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Sec's speechwriter

REMARKS: WORLD BANK/IMF ANNUAL MEETING
SHERATON WASHINGTON
WASHINGTON, D.C.
WEDNESDAY, SEPTEMBER 27, 1989
9:35 A.M.

THANK YOU. AND THANKS ESPECIALLY TO MY GOOD FRIEND Sec. treas. NICK BRADY, FOR THOSE WARM WORDS, AND FOR HIS OUTSTANDING ECONOMIC LEADERSHIP -- BOTH AT HOME, AND ABROAD. [[PAUSE]]

CHAIRMAN LEE, PRESIDENT CONABLE, MR. CAMDESSUS [[KAHM-DEH-SOO]] IT IS A PLEASURE FOR ME TO BE HERE ~~THIS MORNING~~, AND TO WELCOME YOU TO WASHINGTON. DC AND IT IS A SPECIAL PRIVILEGE FOR ME TO BE HERE IN THE COMPANY OF MY OLD FRIEND, former Cong. now Pres. BARBER CONABLE.

WE IN THE UNITED STATES ARE KEENLY AWARE OF THE IMPORTANCE OF THESE ANNUAL GATHERINGS, WHICH DRIVE THE WORK OF ALL OF US IN MAINTAINING A STRONG INTERNATIONAL ECONOMIC AND FINANCIAL SYSTEM.

THIS IS MY FIRST OPPORTUNITY TO SPEAK TO YOU AS PRESIDENT of the US. BUT I HAVE FOLLOWED THE ACTIVITIES OF THE INTERNATIONAL MONETARY FUND AND THE WORLD BANK THROUGHOUT MY YEARS OF PUBLIC SERVICE. I HAVE VISITED MANY OF YOUR HOMELANDS, AND SEEN FIRST-HAND THE PROBLEMS CREATED BY INADEQUATE GROWTH AND DEVELOPMENT -- PROBLEMS THAT YOUR TWO DISTINGUISHED INSTITUTIONS ARE WORKING hard TO SOLVE.

WE HAVE WITNESSED A DRAMATIC SHIFT OVER THE PAST FEW YEARS IN THE DEBATE OVER HOW TO ACHIEVE SUSTAINED GROWTH AND DEVELOPMENT.

ALL ACROSS THE WORLD, THERE HAS BEEN AN ALMOST SIMULTANEOUS REDISCOVERY OF THE POWER CREATED WHEN INDIVIDUALS ARE GIVEN THE FREEDOM TO ACT IN THEIR OWN BEST INTERESTS.

TRUE, WE'RE HERE TODAY MAINLY TO DISCUSS <u>ECONOMIC</u> FREEDOM. BUT MAKE NO MISTAKE. IN THE END, BOTH ECONOMIC FREEDOM -- AND <u>POLITICAL FREEDOM</u> -- ARE ESSENTIAL AND INSEPARABLE COMPANIONS ON THE ROAD TO NATIONAL PROSPERITY.

THE JURY IS NO LONGER OUT. LOOK AT THE TWO ECONOMIC SYSTEMS AND SEE WHO HAS PROSPERED AND WHO HAS STRUGGLED. \\ **LET'S PUT AN <u>END</u> TO THIS ECONOMIC EXPERIMENT. \/\/ BECAUSE <u>HISTORY</u> <u>HAS</u> <u>DECIDED</u>.** [[PAUSE]]

IT IS NOT CLIMATE, NATURAL RESOURCES, OR CULTURAL TRADITIONS THAT MAKE THE DIFFERENCE. I SAID IT IN MY own INAUGURAL ADDRESS:

"WE KNOW WHAT WORKS: <u>FREEDOM</u> WORKS. WE KNOW HOW TO SECURE A MORE JUST AND PROSPEROUS LIFE FOR MAN ON EARTH: THROUGH <u>FREE</u> MARKETS, <u>FREE</u> SPEECH, <u>FREE</u> ELECTIONS, AND THE EXERCISE OF <u>FREE</u> <u>WILL</u> UNHAMPERED BY THE STATE." [[PAUSE]]

IN LATIN AMERICA, in AFRICA, ~~AND~~ MEXICO, COURAGEOUS LEADERS ARE TURNING AWAY FROM STATE CONTROL OF THEIR ECONOMIES. ECONOMIC RESTRUCTURING AND DEREGULATION ARE OPENING THE DOOR TO PRIVATE INITIATIVE. AND ALREADY THEY ARE SEEING RESULTS.

EVEN MORE STUNNING IS THE TRANSFORMATION IN THINKING IN THE COMMUNIST COUNTRIES -- IN BOTH THE SOVIET UNION AND IN EASTERN EUROPE.

DURING ~~OUR~~ MY RECENT TRAVELS IN POLAND AND HUNGARY, ~~WE~~ I WERE IMPRESSED BY THE PEOPLE. BUT ~~WE WERE~~ I WAS ALSO IMPRESSED BY THE ALMOST UNIVERSAL ACCEPTANCE OF THE FREE MARKET AS THE BEST HOPE -- INDEED, THE ONLY HOPE -- FOR REVERSING THE ECONOMIC FORTUNES OF THESE TWO PROUD COUNTRIES.

AND WE WILL WELCOME THE EFFORTS OF THE SOVIET UNION TO LIBERALIZE AND DECENTRALIZE THEIR ECONOMY. I HAVE SAID MANY TIMES THAT I WANT TO SEE PERESTROIKA SUCCEED. A MORE OPEN AND HUMANE SOVIET UNION CAN ONLY BE IN THE BEST INTEREST OF THE WEST. AND AS WE SEE THE EVIDENCE OF THAT REFORM, WE CAN MATCH IT WITH STEPS OF OUR OWN.

THE REDISCOVERY OF THESE BASIC TRUTHS IN THE EAST HAS BEEN MATCHED BY A RECOMMITMENT TO THEM IN THE WEST. TODAY THE MEMBERS OF THE EUROPEAN COMMUNITY ARE DEDICATED TO ELIMINATING INTERNAL BARRIERS TO ECONOMIC ACTIVITY BY THE END OF 1992. AND, EUROPE'S LEADERS ASSURE ME THAT THIS WILL NOT BE AT THE COST OF NEW EXTERNAL BARRIERS TO TRADE WITH THE E.C.

THE PERUVIAN ECONOMIST, HERNANDO DE SOTO, HAS HELPED US UNDERSTAND A WORLDWIDE ECONOMIC PHENOMENON. BY WALKING THE STREETS OF LIMA, NOT ANALYZING OFFICIAL STATISTICS, HE FOUND THAT THE POOR OF LATIN AMERICA -- WHO HAVE NEVER READ JEFFERSON OR ADAM SMITH -- RAN THEIR AFFAIRS DEMOCRATICALLY, OUTSIDE THE FORMAL ECONOMY, ORGANIZING THEIR PRIVATE, PARALLEL ECONOMY IN A FREE AND UNREGULATED MANNER.

DE SOTO'S GREAT CONTRIBUTION HAS BEEN TO POINT OUT WHAT, IN RETROSPECT, MAY SEEM OBVIOUS: PEOPLE EVERYWHERE WANT THE SAME THINGS. AND WHEN LEFT ALONE BY GOVERNMENT, PEOPLE EVERYWHERE ORGANIZE THEIR LIVES IN REMARKABLY SIMILAR WAYS.

DE SOTO'S PRESCRIPTION OFFERS A CLEAR AND PROMISING ALTERNATIVE TO ECONOMIC STAGNATION IN LATIN AMERICA AND OTHER PARTS OF THE WORLD. GOVERNMENTS MUST BRING THE "INFORMAL" WORKERS INTO THE REGULAR ECONOMY -- AND THEN GET OUT OF THE WAY, AND LET INDIVIDUAL ENTERPRISE FLOURISH.

WE EACH MUST DO OUR PART. AND YES THE INDUSTRIAL COUNTRIES HAVE A SPECIAL RESPONSIBILITY. WE MUST COORDINATE ECONOMIC POLICIES TO HELP PROVIDE SUSTAINED GROWTH WITH LOW INFLATION, REDUCED TRADE IMBALANCES, AND GREATER STABILITY IN EXCHANGE MARKETS.

WE IN THE UNITED STATES ARE WORKING ESPECIALLY HARD TO REDUCE ~~THE~~ our own FEDERAL BUDGET DEFICIT, AND TO INCREASE OUR NATIONAL SAVINGS RATE.

ALL OUR NATIONS HAVE A RESPONSIBILITY TO ENSURE A FAIR AND OPEN TRADING SYSTEM. WE HAVE A TREMENDOUS OPPORTUNITY TO ADVANCE THAT CAUSE NOW, BY MAKING A SUCCESS OF THE all important URUGUAY ROUND OF TRADE NEGOTIATIONS.

MAKING THE POLITICAL COMMITMENTS NECESSARY TO ENSURE A SUCCESS WILL NOT BE EASY, BUT WE MUST STRENGTHEN THE GATT, AND ALLOW OUR MARKETS TO OPEN IN A MUTUAL, STEP-BY-STEP FASHION.

AS WE SEEK TO EXTEND AND EXPAND GROWTH IN THE WORLD ECONOMY, THE DEBT PROBLEMS FACED BY DEVELOPING COUNTRIES ARE CENTRAL TO THE AGENDAS OF THE IMF AND THE WORLD BANK. OVER THE PAST YEAR, THE INTERNATIONAL COMMUNITY'S STRENGTHENED APPROACH TO THESE PROBLEMS HAS PROVIDED NEW HOPE FOR DEBTOR NATIONS.

AMERICA'S SECRETARY OF THE TREASURY, NICK BRADY, HAS HELPED DIRECT THE FOCUS ON DEBT REDUCTION AS A COMPLEMENT TO CONTINUED NEW LENDING -- BRINGING DEVELOPING NATIONS AND COMMERCIAL BANKS BACK TO WHERE THEY BELONG: Back at THE NEGOTIATING TABLE.

QUICK ACTION BY BOTH THE IMF AND THE WORLD BANK HAS GIVEN THIS NEW STRATEGY VITAL SUPPORT. BY MAKING CLEAR THE TERMS UNDER WHICH THEY WILL SUPPORT THE REDUCTION OF DEBT BURDENS -- AND BY WORKING WITH COUNTRIES TO DEVELOP THE NECESSARY ECONOMIC REFORM PROGRAMS -- THESE INSTITUTIONS HAVE MADE IT POSSIBLE TO REDUCE DEBT BURDENS AND PROVIDE A SOLID FOUNDATION FOR GROWTH.

THANKS TO THESE INITIATIVES, MEXICO REACHED AN AGREEMENT WITH ITS CREDITOR BANKS ENABLING MEXICO TO MAKE ENORMOUS PROGRESS IN REDUCING ITS DEBT BURDEN. IT ALSO HELPED RESTORE CONFIDENCE IN THE MEXICAN ECONOMY WHICH HAS ALREADY RESULTED IN A RETURN OF CAPITAL AND NEW FOREIGN INVESTMENT.

THIS AGREEMENT UNDERSCORES THE BENEFITS OTHER DEBTOR COUNTRIES STAND TO REALIZE FROM THIS APPROACH. MEXICO'S SAVINGS FROM THIS PACKAGE WILL FREE RESOURCES FOR PRODUCTIVE USE IN THE ECONOMY, LEADING TO INCREASED INVESTMENT AND IMPROVED GROWTH.

WHAT MEXICO HAS DONE IS NOT A MIRACLE. IT IS A PRODUCT OF HARD WORK AND SUSTAINED COMMITMENT.

THE STRENGTHENED DEBT STRATEGY IS FLEXIBLE ENOUGH TO ADDRESS THE UNIQUE NEEDS OF EACH COUNTRY. **BUT THE STRATEGY WILL NOT WORK WITHOUT SOUND ECONOMIC POLICIES IN DEBTOR COUNTRIES.**

INEFFICIENT, UNREALISTIC, AND GROWTH-STIFLING POLICIES simply **MUST GO.** BENEFITS ARE AVAILABLE TO A BROAD RANGE OF OTHER COUNTRIES THAT PURSUE ECONOMIC REFORMS. SEVERAL ARE NOW ACTIVELY ENGAGED WITH THE IMF AND WORLD BANK, AND WITH THE BANKING COMMUNITY.

COMMERCIAL BANKS HAVE A SPECIAL ROLE IN MAKING THIS PROCESS WORK AND MUST FOLLOW THROUGH ON EFFORTS MADE WITH MEXICO AND THE PHILIPPINES, AND BROADEN THEIR EFFORTS WITH OTHER COUNTRIES.

WE ENCOURAGE THESE STEPS NOT AS SELF-SACRIFICE -- BUT AS SELF-INTEREST. TRUE, SUCCESS NOT ONLY WILL HELP THE DEBTOR NATIONS. BUT IT WILL ALSO STRENGTHEN THE BANKS, BY PUTTING THEIR own PORTFOLIOS ON A SOUNDER FOOTING.

ONE OF THE LESSONS OF THE 1980'S, ESPECIALLY THE DEBT CRISIS, IS THAT WE'RE ALL IN THIS TOGETHER. AND WHEN WE COOPERATE, WE ALL COME OUT WINNERS.

THE IMF AND THE WORLD BANK ARE AT THE CROSSROADS OF OUR COOPERATIVE EFFORTS. THE IMF MUST CONTINUE TO FOSTER THE SOUND ECONOMIC POLICIES NECESSARY FOR SUSTAINED GROWTH. AS PART OF THAT RESPONSIBILITY, THE FUND HAS ASSUMED AN IMPORTANT AND WELCOME ROLE IN THE STRENGTHENED DEBT STRATEGY. very

THE UNITED STATES RECOGNIZES THAT THE IMF MUST HAVE ADEQUATE RESOURCES TO FULFILL ITS CRITICAL ROLE. and WE WILL CONTINUE TO WORK WITH OTHER MEMBERS, IN THE HOPE OF REACHING A DECISION ON QUOTAS BY THE END OF THE YEAR. THE UNITED STATES HAS ALWAYS SUPPORTED THE IMF AND we WILL CONTINUE TO DO SO.

WE ALL LOOK TO THE WORLD BANK TO HELP BUILD THE FOUNDATION FOR A FUTURE GLOBAL PROSPERITY THAT REACHES ALL PEOPLES. ITS EFFORTS TO PROMOTE STRUCTURAL REFORM AND DEVELOPMENT ARE CRUCIAL TO RESOLVING DEBT PROBLEMS. THE BANK'S DECISIONS TO TAKE ON NEW RESPONSIBILITIES ON THE DEBT FRONT ARE WELCOME.

ALSO, TO ADDRESS THE SIGNIFICANT PROBLEMS OF THE POOREST COUNTRIES, THE INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA) WAS ESTABLISHED AND WILL CONTINUE TO HAVE THE SUPPORT OF THE UNITED STATES.

WE HAVE ALSO LEARNED, AS I EMPHASIZED MONDAY AT THE U.N., AND LAST SUMMER AT THE PARIS SUMMIT, THAT **ENVIRONMENTAL DESTRUCTION KNOWS NO BORDERS.**

TO MAKE GROWTH TRULY SUSTAINABLE, WE MUST WEIGH ENVIRONMENTAL CONSIDERATIONS MORE HEAVILY AS WE MAKE ECONOMIC DECISIONS. WE MUST ALSO FIND WAYS TO STRENGTHEN OUR ENVIRONMENTAL AND DEVELOPMENTAL EFFORTS, THROUGH INNOVATIVE THINKING SUCH AS "DEBT FOR NATURE" TRANSACTIONS.

OVER THE YEARS -- AS WE'VE COME TO UNDERSTAND THE EFFECT OF ENVIRONMENTAL DESTRUCTION ON THE LONG-TERM GROWTH OF DEVELOPING COUNTRIES -- THE WORLD BANK HAS INCREASED THE PRIORITY IT ASSIGNS TO ENVIRONMENTAL CONCERNS. WE APPLAUD THOSE EFFORTS. BUT THERE IS MORE TO BE DONE. WE NEED TO WORK MORE COOPERATIVELY TO DEVELOP CONSTRUCTIVE SOLUTIONS TO GLOBAL WARMING, INCLUDING MEASURES TO PROMOTE ENERGY EFFICIENCY AND CONSERVATION AND GREATER PROTECTION OF FOREST RESOURCES.

IN ADDRESSING THE CHALLENGES OF THE 1980'S, WE HAVE COME TO A DEEPER UNDERSTANDING OF THE IMPORTANCE OF COOPERATING AS A COMMUNITY OF NATIONS TO ADDRESS COMMON PROBLEMS.

I CAN THINK OF NO BETTER CURRENT EXAMPLE THAN THE NEED TO WORK TOGETHER TO DEAL WITH INTERNATIONAL DRUG TRAFFICKING AND MONEY LAUNDERING. IT IS A WORLDWIDE PROBLEM. DRUG MONEY UNDERMINES HONEST BUSINESSES, CORRUPTS POLITICAL INSTITUTIONS, AND EVEN THREATENS THE SECURITY OF NATIONS. TO CONCEAL THEIR OBSCENE PROFITS, DRUG BARONS MUST WASH THEIR MONEY BY CYCLING IT THROUGH FINANCIAL INSTITUTIONS AND ILLEGITIMATE SHELL CORPORATIONS.

THE UNITED STATES RENEWS ITS CALL UPON ALL COUNTRIES TO RATIFY THE UNITED NATIONS VIENNA CONVENTION, AND MAKE MONEY LAUNDERING A CRIMINAL AND EXTRADITABLE OFFENSE. WE NEED TOUGH MEASURES TO TRACK DOWN AND CONFISCATE THE PROFITS OF DRUG-RELATED CRIME.

I AM ENCOURAGED BY THE G-7 DEMOCRACIES' INTEREST IN A COORDINATED RESPONSE TO THE MONEY LAUNDERING MENACE. I URGE EVERYONE TO JOIN WITH US TO EXPLORE NEW WAYS TO STOP MONEY LAUNDERING IN ITS TRACKS.

AND THERE MAY BE NO GREATER OPPORTUNITY BEFORE US ALL TODAY THAN THE CHALLENGE OF POLAND AND ~~MORE~~ in the BROADL~~Y~~er landscape EASTERN EUROPE -- WHERE COUNTRIES ARE IN THE THROES OF DRAMATIC POLITICAL AND ECONOMIC CHANGE.

THE UNITED STATES AND ITS INTERNATIONAL PARTNERS HAVE ALREADY UNDERTAKEN NEW INITIATIVES TOWARD POLAND. BUT NOW, IN LIGHT OF CLEARLY GROWING NEEDS, THE RECENT ACCESSION OF A SOLIDARITY-LED GOVERNMENT, AND OUR SELF-EVIDENT STAKE IN ITS SUCCESS, WE MUST DO MORE. WE UNDERSTAND THE POLISH GOVERNMENT HAS UNDER CONSIDERATION A BOLD PLAN FOR ECONOMIC RECOVERY.

I CALL ON THE I.M.F. AND THE WORLD BANK TO WORK RAPIDLY WITH POLAND TO DEVELOP SUCH A PROGRAM AND ENSURE ITS SUCCESSFUL IMPLEMENTATION. FOR ITS PART, THE UNITED STATES INTENDS TO BE OUT IN FRONT OF THIS EFFORT, TO TAKE ADVANTAGE OF THIS HISTORIC DEVELOPMENT AND TO ENSURE ITS SUCCESS.

TODAY OUR MUTUAL EFFORTS TO IMPROVE GLOBAL GROWTH, TO EASE THE BURDENS OF DEVELOPING COUNTRY INDEBTEDNESS, AND TO OPEN UP MARKETS FOR TRADE, HAVE DEMONSTRATED ANEW THAT PROGRESS IS BEST ACHIEVED BY FACING PRESSING ISSUES TOGETHER.

THIS IS A LESSON WE MUST CARRY WITH US INTO THE 1990'S IF WE ARE TO PASS ON TO FUTURE GENERATIONS A GLOBAL ECONOMY THAT IS STRONG AND RESILIENT, AND ABLE TO PROVIDE FOR THE ASPIRATIONS OF THE CITIZENS OF ALL OUR COUNTRIES.

THANK YOU FOR YOUR HARD WORK, YOUR SERVICE, YOUR COMMITMENT. GOD BLESS YOU AND THE NATIONS YOU REPRESENT.

# # #

THE WHITE HOUSE
WASHINGTON

September 25, 1989

INFORMATION

MEMORANDUM FOR THE PRESIDENT

THROUGH: CHRISS WINSTON CW

FROM: EDWARD McNALLY EMcN

SUBJECT: REMARKS FOR THE WORLD BANK/IMF ANNUAL MEETING

I. SUMMARY

Attached for your consideration and review are draft remarks for Wednesday morning's address to the annual meeting of the World Bank and the International Monetary Fund.

II. DISCUSSION

At 9:35 a.m. on Wednesday, September 27, 1989, you are scheduled to arrive at the Sheraton Washington Hotel to address the annual meeting of the World Bank and the International Monetary Fund.

You will be introduced by Treasury Secretary Nicholas Brady. An audience of approximately 3,500 international bankers is expected to attend.

The attached remarks were originally developed in a draft prepared by the Treasury Department, after being re-worked here by Stephen Farrar, Associate Director for International Economic Policy in Roger Porter's Office. The remarks emphasize your belief in the power of free markets and free choices to bring about national prosperity for any country, offer your support for the Brady Plan for debt relief, and underscore your commitment to safeguarding the environment even while promoting economic development abroad.

McNally/Simon
September 25, 1989 7:30 pm
Draft Four (B:IMF)

PRESIDENTIAL REMARKS: WORLD BANK/IMF ANNUAL MEETING
SHERATON WASHINGTON
WASHINGTON, D.C.
WEDNESDAY, SEPTEMBER 27, 1989
9:35 a.m.

Thank you. And thanks especially to my good friend Nick Brady, for those warm words, and for his outstanding economic leadership -- both at home, and <u>abroad</u>. [[PAUSE]]

Chairman Lee [[TYU KYU SUNG LEE, CHAIRMAN, WORLD BANK BOARD OF GOVERNORS]], President Conable [[BARBER CONABLE, WORLD BANK PRESIDENT]], Mr. Camdessus [[KAHM-deh-SOOS]] [[MICHEL CAMDESSUS, IMF MANAGING DIRECTOR]].

It is a pleasure for me to be here this morning, and to welcome you to Washington.

And it is a special privilege for me to be here in the company of my old friend, Barber Conable.

Almost 20 years ago, when Barber sat next to me in the House Ways and Means Committee, we had a bet about who would be first to become <u>President</u>. [[PAUSE]] We never said, "President of <u>what</u>" -- so now Barber claims he beat me by <u>two years</u>. [[PAUSE]]

Remember the reaction when Barber was named bank president? The headlines all said: "BARBARA WHO?" [[PAUSE]] That's okay. Until this year, the same thing happened all the time to <u>Barbara Bush</u>. [[PAUSE]]

We in the United States are keenly aware of the importance of these annual gatherings, and we are proud that we can be your hosts, as we have been for over 40 years since these institutions were created. We regard these meetings as key events -- events that drive the work of all of us in maintaining a strong international economic and financial system.

This is my first opportunity to speak to you as President. But I have followed the activities of the International Monetary Fund and the World Bank throughout my years of public service. I have visited many of your homelands, and seen first-hand the problems created by inadequate growth and development -- problems that your two distinguished institutions are working to solve.

But today, we're here to talk not about problems -- but about solutions.

We have witnessed a dramatic shift over the past few years in the debate over how to achieve sustained growth and development.

And although not a banker, you should know that I do have a degree in economics. It taught me one simple lesson: When you're standing in front of the world's greatest concentration of financial genius -- don't talk about economics. [[PAUSE]]

Let's talk instead about FREEDOM.

All across the world, there has been an almost simultaneous rediscovery of the power created when individuals are given the freedom to decide -- the freedom to act in their own best interests.

True, we're here today mainly to discuss economic freedom. But make no mistake. In the end, both economic freedom -- and

<u>political</u> <u>freedom</u> -- are essential and inseparable companions on the road to national prosperity.

The jury is no longer out. Take any <u>one</u> people, give them <u>two</u> sets of rules, and see who prospers and who struggles. Since World War II, we have seen two Germanys, [two Chinas], and two Koreas. It's been almost 50 years. \\ **Let's put an <u>end</u> to this economic experiment.** \/\/ **Because <u>history</u> <u>has</u> <u>decided</u>.**
[[PAUSE]]

It is not climate, natural resources, or cultural traditions that make the difference. I said it in my inaugural address:

"We know what works: <u>Freedom</u> works. We know what's right: <u>Freedom</u> is right. We know how to secure a more just and prosperous life for man on Earth: through <u>free</u> markets, <u>free</u> speech, <u>free</u> elections, and the exercise of <u>free</u> <u>will</u> unhampered by the state." [[PAUSE]]

In Latin America, Africa, and elsewhere, courageous leaders are turning away from state control of their economies. Through economic restructuring and deregulation, they are opening the door to private initiative. And already they are seeing results.

In Mexico, for example, sound economic policies adopted by the Salinas government -- coupled with their recent agreement with creditor banks -- are leading to a increased capital and foreign investment, and reduced domestic interest rates.

Even more stunning is the transformation in thinking in the communist countries -- not only in the Soviet Union, but in Eastern Europe.

Our recent travels among the people of Poland and Hungary led to many dramatic and stirring encounters. But almost as much as we were impressed by the people, we were impressed by the almost universal acceptance of the free market as the best hope -- indeed, the <u>only</u> hope -- for reversing the economic fortunes of these two proud countries.

The <u>rediscovery</u> of these basic truths in the <u>East</u> has been matched by a <u>recommitment</u> to them in the <u>West</u>. Today the members of the European Community are dedicated to eliminating internal barriers to economic activity by the end of 1992. And, Europe's leaders assure me that this will not be at the cost of new external barriers to trade with the E.C.

The Peruvian economist, Hernando de Soto, has helped us understand this worldwide phenomenon by documenting the process in Latin America.

De Soto was raised in Peru, and educated there and in Europe, where he lived until 1979. But the chronic privation of his homeland haunted him. Rather than analyzing flow-charts or official statistics for the answer, he began walking the streets of Lima.

He found that the poor of Latin America -- who have never read Jefferson or Adam Smith -- ran their affairs <u>democratically</u>, <u>outside</u> the formal economy, organizing their private, parallel economy in a free and unregulated manner.

De Soto's great contribution has been to point out what, in retrospect, may seem obvious: **People everywhere want the same**

things. And when left alone by government, people everywhere organize their lives in remarkably similar ways.

De Soto's prescription offers a clear and promising alternative to economic stagnation in Latin America and other parts of the world. Governments must bring the "informal" workers into the regular economy -- and then get out of the way, and let individual enterprise flourish.

The wider application of these principles within our economies is critical to achieving the stronger, more prosperous, global economy of tomorrow.

We each must do our part. The industrial countries have a special responsibility. We must coordinate economic policies to help provide sustained growth with low inflation, reduced trade imbalances, and greater stability in exchange markets.

We in the United States are working especially hard to reduce the federal budget deficit, and to increase our national savings rate.

All our nations have a responsibility to ensure a fair and open trading system. We have a tremendous opportunity to advance that cause now, by making a success of the Uruguay Round of trade negotiations.

Making the political commitments necessary to ensure a success will not be easy in any of our countries. **But it must be done.** We must strengthen the GATT, and allow our markets to open in a mutual, step-by-step fashion.

As we seek to extend and expand growth in the world economy, the debt problems faced by developing countries are central to the agendas of the IMF and the World Bank. Over the past year, the international community's strengthened approach to these problems has provided new hope for debtor nations.

America's Secretary of the Treasury, my good friend Nick Brady, has helped direct the focus on debt reduction as a complement to continued new lending -- bringing developing nations and commercial banks back to where they belong: <u>the negotiating table</u>.

Quick action by both the IMF and the World Bank has given this new strategy vital support. By making clear the terms under which they will support the reduction of debt burdens -- and by working with countries to develop the necessary economic reform programs -- these institutions have made it possible to reduce debt burdens and provide a solid foundation for growth.

Thanks to these initiatives, Mexico reached an agreement in July with its creditor banks. The deal enabled Mexico to make enormous progress in reducing its debt burden. It also helped restore confidence in the Mexican economy which has already resulted in a return of flight capital and new foreign investment.

This agreement underscores the benefits other debtor countries stand to realize from this approach. Mexico's savings from this package will free resources for productive use in the economy, leading to increased investment and improved growth.

What Mexico has done is not a miracle. It is a product of hard work and sustained commitment.

The strengthened debt strategy is flexible enough to address the unique needs of each country. **But the strategy will not work without sound economic policies in debtor countries.**

Inefficient, unrealistic, and growth-stifling policies must go. Benefits are available to a broad range of other countries that pursue economic reforms. Several are now actively engaged with the IMF and World Bank, and with the banking community -- Costa Rica, Venezuela, Poland, and Morocco, to name a few.

Commercial banks have a special role in making this process work. It is important that the banks follow through on efforts made with Mexico and the Philippines, and broaden their efforts with other countries.

We encourage these efforts not as self-sacrifice -- but as self-<u>interest</u>. True, success not only will help the debtor nations. But it will also strengthen the <u>banks</u>, by putting their portfolios on a sounder footing.

One of the lessons of the 1980's, especially the debt crisis, is that **we're all in this together. And when we cooperate, we all come out winners.**

The IMF and the World Bank are at the crossroads of our cooperative efforts. They are distinct institutions, even though their work is complementary and their objectives often overlap.

The <u>IMF</u> must continue to foster the sound economic policies necessary for sustained growth. As part of that responsibility, the Fund has assumed an important and welcome role in the strengthened debt strategy.

The United States recognizes that the IMF must have adequate resources to fulfill its critical role. We will continue to work with other members, in the hope of reaching a decision on quotas by the end of the year. The United States has always supported the IMF and will continue to do so.

We all look to the World Bank to help build the foundation for a future global prosperity that reaches all our citizens.

Its efforts to promote structural reform and development are crucial to resolving debt problems. The Bank's decisions to take on new responsibilities on the debt front are welcome.

In order to address the significant problems of the poorest countries, the international community established the International Development Association (IDA) within the Bank as a means of providing concessional resources to those countries. I.D.A. will continue to have the support of the United States as it has had in the past.

We have also learned, as I emphasized Monday at the U.N., and last summer at the Paris Summit, that **environmental destruction knows no borders.**

[The twin problems of crushing debt levels and a deteriorating environment threaten not only the development, but even the stability of our neighbors in Latin America, Africa, parts of Asia and even Europe. And global warming and rapid deforestation pose a threat to all humankind.]

We face unprecedented problems. We need -- and we can find -- unprecedented solutions.

To make growth truly sustainable, we must weigh environmental considerations more heavily as we make economic decisions. We must also find ways to strengthen our environmental and developmental efforts, through innovative thinking such as "debt for nature transactions."

Because with leadership, problems can become opportunities.

Over the years -- as we've come to understand the crippling effects environmental destruction can have on the long-term growth of developing countries -- the World Bank has increased the priority it assigns to environmental concerns. We applaud the efforts made thus far. But there is more to be done. In particular, we need to work more cooperatively to develop constructive solutions to global warming, including measures to promote energy efficiency and conservation and greater protection of forest resources.

In addressing the challenges of the 1980's, we have come to a deeper understanding of the importance of cooperating as a community of nations to address common problems.

I can think of no better current example than the need to work together to deal with international drug trafficking and money laundering. It is a worldwide problem. Drug money undermines honest businesses, corrupts political institutions, and even threatens the security of nations. To conceal their obscene profits, drug barons must wash their money by cycling it through financial institutions and illegitimate shell corporations.

The United States renews its call upon all countries to ratify the United Nations Vienna Convention, and make money laundering a criminal and extraditable offense. We need tough measures to track down and confiscate the profits of drug-related crime.

I was encouraged at the 1989 Economic Summit, when the G-7 industrial democracies demonstrated an active interest in a coordinated response to the money laundering menace. My country will host next year's summit, and I guarantee that the United States will be pushing for further progress and bold action. I urge everyone to join with us to explore new ways to stop money laundering in its tracks.

This, too, is a matter of returning to basic truths. More than thirty years ago, President Eisenhower spoke to this group about his experiences in wartime. He recalled working with groups that had to develop real cooperation among themselves -- or there could be no success.

Ike noted, as I do now, that there were people in the audience who were our allies in that grand effort. He said:

"We early found one thing: without the heart, without the <u>enthusiasm</u> for the cause in which we were working, no cooperation was possible. <u>With</u> that enthusiasm, subordinating all else to the advancement of the cause, cooperation was <u>easy</u>."

Today our mutual efforts to improve global growth, to ease the burdens of developing country indebtedness, and to open up markets for trade, have demonstrated anew that progress is best achieved by facing pressing issues together.

This is a lesson we must carry with us into the 1990's if we are to pass on to future generations a global economy that is strong and resilient, and able to provide for the aspirations of the citizens of all our countries.

Thank you for your hard work, your service, your commitment. And thank you for coming to Washington. Godspeed you in your efforts here, and God bless you and the nations you represent.

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McNally/Simon
September 22, 1989 a.m.
Draft Three (B:IMF)

PRESIDENTIAL REMARKS: WORLD BANK/IMF ANNUAL MEETING
SHERATON WASHINGTON
WASHINGTON, D.C.
WEDNESDAY, SEPTEMBER 27, 1989
9:35 a.m.

[[ACKNOWLEDGEMENTS]]

It is a pleasure for me to be here this morning, and to welcome you to Washington.

And it is a special privilege for me to be here in the company of my old friend, Barber Conable.

Almost 20 years ago, when Barber sat next to me in the House Ways and Means Committee, we had a bet about who would be first to become President. [[PAUSE]] We never said, "President of what" -- so now Barber claims he beat me by two years. [[PAUSE]]

Remember the reaction when Barber was named bank president? The headlines all said: "BARBARA WHO?" [[PAUSE]] That's okay. Until this year, the same thing happened all the time to Barbara Bush. [[PAUSE]]

We in the United States are keenly aware of the importance of these annual gatherings, and we are proud that we can be your hosts. We regard these meetings as key events -- events that drive the work of all of us in maintaining a strong international economic and financial system.

This is my first opportunity to speak to you as President. But I have followed the activities of the International Monetary Fund and the World Bank throughout my years of public service. I have visited many of your homelands, and seen first-hand the problems created by inadequate growth and development -- problems that your two distinguished institutions are working to solve.

But today, we're here to talk not about problems -- but about <u>solutions</u>.

We have witnessed a dramatic shift over the past few years in the debate over how to achieve sustained growth and development.

And although not a banker, you should know that I <u>do</u> have a <u>degree</u> in <u>economics</u>. It taught me one simple lesson: When you're standing in front of the world's greatest concentration of financial genius -- don't talk about <u>economics</u>. [[PAUSE]]

Let's talk instead about <u>FREEDOM</u>.

All across the world, there has been an almost simultaneous rediscovery of the power created when individuals are given the freedom to <u>decide</u> -- the freedom to act in their own best interests.

True, we're here today mainly to discuss <u>economic</u> freedom. But make no mistake. In the end, both economic freedom -- and <u>political</u> <u>freedom</u> -- are essential and inseparable companions on the road to national prosperity.

The jury is no longer out. Take any <u>one</u> people, give them <u>two</u> sets of rules, and see who prospers and who struggles. There are two Germanys, two Chinas, and two Koreas. It's been almost 50 years. **Let's put an <u>end</u> to this economic experiment. Because <u>history</u> <u>has</u> <u>decided</u>.** [[PAUSE]]

It is not climate, natural resources, or cultural traditions that make the difference. I said it in my inuagural address:

1-20-89

"We know what works: Freedom works. We know what's right: Freedom is right. We know how to secure a more just and prosperous life for man on Earth: through free markets, free speech, free elections, and the exercise of free will unhampered by the state." [[PAUSE]]

Stephen Farrar

In Latin America, Africa, and elsewhere, courageous leaders are turning away from state control of their economies. Through economic restructuring and deregulation, they are opening the door to private initiative. And already they are seeing results.

Treasury Dept. Int'l. Div.

In Mexico, for example, sound economic policies adopted by the Salinas government are pointing to a return of flight capital, and increased foreign investment.

Even more stunning is the transformation in thinking in the communist countries -- not only in the Soviet Union, but in Eastern Europe.

Our recent travels among the people of Poland and Hungary led to many dramatic and stirring encounters. But almost as much as we were impressed by the people, we were impressed by the almost universal acceptance of the free market as the best hope -- indeed, the only hope -- for reversing the economic fortunes of these two proud countries.

The rediscovery of these basic truths in the East has been matched by a recommitment to them in the West. Today the members of the European Community are dedicated to eliminating internal barriers to economic activity by the year 1992.

The Peruvian economist, Hernando de Soto, has helped us understand this worldwide phenomenon by documenting the process in Latin America.

Forbes 1-23-89

de Soto was raised in Peru, and educated there and in Europe, where he lived until 1979. But the chronic privation of his homeland haunted him. Rather than analyzing flow-charts or official statistics for the answer, he began walking the streets of Lima.

He found that the poor of Latin America -- who have never read Jefferson or Adam Smith -- ran their affairs democratically, outside the formal economy, organizing their private, parallel economy in a free and unregulated manner.

de Soto's great contribution has been to point out what, in retrospect, may seem obvious: **People everywhere want the same things.** And when left alone by government, people everywhere organize their lives in remarkably similar ways.

de Soto's prescription has been successful everywhere it's been tried. Governments must bring the "informal" workers into the regular economy -- and then get out of the way, and let individual enterprise flourish.

The wider application of these principles within our economies is critical to achieving the stronger, more prosperous, global economy of tomorrow.

Stephen Farrar

We each must do our part. The industrial countries have a special responsibility. We must coordinate economic policies to help provide sustained growth with low inflation and greater stability in exchange markets.

We in the United States are working especially hard to reduce the federal budget deficit, and to increase our national savings rate.

All our nations have a responsibility to ensure a fair and open trading system. We have a tremendous opportunity to advance that cause now, by making a success of the Uruguay Round of trade negotiations.

Making the political commitments necessary to ensure a success will not be easy in any of our countries. **But it must be done.** We must strengthen the GATT, and allow our markets to open in a mutual, step-by-step fashion.

As we seek to extend and expand growth in the world economy, the debt problems faced by developing countries are central to the agendas of the IMF and the World Bank. Over the past year, the international community's strengthened approach to these problems has provided new hope for debtor nations.

America's Secretary of the Treasury, my good friend Nick Brady, has helped direct the focus on debt relief, bringing developing nations and commercial banks back to where they belong -- the negotiating table.

Quick action by both the IMF and the World Bank has given this new strategy vital support. By making clear the terms under

Stephen Farrar

which they will support the reduction of debt burdens -- and by working with countries to develop the necessary economic reform programs -- these institutions have made it possible to reduce debt burdens without eliminating growth.

Thanks to these initiatives, the United States was able to broker an agreement in July between Mexico and its biggest private lenders. The deal enabled Mexico to make enormous progress against its debt burden -- some ten to twelve billion dollars.

This agreement underscores the benefits other debtor countries stand to realize from this approach. Mexico's savings from this package will free resources for productive use in the economy, leading to increased investment and improved growth.

What Mexico has done is not a miracle. It is a product of hard work and sustained commitment.

Looking Forward p. 23-24

My father, Prescott Bush, Sr., was a successful businessman, a banker whose forte was reorganizing failing companies, turning money losers into profit makers. Dad believed in the old Ben Franklin almanac maxims when it came to earning, saving, and spending. We grew up understanding that life isn't an open-ended checking account.

The strengthened debt strategy is flexible enough to address the unique needs of each country. **But the strategy will not work without sound economic policies in debtor countries.**

Inefficient, unrealistic, and growth-stifling policies must go. Benefits are available to a broad range of other countries

Stephen Farrar

that pursue economic reforms. Several are now actively engaged with the IMF and World Bank, and with the banking community -- Costa Rica, Venezuela, and Morocco, to name a few.

Commercial banks have a special role in making this process work. It is important that the banks follow through on efforts made with Mexico and the Philippines, and sustain this momentum with other countries.

We encourage these efforts not as self-sacrifice -- but as self-interest. True, success not only will help the debtor nations. But it will also strengthen the banks, by putting their portfolios on a sounder footing.

One of the lessons of the 1980's, especially the debt crisis, is that **we're all in this together. And when we cooperate, we all come out winners.**

The IMF and the World Bank are at the crossroads of our cooperative efforts. They are distinct institutions, even though their work is complementary and their objectives often overlap.

The IMF must continue to foster the sound economic policies necessary for sustained growth. As part of that responsibility, the Fund has assumed an important and welcome role in the strengthened debt strategy.

The United States believes that the IMF must have adequate resources to fulfill its critical role. We will continue to work with other members, in the hope of completing the current review of quotas by the end of the year.

Brady Speech?

However, if we are to ask our taxpayers to put up additional resources, they must be assured that the funds are truly needed, and will be used prudently and effectively to achieve shared objectives.

We all look to the World Bank to help build the foundation for a future global prosperity that reaches all our citizens.

Its efforts to promote structural reform and development are crucial to resolving debt problems. The Bank's decisions to take on new responsibilities on the debt front are welcome.

To promote the Bank's objectives, the international community established the International Development ~~Agency~~ Association within the Bank as a means of providing concessional resources to the poorest countries. We must all continue to support its activities.

UN speech 9-25-89

We have also learned, as I emphasized Monday at the U.N., and last summer at the Group of Seven, that **environmental destruction knows no borders.**

The twin evils of crushing debt levels and a deteriorating environment threaten not only the development, but even the stability of our neighbors in Latin America, Africa, parts of Asia and even Europe. And global warming and rapid deforestation pose a threat to all humankind.

We face unprecedented problems. We need -- and we can find -- unprecedented solutions.

To make growth truly sustainable, we must weigh environmental considerations more heavily as we make economic decisions. Let us charge those responsible for managing debt reduction with finding ways and means to strengthen development strategy through "debt for nature transactions" and other innovative plans.

Because with leadership, problems can become opportunities.

Over the years -- as we've come to understand the crippling effects environmental destruction can have on the long-term growth of developing countries -- the World Bank has increased the priority it assigns to environmental concerns. The Bank has introduced such topics as reforestation, biological diversity, air pollution, and waste disposal, into its country programming and economic policy dialogue. We applaud these efforts. And we will continue to support them.

Barber Conable speech 9-27-88

In addressing the challenges of the 1980's, we have come to a deeper understanding of the importance of cooperating as a community of nations to address common problems.

This, too, is a matter of returning to basic truths. More than thirty years ago, President Eisenhower spoke to this group about his experiences in wartime. He recalled working with groups that had to develop real cooperation among themselves -- or there could be no success.

9-28-56

Ike noted, as I do now, that there were people in the audience who were our allies in that grand effort. He said:

"We early found one thing: without the heart, without the <u>enthusiasm</u> for the cause in which we were working, no cooperation was possible. With that enthusiasm, subordinating all else to the advancement of the cause, cooperation was easy."

Today our mutual efforts to improve global growth, to ease the burdens of developing country indebtedness, and to open up markets for trade, have demonstrated anew that progress is best achieved by facing pressing issues together.

This is a lesson we must carry with us into the 1990's if we are to pass on to future generations a global economy that is strong and resilient, and able to provide for the aspirations of the citizens of all our countries.

Thank you for your hard work, your service, your commitment. And thank you for coming to Washington. Godspeed you in your efforts here, and God bless you and the nations you represent.

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(McNally/Simon)
September 21, 1989
Draft Two (B:IMF)

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Thank you for your hard work, your service, your commitment. And thank you for coming to Washington. Godspeed you in your efforts here, and God bless you and the nations you represent.

# # #

September 22, 1989

MEMORANDUM FOR ED McNALLY

FROM: BOB SIMON

SUBJECT: IMF/WORLD BANK DETAILS

TIME: 9:35 am

AUDIENCE: 3,500

ACKNOWLEDGE: Chairman Lee, President Conable, Mr. Camdessus

(Tyu Kyu Sung Lee, Chairman of Board of Govs.)
(Barber Conable, President of World Bank)
(Michel Camdessus [KAHM-deh-SOOS] IMF Managing Director)

OTHER: Secretary Nick Brady will introduce the President.

Shortly after the speech, the President departs for the Education Summit in Charlottesville.

THE WHITE HOUSE
WASHINGTON

September 19, 1989

MEMORANDUM FOR ED MCNALLY
BOB SIMON

FROM: STEPHEN P. FARRAR SPF

SUBJECT: The President's IMF/World Bank Speech

I found the Treasury draft of the September 27 speech to be uninspired. In an attempt to identify some clearer themes the President could develop, I have prepared the attached redraft. Please use it as you see fit.

I would be pleased to discuss the speech further or help develop any substantive issues you think should be included.

Attachment

cc: Jim Pinkerton

DRAFT
September 19, 1989

ADDRESS BY PRESIDENT BUSH
1989 IMF/WORLD BANK ANNUAL MEETINGS
WASHINGTON, D.C.

It is a pleasure for me to be here with you this morning, to welcome you to Washington. We in the United States are well aware of the importance of these annual gatherings, and we are proud that we can be your hosts, at least on alternate years. I regard the annual meetings as key events that drive the work of all of us in maintaining a strong international economic and financial system. The financial genius that is concentrated in this hall is truly awesome.

This is my first opportunity to speak to you as President, but I have followed the activities of the International Monetary Fund and the World Bank for many years. During my years in public life, I have visited many of your countries and have seen first-hand the problems created by inadequate growth and development, problems that these two distinguished institutions are working to solve.

Please permit me an observation based on my years of association with issues central to the missions of the Fund and the Bank. I am struck by the dramatic shift over the past few years in the debate over how to achieve sustained growth and development.

I believe that the underlying reason for this shift is captured in the word "freedom". All around the world, there has been an almost simultaneous rediscovery of the power created when individuals are given the freedom to determine and act according to their own best interests. For our purposes today, I am speaking mainly of economic freedom, but in the end economic and political freedom are inseparable.

-- In Latin America, Africa, and elsewhere, courageous leaders are turning away from state control of their economies. Through economic restructuring and deregulation, they are opening the door to private initiative, and are already seeing results. In Mexico, for example, sound economic policies adopted by the Salinas regime are pointing to a return of flight capital and increased foreign investment.

-- The transformation in thinking in the Communist countries has been even more stunning, not only in the Soviet Union, but in Eastern Europe. During my travels in Poland and Hungary in July, I was impressed by the almost universal acceptance of the free market as the best hope for reversing the economic fortunes of these two proud countries.

-- This recommitment to basic truths is also apparent in developed countries, notably in Western Europe, where the members of the European Community have dedicated themselves to eliminating internal barriers to economic activity by the year 1992.

The Peruvian economist Hernando de Soto has helped us understand this phenomenon by documenting the process of urbanization in Latin America. His great contribution has been to point out what, in retrospect, may seem obvious -- that people everywhere seem to want the same things and seem to organize their lives in remarkably similar ways. The poor of Latin America, who have never read Jefferson or Adam Smith, run their affairs democratically and organize their private, parallel economy in a free and unregulated manner.

The wider application of these principles within our economies is critical to achieving the stronger, more prosperous global economy of tomorrow. We each must do our part.

-- The <u>industrial countries</u> have a special responsibility to coordinate economic policies to help provide sustained growth with low inflation and greater stability in exchange markets.

-- We in the United States are working especially hard to reduce the Federal budget deficit and to increase our national savings rate.

-- All of our nations have a responsibility to ensure a fair and open trading system. We have a tremendous opportunity to advance that cause now by making a success of the Uruguay Round of trade negotiations. Making the political commitments necessary to ensure a success will not be easy in any of our countries, but it must be done. We must strengthen the GATT and allow our markets to open in a mutual, step-by-step fashion.

As we seek to extend and expand growth in the world economy, the debt problems faced by developing countries are central to the agendas of the IMF and the World Bank. Over the past year, the international community's strengthened approach to these problems has provided new hope for debtor nations.

-- Quick action by both the IMF and the World Bank has given this new strategy vital support. By making clear the terms under which they will support the reduction of debt burdens and by working with countries to develop the necessary economic reform programs, these institutions have made it possible to reduce debt burdens without eliminating growth.

-- Mexico's recent agreement with its commercial banks underscores the benefits other debtor countries stand to realize from this approach. Mexico's savings from this package will free resources for productive use in the economy, leading to increased investment and improved growth.

-- What Mexico has done is not a miracle. It is a product of hard work and sustained commitment. The strengthened debt strategy is flexible enough to address the unique needs of each country. But the strategy will not work without sound economic policies in debtor countries. Inefficient, unrealistic, and growth-stifling policies must go. Benefits are available to a broad range of other countries that pursue economic reforms. Several are now actively engaged with the IMF and World Bank, and with the banking community -- Costa Rica, Venezuela, and Morocco, to name a few.

-- Commercial banks have a special role in making this process work. It is important that the banks follow through on efforts made with Mexico and the Philippines, and sustain this momentum with other countries. Success not only will help the debtor countries but will strengthen the banks by putting their portfolios on a sounder footing.

One of the lessons of the 1980's, especially the debt crisis, is that we're all in this together. When we cooperate, we all come out winners. The IMF and the World Bank are at the crossroads of our cooperative efforts. They are distinct institutions, even though their work is complementary and their objectives often overlap.

-- The IMF must continue to foster the sound economic policies necessary for sustained growth. As part of that responsibility, the Fund has assumed an important and welcome role in the strengthened debt strategy. The United States believes that the IMF must have adequate resources to fulfill its critical role. We will continue to work with other members in the hope of completing the current review of quotas by the end of the year. However, if we are to ask our taxpayers to put up additional resources, they must be assured that the funds are truly needed and will be used prudently and effectively to achieve shared objectives.

-- We all look to the <u>World Bank</u> to help build the foundation for a future global prosperity that reaches all our citizens. Its efforts to promote structural reform and development are crucial to resolving debt problems. The Bank's decisions to take on new responsibilities on the debt front are welcome. To promote the Bank's objectives, the international community established the International Development Agency within the Bank as a means of providing concessional resources to the poorest countries, and we must all continue to support its activities.

-- Sustainable growth and development is at the heart of the World Bank's work. Over the years, as evidence accumulated about the crippling effects environmental degradation can have on the long-term growth of developing countries, the Bank has increased the priority it assigns to environmental concerns. The Bank has introduced such topics as reforestation, biological diversity, air pollution, and waste disposal, into its country programming and economic policy dialogue. To make growth truly sustainable, we must weigh environmental considerations more heavily as we make economic decisions. I believe it is critical that the World Bank integrate such concerns into its activities and pursue expanded efforts to protect the environment.

In addressing the challenges of the 1980's, we have come to a deeper understanding of the importance of cooperating as a community of nations to address common problems. Our mutual efforts to improve global growth, to ease the burdens of developing country indebtedness, and to open up markets for trade have demonstrated that progress is best achieved by facing pressing issues together. This is a lesson we must carry with us into the 1990's if we are to pass on to future generations a global economy that is strong and resilient, able to provide for the aspirations of the citizens of all our countries.

Welcome Address by President Bush to 1989 IMF/World Bank Annual Meetings

The United States is pleased to be your host for this 44th Annual Meeting of the IMF and World Bank. I welcome this opportunity to speak with you in this forum for the first time. We have many challenges to face together, and I want to underscore my personal dedication to work closely with all of you in addressing areas of concern to these distinguished institutions.

I have a vision for both the United States and the world economy. It requires that we move forward with determination and compassion toward a better tomorrow -- to face problems head-on and to forge practical and long-lasting solutions. By joining forces with other nations, we can, indeed, make way for a bright future.

We have already made great strides in the economic sphere. The decade that is closing has seen the rise of a "new wind" of private initiative, economic restructuring, and deregulation spreading from country to country and continent to continent. From the United States, Europe, and Japan to Latin America, Eastern Europe, and Asia, the momentum of sound economic policies that reward individual initiative is building and bringing results of which we can be proud.

Underlying this trend is a broad recognition that government controls can stymie growth and that economic freedom is essential to progress and prosperity. Reaffirmation and wider application of these principles within our economies are critical to our efforts to lay the basis for a stronger, more prosperous global economy tomorrow.

In addressing challenges of the 1980s, we have also come to a deeper understanding of the importance of cooperating as a community of nations to address common problems. Our mutual efforts to improve global growth, to ease the burdens of developing country indebtedness, and to open up markets for trade have demonstrated that progress is best achieved by facing pressing issues together.

At the same time, we have all come to recognize that ~~respect has grown for the concerns of other nations.~~ As we pursue common goals, we must take into account the needs of needs of individual nations involved in the effort. ~~At the same time,~~ each of us must do our best to balance our domestic objectives with our international responsibilities.

We are beginning to recognize more fully the impact our choices today will have on the lives of future generations. We have a common obligation to pass to those who follow a global economy that is stronger and more resilient than the one we received. One area in which we can all do more is protecting the environment -- to assure that today's resources are wisely husbanded and tomorrow's world is livable.

Global Action Program for the 1990's

The lessons of the past and our success over the last decade provide a sound basis for moving ahead. We must each do our part to assure a successful global action program for the 1990's.

Not Sure

As a first priority, we must continue to strive for strong global growth -- on which all nations depend. Industrial countries have a special responsibility in this area. Their strong influence on the broader economy gives them a special responsibility to provide the basis for a sound, open, and growing world economy. We have seen some results. Efforts by the Group-of-Seven industrial nations to coordinate economic policies have helped provide sustained growth with low inflation and greater stability in exchange markets.

However, I think we all recognize the need to ~~expand~~ sustain growth. To do so, each of us must take necessary policy steps. Definitive action in the United States has produced strong non-inflationary growth, substantial investment, and growing competitiveness in world markets. We are working to ensure that this performance will continue. The federal budget deficit is being reduced, and we are moving to strengthen our national savings rate. Preserving an open, growing world economy is a

Strengthen

responsibility of all nations. Others must do their part to sustain growth.

The goal of global prosperity requires a special focus on a fair and open trading system. We all recognize the broad benefits of trade, but few are prepared to move unilaterally to remove existing trade barriers. This simple reality has led us to develop a system of negotiations and rules which gives countries the opportunity to open their markets mutually and step-by-step. The General Agreement on Tariffs and Trade, or GATT, has served this purpose well. We now need to strengthen the GATT and reaffirm our commitment to it. The first step is for all countries, including developing countries, to dedicate themselves to avoid creation of new barriers to trade. At the same time, all must focus on moving decisively in the Uruguay Round to reduce existing barriers to equip us to face future challenges.

ag sector, taken LDCs away advantage

As we seek to extend and expand growth in the world economy, the debt problems faced by developing countries continue to warrant close attention. The international community's effort to strengthen its approach to these problems has provided new hope for debtor nations -- and also reflects the need for a new realism on the part of commercial banks.

Quick action by both the IMF and World Bank has given this new strategy vital support. By making clear the terms under which they will support the reduction of debt burdens and by working with countries to develop the necessary economic reform programs, these institutions have made it possible to move simultaneously toward both objectives. We must jointly sustain this effort in the period ahead.

Commend them

Mention debt reduction

The recent Mexican agreement with its commercial banks underscores the potential benefits of this approach for debtor countries. Mexico's savings from this package will free resources for productive use in the economy. In tandem with the dedicated Mexican economic reform effort, it has already reduced fiscal pressures, helped restore confidence in the Mexican economy, and brought capital home. Mexico can look forward to increased investment and improved growth as a result.

Substantial real interest rate reduction: Reconfirmation of right policy

Mention C Rica, Morocco, Venezuela

Such benefits are available to a broad range of additional countries which seriously pursue economic reforms. Several are now actively pursuing negotiations with the IMF and World Bank, and with the banking community. The international approach is flexible enough to address the unique needs of each country.

Commercial banks must help make this process work. It is important that the banks follow through on efforts made with Mexico and the Philippines and sustain this momentum in negotiating with other countries. Banks need not do this just to benefit debtor countries. By adjusting the value of their

 LDCs are strengthened too.

loans to developing countries, banks will strengthen portfolios and place their institutions on sounder footing. ability to repay.

None of these measures will make a difference for debtor countries, however, unless they establish sound economic policies. External debt itself did not create the economic problems faced by many of these countries. Inefficient, unrealistic, and growth-stifling policies must go. We in the United States understand that such steps are difficult. But debtor countries must take the lead as the international community reaches out to help them. They must set their economies on solid ground.

re-orient development away from big, showy projects & govt.-owned business & those that cause environmental devastation

We must not overlook the plight of the poorest countries in our efforts to resolve the problems of countries with large commercial bank debt. The United States has supported a number of initiatives to address the needs of these countries. Most recently, we have indicated that we are prepared to forgive up to $1 billion of debt owed the U.S. by Sub-Saharan African countries which are implementing economic reform programs developed with the IMF and World Bank. We welcome similar efforts by other creditor governments to help these countries restructure their economies and improve the lives of their citizens. Poland: same thing?

We continue to rely on the international financial institutions to lead our cooperative efforts in developing countries. The work of the IMF and World Bank is complementary, and their objectives often overlap. Yet each has a distinct and critical role to play.

The IMF takes seriously its responsibility for fostering the sound economic policies necessary for sustained growth. The work of this institution is a credit to all its members. As a trusted and valuable institution, the IMF has an important role to play in the strengthened debt strategy, and we welcome the recent measures taken to enable it to assume this position. The United States recognizes that the IMF must have adequate resources to fulfill its critical role. We will continue to work cooperatively with other members in the hope of completing the current review of quotas by the end of the year. However, if we are to ask our hard-pressed taxpayers to put up additional resources, the must be assured that the funds are truly needed and will be used prudently and effectively to achieve shared objectives.

The World Bank carries out parallel goals by encouraging structural reforms and guiding countries' development. These efforts are also crucial to resolving debt problems, and the World Bank's decisions enabling it to take on new responsibilities in this regard are similarly welcome. In addition, however, we all look to the World Bank to help build the foundation for a future global prosperity that reaches all our citizens. As part of this charge, the international community established the International Development Agency within the Bank as a means of providing concessional resources to the poorest countries, and we must all continue to support its activities.

Sustainable growth and development is at the hear[t] of the World Bank's work. We have been working over the years to increase the Bank's priority on environmental concerns. Progress has been made, but environmental degradation crippling to the long-term growth of developing countries, as well as the rest of the world, continues. To make growth truly sustainable, we must weigh environmental considerations more heavily as we make economic decisions. Consequently, I believe it is critical that the World Bank integrate such concerns into its activities and pursue expanded efforts to protect the environment.

avoid the mistake of those of us in the ~~developed~~ industrial countries learned painfully from
URGENT

We have to look forward. We all have our own interests to pursue. But to protect these interests we will do best to expand the opportunities in the global economy for each of our citizens. We must therefore take heed of the need to restructure our economies, open our trading regimes, and pursue sustainable growth in each country -- developed and developing. The IMF and World Bank have helped guide us thus far, and we rely on them for continued leadership. Each of us must assume responsibility, however, and take action. Our cooperative efforts are only as strong as our individual contributions.

The Heritage Foundation Backgrounder

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The Center for International Economic Growth

September 22, 1989

WHY THE WORLD BANK SHOULD READ ITS OWN REPORT

INTRODUCTION

As the World Bank and International Monetary Fund (IMF) prepare to convene their annual meeting in Washington next week, the delegates should study what could become the hottest new publication on economic development. It is the *World Development Report*, issued each year by the World Bank. While this year's topic, the condition of financial systems in less developed countries (LDCs),[1] would seem to be tedious, the content and message of the report are anything but. They analyze how LDC governments have contributed to the deterioration of central and commercial banks, stock markets, and similar institutions in the developing world. While the Report avoids ideological stands, it suggests by implication, and sometime explicitly, reforms needed to restore these institutions to economic health.

World Bank officials should read their own report and use its insights to plan and pursue a strategy that will establish in the LDCs the private banks and capital markets necessary for sustained economic growth. The report too should be of interest to the United States and other countries attempting to deal with the LDC debt problem and to promote economic growth in these countries.

Indispensable Medium. Money, of course, is indispensable for any economy in providing a medium of exchange to facilitate economic transactions. Banks and other financial institutions allow surplus assets to be funneled into productive investments. Capital and stock markets allow money for large economic ventures to be raised and investment risks to be reduced by permitting individuals to diversify their assets.

1 *World Development Report 1989: Financial Systems and World Development Indicators*, issued in June 1989. Hereinafter referred to as the World Bank Report.

The new World Development Report documents how LDCs have undermined their financial systems and thus exacerbated their own economic problems. By requiring their banks to lend to certain industries, sectors, or enterprises, for instance, LDC governments have misallocated resources and left few funds for businesses, entrepreneurs, and consumers who did not enjoy such privileges. The Report also describes how credit privileges for inefficient state-owned enterprises cause capital shortages and lead to foreign borrowing and debt. And the Report illustrates how LDC governments, to cover huge state expenditures, ultimately resort to printing money, triggering massive inflation which undermines the currency itself.

To correct the situation described by the World Bank, reform in the LDCs is now essential. This reform should require:

1) Central banks to maintain stable, noninflated currencies.

2) Government direction of lending to cease.

3) Repeal of regulations that discourage or prohibit private banking.

4) Banks in government hands to be privatized.

5) Reform of legal systems to protect the property and rights of borrowers and lenders.

6) Grass-roots savings and credit to be encouraged.

For years the World Bank and IMF loaned money to LDCs and looked the other way as these countries practiced policies that the Bank now wisely criticizes. By allowing the LDC governments to avoid for so long the consequences of their actions, these policies continued and economic reform was impeded. The new *World Development Report* therefore is a welcome sign that the World Bank not only understands the disastrous mistakes of LDC financial policy but also has learned that lending to countries even as they continue such practices only throws good money after bad. The World Bank's vast staff would do well to study the new Report and use it as a compass to guide future policies and programs.

THE FUNCTIONS OF MONEY AND CREDIT.

Economic development is often thought of in terms of the ability of factories to produce goods, farmers to grow crops, and, ultimately, consumers to purchase the goods and services necessary for a higher standard of living. Yet financial instruments and institutions perform the indispensable function of facilitating nearly all economic transactions.

The World Bank Report correctly points out that "The financial system makes its biggest contribution to growth by providing a medium of exchange."[2] Money has several characteristics that make it far superior to the

2 World Bank Report, p. 26.

exchange of goods by barter. As it originally developed, money was a commodity, usually gold or silver, that was durable and thus could be stored for long periods, unlike perishable goods. It was easily divisible, unlike bartered goods such as houses or cattle. Money was compact and easy to carry. Further, the market values of goods could be compared in terms of money.[3]

"Renting Out" Surplus Funds. At any given time there always are some businesses or individuals who might not wish to spend their surplus assets on immediate consumption or investments. At that same moment, however, there are others who might not have funds on hand to meet their consumer or investment needs. Those with surplus money are often willing to "rent out" their funds to others, with the original loans plus the rent or interest being paid back out of the borrowers' future earnings or profits.

The World Bank Report observes that "Savings determines the rate at which productive capacity, and hence income, can grow. On average, the more rapidly growing developing countries have had higher saving rates than slower-growing countries."[4] For example, the Report found that countries with savings rates averaging 28 percent of Gross Domestic Product had high annual growth rates of over 7 percent. Countries with savings rates of around 19 percent grew at a slow annual rate of less than 3 percent.

Grass Roots Money Lenders. Much development occurs from the ground up with the efforts of individuals and small businessmen. The Report notes that "...firms and households finance much of their investment directly out of their own saving. Only when investment exceeds saving is it necessary to borrow...."[5] It notes further that, "In the early stages of development, relatives, friends, and moneylenders may be the only sources of external finance. As the financial system grows, local banks, then national financial institutions, and finally securities markets and foreign banks become sources of funds for investors."[6] The Report notes, for example, that in the late 1940s, Nigeria had as little as 29 bank branches. Money lenders operated in the informal sector in institutions known as "*isusu*." With the growth of indigenous national financial institutions, the financial system began to expand. By 1962, there were more than 200 commercial banks in Nigeria.[7]

The existence of savings and credit allows households to enjoy the immediate benefits of various goods and services by borrowing against future earnings. For businesses, credit is crucial. Short-term credit is essential for merchants to keep inventories at levels to meet customer demand. Longer term credit is important not only for establishing productive enterprises but also for expansion, purchases of new equipment and machinery, research and

3 See Ludwig von Mises, *Theory of Money and Credit* (Irvington-on-Hudson: Foundation for Economic Education, 1971) for a discussion of the origins and functions of money.

4 World Bank Report, p. 27.

5 World Bank Report, p. 28.

6 World Bank Report, p. 29

7 World Bank Report, p. 48, Box 3.4.

development of new products, and modernization of the production process for maximum efficiency.

Implied by the World Bank Report is that, for economic growth to be steady, the supply of money also must grow at a slow and steady pace. Large, erratic fluctuation of the money supply would cause the value of the currency that is being saved, lent, or borrowed to fluctuate similarly. The use of money for economic activities would become increasingly risky and such activities would suffer.

THE COMPONENTS OF A FINANCIAL SYSTEM

For economies to develop rapidly and efficiently, intermediate institutions between savers and investors are indispensable. States the World Bank Report:

> Financial systems provide payment services. They mobilize savings and allocate credit. And they limit, price, pool, and trade the risks resulting from these activities. These diverse services are used in varying combinations by households, businesses, and governments and are rendered through an array of instruments (currency, checks, credit cards, bonds, and stocks) and institutions (banks, credit unions, insurance companies, pawnbrokers, and stockbrokers).[8]

Among the key financial institutions are:

Central Banks. Money in the form of paper currency is provided in all countries today by government monopolies called central banks. While in the past currency was backed by commodities like gold, today paper currency, which is produced in limited quantities, in various denominations, and which is replaced when it wears out, is useful as a medium of exchange to the extent that governments increase its supply on a slow, steady basis. The value of one country's currency against that of another's might rise or fall depending on such factors as the relative supplies of each currency, the desires of individuals to invest in a given country, and general confidence in a given country's government and economy.

Commercial Banks. Banks provide a place for individuals and businesses to deposit savings and to obtain loans. In the U.S., banks that accept savings and make loans to individuals and businesses are legally separate from investment or commercial banks. The latter specialize in purchasing and marketing stock to help finance business ventures.

The World Bank Report points out that commercial banking was crucial to economic growth in the West. Modern banking and accounting practices were

8 World Bank Report, p. 25.

developed in the city-states of Northern Italy during the 15th century by individual businessmen seeking better ways to finance trade and lessen the risk of loss for exporters and importers.[9] Only later did governments become involved in banking regulations.

When central banks keep money supplies stable, interest rates are determined by the supply of savings and the demand of loans. Bankers who judge wisely and lend to productive individuals and businesses make a profit. Those who do not, lose money. In a system with private banking and no major restrictions on market entry, competition provides incentives for bankers to direct funds to the most productive enterprises and provides customers with greater access to credit.

Capital and stock markets. Many business activities require substantial, long-term investments and access to credit. Capital markets provide long-term debt and equity finance for the government and the corporate sector. Debt finance occurs when borrowing is used to finance expenditures. An interest charge is paid for the amount borrowed. Equity financing occurs when stock is bought and the buyer receives a dividend for his purchase.[10] Stock markets allow many individuals to pool their investment resources. Shares of stock are usually purchased from businesses and marketed by commercial banks. If the business makes a profit, stock owners receive a profit or dividend for each of their shares. Stock markets also allow individuals to reduce their financial risks. By owning shares in many different enterprises, an individual does not lose all of his assets if one investment goes bad.

Legal institutions and accounting practices. Protection of private property rights and the certainty of legal titles to property are essential for any market system, and especially crucial to the financial system. The World Bank Report observes that an individual's or business's property often provides the necessary collateral against which banks make loans, for example, "by allowing borrowers to offer security in the form of mortgages over real estate...."[11] The Report also observes that business laws and conventions define what is meant by a contract and what are the obligations of the parties involved. A legal system provides adjudication of business disputes and the enforcement of contractual agreements. Standardized accounting practices allow businesses and investors, lenders and borrowers, to know the value of their assets, whether a profit or loss has been realized, and in general, how an enterprise might be expected to perform in the future.[12]

Macroeconomics. A theme found throughout the World Bank Report is that correct macroeconomic policies are important to the health of a financial system. Government taxing, borrowing, and spending policies can deter

9 World Bank Report, pp. 41-43.
10World Bank Report, p. 109.
11World Bank Report, p. 87.
12World Bank Report, p. 85-86.

investments and absorb much of a country's savings, leaving little for private businesses and individuals. Trade restrictions can rob industries of access to necessary inputs and consumers of access to goods that could raise their living standards. Government regulations and restrictions on business can deter business creation and expansion, slowing down economic growth. Massive government spending and borrowing by LDCs, and printing currency to cover the resulting debts, has contributed to high inflation rates. "The average inflation rate in developing countries increased from 10 percent a year in 1965-73 to 26 percent in 1974-82 and 51 percent in 1983-87. During 1983-87, seven countries (Argentina, Bolivia, Brazil, Nicaragua, Peru, Sierra Leone, and Uganda) had average inflation rates of more than 100 percent...."[13] Financing public sector industries has been costly for LDCs.

CAUSES OF FINANCIAL DISTRESS IN THE THIRD WORLD

In light of the importance of financial institutions to economic growth, most LDCs began on the wrong financial footing. In most cases the government owned some or all of the commercial and savings banks, in many cases prohibiting private banking altogether. This set the stage for serious abuses. The World Bank Report paints a picture of many (probably most) LDC governments systematically undermining the ability of their citizens and businesses to engage in productive activities, and thus bringing about their own economic problems.

Directed Credits. The World Bank Report describes how LDC governments sought to promote economic growth by forcing investments into certain sectors of the economy. It points out that

> ...in Pakistan in 1986, 70 percent of new lending by national banks, which dominate the banking system, was targeted by government...In India about one-half of bank assets had to be placed in reserve requirements on governments bonds, and 40 percent of the remainder had to be lent to priority sectors at controlled interest rates. In Yugoslavia in 1986, 58 percent of short-term loans were directed credits. In Brazil in 1987, government credit programs accounted for more than 70 percent of credit outstanding to the public and private sector.[14]

Sometimes, governments would use loan guarantees to specific enterprises to assure that credit was distributed according to government desires.[15]

But whether the banks involved were government-owned or private, and whether certain industries or enterprises were singled out for special favors by directed lending or loan guarantees, in the end, the government was

13World Bank Report, p. 62.
14World Bank Report, p. 55.
15World Bank Report, p.57

forced to cover the costs to the financial sector of their policies. And with governments requiring banks to make specific kinds of investments, little capital was left for business that did not enjoy government favor. Especially hard hit have been small businessmen, entrepreneurs, and of course, the consumers. Further, by directing funds by law or decree to certain sectors and industries, governments removed much of the incentive for bankers to be concerned about the quality of their loans.

Priority for State-Owned Enterprises. In many cases, government-directed credit went to state owned enterprises (SOEs). The World Bank Report states that, "The share of SOEs in nongovernmental borrowing from domestic banks in 1983-85 was 56 percent in Guyana, 43 percent in Mexico, 25 percent in Nepal, and 18 percent in Brazil."[16] Then, in one of its most damning statements, the Report explains that "Whatever conclusion is drawn concerning the impact of directed credit programs on growth and the distribution of income, it is clear that they have damaged financial systems. Many directed credits have become nonperforming loans."[17] This was in part because, "Directed credit programs have often been used not to correct the inadequacies of financial markets but to channel funds to priority sectors regardless of whether these were the most productive investments."[18]

Many of the state-owned enterprises turned into inefficient, wasteful, and corrupt money losers. Rather than shutting down such enterprises, for political reasons LDC governments continued to keep them afloat with new directed or borrowed money. Further, in the case of many failing private businesses, rather than let them shut down, governments continued to provide subsidies and in many cases simply nationalized such enterprises.

By diverting credit to inefficient enterprises, governments dried up credit for more productive endeavors. The situation became worse during the worldwide economic problems of the 1970s. Instead of adjusting to changing economic realities, most LDC governments increased their intervention and subsidies. The result: staggering costs of directed and subsidized credit. The World Bank Report finds that:

> ...in Brazil in 1987 [subsidies] were estimated at between 4 and 8 percent of GDP [Gross Domestic Product]. In Mexico subsidies relating to development finance institutions and official trust funds were estimated to average 3 percent of GDP during 1982-87. Subsidies of this magnitude, when financed by the central bank or charged to the government budget, have compromised efforts at monetary or fiscal restraint.[19]

16World Bank Report, p. 57.
17World Bank Report, p. 59-60.
18World Bank Report, p. 59
19 World Bank Report, p. 59.

Faced with large and growing debt burdens, inefficient economies, capital flight, and massive tax evasion by citizens who had little trust in their governments, LDC governments found it easier to resort to budget deficits and monetary inflation than to maintain responsible monetary and fiscal policies.

Accumulating Debt. LDC governments have been able to pursue their flawed economic and financial practices for several reasons. For one thing, the World Bank Report observes in self-criticism, "Subsidies have sometimes been covered by low cost loans from international agencies...."[20] For another, "By the 1980s many developing countries had come to rely on foreign borrowing to help finance increasing public sector deficits...For example, in 1984 the [public sector borrowing requirement] was 15 percent of GDP in Argentina...."[21]

What the *World Development Report* delicately fails to note is that its sister organization, the International Monetary Fund (IMF), gave what amounted to loan guarantees to encourage such lending from foreign private banks to the LDC governments. As these governments used more funds to bail out state-owned enterprises and cover huge government payrolls, the private sector and smaller entrepreneurs were starved for credit. This meant that the country's productivity suffered and that it was less likely that LDC governments would be able to pay their debts.

Destroying the Currency. In the end, many LDC governments resorted to the printing press. They simply printed up currency to cover budget deficits caused by, among other things, money losing enterprises. This undermined the currency itself and ignited massive inflation. Inflation in Argentina was around 250 percent per month this year. In 1985, inflation in Bolivia was over 50,000 percent for the year, though it was impossible to measure accurately. In such situations people abandoned the official currency. American dollars or some other hard currency used in the black market became the principal medium of exchange and store of value. Citizens converted their local currency to hard currencies and smuggled their funds out of the country. Today the value of such deposits in Western banks equals the foreign commercial debts of all of the LDCs combined.[22]

High inflation harmed especially the small entrepreneurs, who must pay for raw materials, tools, and other business expenses. Because they found it impossible to save funds, such businesses could not expand or sometimes even remain in operation.

Some LDCs that depended on commodity exports undermined their financial systems in a different yet equally effective way. Unable to compete

20World Bank Report, p.59
21World Bank Report, p. 61.
22"LDC Debt Reduction; A Critical Appraisal," in Morgan Guaranty Trust Company, *World Financial Markets*, December 30, 1988, p. 9.

in an international market, the government solution often was to devalue the currency to make exports cheaper for overseas customers.[23] Exports showed nominal gains as a result. However, consumers and businessmen alike faced higher prices in the domestic market. This was due in part to the higher costs for imported products. In addition, domestic industries had less competition from foreign enterprises. Further, the domestic industries also had to pay higher prices for their inputs. This meant higher prices for domestically produced goods.

The lesson that can be drawn from the World Bank Report is that the ruin of currencies and financial systems by LDC governments has left their economies in shambles.

NEEDED: FUNDAMENTAL FINANCIAL REFORM.

Though overdue, it is very welcome – and important – that the World Bank recognizes that LDC governments have wrecked their own credit systems, capital markets, and currencies. It is no mystery why these countries cannot deal with their debt burdens or offer their own people opportunities to translate productive economic activity into higher living standards. The question is: what can the World Bank, IMF, and the governments of the developed countries now do? The answer, sometimes implied, sometimes directly stated, in the new World Bank Report, is that the LDCs must adopt far-reaching, free market financial reforms.

Key elements of such reforms should include:

1) A Stable Currency.

The kind of runaway hyperinflation that has plagued the LDCs is caused solely by the governments themselves, specifically by central banks printing currency to meet budget demands. Such inflation renders a currency of little use as a medium of exchange and slows or even stops many productive economic activities. Such inflation can be stopped quickly if the political will exists. Bolivia brought its hyperinflation down from tens of thousands percent in 1985 to 16 percent in 1987. Argentina brought its inflation rate, which in June was around 250 percent per month, down to single digit levels by September.

While not suggested by the World Bank Report, one way to prevent future inflation might be to insulate central banks in part from the political process so that politicians will not be tempted or able to print money to purchase short-term political advantages at the long-term expense of the economy. The first job of the head of a country's central bank should be to protect the stability and integrity of the currency so that it can function efficiently as a medium of exchange.

23World Bank Report, p. 2.

2) No Special Privileges for State-Owned Enterprises.

Ultimately, state-owned enterprises should be returned to the private sector. During the transition period, LDC governments must end special credit privileges, loan guarantees, and direct subsidies of the state-owned enterprises, for these undermine the financial system. While the World Bank Report cites cases of government interference that have not led to disaster, these are rare and often due more to luck than to wise government policy. The dangers of such interference, as documented by the World Bank Report, are grave. Therefore commercial banks no longer should be forced by governments to target or direct credit to certain industries, sectors, or enterprises. Such reforms will not necessarily stop government borrowing from commercial banks. But they will expose the costs of such practices and cause governments to make hard decisions concerning whether funds are to be productively invested or wasted on money-losing operations.

3) Market-Determined Interest and Exchange Rates.

Both interest rates and exchange rates should be set by market supply and demand, not by government dictates. The World Bank Report recognizes that interest rates kept artificially low by state mandates lead to low levels of savings and capital shortages. Exchange rates, the price it costs to purchase foreign currency, when set higher than the market rate can attract imports at the expense of more efficient local industries and ultimately drain a country's treasury. Exchange rates set lower than market levels can cause price increases for businesses and consumers and lower living standards.

4) Legalized Private Banking.

Competition among banks creates incentives for bankers to make productive loans and gives customers greater access to credit. Where private banking is banned by LDC governments, it should be legalized. Yet as the World Bank Report observes, "Lack of effective competition is [often due] to restrictions on interest rates, on product innovation, on branching, and on the entry of new institutions."[24] Regulations that have the effect of reducing private banking competition should be reformed.

5) Privatized State-Owned Banks.

The financial institutions owned by the state should be returned to the private sector. The record of state-owned and directed financial systems has been a disaster in the LDCs. When governments can cover the losses of institutions that are poorly managed or make loans based on political rather than economic considerations, there is little incentive for such institutions to improve. And if a system does allow private banking, competition from the state-owned enterprises is hardly fair or economically sound.

24 World Bank Report, p. 103.

6) Legal Reforms.

The World Bank Report correctly observes that

> If financial systems are to be efficient and robust, they must be set within a suitable legal and regulatory framework...A system of laws and regulations is needed to promote the use of contracts that are clear about the rights and obligations of contracting parties, to encourage discipline and the timely enforcement of contracts, and to foster responsible and prudent behavior on both sides of the financial transaction.[25]

This means the legal recognition of property titles so that persons can use assets as collateral for loans. This also allows lenders to have some assurance of compensation in case of default. This has been a problem in many LDCs. In Egypt and Pakistan, for example, the foreclosing procedures are so slow that it often takes five years for banks to foreclose on bad loans.[26]

7) People's Capitalism.

Normal economic development is usually driven by smaller enterprises and entrepreneurs. Small businessmen save money or borrow small sums to reinvest in their businesses. As they become more prosperous perhaps they open new enterprises. It is in such small enterprises that the vast majority of jobs in most LDCs are found. Financial mismanagement in LDCs has retarded the normal development process. The World Bank Report breaks new ground for an international institution by focusing attention on the sort of informal financial arrangements that take place outside of the formal banking channels, often as a reaction to the inefficiencies of the formal institutions. It also focuses attention on the possibility of success for small, local lending institutions. The Grameen Bank in Bangladesh, for example, arose out of a need to serve the rural poor of that country. Since 1976 this bank has grown to 300 branches serving 5,400 villages. All are locally managed and make loans averaging $100 dollars. The loan payback rate is over 97 percent. International institutions and governments thus should focus on the need to promote grass-roots banking and capital markets through economic reforms and deregulation in the LDCs.

25World Bank Report, p. 84.
26World Bank Report, p. 77.

CONCLUSION

The World Bank is to be congratulated for this year's annual *World Development Report*, which calls attention to the importance of financial systems to economic growth, to the damage that LDC governments have done to their economies by control of credit and the undermining of currencies, and to the kind of reforms needed if these systems in LDCs are to most effectively facilitate economic activities.

Guide for the Future. As World Bank officials gather in Washington for their annual meeting, they should study the lessons of their own Report. It is valuable, of course, not only as a chronicle of the past's mistakes but as a guide for avoiding them in the future. On the agenda, after all, for the World Bank, the IMF, the U.S., and other industrialized nations is the search for ways to deal not only with the LDC debt crisis but with the problem of the collapsing economies of Central and Eastern Europe.

In the case of LDCs in Latin America, Africa, and Asia, sound financial policies advocated by the World Bank should continue to be a top priority. In the case of Central and Eastern Europe, the World Bank should avoid mistakes of the past. Rather than push huge loans and more debt onto these countries, market-oriented financial systems first must be created.

Toward Higher Living Standards. The citizens of the less developed countries have demonstrated that they are as hardworking and entrepreneurial as people anywhere in the developed world. The problem has been that flawed economic policies have cheated these citizens of the rewards that should have come from that hard work.

While financial systems are often thought of in terms of large banks and impersonal institutions, such systems are most important at the grass roots. They allow people to save their money for consumption or for investments. They give small businessmen access to much needed credit. If the people of LDCs are to be given an opportunity to translate their hard work and efforts into higher living standards, sound financial institutions and systems are essential. The World Bank's new *World Development Report* offers a guide on how to do this.

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How much of a credit risk?

An informal way to grow

THE OTHER PATH. By Hernando de Soto. *Harper & Row; 271 pages; $22.95. To be published in Britain by I.B. Tauris*

FOR decades, Latin Americans and visitors to the region have realised that the numbers of street vendors and black-market businesses have been growing, and that more and more land outside the cities has been seized by landless peasants. But nobody has explained how this "informal sector" works, nor how big it is. Now Hernando de Soto has done so, at least for Peru. "The Other Path" is a considerable achievement. It should jolt Latin American governments and serve as a guide for all those concerned with helping the poorest of the poor.

Mr de Soto reckons that the informal sector in Peru makes up 48% of the total labour force. "Informals" work 61% of all man-hours and create 38% of the GDP. They have set up 274 markets in Lima; they run 93% of the buses; they have built 42% of the housing. This fascinating book describes in detail how groups of poor people organise land-grabs and try to legitimise the homes they have built, how rudimentary land registers are organised, how informal-sector bus services are planned and launched, and how hawkers stake out streets for stalls and eventually create their own markets.

All this usually occurs in the face of bureaucratic incomprehension. Latin America inherited from seventeenth-century Europe a top-heavy mercantilist tradition; that is mostly why its economies are held back, while those in South-East Asia soar. In Peru it takes nearly seven years to obtain the right to build a house on state-owned wasteland. It takes 43 working days and $590 to obtain approval to set up a small store. A permit for a small factory takes 289 working days and a ten-month wait. There is no legal way to set up an independent bus service.

The system condemns the "informals" to smallness. It is hard to expand because banks usually ask for collateral for loans. If businesses become too big, the authorities will swoop on them. Micro-entrepreneurs spend much time dodging petty officialdom. Contracts are usually oral; paper versions do not amount to much, and the courts are no use in dealing with broken ones. Informals find it hard to sell a business which does not legally exist, or a house that has no title.

Legitimate firms are not much better off. Their administrative staff have to spend 40% of their time on red tape. The state taxes the formal sector highly because it collects next to nothing from the informal sector, and it needs money to administer both. Legitimate firms seek, and obtain, special privileges to offset this disadvantage. As Mr de Soto remarks:

> It is obvious to even the most formal and peaceful of citizens that the existing legal system—the red tape, the widespread mistreatment on waiting lines, the bribes, the rudeness—are a Kafkaesque trap which prevents . . . their country's resources from being used efficiently.

What to do? Mr de Soto is a free-marketeer. His solution is simple. Property rights must be simplified, homes and businesses registered. State intervention must be reduced (99% of Peruvian government decisions are by administrative fiat). Business should be given a free rein, and breaches of contract should be dealt with by more efficient courts. Such measures would amount to a revolution in state-strangled Peru.

"The Other Path" applies, in differing degrees, to other Latin American countries. The informal sector comprises roughly a third of Latin America's working population. In Bolivia, Ecuador and Nicaragua it amounts to roughly half. Mr de Soto may not have told Latin Americans anything particularly new, but he has shone a spotlight on an aspect of society that has been long neglected.

Things are already changing. The Inter-American Development Bank (IDB), which is aware of the problem and has lent $72m to 165 projects for micro-entrepreneurs in the past ten years, has decided to do much more. As its president explains, the IDB wants to establish itself

> as the bank for Latin America's informal sector. This means having an in-depth understanding of the reality of the informal sector and making a whole-hearted commitment to its development, so as to make this one of the focal points of the bank's . . . policies in the region.

This is a big change of emphasis in bank lending. It is also an approach which complements Mr de Soto's. "The Other Path" sets its own limits: cut the red tape and free the market, and the market will take care of itself. Such an approach would release the energies of millions of Latin Americans and increase GDP. But it is not enough.

Even if the red tape is cut, a vigorous effort will still be needed to get credit to the poor and ill-educated informals, who are scared of banks. The IDB and agencies such as the International Fund for Agricultural Development have increasing experience of successful lending to "peer groups", who have little or no collateral. Money reaches them through well-intentioned banks, co-operatives and charities such as Oxfam.

Credit is not enough either. The informals also need know-how. They need help in accounting, marketing and using modern technology. "The Other Path" is the right path. But it is a long one.

Here is a truly revolutionary book. It says poor countries stay poor, not because of capitalism but for lack of it.

The right path

Author Hernando de Soto
Capitalism, not socialism, is the true revolutionary force.

Carrie Boretz

By Ronald Bailey

IN ITS 1989 *State of the World's Children Report,* the United Nations Children's Fund departed from its high-minded purpose to indulge in a nasty bit of capitalist-bashing. "Over 900 million people—mostly women and children—are worse off than a decade ago," reads the press release accompanying Unicef's heavily promoted report. And who's to blame? Why, cold-hearted bankers, of course. All those poor folks are hungry, the Unicef flackery proclaimed, "because debt payments by the world's poorest nations have drained funds from essential health and educational services."

Propaganda garbage like this discredits Unicef and the entire U.N., but it does something far worse: It encourages the developing countries to blame their problems on outsiders rather than shouldering their own responsibilities for their ills. Statist societies predominate in the poorer countries, whether the rulers are military dictators or so-called Marxist-Leninists. The governments strangle individual initiative, then blame the inevitable lack of economic growth on bankers and the like. Unicef encourages this Johnny-pushed-me attitude.

Hernando de Soto, a Peruvian, says: nonsense. Much Third World economic illness is self-imposed. His book, *The Other Path: The Invisible Revolution in the Third World* (Harper & Row, $22.95), has been a bestseller in Latin America and appears here this month in English translation.

The book has stirred wide debate in Latin America and has shaken many of that area's intellectuals out of their comfortable anticapitalist attitudes. De Soto says simply that Peru's poverty—and by extension the poverty of many poor countries—is caused by its own leadership, which prevents the struggling masses from creating wealth. Capitalism has not failed Peru; Peru and most other developing countries have never tried capitalism.

His case is strengthened by the undeniable fact that the few developing countries that have embraced capitalism—South Korea and Taiwan, for example—have shot way ahead of the others in wealth and well-being.

De Soto, an economist and businessman, rejects both the political left and the traditional political right as it exists in Latin America. Both, he writes, are fundamentally statist. *The Other Path,* his book's title, is a clever reference to a Peruvian Marxist terrorist cult called the Shining Path. The other path—the path not taken—is genuine capitalism, genuine dependence on individual initiative.

Hernando de Soto was raised in Peru and educated there and in Switzerland. He told FORBES that he always resented the attitude, prevalent among Western intellectuals, that poor countries were culturally unsuited to capitalism. De Soto, a shrewd observer, thinks that individual initiative is the natural way for people to take care of their economic needs.

"It made me very angry to be told that I was culturally inferior, culturally not suited to the market economy system," De Soto told FORBES during a New York visit a year ago. "Behind the arguments of the traditional [economic] development crowd," he added, "there's always racial prejudice."

De Soto worked in Switzerland until 1979. But the problem of persistent poverty in his native land haunted him. Instead of turning to traditional textbooks for an answer, or to Marxist "science," he began walking the streets of Lima. What did he find? That nearly half of Peru's work force lived and worked outside the formal system of Peruvian law. The law, whether administered by right- or left-wingers, simply excluded them. There were no jobs for them, no room for them in formal trade unions; they could not get licenses to peddle on the streets. Yet they did not starve. They ran transport services without licenses, peddled illegally on the streets, built makeshift houses on state land—somehow survived.

"Those who are poor," De Soto writes, "are forced to engage in essentially honest activities such as building, trade, industry, or transport without the protection of the law." De Soto calls those people and their activities "informal" rather than "black market," since the latter term has unsavory, antisocial connotations.

Note that he is not talking about the kind of black market economy that exists in the U.S. and other advanced countries, which involves either criminal money or money circulating outside the tax system. He is talking about people who practice individual initiative without benefit of the law—a system of law that forbids them to do what they must to survive. They break the law, not because they want to, but because they have no other way to live.

Why must millions of poor Peruvians—and hundreds of millions of impoverished people throughout the developing world—live outside the law? Because, replies De Soto, their military and civilian leaders subject them to a precapitalistic mercantilism in which a small elite controls a legal system designed to reinforce the privileges of that elite. Not all of the elite live in grand haciendas. Some sit in government offices, work in trade union jobs, benefit from protected monopolies, wear military gold braid. An Argentine railroad worker who draws a salary for doing little or nothing is part of the protected elite even though he or she doesn't have a huge income; his or her privilege is at the expense of the taxpayer and the ordinary Argentinean.

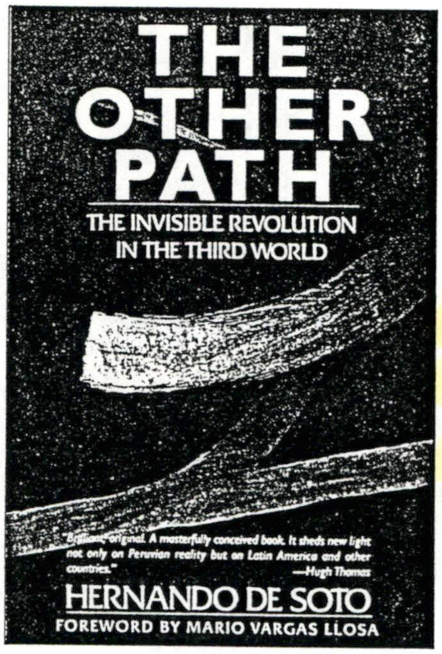
Peru's bureaucracy now spews out some 27,000 new laws per year—over 70 per day. In Peru, as in much of the Third World, competition is not for markets but for government favors and privileges.

Does some mass moral failing explain the pervasive corruption that is often blamed for Third World poverty? Not at all, says De Soto. The administered, arbitrary mercantilist system itself breeds corruption. As De Soto put it to FORBES, "You can buy and sell the law." He notes that setting up a legal sewing business in Lima, for example, required 289 days, 2 bribes, 11 permits and cost a total of \$1,231. That amount was 32 times the monthly minimum living wage.

This, says De Soto, is not capitalism but mercantilism—an inheritance from the Europe of the 16th to 18th centuries. The poverty of mercantilism persisted in Western Europe until the capitalist revolution gathered steam in the 18th century; it can be seen in the Soviet Union and throughout the Third World today.

"Mercantilism was a politically administered economy in which economic agents were subject to specific, detailed regulation," writes De Soto in *The Other Path*. "European mercantilism was characterized by the close ties that existed between an ever present state and a privileged and exclusive entrepreneurial clique."

What is mercantilism? We have some of it in the U.S. Rent control, for example. By law it assures cheap housing for a privileged minority and discourages investment in residential property; helping a relative few, it freezes out the majority. We used to have much more: exclusive routes for airlines and truckers, union domination of construction to the exclusion of outsiders. Fortunately for the U.S. standard of living, mercantilism is fairly rare here.



In this context, capitalism, not socialism, is the true revolutionary force, upsetting neat, restrictive arrangements, causing many to fail and others to succeed but creating wealth and spreading it.

What has happened in Peru, De Soto writes, is that free enterprise has grown up spontaneously on the fringe of the mercantilist system. De Soto estimates that the informals contribute almost 40% of Peru's gross domestic product and over 60% of the hours devoted to work. Most inhabitants of Lima get around on transport run by people and organizations that are theoretically extralegal.

De Soto shows that by staying alive and striving to improve their standard of living, Peru's informals have been eroding the foundations of Peru's mercantilist society. Authorities have had to make some grudging accommodation to the informal operators; otherwise the economy would already have collapsed. Urban street vendors, for example, whose activities are still illegal, are left largely alone if they pay "excise" taxes. Much red tape has been eliminated from the process of establishing informal neighborhoods. And informal bus operators can eventually get their routes officially recognized by a ponderous process. Call it a quiet capitalist revolution.

Why doesn't the ruling elite in Peru and in other poor countries stop this spread of "illegal" enterprise? In Marxist-Leninist dictatorships like Cuba and the Soviet Union, they largely succeed in driving individual enterprise underground through terror. However, right-wing authoritarian governments rarely are prepared to use that level of violence.

American bankers and politicians are worried about Latin American debt. But are they doing the right things? No, De Soto says. They should pay less attention to politics—which party wins or loses at the polls—and put pressure on the governments to bring the informals into the regular economy, to get out of the way and let individual enterprise flourish.

De Soto's book—which is a surprisingly easy read—is light on theory and strong on concrete detail about how individual enterprise among the poor is doing more for them than all the state programs. Encouragingly for the cause of freedom, De Soto has caught the imagination of many of Latin America's traditionally anticapitalist intellectuals.

In Mexico and in Argentina people who have been influenced by De Soto are making similar studies of their countries' burgeoning extralegal economies. People are also looking to the work of London School of Economics professor Peter Bauer, who made similar discoveries about poverty and development in Africa (FORBES, *Feb. 22, 1988*).

If those people at Unicef really want to help the children of the poor countries, they might stop their sterile banker-bashing and start listening to people like Hernando de Soto. *The Other Path* is a major work, one destined to change the way the world understands wealth and poverty. Beyond Keynes, beyond Marx, it gets to the heart of the economic paradox of spreading poverty in an increasingly rich world. ■

we sat next to each other when attending who would be president first -

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Don't feel bad. Up until this year, My wife used to get that reaction all the time.

HEADLINE: The canny nomination of Barbara Who

BODY:

"Barbara who'?" was the reaction of many at the World Bank to the news that Mr Barber Conable will succeed Mr Tom Clausen as president of the bank. Though Mr Conable is only America's proposed candidate, his approval by the Bank's board is a formality. The United States is the Bank's biggest shareholder and custom holds that the bank has an American president.

The search for the big job in develop ment wended its way through Mr Paul Volcker, who preferred the Fed, America's secretary, Mr William Brock, who said no for personal reasons, and America's ambassador to the EEC, Mr William Middendorf, who scared Latin Americans and Europeans by believing in the gold standard and other quaint causes. It all seems to symbolise the Bank's decline from the great days of Mr Robert McNamara.

Yet Mr Conable may prove a canny choice. For the first time in years, the Bank will be run by somebody that America's Congress trusts. Mr McNamara, a defence secretary during the Vietnam war, could not go to Capitol Hill without bodyguards. Mr Clausen, a former private banker who was President Carter's nominee, was always an outsider both to Congress and to the Reagan administration.

Mr Conable has influential friends. He served as chairman of the campaign finance committee when Mr George Bush tried to secure the Republican party's presidential nomination in 1980. A fellow campaign worker was Mr James Baker, now treasury secretary. In his 20 years in the Congress, where he ended up as top-ranking Republican on the house ways and means committee, Mr Conable won a reputation for some thoughtful independence of mind. What he lacks is experience of banking (and how do you trust a banker with a name like Conable?). Nor has he run anything larger than his father's law firm.

GRAPHIC: Charts 1 through 3, World Bank, Source: Annual report

Barber had experience solving debt problems way before coming to the World Bank. He was my 1980 campaign finance chairman - good training for his present duties.

Welcome Address by President Bush
to 1989 IMF/World Bank Annual Meetings

Introduction/General Theme

Decade that is closing has seen the rise of a "new wind" of economic freedom, private initiative, restructuring of economies, and deregulation spreading from country to country and continent to continent.

- o From the U.S., Europe, and Japan to Latin America, Eastern Europe, and Asia.

Recognition that government controls can stymie growth, and that economic freedom is essential to progress and prosperity.

- o Major efforts underway to lay the basis for a stronger, more prosperous global economy tomorrow.

Also a deeper understanding of the importance of cooperation as a community of nations in addressing common problems:

- o Debt
- o Global growth
- o Trade

... and greater consideration of the needs and objectives of others as each nation formulates its own policies.

A community of nations also has a joint responsibility to future generations. We must move now to protect the environment.

Global Action Program for the 1990's

The lessons of the past and our success over the last decade provide a sound basis for moving ahead, provided each of us does our part.

(1) Global growth

- o Industrial countries have a special responsibility to provide the basis for a sound, open growing world economy on which all nations depend.
- o G-7 efforts to coordinate economic policies have helped provide sustained growth with low inflation and greater exchange rate stability.
- o Important that global economic growth be extended and that each of us implement the measures necessary to achieve that objective.

(2) Trade

- o Fair, open trading system essential for global prosperity.

- o All countries, including developing countries, have a responsibility to tear down existing barriers and avoid erecting new ones. Importance of successful Uruguay Round.

(3) Debt

- o Strengthened debt strategy has provided new hope for debtor nations, and reflects need for new realism by commercial banks.
- o International community must carry forward cooperative efforts endorsed last spring.
- o Mexico, Philippines packages already agreed in principle; other countries actively pursuing negotiations.
- o Important for the banks to follow up and to sustain momentum. Rationalization of bank LDC loan portfolios will benefit banking community as well as debtors.
- o Debtor nations, for their part, must assure sound policies as ultimate prerequisite for growth.

(4) IMF

- o IMF responsible for fostering the sound economic policies necessary for sustained growth.
- o Warmly welcome recent measures to enable IMF to play its part in the strengthened debt strategy.
- o Essential that IMF remain true to its heritage as a provider of temporary balance of payments financing, which is the basis for its effectiveness.

(5) World Bank

- o Continuing role in encouraging both structural reforms and development.
- o These efforts are crucial to resolve current debt problems and to provide basis for future prosperity.
- o Support IDA as a means of helping the poorest countries.
- o Also urge new efforts to support the environment.

Meeting with Deane Hoffman, NSC + Steve Farrar
9-15-89

Challenges of IMF to help those shifting from Communism + LDCs to restructure economies, market mechanisms.

Peter Rodman

De Soto - informal economy - see Austen

EC 92
US - Canada free trade agreement

Pres. appreciates value of mtg.

inflation – problems still stem from inflation
from the 70s
exchange rates – differential in inflation

we are helping LDCs, but we
are helping our own banking system as well