difficulty managing a large number of donors and donor projects. This, coupled with the increased need to provide aid in quick-disbursing form to support policy action and for rehabilitation and maintenance, has led donors and recipients to look to the World Bank to increase its coordination efforts.

Monitoring arrangements for adjustment programs will have to be designed on a case-by-case basis, in light of each borrower's relationship with the Bank, the IMF, and other multilateral institutions. It is clear that increased collaboration between the World Bank and the IMF is required. The areas of economic policy dealt with by each institution are related and complementary, as is the financial assistance each can provide. Furthermore, macroeconomic stabilization and structural adjustment must be pursued simultaneously and in a unified way: in short, as two sides of the same coin—growth. Bank-Fund collaboration has grown substantially in recent years as the two institutions have sought to increase the complementarity of their programs and their capacity to respond to the needs of developing countries. Exploration of ways to further improve this collaboration continues.

An integral component of this concerted international adjustment with growth effort is increased World Bank lending to countries that implement serious policy reform. Higher levels of lending are needed both to support these reform programs and to stimulate other financial flows. The timing and level of additional World Bank lending will, of course, depend on the adoption and implementation by these countries of medium-term adjustment programs. Since increased lending by the Bank will naturally affect its own resource requirements, additions to its capital base will be needed in the near future. As the ministers at the spring 1986 meeting of the Development Committee agreed, the Bank should be provided with the capacity to increase its quality lending and should not be constrained by lack of capital or borrowing authority in meeting future demand. As a result, increased attention is being given to the issue of the potential size and timing of a general capital increase for the Bank.