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RECONSTRUCTION AND DEVELOPMENT

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Address by Mr. Eugene R. Black, President of the International Bank for Reconstruction and Development, In Presenting the Fourth Annual Report of the International Bank to the Board of Governors.

This is the third meeting of the Board of Governors that it has been my privilege to attend, and my first as President of the Bank. I am deeply aware of the important responsibilities of this new post, and of the high standards of achievement set by my predecessor, Mr. McCloy. But the sound policies and cooperative relations established under his leadership provide a firm foundation on which we can build the Bank's future. I welcome the opportunity to work with you in this task.

The past year has been, I think, a period of substantial progress and accomplishment for the Bank. Our activities are summarized at some length in the Fourth Annual Report, and I shall not repeat what is said there. But I do want to touch briefly on a few high spots of our recent operations, and to suggest some possible implications for the Bank of broader currents in the world economy.

Most of our loans during the past twelve months have been for projects designed to increase the output of useful goods and services in less developed countries. These development loans make up a considerable total and, as is indicated in the annual report, negotiations for the financing of a number of other development projects are well advanced. But I must say frankly that the volume of development loans granted to date has not come up to our earlier expectations.

This gap between hopes and performance is partly the result of over-optimism about the length of time it would take to get the Bank fully organized -- to bring together a competent staff, to define our policies and procedures and make them clear to our member countries, and to gather the economic and technical data necessary for sound decisions. The acceleration of our activity during the past year shows, I think, that this preliminary phase is largely behind us.

More important at present are the difficulties which are more or less universal in underdeveloped countries -- the lack of economic data, of experienced personnel, of well-organized projects, of local capital, and all the other deficiencies that are both the cause and the consequence of underdevelopment. It is no accident that the development loans we have made thus far have been mainly to countries where considerable economic and technical advance has already taken place, and to enterprises with a substantial record of experience behind them. The greater the progress a country has already made in development the easier it is for it to progress further; and by the same token it is almost always easier to expand a going concern than to start a new one from scratch.

Yet the essence of successful economic development, and therefore the essential task of the Bank, is precisely to bring new enterprises into being and new techniques into effective use in economically retarded areas -- and the more retarded the country the more urgent and challenging is our task.

I believe we have made good progress in overcoming some of the special difficulties of economic development which are analyzed in the annual report. Through missions to most of our less developed member countries, we have greatly enlarged our knowledge of their economic problems and needs, their capacity to absorb and service external loans, and the merits of particular development projects. A better understanding now prevails, I think, of the Bank's policies and methods; and more and more governments are eliminating legal or procedural obstacles to loans from the Bank by taking appropriate action to enable them to incur or guarantee such loans.

Perhaps most important, through our surveys and discussions with member governments, we are better able to assist the less developed countries in diagnosing and solving their own problems. Giving advice is not, of course, our primary function. But we have an immediate and vital concern in trying to promote conditions favorable to the success of our loans and to the increase of productive investment from other sources. I believe that one of the most constructive contributions we can make to the progress of development, especially in the least advanced countries, is to help make available to them the experience of other nations. Moreover, the resulting close and continuous relationship with our members helps to speed up the preparation of development plans and the execution of projects for which Bank financing is appropriate.

The initial cultivation of the seeds of development has, therefore, been a somewhat longer task than at first we had hoped. I am confident, however, that we may look forward to an abundant harvest. The first fruits -- the loans granted during the past year -- are to me the source of considerable satisfaction.

It is also a source of satisfaction that the Bank has been able during the past year to make its first loan to one of its members in

Eastern Europe. The difficulties and uncertainties cited in the Third Annual Report still exist, and have hampered further loans by the Bank in this region. But these difficulties have been lessened somewhat by economic developments -- notably the increasing availability of manufactured goods in Western Europe urgently needed by Eastern Europe and the similar availability of essential materials in Eastern Europe which are required by the Western countries. If these trends continue and political tensions are relaxed, the possibilities for constructive assistance by the Bank to its Eastern European members should expand considerably.

I am also happy to report that during the past month we have been able to conclude our first loan to one of our Asian member states, and I feel confident that this financing will be followed by other transactions by the Bank in that great region of the world. In the Middle East we have not yet consummated any loan, but, as the annual report shows, we have been examining a number of projects in various Middle Eastern countries, some of which I hope will qualify for Bank financing in the relatively near future.

On the other side of the balance sheet for the year, I am sorry to say that we have not succeeded to the extent we had hoped in broadening the international character of the financial resources at the disposal of the Bank. I refer in particular to our efforts to obtain additional consents to the use in our lending operations of the 18% local currency part of the Bank's capital. Apart from the United States, which has made the full amount of its 18% currency available, some releases have been made by Belgium, Canada, Denmark and the United Kingdom. They amount in the aggregate, however, to only slightly more than the equivalent of 12 million dollars.

In my judgment, it is extremely important that the Bank receive greater help from its members in this connection. The strength of the Bank is that it is an international cooperative institution. Its ownership, its purposes and its responsibilities are shared by all its member nations. We who are familiar with the Bank and its basic concepts appreciate, of course, that the international character of the Bank's resources is best demonstrated by the fact that no matter in which capital market the Bank may borrow, each member country pledges its credit that the Bank will meet its obligations. This real but subtle point unfortunately tends to be overlooked by the world at large and there is an increasing disposition to cite the Bank's reliance on dollars for lending purposes as evidence that it has only limited international participation.

My experience has been that the most effective answer to these criticisms is to show that the Bank is making use of other resources besides dollars and in particular of the 18% currencies of members other than the United States. Accepting the reality that the United States must remain the chief potential source of lending capital for the Bank for some time to come, I still believe that it is possible for a number of other member governments to make a substantial amount of their 18% capital subscription available for lending.

I do not make this plea for larger releases from the 18% subscriptions merely to underline the word international in our title. We have a definite use for these currencies. So long as inconvertibility continues many countries will be able to repay indebtedness in other currencies although they may not be able to service dollar loans.

It is true that most of the countries from which we would like consent to use their 18% subscriptions have pressing investment needs at home and are actually net importers of capital. But many of them still invest substantial sums abroad. I do not think I am asking too much if I call on these countries to make a part of their foreign investment through the medium of the Bank.

There is another method by which many of our member countries can add to the international character of the Bank's resources and that is to increase the eligibility for investment of the Bank's bonds. Through legislative or administrative action in a number of countries, a substantial contribution can be made by our members to the creation of a broader market for those bonds. I attach importance to this matter and I propose to discuss it with you in more detail at a later stage of the meeting.

I should like to turn now to a matter much wider in scope than the Bank's own operations but which nevertheless profoundly affects the Bank and is of vital concern to all the countries represented at this table. I am speaking of the problem of European recovery.

As was foreshadowed in the Bank's annual report a year ago, problems of development have increasingly occupied our attention. Since the last Governors' meeting we have made only two small loans to Western European countries. Necessarily the principal role in assisting European reconstruction is being played by ECA.

Nonetheless European recovery is of vital importance to the operations of the Bank because of the pivotal part played by the great trading nations of Europe in the functioning of the world economy. European purchases and sales abroad have long been a decisive factor in balancing international trade. Unless the European economies can be reestablished on a stable basis the economic position of almost every country, even of those in the dollar area, will be insecure. In passing upon loan applications, whether from countries in Latin America, Asia, the Middle East, or elsewhere, we always come face to face with the necessity for appraising whether the customary trade of these countries with Europe can be reestablished on a satisfactory basis. It is, therefore, no exaggeration to state that the soundness of all our loans is affected by the outcome of the European recovery efforts.

The first objectives of the European Recovery Program -- to expand production and restore financial stability in the participating countries -- have been achieved to an impressive extent. But we must face the fact that, though prewar levels of output have been reached and surpassed and though the menace of inflation has been curbed, progress along these lines alone is no longer enough. It has become plain, I think, that the time has now arrived for making fundamental readjustments in present patterns of trade and production. And if these necessary readjustments are to be made successfully, they must include complementary action by both the European countries and the United States.

So far as concerns the European countries, the most urgent requirement is obviously to sell more of their production abroad, and particularly in dollar markets. In order to accomplish this, many things are necessary -- but to my mind the most important are to reduce export costs and to make exports to the dollar area at least as attractive to individual producers as sales either in the domestic market or in other foreign areas.

In my judgment there are several lines of action which must be followed to achieve these objectives. The first, which I need not elaborate before this audience, and which is appropriately dealt with at some length in the annual report of the International Monetary Fund, is the establishment of a system of exchange rates which will assist the dollar-deficit countries to compete effectively in world markets, will furnish an incentive to exporters to increase their sales in the dollar area and will encourage importers to buy, to the extent possible, in countries whose currencies they can best afford. I do not underestimate either the complexities or the far-reaching consequences of such action, but I fail to see how it can be avoided.

The second line of approach must be to reduce the domestic costs of production, both by increasing the efficiency of management and labor and by limiting the burden of indirect costs, principally government expenditures, which must be borne by producers. In most countries the level of productivity has already risen substantially since the war, but they still lag far behind the United States and Canada.

It has been pretty well demonstrated, I think, that productive efficiency cannot be brought about merely through governmental edict or exhortation. To make the most effective use of existing productive facilities, real incentives are required, and perhaps most important, the pressure of competition. To my mind, one of the most essential steps toward solution of the dollar problem is for the dollar-deficit countries to start clearing away the wilderness of bilateral arrangements, special currency controls, quotas and similar restrictions, both internal and external, which have grown up over the past 20 years to protect inefficient production and trade practices. I don't suggest that this can or should be done overnight. The important thing is to begin now to move -- and to move rapidly -- toward a freer, more competitive exchange of goods.

The problem of reducing the burden of governmental costs on production is a difficult one, particularly susceptible to controversy and misunderstanding. Since World War II many governments have committed themselves to extensive programs of social welfare. No one can dispute their right to follow this course, if they have the means to undertake it. Unfortunately, however, it has become apparent that many countries cannot now afford ambitious programs of social services without either reducing their living standards in other respects or cutting back their productive investments designed to make possible a better standard of living in the future.

In addition to the necessary reduction in costs, it is important that the European countries undertake vigorous, concentrated measures to broaden their market in the United States and Canada. What is required, I believe, is not only the offer of a greater variety of goods adapted to American tastes and priced attractively, but also a wider and more forceful attack on the attention of the American consuming public.

If the European countries take energetic action along these lines in the months ahead, they should with continued ECA aid be able to make additional significant progress towards true recovery. I regard the continuance of ECA aid essential, but I believe it important that the aid should be so allocated as to give the participating countries the greatest possible incentive to pursue this new course of action. However useful the present method of ERP programming has been to date, I think the time has come when it, too, calls for review. I therefore welcome the announcement by Mr. Hoffman that allocation of ECA aid during the second half of the current fiscal year will be directly related to the performance of the participating countries, acting both individually and collectively through the OEEC, in effectively using the aid and realizing the objectives of the Recovery Program.

Up to the present time assistance from ECA has been allocated primarily on the basis of the anticipated dollar deficit of the respective countries -- the largest shares going to those having the biggest deficits. It is true that, in estimating the deficits, it has been assumed that the countries concerned would take effective action to reduce the dollar gap. Nevertheless, the incentive has tended to be a negative one since the greater the gap, the greater the claim for aid, while the smaller the deficit, the less assistance was likely to be anticipated. Furthermore, so long as ECA dollars cannot be saved, but only used for current imports, the ERP countries have difficulty in building up adequate foreign exchange reserves, without which they cannot relax their trade and currency controls or face with confidence the difficult years after 1952.

I know that ECA is fully conscious of this problem and is doing all within its power to encourage the participating countries to carry out the necessary readjustments. I am nevertheless troubled about the situation because I believe that the basic difficulties may not be as readily susceptible of solution if dealt with only within the terms of the powers now available to ECA.

Specifically, I suggest that careful thought be given to the following approach: First, that the share of ECA aid to each participating country be defined as clearly as possible for the remainder of the Recovery Program, and each country be given assurance that its share will not be reduced if it earns or saves more dollars than had been expected, nor increased if its dollar deficit grows larger; and second, that all restrictions be removed from the use to which ECA dollars may be put so that such dollars will cease to be "soft dollars" and each country will have the opportunity to make the most economic use of the aid provided.

If this approach should prove feasible, it may have most salutary effects. Each country would know how much dollar aid it could count on and, knowing that no further aid could be anticipated, would be encouraged to husband it carefully. Responsibility would be squarely placed upon the participating nations to take the measures necessary for their own recovery.

I should like to emphasize one further point. Action by the dollar-deficit countries, however soundly conceived and vigorously executed, will not suffice to solve the dollar problem unless the United States takes complementary measures. For despite a rather remarkable shift in the attitude of the United States in recent years, some of its policies are still basically inconsistent with its position as the great creditor nation of the world. Modifications of these policies, like those that are necessary in Europe, may injure particular groups or interests within this country, but in my judgment such modifications are essential both to restore the health of the world economy and to maintain America's own prosperity.

United States tariffs provide the most important case in point. Their overall level has been greatly reduced since the early thirties, but at certain crucial points they remain a barrier to the import of foreign goods. Moreover, producers in other countries fear, with some justification, that if they should succeed in establishing a market for their goods in the United States, their efforts would be negated by new or higher protective tariffs. Even where the level of duties does not exclude foreign goods, they are frequently kept out by unduly complex customs procedures and regulations.

In addition to tariff barriers there are also a number of other types of restrictions designed to protect American companies against foreign competition, which are hardly consistent with the expressed policy and long-range interests of the United States. In my judgment, it does not make good sense for America to encourage the production of goods for the domestic market which could more economically be imported, and certainly all attempts to use the aid programs as a vehicle for dumping surplus goods abroad should be strongly resisted.

I would like to close on a note of guarded optimism. When rationing stopped after the war, there was a shortage of many classes of goods. In some cases the shortage was so acute as to drive people to extraordinary lengths to obtain the goods they wanted. It is astonishing how quickly some of these "acute" shortages disappeared when there was a moderately increased flow to the market. To suggest that the dollar shortage can be compared with that of butter would be wishful thinking, but I do believe the world is somewhat in the grip of a "shortage" psychosis. If only -- and it is no small "if" -- if only we can start on the way towards equilibrium, we may find the effects of returning confidence highly cumulative and our difficulties dispelled more quickly than we dared hope.