REFLECTIONS ON DEVELOPMENT

Issues Facing Developing Countries

MOEEN A. QURESHI
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Foreword

The World Bank is issuing this collection of speeches to mark the retirement of Moeen A. Qureshi after thirty-five years of truly distinguished service to the International Monetary Fund and the World Bank Group. Throughout his unique and illustrious career, he has displayed outstanding professional and personal qualities, as well as a deep commitment to development.

His accomplishments are many. As Executive Vice President of the International Finance Corporation (IFC), he oversaw the nearly threefold expansion of IFC's investments and the first increase in IFC's capital. During his tenure as Senior Vice President, Finance, he made major contributions to the negotiation of several replenishments of the International Development Association and the 1981 capital increase of the International Bank for Reconstruction and Development, and to the strengthening of the Bank's borrowing operations and liquidity management. More recently, as Senior Vice President, Operations, for the past five years, he has directed a significant reorientation and expansion of the World Bank's operations in support of poverty reduction, the environment, and promotion of the private sector.

The speeches in this publication are testimony to Moeen Qureshi's leadership, vision, and achievements. I am confident that this collection will help enhance public knowledge about development and about the evolution of development philosophy within the Bank Group.

Lewis T. Preston
Introduction

In high places and large institutions, speeches are frequently the work of committees. The speeches in this volume are not. They are the special intellectual contribution of one fine and thoughtful man to the evolving world of development. His experience is extensive, his perception clear, and his germinal views independent. I count myself fortunate to be among the many who have trusted and benefited from his counsel.

Moeen Qureshi epitomizes a rare breed of development practitioners, schooled and experienced in finance and economics, and equally at home with macroeconomic and sectoral policy. The breadth of Moeen's experience — at the IMF, at IFC, and within the World Bank, all building on his early years of service in finance and planning in the government of Pakistan — has given him a uniquely comprehensive perspective on development. He is able to explain development from the vantage points of someone in the private sector, in government, and in international financial institutions advising governments. In each area, his perspective is grounded in personal experience.

These speeches accurately convey Moeen Qureshi's broad vision of development. Spanning his career with the World Bank Group, they reflect his preoccupations and track his interests, which mirror — indeed, in many cases, foreshadow — thinking in the wider development community. They also touch on many of my own particular concerns, which with his help I was able to bring to the center of the development agenda during my term as President of the World Bank. His speeches prove that Moeen is an intellectual of the highest order, but is undistracted by grand, abstract ideas. Reading these speeches, one is struck by his pragmatism; the wisdom of the practitioner has always been the hallmark of his leadership. In a world full of problems, he is a problem solver, committed to practical action.

It is no surprise that the development agenda has been a recurring theme of his speeches over the years. Nevertheless, readers will see in his approach a special twist — namely a focus on grassroots involvement. We have all learned by now that, without grassroots support, intervention — no matter how clever or well intended — will not be sustainable. But Moeen Qureshi has long been saying precisely that, on all manner of development issues. Speaking in 1979 on "The Emerging Development Agenda," he highlighted the problem of poverty as a critical issue — both within and across countries. He emphasized that increased
resource transfers alone cannot solve the problem of in-country inequalities in income distribution. Rather, he argued that "fundamental policy and institutional changes in the countries themselves" are required. This, of course, was a theme that Moeen Qureshi advanced during his tenure as Senior Vice President, Operations. He subsequently personally provided leadership for increasing attention to nongovernmental organizations and to popular participation, and more generally for bringing the Bank's poverty strategy from the macroeconomic to the microeconomic level. His personal commitment is reflected in his remarks at the Conference on Learning from the Grassroots in 1988, and more recently at the International Development Conference in January 1991.

The speeches on private investment and financing make clear Moeen Qureshi's insistence on harnessing market incentives to advance the cause of development. This is nowhere more apparent than in his 1977 address on "The Future of Private Enterprise in Developing Countries," which deals quite candidly with problems in bringing together private investors and governments. The speeches on broader financing issues span a period of more than fifteen years, starting with the Euro-currency market and ending with the debt crisis. They reveal a rigorous analytic approach to interpreting emerging trends, which gave him a head start in anticipating the effects of these trends. Noting the emergence of the debt crisis and the risks it posed for development, he explains its genesis in dispassionate terms not common to the times — as an unfortunate by-product of the global recession and high interest rates sparked by anti-inflation policies in developed countries. Time has proven him both correct in his analysis of the causes of the crisis and prescient in his identification of the effects on development.

At the 1990 Wealth of Nations Conference, Moeen Qureshi succinctly stated his belief in the fundamentals of development. His five golden rules of development for countries are:

- Invest in people.
- Create a sound financial environment that encourages savings, efficient markets, and investment.
- Endow peasant farmers with permanent use of the land, access to knowledge, and freedom to exploit these resources.
- Promote maximum competition in trade and industry.
- Avoid imposing dogmas and doctrinaire strategies of development.
These elements appear constantly in his speeches on country issues. Because country circumstances vary widely, appropriate responses need to be tailored to a complex set of political, economic, and social factors. In Africa, the focus is on population, poverty, and the environment. In Asia, the emphasis is on private sector development because experience has shown the productive enterprise is best left to the private sector. The social sectors in Pakistan and population in India are also highlighted. In Eastern Europe, the issue is the reorientation of the role of the state—from intervention in all aspects of economic activity to a more specific regulatory and supportive role. There he also stresses the social safety net, financial sector reform, and the debt problem. In speaking in 1985 on “Overcoming the Latin American Economic Crisis,” he recommended reduced government interventions and improved competition, within a sound macroeconomic framework. Happily, that medicine was taken by many countries—with the good effects we are observing today.

Taken as a whole, the pages that follow reflect the thinking of a man whose strong roots in the fundamentals of development kept him from being blown off course by the sometimes heady winds of international finance. In whatever role he played, he has consistently applied the simple model of self-interest—equally to the multinational banker and to the peasant farmer—as a basis for understanding behavior. But he has combined this with a model for the public interest—including the benefits of investing in human capital and in a sound regulatory, financial, and macroeconomic framework—as a basis for policy formulation. His ability to shift from one area of expertise to another, constantly broadening the lessons of his experience, helped him evolve into the consummate intellectual and development professional.

I recommend these speeches to the reader interested in learning about the modern art of development—and about a man in development who has been instrumental in shaping the evolution of development thinking and policies around the world.

Barber B. Conable
Development Overview
1. The Emerging Development Agenda

Netherlands Finance Company for the Developing Countries
June 29, 1979

The issues of international economic development have in recent years occupied a position in world politics that is unique in the course of human history. While nations have been concerned with the well-being of their own peoples, only in the last 25 years or so has this concern seriously extended beyond their own borders and territories.

Thus, as we approach the end of this decade, it is, perhaps, time to reflect on what has been accomplished, where we are today, and what we might reasonably expect to happen over the remaining two decades of this century.

The Record

We have just lived through an unprecedented quarter century of history. Despite its considerable failings, the period was extraordinarily successful. Even though it is the period that ushered in the threat of nuclear holocausts—it is also a period during which more than a hundred nations encompassing half of humanity gained independence. Although it has been a period during which serious concerns for the ecological health of the planet were raised—it has also been a period during which a technological revolution occurred in communications, computers, and industrial systems which will help us cope with these problems.

It has also been a period during which the developing countries joined, for the first time, in the process of rapid economic development. Over the past 25 years per capita income has grown at a rate exceeding 3% per annum—as compared to a growth rate in the now industrialized countries during the like period of about one percent—and total domestic production increased between 5-6% per annum.

Their trade has been growing—increasing 600% over the last decade alone—with manufactured goods becoming an increasingly important part of that trade. Over the last fifteen years, the developing countries have been able to absorb nearly one-third of the growth in the exports
of manufactures of the industrial countries and currently take about one-quarter of their total exports.

Investment, largely internally generated, has been exceptionally strong, especially in the more advanced developing countries and has been growing in the 1970s at almost 9% per annum.

Measured in more human terms, the well-being of the large numbers of people improved over the same period. In the past two decades, literacy rates in the low-income countries more than doubled; infant mortality decreased by over 15%; life expectancy increased by over 20%. More people in more countries had access to potable water, minimum health services and sewerage than ever before in human history.

The experience of the developed countries was just as spectacular: in Europe, in particular. The economic growth of the industrialized countries in the last quarter century has exceeded that of the previous 100 years.

The last quarter century was truly, as Herman Kahn the futurist, put it, La Deuxième Belle Époque.

Where We Are Today
Do the successes of the last two decades allow us to rest on our laurels—to believe that the job is finished? Before we decide this question, consider the following.

Poverty
In the low-income developing countries, life expectancy is still almost half of what it is in the industrialized countries; infant mortality is eight times as high; adult literacy is almost one quarter.

In spite of the tremendous successes of the past two decades almost 800 million—over three times the total population of Europe—live on the very edge of human existence, beneath any reasonable definition of human decency. We live in a world in which more people die of starvation and preventable terminal diseases each year than perished each year of World War II.

The per capita incomes of the industrialized countries is about $6,200 per annum, that of the middle-income countries about $750. In the low-income countries—which constitute about 30% of the world's pop-
ulation, it is about $150, or about 2.5% of that of the industrialized countries.

In many respects duplicating the progress made in the past two decades will be more difficult. For one thing, it is not possible anymore to speak of a monolithic developing world. As a result the problems of development have become more complex.

The Fragmented World

In the past, development problems and issues were addresses in terms of a bipolar world—there were the rich and there were the poor.

We have increasingly come to recognize that this simplistic approach to development is no longer applicable to today's world.

In today's world countries are developing at different rates and the basis upon which they are developing differs widely. This has led to a divergence of interests and objectives, and a fragmentation of the developing world—a fragmentation, I might add, that has always existed in the industrialized world. This has made the problem of achieving consensus and a resolution of development issues increasingly difficult.

The emergence of the capital surplus oil exporting countries is one obvious example of this phenomenon. There is also a growing class of middle-income countries who, for the past decade have been growing at twice the rate of the OECD countries. Today, they have only one-fifth of the gross product but the annual increment of their GNP is more than one-third of that of OECD countries. Should these relationships continue, within the next half decade their annual increment of gross product will exceed that of the United States.

Five so-called developing countries—Mexico, Brazil, Spain, the Peoples Republic of China, and India—each have a larger GNP than 9 of the 19 industrialized countries, including Switzerland, Sweden, and Belgium.

On the other hand, there is a group of countries with an annual growth of per capita income of about 0.9% whose prospects of getting into the mainstream of economic prosperity in the near future appear much more difficult. Even if their per capita incomes were to grow at the unlikely rate of 3.5% per year between now and the end of the century, it would, at the turn of this century, only approximate that of Europe in the late 1700s, in nominal terms.
So we have more than just a convenient and homogeneous category of third world countries; we have in fact an assortment of countries involved in a dynamic process of social change and economic development.

Some of the developing countries are resource rich, others poor. Some have huge internal markets, others must rely almost exclusively on international trade for their future growth prospects. In this environment, it is not surprising that the problem of international development often seems very complex and confused, and consensus is hard to reach.

**Relations between the Developing Countries**

Nowhere is this complexity better reflected than in the current agenda of development issues, the controversy which surrounds it, and the state of relations between the industrialized and developing countries.

The so-called North-South debate and all that it conjures up in the mind is perhaps most symptomatic of the current state of affairs.

The basis of the current confrontation between the developed and developing worlds are issues relating to the questions of access and opportunity. The developing nations feel that they have not shared equitably in the rapid global economic growth. In the early 1970's they stated these grievances and offered an agenda to redress what they felt to be serious imbalances.

The agenda included better access for their manufactured goods into the markets of the industrialized world, more stable and preferably higher prices for their raw materials, renegotiation of their external public debt, curbs on the activities of multinational corporations and improved access to their technology, a greater share on the management of the international monetary system and international financial institutions, a growing share in the world's industrial production, and new and less demeaning aid relationships. Collectively, their goals came to be known as the "new international economic order."

It is relatively easy to review the progress that has been made on the issues of the NIEO—very little. And to sum up the current situation, one has to conclude that confrontation is still the order of the day.

There is, however, one trend that is well underway that may change the nature of not only the agenda of development issues, but the nature of the relationships between the developed and developing worlds.
Interdependencies

Today we are in a world similar to that of a group of men who were travelling in a boat. Suddenly, one of the men took a drill and began to bore a hole under his seat. The other passengers looked at what he was doing with horror and shouted: “What are you doing?”

He replied, “What has that to do with you? Aren’t I drilling the hole under my own seat?”

Within the next two decades I do believe that the fool with the drill will either no longer be a fool, or he will no longer be in the boat.

The key to changes is the phenomenon of what we have come to call global interdependence.

In the growing literature on the subject, there is a description of interdependence that serves as well as any other to illustrate my point.

Edward Korry, writing in a periodical appropriately named The Interdependent, offered the following:

It is the link between the disappearance of anchovies off the coast of Peru and the higher price of soybeans in Peoria, between the auto fumes caught in the atmosphere and the drifting of monsoons off their customary life-giving paths, between spiraling birth rates and the dignity of women, between the scarcity of raw materials and the erosion of money...

It is my feeling that greater interdependence among nations, both industrialized and developing, is a trend that is well established and will continue, with even greater speed, over the next two decades. It is a more genuine form of interdependence than that which existed in the past, and it will increasingly dominate and shape the focus and resolution of development issues over the next two decades.

The Changing Economic Environment

As we look to the future there are changes, already becoming visible, in the international economic environment.

One of these changes is a recognition, that I touched upon earlier, that it is no longer meaningful to think in terms of a “three-world” economy with the third world essentially dependent upon the largesse from the first and second for its survival and advancement. As this becomes more
apparent, the intricate web of relationships which bind national economies together will draw tighter.

Another is the fact that the industrialized countries are becoming more dependent upon the developing economies—for markets, outlets for investment, for raw materials, labor and so on. The industrial countries will have to include in the calculus of their economic policies the effect their policies have on the economic health of the developing countries—something which has not loomed large in their considerations in the past.

Third is the fact that as the world economy grows it will have to struggle to adjust to the increasing demands for more non-renewable resources, including fossil fuels, for which many developing countries have significant potential. On the basis of current trends, the world economy should grow from about $8 trillion to $12 trillion, in constant dollars, over the next decade. But this will need concerted action on the part of both developed and developing countries to find equitable formulas that serve the interests of all countries.

Finally, one must consider the effect of the growing economic ties between the developing countries themselves, their greater self-reliance and therefore a lessening of their dependence on the industrial countries.

These emerging trends in the global economy are the signposts for tomorrow, which can guide us to the likely thrust of the development debate over the next two decades.

The Future Development Issues

Let us speculate for a moment now on the emerging shape of issues of the future, as they relate to the process of development, to the relationship between the developed and developing worlds, and to the growing internationalization of the world's economy.

First, let us turn to the problems of poverty. There appears to be a worldwide consensus that something must be done not only for the sake of humanity but for the sake of reducing worldwide tensions to eradicate its worst forms.

There are however two types of poverty—let us call them "internal poverty" and "national poverty."

"National poverty" refers to the traditional concept of a developing country—a country in which the general level of economic well-being is low. "Internal poverty" refers to the distribution of incomes within a
country. The fact is that as more and more countries emerge from "national poverty," they have found that in their struggles to improve themselves, they have left behind large segments of their population mired in desperate poverty.

It is clear the "internal poverty" cannot be solved simply by increasing the transfer of resources from the developing world—it will require fundamental policy and institutional changes in the countries themselves. What the developing countries, especially the middle-income and newly industrialized countries, do about this problem is more important than the levels of development assistance. What they can do, and how they can do it, will become an increasingly important item on the development agenda.

On the other hand, countries which suffer from "national poverty" can be helped and must be helped through concessional resource flows from more affluent countries.

Second, because of the continuing needs of the developing countries the issues of the transfer of resources from the developed countries will continue to be an issue in the decades to come. It will, however, be a more complex issue because of the increased diversity of developing countries.

The flows of external capital to developing countries have grown at impressive rates in recent years and have provided essential support for their development efforts. In 1970 the flow of external funds was about $24 billion. By 1977, this had grown to $63 billion and is projected to increase to about $140 billion by the end of 1980. Although the developed countries have provided and continue to provide financial assistance to the developing countries, the bulk of the increase has come and must continue to come from private capital sources.

In spite of recent advances in multilateral lending and in private capital flows, there are grounds for concern, especially with respect to resource transfers on concessional terms.

The problem of resource transfers as a development issue is clearly seen by the fact that although about 30% of the world's population lives in low-income countries, these countries receive only about 8% of the total private capital flows to developing countries. Within the decade they will require a quadrupling of external funding even to support very moderate growth rates. It is not expected that by that time these countries will have access in any significant way to private capital markets. They
will need to supplement their very meager savings with funds on concessionary terms in order simply to achieve some improvement in their per capita income.

In the case of the lower middle-income countries, the prospects for their gaining access to private capital markets are better. However, it will not occur unless official flows are provided and directed towards establishing the conditions where they can support additional amounts of debt burden. In addition, more active efforts by development institutions must be directed towards assisting these countries gain access to international private capital markets.

In the middle-income countries, the current trend to greater reliance on private capital flows should continue. Current projections are that their external funding requirement will nearly triple over the next decade with close to 80% being provided by private capital sources. However, unless these countries have the means to earn increasing amounts of foreign exchange through increased exports—especially manufactured exports to the developing countries—their debt-service ratios will deteriorate to the point where additional debt could not be carried.

In short, there are three major issues regarding the transfer of resources which must be resolved over the next two decades.

First, steps must be taken to assure that sufficient amounts of concessionary assistance are made available to the low-income countries—particularly in Africa and to a lesser extent Asia. These countries have no other alternative than to rely on concessionary official flows and their development would be severely restricted without them.

Second, steps must be taken to assure the continued strength of international credit markets and institutions. By 1990 these institutions are projected as having to supply over $275 billion gross, or about $50 billion net per year, to the developing countries. Special attention should be paid to ensuring that any actions, such as placing the Eurocurrency markets under greater restrictions, should avoid abrupt and unsettling adjustments which would cut off or slow down the flow of funds to the developing countries.

Third, steps must be taken to assure the continued support for both bilateral and multilateral financial institutions which provide the underpinnings of intermediation and confidence that are essential to the continued flows of private capital.
North-South Relations: A Basis for Cooperation

We are entering into a period in which basic structural changes in the world's economies are occurring.

These changes are occurring both in national economies—developing and developed—and at the international level: in patterns of international production; trade and resource flows.

For example, the economic structure, technology, planning and underlying attitudes of the industrial nations have been founded on the assumption of cheap energy throughout the century. As the cost of energy now becomes permanently established as a significantly larger component of total economic costs, it seems virtually certain that the economies of industry and the available choice of industrial strategies will be permanently affected. The structural adjustments needed to reflect these conditions are just getting underway.

It is increasingly clear that the developing countries are becoming much more important to the economic health of the industrialized countries. The reverse of course has always been true.

Accelerated progress and growing markets in the developing countries hold out the promise of new opportunities for trade and investment for the industrial economies. However, the structural adjustments needed to take advantage of these changes, in both the developed and developing countries, have only barely begun.

These changes are occurring now. It may be possible to postpone the time when these forces must be dealt with—it is not possible to postpone it forever. If the challenge is met by the international community with foresight and wisdom, the adjustments involved will be easier and less traumatic, but they cannot be avoided any more than it is possible to stay the tides.

These structural adjustments are rooted in the growing process of international interdependence. And because of this, there will become more and more areas in which both sides will perceive that it is in their self-interest to cooperate, to compromise, and to seek mutually beneficial solutions to development issues.

This, combined with the fact that it will become increasingly apparent to both sides that neither can exercise its power with impunity—whether it should be to withhold supplies of raw materials or withhold markets—
provides the real basis upon which development issues are likely to be shaped and resolved in the coming decades.

The Emerging Agenda

It is for this reason that I see the development agenda of the future less preoccupied with closing the so-called gaps between the industrialized and developing countries, and likely to be focused on more practical proposals for ensuring access to resources and opening opportunities for further economic expansion in developed and developing countries alike.

I can see diminishing preoccupation with vague targets designed to muster political support and a more rigorous pursuit of specific initiatives for achieving mutually beneficial gains in the field of investment, trade, and access to resources and know-how.

In this context, let me say a word about FMO and IFC which belong to a rather small and, if you will, a specialized brotherhood of development institutions. In many respects we share common objectives and go about our assigned tasks in much the same way. And it is my sincere hope that the pattern of joint efforts we have established in the recent past will grow and prosper in the near future. By sharing and learning from each other not only can we become more effective institutions but, more importantly, we can effectively assist those we have been established to serve.

We also share in one other thing—the need to have the foresight to anticipate the future. We have been assigned a role to assist others in meeting the challenges of tomorrow. It is important that we do so with some reflection as to the future course of events.
It is a great pleasure for me to be able to address this Sunday supper meeting here at the International House. For me, it is a personal pleasure to do so at the invitation of Gordon Evans. I know of no one who has a greater commitment to the economic and social advancement of the developing countries, and no one who has labored harder to advance that cause. I was flattered that he would choose me to be a guest speaker at one of only two such occasions this semester. I am also informed that residents of the International House represent seventy-three countries. This is an ideal audience before which to discuss—what I consider to be—one of the most pressing problems in the international arena.

I am referring to the present crisis in development.

What is the nature of this crisis? How has it come about, and what can be done about it? In particular, what is, or what can be, the role of the multilateral financial institutions in helping resolve the crisis? This latter topic is one that is particularly close to me, as I have spent the greater part of my working life in these institutions—first, in the International Monetary Fund, and now in the World Bank. It is also a topic that has come in for increasing attention and is not without controversy.

What I refer to as a "development crisis" is a crisis in the economic and financial affairs of the developing countries—the most serious since the Second World War—which threatens the continuation of the economic and social progress which they have been able to sustain for well over a quarter century. Indeed, the development situation has already deteriorated in large segments of the developing world—in Sub-Saharan Africa and in Latin America—where the previous trend of economic growth has been reversed, and even in the most dynamic parts of East Asia the rate of growth has been halved.

The current crisis threatens not only the ability of the developing countries, especially the poorest countries, to sustain even a modest development effort, it is beginning to erode and undermine support for
the entire system of multilateral cooperation and aid which has been so painstakingly built up over the years by so many men of foresight and vision.

It is particularly tragic, and somewhat ironic, that this should happen now, when there is clear evidence that the global society is becoming so much more closely knit and integrated than could have been envisioned even three or four decades ago, when the first steps were taken towards building up the present structure of multilateral assistance and cooperation.

The development crisis to which I have referred is, of course, part and parcel of a global phenomenon—of an industrialized world that is itself in a state of economic crisis.

The current recession in the industrialized countries is the longest, and by most standards the deepest, for half a century. Unemployment in the OECD countries stands at a post-war record of 32 million, and the rate of industrial capacity utilization, of production, and of profitability remains dangerously low.

There are three related areas where the interface between the developing and industrialized countries has particular significance to the issues that I wish to take up with you this evening.

These are trade, debt, and capital flows.

These are also the issues that have lately been given a great deal of publicity. This is because developments in each of these areas threaten a breakdown in existing arrangements, and therefore breed an air of crisis.

The decline in world trade threatens trade warfare, protectionism, and competitive exchange rate adjustments between countries. The problem of the mounting developing country debt brings up the specter of an imminent collapse of the international banking system, and the drying up of capital flows, both official and private, to the developing countries foreshadows an end to their development progress.

To put this into perspective, let me now outline some of the developments in the world economy that have given rise to the present situation, and, in particular, to the way in which issues of trade, debt, and capital flows have contributed to the current climate of crisis.

The overall economic crisis facing the developing world is the result of a combination of several major factors:
The sharp and protracted recession in the industrial countries, which has led to a sharp decline in commodity prices and to a reduction in the volume of their exports due to lower demand and protectionist trade policies.

- High rates of interest, which have increased debt service payments.

- A significant reduction in the flow of both concessional and non-concessional funds to developing countries.

As I noted, a recession in the industrial countries has proved longer lived and more difficult to break out of than originally expected. Growth rates in the OECD countries fell from 3.2% in 1979 to 1.2% in 1981. A strong revival was originally forecast for the second half of 1982, but it did not materialize, and it now seems that 1982 ended probably with a decline in GDP of 0.2%. The outlook for 1983 is very uncertain. While there are some hopeful signs, particularly in the U.S., only a modest recovery is now forecast. There is even a danger that, without concerted international action to promote world recovery, the incipient signs of expansion which are now being so widely perceived will prove illusionary, and any genuine resumption of economic growth will be deferred until 1984.

The depth of the recession is mirrored in the serious decline in world trade; there was no growth in the volume of international trade in 1981, and 1982 saw a decline.

The trade of developing countries has been particularly hard hit.

First, primary commodity prices have fallen sharply. This was not offset by a reduction in prices of manufactured imports, despite the abatement of inflation in the industrial countries. As a result, the overall terms of trade of non-oil developing countries declined steadily over the last three years, with the lowest income countries, which were the most affected, suffering a decline in terms of trade of 25% between 1979 and 1982.

Second, the growth in the volume of exports of the non-oil developing countries has been steadily declining from an annual average of 8% between 1978 and 1980 to only 2% in 1982. This reflects both problems of demand and of access to markets. With rising unemployment in the industrial economies, protectionist pressures, often aimed at imports from the developing countries, have increased greatly. The decline in terms of trade and in export growth has forced the non-oil developing countries to cut back on their imports, including imports of investment goods, and this has affected investment and growth rates.
Despite the retrenchment in imports, the non-oil developing countries recorded yet another deficit of record proportions in the current account of the balance of payments of around $80–85 billion in 1982. They seem headed for yet another massive payment deficit in 1983, the size of which depends on their ability to find ways of financing it.

Let me turn now to the second major element in the emerging crisis—the debt situation of the developing countries.

The impression that one frequently obtains from reading the press is that the debt problem has arisen because either:

- the developing countries may have mismanaged their affairs, or
- the international commercial banks have followed unsound development policies, or
- possibly both.

While there are undoubtedly cases of developing countries having seriously bungled their affairs, as well as of commercial banks that have clearly been imprudent, this is a far from accurate characterization of either the nature or the genesis of the external debt problem of the developing countries.

Many of you will recall that up to a year or so ago, this was not regarded as a problem at all. Indeed, Euro-market syndications—the main vehicle for lending to the developing countries—were being hailed as a prime example of the free market's financial wizardry, which had made the recycling of petro-dollars possible.

The main reason that the external debt of the developing countries, which has been growing steadily in recent years, is now perceived to be a serious problem is that, given the current international environment, the economic growth prospects of the developing countries seem much less favorable than they did just a couple of years ago. In this sense, the so-called debt problem is more a symptom rather than the cause of the very serious economic problems in the areas of trade and development that confront the developing countries.

From the standpoint of the developing countries, the strong anti-inflationary stance adopted by some of the major industrial countries, especially the U.S., and the heavy reliance placed on monetary policy as the principal corrective instrument, could not have come at a less opportune
time. These policies resulted in historically high levels of real and nominal interest rates, and greatly increased their burden of debt service at a time when their export markets were drying up due to the economic recession.

It is not commonly realized that in most industrial countries corporate and other borrowers can deduct, for purposes of taxation, interest charges as an expense, so that for any individual or corporate borrower, the effective cost of borrowing is substantially lower than the prevailing interest rate. The developing countries, on the other hand, have to bear the full burden of prevailing interest rates, since they must make the necessary capital transfer of debt service to the industrial countries.

Total developing countries' medium- and long-term debt rose from around $350 billion in 1979 to about $530 billion in 1982, but the burden of servicing this debt rose by a higher multiple since Euro-market rates more than doubled. It is illustrative that a rise of 1 percentage point in interest on the combined present debt of Mexico, Argentina and Brazil—the three largest developing country borrowers—requires additional service payments of about $1.2 billion.

Let me turn now to the final aspect of the interface between the developing and developed world to which I have referred earlier—the flow of capital.

The much publicized external debt problems of a few large borrowing countries have already dampened the enthusiasm of private international commercial banks to continue lending to the developing countries. Commercial bank lending accounted for nearly two-thirds of the total flow of capital to the developing world in the recent past, and cannot really be substituted.

The prospect for the other major component of capital flows—namely, official development assistance (ODA)—is even less promising. During the two decades of 1960–80, official development assistance doubled in real terms. However, ODA declined by about 4% in real terms in 1981, and it appears to have dropped further in 1982.

This is a matter of even greater concern than the drop in private capital flows. A large number of the poorest developing countries have no access to private commercial credit; they rely almost entirely on concessional aid funds to supplement their own meager resources for development, and the most important source of concessional assistance to the poorest
countries is IDA—the affiliate of the World Bank that provides loans on
c concessional terms to the poorest countries.

It is widely known that we have had great difficulty in getting releases
for the Sixth Replenishment of IDA, agreement on which was reached
in 1979. You can therefore imagine the problems that lie ahead in
negotiating IDA-7, the next IDA replenishment, which will cover the
period 1985-90. While I shall have more to say on this later, there is no
doubt that there is a prevailing feeling of aid fatigue in the major donor
countries reflecting, in the main, their own budgetary and economic
constraints.

What does all this mean for development? The situation varies a great
deal from country to country, but, in broad terms, the rate of economic
growth in the oil-importing developing countries, which averaged over
5% during 1960-1980, fell to 2% in 1981, and has clearly dropped further
since then. Indeed, as I mentioned earlier, the most recent indications
are for a negative rate of growth in both Latin America—which in
previous years had made such rapid economic strides—and in Sub-
Saharan Africa.

The situation is thus serious. Let me outline some actions that could be
taken to alleviate the difficulties facing the developing countries. And,
let me also share with you some thoughts on the role of the international
institutions in these circumstances.

The only turn of events that might begin to reverse all of the unfavorable
trends affecting the economies of developing countries would be a strong
resurgence of economic growth in the industrial countries. Only that
would quickly improve prospects of trade and commodity prices and
would enable developing countries to grow, service their debt and resume
investment. It might also improve the climate for development assis-
tance.

The truth is that, in the world of today, a sustained prospect of recovery
is unlikely to be triggered by the actions of a single nation, however large,
or even by a group of industrial nations. The global economy is now so
interdependent that a strong and sustained world recovery will require
concerted international action by nations, including a strong contribu-
tion by multilateral institutions which, after all, were set up as instru-
ments of international cooperation.
The meeting of the Interim Committee of the IMF just a couple of days ago is evidence of the growing awareness that an internationally coordinated effort is needed to organize a global recovery. The agreement to replenish the resources of the IMF is an excellent start towards enabling that institution to provide international liquidity as needed, and to function effectively as a lender of the last resort. Hopefully, the forthcoming economic summit at Williamsburg can provide yet another forum for a concerted approach to these global issues.

I have said that overcoming the present crisis in development will require a concerted effort. It is a valid question to ask what the developing countries themselves have already done, or can do, to cope with problems of economic recession and diminishing capital flows.

The picture is mixed. Some countries, which have a weak balance of payments position, have recognized that they must use foreign borrowing and aid to facilitate, and not avoid, necessary domestic economic adjustments. Some others have pursued unsustainable growth objectives, borrowed heavily, and now find themselves in severe debt service and other difficulties. I am sure you can identify these countries without any pointers from me.

It is, however, in working with the developing countries that, I believe, the multilateral financial institutions are able to play an important and constructive role. There is a wide community of multilateral aid agencies—those of the United Nations; the Bretton Woods branch of that family—the World Bank and the International Monetary Fund—and, of course, the regional development banks. I shall concentrate my remarks on the Bretton Woods institutions; firstly, because I am most familiar with them and, secondly, because I believe that their financial and technical contribution to the situation can make a real difference.

The IMF and the World Bank have distinct, though closely complementary, roles. The IMF's primary focus is to facilitate balance of payments adjustments, while that of the Bank is to ensure a sound and effective development process. In the present situation, where many developing countries are trying to cope with massive balance of payments disequilibrium, and with the burden of large foreign debt obligations, the IMF clearly has the leading role to provide immediate liquidity and financial relief, while a country takes steps to restore viability to its external financial relations.

In the recent actions to restructure debt packages for Mexico, Brazil, and Argentina, the IMF performed the role not only of a lender, but also of
a coordinator of other lenders. It also insisted that recipient countries undertake a series of policy changes that would improve their long-term prospects for servicing their debts.

The World Bank's role is to be seen in a longer term time perspective. Its purpose is not to provide immediate liquidity, but rather to strengthen the long-term productive and development capabilities of its member nations by providing them with long-term capital and technical advice. The Bank cannot, however, be insensitive to the current difficulties of many of its member governments, for whom the immediate problem is economic survival, rather than safeguarding long-term development.

Accordingly, the World Bank has taken the following initiatives to alleviate the current difficulties of its member governments.

First, the World Bank expects to undertake a two-year Program of Special Assistance to its borrowers. This program will include loans in support of policy and structural changes deemed necessary to sustain development in the present circumstances. The focus of the program is to ensure that high priority and vital investments necessary for long-term growth, which might otherwise have been postponed, can be financed. In essence, we are seeking to provide assistance to borrowers in reordering investment priorities. We are also seeking the support of other lenders in this effort.

The full effect of this program will be to accelerate disbursement of IBRD funds by about $2 billion over the next 18 months. That is a fairly sizeable increase in our annual level of disbursements which now runs at around $7 billion per year, but it is not a large amount in terms of the needs of the countries, or the total level of development assistance.

Second, we have recently taken steps to increase co-financing with the private commercial banks in an attempt to build up the confidence of individual private lenders in lending to the developing countries. We have adopted a new type of lending arrangement which we hope will encourage private lenders to join us in financing selected Bank projects. As a result, we expect a significant increase in the level of private co-financing with the World Bank which had already reached some $3.5 billion last year.

So far, I have talked about actions by the World Bank, or, more specifically, IBRD, which lends to nations that are deemed to be creditworthy for Bank loans. An even more urgent area to address is the plight of the
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poorest nations, who have a per capita income of $500 and below, and many of which are not creditworthy for IBRD loans.

These countries are the parish of IDA. Often they are primary commodity producers; in many cases, they rely on a single commodity. They have been devastated by the slump in commodity prices and trade. They are largely untouched by the international debt crisis because they were not considered creditworthy by commercial banks. As their export revenues have fallen and their ability to import has declined, their development programs, modest as they were, have been totally disrupted. For many of these countries, IDA is the single largest source of concessionary aid.

As you know, IDA was established in 1966. Twenty-two years have passed since then, and IDA has more than lived up to the confidence of its founders. In brief, $27 billion has been committed by donor countries to finance over 1,300 projects in 78 countries. The sheer scale of its operations has been an unprecedented achievement of international cooperation.

However, this very positive program of assistance on which the poorest countries rely is now at risk. Difficulties with the U.S. contribution to IDA-6, which the Congress has extended over a four-year period, rather than the three years originally agreed, has resulted in a reduction in IDA lending. And there is a danger that Congress might not complete its appropriations even within the four-year period promised by the U.S. Administration.

While the amounts involved, only about $245 million or so, are trivial in U.S. budgetary terms, failure to complete IDA-6 in the promised four years could be the signal that spells the breakdown of the entire IDA exercise. Insofar as IDA is concerned, we are, in a very real sense, at the crossroads. IDA was originally set up at the initiative of the U.S. The U.S. has been the largest single donor in each of the last six replenishments, although its share has progressively diminished in importance. Because of that historic involvement, great importance is attached by other donors to the position of the U.S. and to the forthcoming action by the U.S. Administration to complete its IDA-6 contribution in 1983. Equally, IDA-7 cannot, in my view, be successfully negotiated unless the U.S. is prepared to participate on a scale that takes account of its own economic position and strength in the world, as well as the current difficulties and requirements of the poorest countries.

In conclusion, the situation in the developing countries is a serious one. There is indeed a “crisis of development.” The situation calls for a
response from all concerned—the developing countries, the industrial countries, and the multilateral institutions.

The multilateral institutions, most notably the World Bank, the IMF, and IDA, have roles that are founded on their strength as instruments of international cooperation. To perform their role, which is in the interest of both developed and developing countries alike, it is vital that they have the support of their members, and are adequately funded. The problems of economic recession and development that the world community now faces are precisely the type of issues that the Bretton Woods institutions were established to help resolve.

I sincerely hope therefore that an awareness of their role and support for them will grow in the coming months. I am also confident that those countries that in the past have been so supportive of development will not wish to see an erosion of the gains—so painfully won and so vital to the well-being of the majority of the world’s people. In the meantime, it is incumbent on all of us to assist in this process by ensuring a clear understanding of the urgency of maintaining a momentum in development. Yes, it is to some extent an issue of humanity and compassion; but it is really much more than that. It is a matter of practical necessity, and hard-headed self-interest; and of fostering the benefits that can accrue to all nations from the close international cooperation that has characterized these last few decades of development.
3. Technology in a Developing World

Mantech Symposium, London
April 26, 1983

It is a great privilege and honor to participate in this distinguished symposium. This morning's program has certainly been thought-provoking.

In his remarks about making technology the servant of humanity, Lord Caldecote rightly highlighted the technology needs of our societies. Raising the living standards of people around the world may be the most worthwhile technological project of the next generation or two.

In my remarks, I want to stress the economic and commercial benefits that can flow to all concerned from the transfer of technology to the developing countries. It is important to emphasize the practical incentives that can help to get this important job done. With the United Kingdom and other industrial nations struggling to revive their own economies, it is urgent that they recognize their stake in third world progress. Otherwise, the vision of reducing poverty around the world may be crowded aside by domestic economic concerns.

So this morning I shall argue, first, that the developing countries are a rapidly expanding market for technology exports. Second, that the World Bank is an effective catalyst for the transfer of technology. And, finally, that for the United Kingdom, as for the other major industrial countries, the supply of technology to developing countries is the emerging area of business growth over the balance of this century.

The developing countries achieved faster economic and technological progress between 1950 and 1980 than at any previous time in their history. The whole world enjoyed a period of unprecedented economic growth, and, on average, the developing economies expanded even faster than the industrial economies.

During this generation of economic expansion, some national economies outperformed others. Among the industrial nations, Japan more than
quadrupled its share in global output. But improvements have also been impressive by historical standards in relatively slow-growing economies like the United Kingdom.

Among the developing countries, even most of the poorest countries enjoyed broad-based improvements in literacy and life expectancy. And several groups of developing countries emerged as new poles of dynamism within the global economy:

- About 20 developing countries—like Yugoslavia, Korea, and Brazil—are newly industrializing.
- The oil-exporting developing countries comprise a second exceptionally dynamic group.
- And in some respects—food production, for example—the largest nations of Asia—China, India, and Pakistan—have also made remarkable progress.

Economic progress, in both the industrial and developing countries, has been spurred on by the rapid development of new technologies and their quick diffusion to the developing regions of the world. Studies from various countries confirm that one-third to one-half of economic growth is normally derived from combining capital, resources, and labor more productively—in a word, technology.

Alfred Marshall wrote that “knowledge is our most powerful engine of production.” And in analyzing the technologies that contributed to the Industrial Revolution here in Britain during the last century, Marshall gave first place, not to new industrial technologies, but to new transportation technologies. Railroads and steamships lowered the cost of bulk transport, expanded global trade, and allowed Britain to specialize in manufacturing.

Our generation has witnessed revolutionary improvements in transportation and communication technologies. As a result, one-fourth of everything produced in the world is not traded internationally. The rapid growth of international commerce has made the world economy more efficient and, in the process, pushed incomes upward everywhere.

And the breakthrough transportation and communication technologies of the last generation (air travel and telecommunications) have been especially suited, not to bulk transport, but to the movement of people and ideas—to the transfer of technology.
The developing countries still depend on the industrial countries for virtually all the modern technology they use. Only 12 percent of the world's scientists and engineers work in the developing countries, and the developing countries account for only 3 percent of the world's investment in research and development. The third world pays the industrial world as much for licenses and know-how as it spends on indigenous research and development.

This dependence has been a hotly disputed issue in international fora. And it has generated more heat than light, sadly enough to the point of barriers being erected where there need be none. Representatives of the developing countries point out that their distinctive problems have not attracted much attention from inventors. For example, the world spends only 2 US cents a year on malaria research for each of the 200 million people in the developing countries who suffer from malaria. Compare that with the $850 per cancer patient that the United States alone spends on cancer research.

Then, too, the dualistic character of developing societies is often aggravated by imported technologies. Elaborate medical equipment is installed in urban hospitals, while most of a country's families do without basics—like clean water and adequate food. Scarce foreign exchange is used to buy modern capital-intensive equipment for a few factories, while thousands of small enterprises struggle on with the most rudimentary methods of production.

But there are also some advantages for the developing countries in this situation. They can draw on the technical knowledge which the industrial countries have accumulated over generations. A good part of this knowledge is available to anyone without charge. And in today's global economy, virtually all industrially significant technologies can be obtained from competing suppliers around the world.

What does the rapid economic growth of the developing countries and their continuing need for technology imports mean to suppliers in the industrial countries? An important, dynamic, and sometimes difficult market.

The industrial countries sell one-fourth of their merchandise exports—and one-fifth of their exports of licenses, know-how, and related services—to the developing countries.

During the seventies, the middle-income developing economies, as a group, grew twice as fast as the industrial economies. Exports of capital
goods and equipment to the developing countries (one form of technology sale) increased 10 percent per year in real terms! Direct foreign investment and payments for licenses and know-how (the other commonly used indicators of technology sales) grew less dramatically during the seventies—but still about 4 percent a year in real terms.

Just now, the developing economies are struggling because of high interest rates and slack demand in the global economy. But their underutilized resources, unsatisfied aspirations, and population growth together almost guarantee that the rapid growth of technology exports to the developing countries will continue again in the future.

The main unmet technological demand of the developing countries is still for technology adapted to the limitations and needs of poor people. But the more successful developing economies have move well up the scale of technological sophistication, so that the third world is now buying a more diverse range of technologies.

Half a dozen developing countries have, in fact, become significant exporters of technology. Korea, for example, is competing worldwide in manufactures, and four of the 50 biggest international construction firms are now Korean. India, Brazil and Mexico are also well-established exporters of technical services and equipment.

The competitiveness of some developing countries in certain lines of manufacturing has accelerated the decline of these activities in the industrial countries. But it is impossible, in today's world, for any nation to retain its competitive edge by restricting technology exports. And, in any case, the industrial countries get better value-for-money in international trade—and thus benefit on balance—from the increasing productivity of the developing countries in manufacturing.

Then, too, as the more dynamic developing economies progress, they are also increasing their import of technology from the industrial countries. They are less likely to need a foreign consulting firm to do routine design work, but they still contract with top-rate foreign engineers for particularly difficult or innovative work. They are in the market for word processors, not pencils.

The increasing sophistication of some of the developing countries is also one reason why the institutional arrangements for the transfer of technology are in flux.
During the 1950s and 1960s, transnational corporations greatly extended their global reach. They brought technology to the developing countries in a package together with organizational skills and financing. But many developing countries became suspicious of transnational corporations—to some extent, suspicious of foreign technology in general.

Developing-country governments imposed conditions on international business that often made technology transfer—and especially direct foreign investment—difficult. At times, they appeared to pursue a concept of "autarky" which proved very costly and wasteful. Many of you are personally involved in the sale of technology exports, and I am sure you could all cite instances in which developing countries blocked technology sales to their own detriment.

In the seventies, developing countries more often imported technology, organizational skills, and financing separately. Their imports of capital goods and their commercial bank borrowing both expanded rapidly, while direct foreign investment grew less rapidly.

Gradually, transnational corporations have learned to adapt themselves to national policies, and some third world governments have become more adept at guiding direct foreign investment without killing it. The debate about whether or not to import foreign technology is, to some extent, fading, as developing countries come to recognize that there is often no viable alternative to importing technology. Today's high borrowing costs, and the liquidity problems that many developing countries are now suffering, also favor a trend back toward direct foreign investment.

At the same time, as more developing countries become sophisticated shoppers for technology and finance, we are likely to see yet more diversity in the institutional arrangements for technology transfer. Countries will pick and choose among the many ways they can get finance and technology—borrowing, direct foreign investment, consultancies, licensing, equipment purchase, training, research—selecting whatever mix seems most appropriate for a particular project.

And active government involvement in technology transfer, in both the selling and buying countries, is likely to remain a fact of international business life for the foreseeable future.
Within this important, changing, and institutionally difficult process of technology transfer to the developing countries, the World Bank has proven to be a useful catalyst.

The World Bank's objectives are much broader than the transfer of technology from the industrial to the developing countries. The Bank's objectives are to help raise living standards and reduce poverty in the developing countries. Toward those ends, we assist countries in their technological development. That includes—but is not limited to—the purchase of technology from industrial countries.

And our work as a technological intermediary is built on the World Bank's more basic function as a financial intermediary. The Bank depends on financial backing and contributions from the industrial-country governments. It raises most of its funds by borrowing on the world's capital markets. And the Bank's lending to the developing countries is supported by a much deeper relationship of cooperation with them on development projects and economic analysis; the developing countries are shareholders of the Bank, as well as its borrowers. Thus, in a unique way, the World Bank gets the industrial and developing countries—and the public and private sectors—all working together.

Because of the World Bank's broad developmental perspective and its success as a financial intermediary, the Bank can and does finance a wide range of third world development activities that commercial investors could not, or would not, finance on their own. In many of the developing countries, for example, the World Bank pioneered in channelling international finance to domestic industry. And the Bank also provides financing for needed improvements in public infrastructure (water supply systems, for example) and in social sectors (such as education). The Bank routinely helps to translate what might otherwise be wishful idealism into specific projects, contracts, training, and construction.

The Bank's projects usually incorporate technological improvements, as well as reforms in development policy and institutions. Most projects include a technical assistance component, mainly domestic and international consultants; the World Bank financed $1 billion in technical assistance last year. In the end, the technological, institutional, and policy improvements embodied in the Bank's lending almost always have more far-reaching effects than our financial contribution.

The World Bank is involved in a wide range of technological development activities.
- Two-thirds of the Bank's education lending, for example, has been for science and technology. Our first loan to the People's Republic of China is helping to re-equip scientific and technological universities.

- Five of the agricultural projects our Board approved last year are totally devoted to research and extension. The Bank also serves as the secretariat for the Consultative Group on International Agricultural Research, a network of research institutes that are at the cutting edge of agricultural technology for the developing regions of the world.

- In the energy sector, the Bank and UNDP together are systematically assessing the energy prospects of 60 developing countries.

For all the projects we finance, the World Bank's procurement norms open competition for the sale of goods and services to all our member countries. We encourage developing countries to build up their own technological capacity. But we also insist that the procurement of goods for Bank-financed projects be economical and that the consultants involved be well-qualified. The Bank normally finances the foreign-exchange component of projects, so 70 percent of the Bank's lending has, in fact, financed international purchases.

Let me give you a sense of the Bank's involvement in technological development by discussing our experience in three areas: industrial technology (which involves relatively straightforward transfers of established technologies), computers (a high-technology area), and urban shelter (an area where the developing countries need low-cost, "appropriate" technologies).

About a fifth of the World Bank's lending is for industry. And one of the Bank's affiliates, the International Finance Corporation, operates mainly in the industrial sector. The IFC doesn't need government guarantees, and it often puts together partnerships between private investors around the world and commercial enterprises in the developing countries.

The clearest lesson that can be distilled from the experience of the Bank and IFC in the transfer of industrial technology is that technology cannot be neatly packaged or effortlessly bought and sold.

The shift of equipment and blueprints is only the beginning of what must almost always be an extended process of learning and adaptation. The IFC has found that the most successful way to elicit the necessary effort from suppliers of technology is to give them an equity share in the
developing-country enterprise they assist. I would hope more of your companies might consider joining as "technical partners" in IFC projects.

The transfer of industrial technology also requires effort on the receiving end. Case studies show that the developing-country firms that successfully introduce new technologies normally budget time and money for training and research. They integrate new technologies into their operations through a series of small changes over a period of years. The initial transfer of technology normally adds less to productivity than the sum of these adaptive efforts.

Therefore, our advice to developing countries is that they buy the industrial technologies they need, but that they also upgrade their own technical capacity—so that they know what they are buying, and can raise productivity through local adaptations. Japan is a model of rapid technological development, and Japan’s approach, when it was a developing country, was just that: it bought technologies that were already on the market, and dedicated its creative energies to adaptation and improvement.

The lesson that successful technology transfer depends on such follow-up effort is important to remember as developing countries now turn their attention to more novel technologies—like computers.

As hardware costs plummet and new software makes computers simple to use, business has already begun talking about the day when African and Asian farmers will all have personal computers, radio-connected to satellite communication systems. Villagers could have access to up-to-date information on weather and markets, and to the enormous computational power of large computers.

The World Bank has often financed computer purchases, mostly for public agencies. And we are participating in efforts to use satellite mapping—to improve weather forecasting, for example, especially for vulnerable countries like Bangladesh.

But information technology, for all its sparkle and future potential, offers no painless or immediate solution to the problems of developing countries. Over and over, we find that an inefficient organization that installs a computer remains inefficient; unless the organization itself becomes better organized, its computer will probably be underutilized.

Initial experiments in the use of satellites to broadcast programs directly into Indian villages proved technologically successful. But because no-
body gave enough attention to the quality of the information that was delivered through the system, the results of the experiments as a whole were disappointing. Villagers around the world already have transistor radios, and we could vastly improve the quality of information available to them (at a tiny fraction of the cost of computers) through better programming. Again, technological advance can seldom be reduced to a discrete transaction. It almost always depends on a developmental process.

Let me now turn to one of the most serious social aspects of technological change—its impact on employment.

In industrial societies, high worker displacement has been experienced by industries which have switched from mechanical or electro-mechanical components for their products to micro-electric components. Similarly, in the service sectors, office automation looms as a major threat, especially to the employment of women who predominate in this area.

This danger of creeping unemployment, as a result of technological change, seems bad enough in industrial societies which are currently suffering from economic stagnation and high degrees of unemployment. How much worse is it likely to be—one wonders—in the developing world, with its heavy population pressure and endemic underemployment. Is the introduction of new technology in the developing countries worth the social cost?

There is no doubt that the application of many new technologies—let us say microcomputers in industry—will displace labor. It is equally true, however, that avoiding their use may condemn industry to low productivity and a loss of international competitiveness.

It is perfectly feasible, though somewhat painful, to take care of unemployment generated by technological innovation, when industry is profitable and expanding, and new job opportunities arise, because people can be retrained and redeployed. There is unfortunately no way to take care of unemployment that is the result of technological obsolescence in a shrinking industry.

So also with the developing countries. The introduction and transfer of new technologies to them cannot be a mechanical or an overnight process. It must be done in steps, consistent with their comparative advantage, and their stage of economic development, and without unduly disrupting their social and cultural values.
However, technologies that do make economic and social sense in their situation hold the promise of exploiting enormous untapped potential, unleashing latent human energies and creating vast new employment opportunities. This, in the final analysis, is what economic and social development is all about—in both developing and developed countries.

Those familiar with the history of agricultural development in the United States in the nineteenth century will recall that, in that century, the agricultural labor force in the United States was reduced to just about 3% of the active population as a result of the mechanization of farming. It seems likely that the technological revolution of the second half of the twentieth century will generate even more rapid change.

We must therefore learn from the experience of countries such as Japan which have shown such remarkable facility and flexibility in organizing, retraining, and redeploying labor, in maintaining the stability of their social fabric and their cultural identity, and thus avoiding the negative social effects of technological change.

The World Bank's relatively broad view of the development process allows us to help minimize such negative effects in our work in the developing countries. Over the last ten years, the Bank has helped to develop and finance new appropriate technologies in agriculture, population and health, education, road construction, and urban development.

In the field of urban development, for example, the Bank has encouraged developing countries to break away from the notion that building codes appropriate in the United Kingdom or the United States could be mechanically applied in Zambia or Peru. Trying to enforce high design standards in cities where most families cannot afford them results in the poor being consigned to semi-legal settlements, often without any services at all. Bank projects have demonstrated the feasibility of laying out serviced residential lots and improving existing slums at costs that are affordable to poor urban families.

In reviewing the overall trends in consultancies financed by the World Bank, we find that architectural and engineering firms still top the list. But the trend has been toward technical assistance in areas like slum improvement, agriculture and rural development, and energy development and conservation. There are opportunities for high-technology consulting, mainly in industry and energy, but the demand is much greater for simple, innovative advice on how to better use local resources to meet local needs. Consultants who can get along with other people and teach what they know to local counterparts are much in demand.
Technology transfer characteristically requires ongoing relationships and gradual learning. And it is perhaps for that reason that the World Bank, which is so deeply and intimately related to the developing countries, has proven to be a useful bridge for the transfer of technology.

The World Bank also maintains close working relationships with the industrial countries, and also with business in the industrial countries. At the present time, we are working to strengthen our relationships to business—by pressing for growth in IFC's program, and by seeking more co-financing from commercial banks. We hope these current efforts will make the World Bank an even more well-traveled bridge for the transfer of technology between the industrial and developing countries.

Each of the industrial countries has its own strengths and weaknesses for the task of putting technology to work for our developing world. The difficulties facing the British economy, and its industry in particular, have been the subject of national debate and policy initiatives for decades. But perhaps I can contribute an observation or two regarding one particular area of the British economy—its technology-related exports to the developing countries.

Over the last two decades, while the share of exports in Britain's national income has grown, the share of exports to the developing countries in Britain's total exports has fallen. But this relative decline in exports to developing countries seems to have bottomed out. And, by every indicator, the export of technology-related items to developing countries is still proportionately more important to the United Kingdom than to any other industrial country.

You may be interested that the British share in consultancy contracts financed by the World Bank is high and growing—now about a sixth of the total.

As I see it, the United Kingdom has two advantages in the competition to supply technology to developing countries. First, the United Kingdom is an exceptionally open, trade-oriented economy, and you have deep historic ties to many developing countries. The social values of this country encourage people here to appreciate technology appropriate to the needs of poor people, and the United Kingdom includes several of the world's centers for research about third world development and, more specifically, about appropriate technology. These factors help to explain
why our borrowing member countries award a substantial share of consulting contracts to British firms.

The other clear advantage of the United Kingdom is general technological excellence. The latest issue of Columbia Business School's Review of World Business reported a study of 500 leading technological innovations between 1953 and 1973. Even though both Germany and Japan now exceed the United Kingdom in technology exports to the developing countries, the U.K. share in leading technological innovations was more than the shares of Germany and Japan together. And the British share of technological innovation increased over the period.

The United Kingdom's leadership in science and technological innovation in the nineteenth century is widely known—but it is less widely recognized that it has also pioneered major technological advances over the last fifty years. I refer not only to the pathbreaking work of scientists such as Rutherford and Chadwick, who helped usher in the nuclear age, or of Fleming in medicine, or more recently, of Milstein in genetic engineering, but rather to the type of basic material and product development, and industrial engineering, which has fueled the growth of modern industry.

It was Morris Motors of Coventry which first developed the engine block machine, and it was the Austin motor car that inspired small-car development throughout the world, including that of Datsun of Japan. Television was first demonstrated by Baird of Scotland, and it was the London Telephone System that first installed the automatic exchange and the first direct dialing system. The first upright vacuum cleaner was a British product, and the use of quartz crystal, which is now revolutionizing watch-making, was first installed in the Greenwich Laboratory.

I would hope that more of the United Kingdom's vital capacity for technological innovation could be turned to the needs of the developing countries. Few fields of technological endeavor have more social or cultural value. And few fields of technological endeavor hold more commercial promise for the United Kingdom itself.

It was Professor Toynbee who wrote that the most powerful change of our epoch is the "awakening" of "the hitherto depressed three-fourths of the world's population" to the possibility of improving their way of life
through technology. Toynbee judged atomic energy and the exploration of outer space to be trifles by comparison.

I believe it was Le Corbusier who said: “There is no such thing as a primitive man, there are only primitive means.” As every corner and cranny of the world is hooked into one jet and electronics network, the demand for better ways of doing things continues to swell in the developing countries.

So as we discuss how technology interrelates with society and culture—as we debate how to make technology the servant of humanity, rather than its master—I would ask you to remember how rapidly the world has been developing. And to remember too something that a former Prime Minister of Iran once said: “Of what use is putting the first man on the moon if we cannot reach the last man on earth?” This indeed is the greatest challenge that faces our societies.

And to take full account of the immense energies of those peoples around the world who now know about—but do not yet fully participate in—the benefits of technology.
4. The Challenges Facing the World Bank

*The Vloeberghs Memorial Lectures, Brussels*
*January 25, 1984*

It is an honor for me to participate in this important lecture series, and I thank you very much for your invitation.

Professor Vloeberghs, in whose memory this lecture series is given, was a highly respected colleague in the World Bank during the years he spent in Washington in the early sixties. He had a keen interest in development issues and a remarkable understanding of the interdependence between the prosperity of industrialized nations, such as Belgium, and economic progress in the third world.

It is for me a great pleasure to be today in Brussels. Belgium is a founding member of the Bretton Woods institutions and has always played a most constructive role in the institutions of the World Bank Group. In recent years, the Belgian authorities and the Belgian representative on our Board, Mr. Jacques De Groote, have strongly supported the various initiatives taken by the World Bank management to increase and adapt World Bank operations and policies to a changing international environment. One example of this was the strong support given by the Belgian authorities to the replenishment of IDA-7; another is our cooperation in the co-financing area. Also, the Belgian commercial banks have arranged several borrowing transactions for the World Bank, first in the Belgian franc market between 1959 and 1972, and more recently the ECU bond market. A number of Belgian enterprises have successfully participated in international competitive bids for the implementation of projects financed by the World Bank and IDA.

Brussels is also the seat of the major institutions of the European Community, and I know that many representatives of these institutions are in this audience. The EEC countries and the EEC institutions are highly esteemed partners of the World Bank. The ten EEC countries together account for 28.4% of the World Bank subscribed capital and have contributed 34.7% of the resources of IDA. We are thus partners in a common cause—the achievement of economic and social progress in an increasingly interdependent world.
You have suggested that I speak to you today on the challenges facing the World Bank. That is a large subject, but in the time at my disposal, I will try to give you an idea of how we at the World Bank see the changing global economic environment, and what we believe the Bank’s responses should be.

A review of the new economic environment, and in particular the situation currently facing the developing countries, should be set in its historical perspective. So let me go back a little way in time.

It is often insufficiently appreciated just what a remarkable economic growth record the developing countries as a group have had.

It is instructive to compare, on the one hand, the average rates at which the economies of today’s developed countries grew over their long periods of advance to industrialization, with the rates at which the developing countries of today grew in the third quarter of this century.

According to evidence assembled and published by Nobel Prize Winner, Professor Simon Kuznets, just over a decade ago, fourteen of today’s industrialized countries—then European countries plus the United States, Japan, Canada, and Australia—achieved together, during the period 1860–1960, an average annual per capita income growth rate of barely 2 percent.

At the time of their entry into modern economic growth, which for most of them was between 1830 and 1870, these countries were already economically ahead of the rest of the world, with relatively high initial levels of per capita product.

Today’s developing countries found themselves at no such advantageous launching point in the middle of this century. These were countries with no history of growth, and with few, if any of the economic preconditions for it. Moreover, rapid progress in disease eradication was steadily boosting population figures.

Thus, the prevailing view was that these countries had little chance of pushing economic growth ahead of population growth. The inherent slowness of economic growth, said the experts, held out possibilities of growth ranging from zero to a very small percentage advance each year. World Bank economic reports of the fifties and early sixties offered predictions of growth rates for developing member countries which were later shown, in many cases, from Colombia to India, to have been pessimistic.
For what happened was this: between 1955 and 1980, the developing countries as a whole achieved an annual average growth rate, not of zero percent as many were predicting, nor even of 2 percent, which today's industrialized countries had barely achieved from 1860–1960, but just over 3 percent. It was a remarkable performance which confounded the economists. They had taken advantage of an international environment more favorable to growth than ever before, and had worked hard to better their capacity to plan and manage their economies efficiently. They steadily raised domestic savings and investment rates. And they put to increasingly productive use the expanding flows of external capital.

Having said that of the group of developing countries, I must emphasize that within the group there was considerable diversity of experience. During the period, the group of middle-income countries, countries such as Thailand, Korea, Tunisia, and Singapore, were growing at an average annual rate of over 3 percent. But for the low-income countries, two-thirds of them in Sub-Saharan Africa, and accounting altogether for 47% of the world's population in 1980, there was only a 2 percent rate of increase in per capita income. And even that rate mainly reflected the relatively strong performance of China, and more recently India.

Nonetheless, from 1955 to 1980, the developing world as a whole made impressive progress. And during this period, the World Bank was recognized as a unique and very effective instrument for helping this growth process. It was active not only in helping put in place the basic infrastructure to support growing economies, such as power facilities and transport systems; it was also investing increasingly in the developing countries' efforts to achieve self-reliance in food production. We can, for example, justly claim to have played a key role in bringing the Indian subcontinent towards food self-sufficiency. Through these two and a half decades of impressive third world economic growth, the institutions of the World Bank commanded broad support among both its rich and poor member nations.

Although economic growth in the developing countries was sustained through most of the seventies, dramatic changes were taking place in the economic environment which were to lead eventually to a breaking of the development momentum by the end of the decade. The shock of quadrupling oil prices in 1973 started the slowdown in growth in the industrial countries which, as a group, sustained consumption while letting investment fall. Many low-income countries had no choice but to do the same. But some middle-income countries adjusted quickly by increasing exports, curtailing imports, and changing production patterns.
Others borrowed heavily, postponing the eventual inevitable adjustments.

Helped by substantial flows of “petro dollars” recycled through the commercial banking system, and by increased flows of concessional capital, average investment rates for developing countries rose sharply. Despite rising inflation, interest rates declined. Most of the developing countries were weathering the storm. Then, in 1978, interest rates turned upwards, prices doubled in a second oil shock, the purchasing power of exports fell dramatically, and the world slid into the worst recession since the 1930s. And this recession was to last for three years. Even those developing countries with excellent growth records had to struggle for modest gains in the face of depressed export markets and high debt-servicing costs. The momentum of third world development was decisively broken, and we discovered just how economically interdependent the global community had become.

What happened?

After 1979 the recession hit world trade: exports grew by only 1.5 percent in 1980, stagnated in 1981, and declined by about 2 percent in 1982. Low growth rates in the industrial countries greatly reduced demand for exports of the developing countries, so that only a handful of the latter managed to increase their exports, mainly in manufactures. Although developing countries cannot any longer be caricatured as exporters of primary commodities and importers of manufactures, for many of them, particularly the poorest, primary products still dominate their exports. Coffee still represents almost 90 percent of Burundi’s recorded exports, and copper more than 70 percent of Zambia’s. Until the trend was finally reversed at the end of 1982, the price decline in non-fuel commodities of importance to the developing countries was catastrophic. At their lowest point, they were, in real terms, after adjusting for the rise in prices of manufactures imported from the industrial world, lower than at any time since World War II.

Meanwhile, and not surprisingly, many developing countries were running into balance of payments difficulties. To the problem of reduced export earnings was added steadily climbing real interest rates which increased their debt-servicing obligations. Some lenders, concerned about the ability of individual borrowers to surmount these difficulties, and uncertain about global economic prospects, became less willing than they had been to increase their lending.
Highly damaging as this prolonged recession proved to be for the developing countries as a whole, some countries were less badly affected than others. As a group, Asian countries—which account for two-thirds of the population of the developing world—increased their per capita incomes in each of the three years of the recession. India and China were among them. They maintained high rates of growth partly because international commerce is less important to these huge countries. They benefited relatively little from international commerce when the world economy was expanding, but they are also less affected by the world economy’s recent dislocations. Another reason is that both countries are pursuing programs of economic rationalization and reform. By contrast, Latin American and low-income African countries suffered declines in per capita incomes, although there were variations in performance, mostly explained by the different policies pursued by individual countries in the 1970s. In the low-income Sub-Saharan African countries long-standing economic problems were greatly exacerbated by the recession. The per capita income of the region is still falling, and could be lower by 1990 than it was in 1960.

That, in a nutshell, is what the three-year recession did to the developing countries. And it will take years to repair the damage that has been done to their prospects.

One of the lessons clearly demonstrated by the recession is that the growth of developing countries depends on steadily expanding trade and capital flows. And both of them are in turn closely related to the level of world economic activity. It is therefore heartening that the industrial world, at least, is on the road to economic recovery. According to the Organization for Economic Cooperation and Development (OECD), the industrial countries as a group are likely to achieve economic growth of 3 3/4 percent in 1984, up from 2 1/4 percent in 1983, and negative growth in 1982. Most of this change is due to the dramatic recovery of the United States; Europe’s economy is still expected to expand just 1 1/2 percent in 1984.

It is clear, though, that this current recovery will not be enough, by itself, to return the developing countries to per capita income growth rates comparable to what they achieved in the past. At the World Bank, we estimate that the developing countries’ economies will average growth of 3 to 3 1/2 percent in 1984, up from less than 1 percent in 1983 and less than 2 percent in 1982. But population is growing more than 2 percent a year in the developing countries, so average per capita income actually
fall in 1982 and 1983, and will increase only a little in 1984. The revival of progress is therefore going to require a concerted effort by the international community in a number of areas over a substantial period of years. For the third world, problems which are the legacy of the recession are still very much with them.

The most dramatic manifestation of these problems has been the debt crisis. Here are the bald facts:

- the total debt of the developing countries amounted to $810 billion at the end of 1983;
- debt-service payments rose by 14 percent to $93 billion in 1982, and up again, but only to $96 billion, in 1983;
- despite the approximate stabilization of interest payments in 1983 at about $46 billion, that figure is still three times what it was in 1978;
- meanwhile, since mid-1982, some thirty countries have had to rene-gotiate terms on as much as $100 billion of their debt.

These reschedulings, together with arrears and lower interest rates, account for the slowdown in the growth of debt-servicing. Nonetheless, it is still growth. And in the meantime, net new commercial bank lending to the developing countries (that is, new lending minus debt-service payments) is not negative. Our Debtor Reporting System at the World Bank shows that the net transfer of medium- and long-term lending from private sources to developing countries was $16 billion in 1981, but had turned to a negative net transfer of $7 billion in 1982. And we estimate a negative net transfer of $21 billion in 1983. In plain language, the developing countries are paying more back to the banks than the banks are lending.

Meanwhile, other types of medium- and long-term capital flows have not grown to compensate for the fall in such flows from the commercial banks. Direct investment, for example by multinational corporations, has declined from $14 billion in 1981 to $10 billion in 1983. Furthermore, the net transfer of medium- and long-term lending from official sources remained more or less constant between 1981 and 1983. This category of lending comprises loans by the World Bank, the other multilateral banks, and export credit agencies.

It is not just the major borrowers, such as those in Latin America, that have been acutely affected by the debt crisis. The low-income countries
of Africa are also in trouble. These countries' debt-servicing problems are small in comparison to Latin America's, but they are huge in comparison to the economic capacity of many of them. Of the eleven countries which negotiated public debt reschedulings through the Paris Club during the first ten months of 1983, five were in Sub-Saharan Africa. Of the sixty-nine Paris Club and commercial bank reschedulings negotiated in the years 1975–83, thirty-four involved Sub-Saharan Africa.

The access of the low-income countries of that region, and elsewhere, to commercial capital flows is, of course, very limited, if there is access at all. They depend on official development assistance—that is to say, grants and highly concessional lending of the type provided by the World Bank's affiliate, the International Development Association (IDA)—for three quarters of all the capital they receive. Yet the total flow of development assistance, from both the industrial countries and the high-income oil-exporting countries is virtually stagnant. And 70 percent of the development assistance from bilateral agencies goes to middle-income rather than low-income developing countries.

Fifty-one countries, thirty-one of them in Sub-Saharan Africa, rely on IDA, and for some of them IDA is their largest source of foreign assistance. IDA's credits are interest-free and for a term of fifty years, carrying only a three-quarters of a percent service fee. The thirty-three nations that contribute to IDA's resources just completed negotiating its funding level for the next three years. They agreed on $9 billion for those three years, a sum much lower, even in nominal terms, than that agreed in 1979 for the previous replenishment of IDA when the negotiated figure was $12 billion. This very disappointing result suggests continued stagnation, or even substantial falls, in official development assistance in the coming years.

It is the unhappy but inescapable fact that, at a time when the developing countries are struggling against the damaging legacy of the recession, the aid they need is not forthcoming. It seems that as the developing countries' economies have plunged deeper into trouble, a general sense of disillusionment has set in among the aid-providing nations. Voices have been raised claiming that here is really little to show for three decades of internationally supported development effort. Donor governments, pushed by public opinion, have been questioning whether the cost to them can be justified. "Aid fatigue" is evident, not just in the United States, but in many of the industrialized countries as well.
Countries tend to look inwards in times of recession, but questions are also being raised about the real impact of aid. Donor governments have become much less willing to allocate scarce budgetary resources to developing countries which seem reluctant to put their houses in order or who disagree with them on bilateral or global political issues. “Why feed the mouth that bites you?” they ask. Or, “should we waste time trying to buy friends with bilateral and multilateral assistance?”

There is plenty of evidence that the impact of bilateral and multilateral assistance—especially the latter—has been a major contribution—in fact crucial—to the developing world’s economic growth so far. Nonetheless, support for economic assistance programs is wavering; political disillusionment and budgetary constraints have taken their toll.

What we are facing now is an extremely serious situation, fraught with danger for the multilateral financial system. This system was put in place at the end of World War II, and gradually developed and refined over the ensuing decades in response to changes in the global economic environment. The key ingredient of this system was a mechanism to transfer surpluses in the capital markets to the nations who were starved of capital which they could put to constructive use. The World Bank was created as such a mechanism to intermediate funds for its members who were creditworthy for such borrowings. IDA was later created to mobilize the concessional finance for those who, by virtue of their low-income status, were not.

This system is now endangered. The middle-income countries are paying back more capital to the industrial world than they are receiving. And the flow of concessional finance to the low-income countries is falling far short of their desperate needs. This is not the effect the system was designed to produce. It has in fact been stood on its head. We at the World Bank are therefore asking ourselves: how do we respond?

As a financial institution the Bank itself, the International Bank for Reconstruction and Development (IBRD), is a huge and profitable intermediary of funds, and IDA is essentially the administrator, on behalf of the donor governments of their contributions of concessional funds. During FY83 the Bank provided close to $15 billion to the developing countries; it borrowed $10 billion in financial markets and it mobilized about $3.5 billion for lending on concessional terms under the auspices of IDA. Of course, such numbers bolster our credibility.

But it is not merely the financial operations of the Bank that count. In the changed economic environment of the 1980s, the influence that the
Bank wields in terms of providing policy advice and assistance to its member governments is even more important. The Bank is a trusted adviser to the developing countries and an effective bridge between the North and the South. The continuing economic policy dialogue between lender and borrower creates a relationship and achieves results which national aid agencies have found difficult to emulate. And our borrowing countries bear witness that this kind of constructive relationship can help strengthen economic reforms, increase productivity, and reduce poverty.

Our role as policy adviser is an established and continuing one, but it has a special importance at this time when developing countries are striving through policy reform to adjust to the changed economic environment. This new economic environment poses two major, related problems which particularly challenge the Bank and require our response: the debt crisis, and the uncertainty of our future levels of capital flows to the developing countries.

Our sister institution, the International Monetary Fund, has the key role in handling the short-term aspects of the debt crisis which I earlier described. Together with the Bank for International Settlements and a number of industrial country governments, the Fund has been putting together the financial packages and proposing the policies that will help these heavily indebted countries through the immediate liquidity crisis and help restore creditor confidence in them. It is essential that the banking system continue prudently to provide new finance. The action being taken by the Fund and its partners to help restore creditor confidence ought to persuade the major banks to sustain, not curb, new lending, and, where necessary, to arrange further restructuring of debt. The banks have helped their borrowers through three extremely difficult years of recession, and it makes no sense to withdraw support now that the global recovery and the adjustment process in developing countries are both underway.

But we must nonetheless realize that the debt problem is not going to go away overnight. It is simply not a short-term problem; it will be with us for years, because for years to come the developing countries will need infusions of borrowed external capital. The key question we have to ask is: How can conditions be created in the developing countries in which debt-servicing is a norm, not a nightmare? The answer surely is: Through a restoration of sustained growth in their economies. And that is where the World Bank comes in, and its role is therefore entirely complementary to that of the Fund. While the Fund works on the immediate liquidity aspects of the problem, the Bank is working to create the conditions
under which the process of long-term development can be fed with external funds without recreating the crisis conditions of today. Short-term solutions to the immediate problems are essential. But they will be no more than pyrrhic victories if no long-term solutions are provided.

The Bank therefore focuses on the process of long-term development, helping to design and finance investment plans, and providing the policy advice which will help countries exploit their comparative advantages, and improve the management and performance of their economies.

That is what we are trying to do in both our middle-income and our low-income member countries. But it cannot be done without sustained capital flows. And that is the second of the related challenges to the Bank. In the world environment of the 1980s, we need to reassess the prospects for capital flows to the developing countries from both governments and the private financial community, and the steps that the World Bank institutions might take to increase and facilitate these capital flows.

It is clear to us that the role the Bank must play is essentially a catalytic role. The Bank is recognized as a very sound institution. Its 37-year record of productive investments, together with its reputation for conservative financial management, has given it a credit standing in the capital markets second to none, enabling us to mobilize funds at the most favorable available rates.

But given the increasing capital needs of the developing countries, we should exploit our catalytic role to the utmost. We must, on the one hand, work with the developing countries in helping them formulate and implement the type of economic policies that will help them adjust to the changing international environment, and sustain a sound development effort that will enable them to service their external capital obligations. And, on the other hand, we must work closely with the international financial community in engendering confidence towards achieving a renewed flow of private capital towards the developing world, in particular the middle-income countries of Latin America and the major borrowing nations of Asia and Southern Europe.

We, in the IBRD must continue to find innovative ways of further accessing the financial markets.

We have already, just a year ago, introduced new co-financing instruments to make additional funds from other sources available in association with our own lending for high priority investments in our member countries. In other recent innovations, our Executive Board authorized
us just last week to market $400 million worth of a new type of medium- and long-term floating-rate notes in the U.S. capital market. We have also recently created what we call a "central bank facility" as a means of broadening the range of instruments available to the Bank for borrowing directly from the central banks of member countries, other governmental institutions and international organizations. In our search for new ways to extend our catalytic role, we are also looking at the idea of establishing a World Bank subsidiary bank which could work in conjunction with commercial banks to stimulate the flow of private capital to the developing countries. We need to explore these and other ideas if we are to meet the challenge of mobilizing greater resources in the years ahead.

For our low-income members, who rely on IDA, a flow of concessional finance is crucial. The recent agreement on an IDA-7 replenishment of only $9 billion represents a totally inadequate response by the international community to the current circumstances and requirements of the poorest countries. There is thus a pressing need to review again the elements that will enable a consensus to be reached within the donor community on the mobilization of additional concessional funds.

The mobilization of supplementary concessional assistance, over and above the recently concluded $9 billion agreement is critical to assure an effective contribution by the World Bank Group of institutions to Sub-Saharan Africa—an area that looms as the most important development challenge over the balance of this century, as much as the Indian subcontinent did nearly a quarter century ago. We expect to assign the highest priority to our work in Sub-Saharan Africa over the balance of the 1980s, but IDA's resources will need to be substantially increased to ensure an effective contribution.

We have therefore to embark on a major program of persuasion. We have to convince donor governments that it makes neither economic nor political sense to let programs of economic assistance to low-income countries weaken and decline. They should recognize that the economic, political and strategic consequences of chronic decline in the poorest countries will not be confined in their impact to those countries alone. They will be felt throughout the international community. And that is what one must expect in an increasingly interdependent world.

We must also convince the donors that concessional funds such as those mobilized and lent by IDA can be, and are being, effectively invested. It is no giveaway program. IDA lending is hard-nosed investing in high
priority projects, producing the same average rate of returns as the IBRD projects do: about 18 percent.

The needs of the low-income countries for such concessional funds must somehow be met. And that means that in IDA's case we shall need to explore new ideas for mobilizing funds. We may need, for example, to look at the possibilities of borrowing funds for IDA, of adjusting the terms of IDA lending to permit a broadening of the range of sources that we can tap, and possibly even of linking IDA funds to particular uses.

Whatever we do, we must draw on our ingenuity and experience to find new and effective ways to mobilize resources for development, for both our middle-income and lower-income members.

But, while the volume of resources that we can mobilize is a critical consideration, what counts above all is the qualitative impact of our assistance, and the influence we can constructively wield through our economic dialogue with our member countries. That is our developmental role, and we seek the support of the international community in equipping ourselves to discharge it.

At the hub of the multilateral system stand the IMF and the World Bank. They are the linchpins of financial multilateralism. If they are weakened by lack of support, the system must surely fall apart, and the world will revert to the more politically encumbered and historically less effective regime of bilateralism. And that would be a tragedy.

There are signs that the crucial importance of the IMF is being progressively recognized by the industrial community. That is very welcome. But it is now urgent that the critical role of the World Bank in aiding the adjustment of the developing countries' economies, and in helping ensure a steady flow of international capital, should also be fully recognized.

That is the challenge that faces the World Bank today. And it is a challenge we have taken up with vigorous determination.
5. The Invisible Hand and the Developing World

The Wealth of Nations 1990 Conference
June 28, 1990

It has been a pleasure to hear the lively and enlightening discussions at this conference. It is a privilege now to join them.

In one sense, this gathering could be seen as proving Lord Keynes’ maxim that “practical men...are usually the slaves of some defunct economies.”

It seems to me, however, that we have come to weigh Adam Smith, not just to praise him. It is in that spirit, at least, that I propose to look at his teachings and their relevance to the developing nations.

There is no question that his “obvious and simple system of natural liberty” explains the efficiency of market economies as convincingly in the post-industrial age as it did at the start of the industrial revolution. Indeed, if Adam Smith’s philosophy needed vindication, it has been receiving it in full measure from Cracow to Quandong in recent years.

This turn—in Eastern Europe we can say, “return”—to free enterprise is dramatic but still in its infancy. Farther along, but less noticed, is the shift to the private sector in a number of third world countries. Those are the arenas where I, as a practitioner rather than a theoretician, see Adam Smith’s postulates not only being put into practice but also being revised by actual experience.

I do not think he would be surprised to find that science had changed the scale and therefore the nature of the atomistic competition he described. Nor would he be surprised—only disapproving—to see government such a force in the market-place, so often a major consumer, borrower, creditor, insurer, rule-maker and developer, even when not a central planner.

What would distress him most about our world, I suspect, would be the number of very poor people in it. Smith quite rightly warned that “no society can surely be flourishing and happy of which by far the greater part of the numbers are poor and miserable.”
But he was confident that the dynamism of untrammeled self-interest would power economic engines to multiply steadily what Smith called “that universal opulence which extends itself to the lowest ranks of the people.” Things have not turned out quite that way. Opulence, there is, but far from universal.

In the world's developing countries, the focus of my remarks today, opulence was and is the exception, but progress has been—and in many areas remains—the rule. Looking back at the ingredients of successful development and looking ahead for strategies to apply where advance has faltered, a practitioner finds that Adam Smith's formulas require certain modifications.

His rules work...but they do not work alone. His system functions best with help from some visible hands.

The vast majority of developing countries for example, have made impressive gains since the last world war in the fight against poverty. Broad indicators of development, such as life expectancy, infant mortality, literacy and access to social services—and not measures of per capita income alone—all show remarkable improvements.

Of course, such advances have not been uniquely the product of private initiative. In the fields of health and education, among others, public investment plays a major role and, the results suggest, a positive one.

Additionally, the advance of technology and of communications has been a significant accelerator. On average in the third world between 1965 and 1985, for instance, per capita consumption rose nearly 70 per cent and life expectancy increased from 50 to 61 years. These impressive overall gains have parallels in statistics on nutrition and education.

In the developing world, as in the industrialized one, however, the greatest progress against poverty has been scored where markets were unfettered and where the public sector confined its role to creating an environment in which the private sector could generate wealth.

That is no minor undertaking. It has to be the product of a conscious policy choice, often a decision to reverse earlier or established patterns of conduct. And again, the results suggest, the policy works.

Not only has growth in Singapore, South Korea, Taiwan, and Hong Kong, been truly phenomenal; more recently some of the larger Asian countries—Indonesia, Thailand, and Malaysia—have also achieved stellar performances. In all these cases, liberal outward-oriented economic
policies combined with the unrestricted movement of labor and capital have unleashed the full potential of private entrepreneurship.

Some of the larger Asian countries—such as China and India—have also recorded spectacular advances over the last decade, after a long period of slow growth. Per capita income in China grew by close to 9% over the last decade while India—with a much more rapidly growing population—also achieved an increase in its per capita income by about 4% per annum over the same period. I have no doubt that the recent spurt in the economic well-being of nearly two billion people owes much to the willingness of both these governments to loosen the array of bureaucratic controls and interventions which had previously stifled markets, enterprise, and innovation. The state which had started out as the principal promoter of development has become its heaviest cross to bear.

In Latin America and Africa—regions that are rich in potential resources—there are some remarkable similarities—and differences—in development experience.

Latin America grew rapidly until the decade of the seventies, propelled by its dynamic private sector and huge injections of foreign capital. Despite a record of growing fiscal imbalances and high inflation in most countries, advance continued until the eighties. Then the combination of domestic inflation, debt and a bloated and inefficient public sector precipitated a crisis.

Nor is the record of the private sector in Latin America unblemished. In the highly speculative and inflationary environment that prevailed in many countries the market encouraged schemers rather than investors, and their misconduct tarnished the image of the mechanism they manipulated.

Across the South Atlantic, in most of Africa, the modest growth that did take place until the early seventies owed much to the periodic buoyancy of commodity prices. With those revenues but no broad-based private sector to work with, African governments took upon themselves the whole task of development. They tried to make state-owned enterprises and institutions the engines of growth.

The crisis that followed the fall of commodity prices and that still afflicts Africa is as much a failure of the policy of etatism as it is of a paucity of investment—domestic and foreign—in human and institutional development. As government and private monopolies mushroomed, indige-
ous markets could not grow or flourish. No modern private sector was able to graft itself on the long and rich tradition of African merchants.

From this mixed picture of nearly fifty years of development experience, what lessons stand out?

I believe we have learned that there is indeed magic in the market place. That magic has worked in East Asia, home to nearly two-fifths of the developing world's population and one-fourth of its poor.

We have learned that rigid and bureaucratic systems of centralized planning, resource allocation and price regulation, do not work. We have only to look at the record of Eastern Europe, China, Peru, and a number of other centrally managed economies to gauge the effects of the evil spell and to applaud their efforts to cast it off.

And we have learned, most importantly, that neither the state, nor the private sector alone, holds the key to the riddle of development. Both must work in tandem, each doing its part, to move society steadily forward.

The East Asian countries that have succeeded by leaving production to the market, certainly owe a debt to Adam Smith and his blueprint for progress. But their markets would not have functioned, and competition would not have flourished, had the government not ensured a level playing field and provided the enabling infrastructure and social services. That is not, perhaps, laissez-faire, but it is permettez-faire, and Adam Smith would probably approve it as a modern definition of government's role.

I believe that he would also approve a few simple guides to development policy that I, as a practitioner of the art, call my five golden rules:

First, investment in human potential and in people is far more important than investment in bricks and mortar. Educating the people must take priority over the building of dams and factories.

Second, the central aim of government policy must be to create a sound financial environment that encourages savings and an efficient market. In that setting, investment will follow on a healthy path. If prices are right, market forces will direct it to productive uses. Overemphasizing growth in investment rather than in savings does more harm than good.

Third, in most developing countries it is necessary to be a physiocrat in the initial stages of development and to focus on agriculture. Every
peasant is a born capitalist. All he—in Africa, she—needs is the permanent use of the land, some access to knowledge, and the freedom to exploit these resources. Given these, he or she will turn even a desert into a garden.

Fourth, in developing trade and industry, the secret of success is promoting maximum competition. Private monopolies are just as bad as public monopolies. The best technology-transfer policy is to eliminate all impediments to competition.

Fifth, only the people themselves know the answers to their development needs, and even they must find the appropriate path through trial and error. Therefore, avoid imposing dogmas and doctrinaire strategies of development on others. In developing countries over-zealous governments have committed more sins of commission than of omission, and their bureaucracies have been the worst offenders, curbing the free markets they should be helping to flourish.

Like other golden rules, these simple ones are more honored in the breach. Recent development history is replete with examples of governments in frantic search of foreign borrowing while they discourage savings at home. The results are written in massive problems of debt and intractible fiscal deficits.

In some cases, massive investment projects go forward while children are denied education and even primary health care. In much of the third world, poor people are the readiest growth asset a nation has, and yet the least well utilized. The returns on well-designed health, education and nutrition programs for the poor are quick and enduring. And where economic adjustment policies are creating the right environment for free enterprise, these investments in the poor can turn farmers into capitalists and slum-dwellers into energetic competitors.

The secret of development thus is to let markets do the things that markets are good at—and they are good at generating productivity and wealth. It also lies in letting the state do the things that the state is good at—and one of the most important is to create conditions in which markets can function in a stable and sustainable manner.

That conception, however, is not immaculate. It usually requires action by government, some of it simply to correct mistaken economic policies that stifle initiative and competition. In that category fall a host of trade
restraints in the form of price subsidies or tariffs or quotas or overvalued currencies, all of them practices that Adam Smith did or would condemn.

Beyond those impediments to market efficiency lie other—protected state enterprises whose monopolistic reach and wastefulness Smith could hardly have imagined. It took governments to create those entities, and it will take governments to find the ways to discipline or dispose of them.

It is easy for economists to discern these errors and prescribe their cure. But it is also easy for theorists to forget that the requisite remedial action must take place in a complex social and political environment, where both old habits and entrenched interests die hard.

That reality points to one paradox of free market reform: governments must be strong enough, which is to say, popular enough, to carry through unpopular measures that are designed, in fact, to weaken their own sway over the economy.

That is a tall order for statesmanship anywhere. Yet it is being attempted in many nations. Some, like Poland, Argentina, Brazil, and Mexico are fortunate enough to have governments armed with mandates to pursue reform. In Africa especially, on the other hand, officials must move resolutely, but cautiously, to insure that changes which will bringundenbted benefits tomorrow do not touch off explosive reaction today.

The World Bank believes their efforts can succeed. Much of its lending and advisory activity in Latin America and Africa, indeed, is designed to reward and support such adjustment programs.

Such backing is a further example of the visible, helping hand to which I referred earlier. It is not just domestic governments which must act to enable free markets to rise and to work. Outside investors, who have an interest in seeing “universal opulence...extend itself,” have to translate that concern into supportive action either as official or private finance and counsel.

Their intervention is essentially important when the would-be reformers face obstacles that are not just of their own making. Africa, for instance, has suffered as much from the ravages of falling commodity prices and adverse terms of trade as from home-grown misrule. Latin America's debt crisis, built on its own legacy of financial excess and imprudence, was triggered and compounded by the hardening of world interest rates.

The private sector is essential to surmounting these challenges, but it cannot be expected to work miracles alone or overnight. As Colombia's
president Virgilio Barco recently said, “Free market economics is not a magic wand which will somehow relieve us of the obligation to care for our fellow human beings.”

In recent times, there have been some shrill voices calling for a cessation of all development aid and for governments to exit from the economic stage, leaving all to the private sector.

These sentiments, while understandable in view of the dismal economic performance of many governments in the recent past, are yet another exercise in futility. One should not forget the severe problems created by monopolistic behavior and speculative markets in the industrialized countries not so long ago. Nor should we ignore the absence of any viable indigenous private sector or markets in most poor countries.

Winston Churchill had it right when he said: “Some see private enterprise as a predatory target to be shot at, others as a cow to be milked, but few are there who see it as a sturdy horse pulling the wagon.” In the developing world, we need the state and the private sector to be pulling together rather than pulling apart.

And is there a case for aid? Especially in the new circumstances, the case for increased private and public foreign investment in the developing world is even stronger.

The rationale for that flow of resources has always been rooted in self-interest. The United States Secretary of the Treasury, Henry Morgenthau, echoed Adam Smith’s argument in 1944 when he spoke of prosperity as a “unique commodity that expands the more widely it is shared.”

For private investment the landscape has been transformed in the developing world. The demolition of the Berlin wall which cleared all the roads to Eastern Europe is, of course, vividly etched in everyone’s mind but perhaps less known is the fact that the formidable obstacles and road blocks which the Andean Pact had built up in Latin America have now virtually disappeared, and that even countries of the Indian subcontinent which once looked upon private investment with deep suspicion and mistrust are now beginning to unpack—if not actually roll out—the red carpet. Thus from the Andes to the Himalayas, and from the Atlas Mountains to the Urals, you see a developing world that is in economic ferment, disavowing the legacy of centralized planning and
state control, and espousing the new credo of free markets and the invisible hand.

In short and nearly in conclusion, then, the world has reached the threshold of a new age of Adam Smith. Further advance depends primarily on the works of individuals and individual governments operating as their silent, non-intrusive but supportive partners.

As the magic of the market place requires that harmonious balance and positive interaction between private and public forces, so the power of the global marketplace also needs to be channeled into orderly competition.

Free trade, in other words, has to be assured by international action, by the decision of governments and the operation of a facilitating superstructure, referee and agent for market forces. That superstructure exists in the Bretton Woods institutions as they perform their original roles: The IMF helping to stabilize exchange rates, the World Bank helping to insure the flow of capital and the GATT setting and steadily liberalizing the rules for trade.

The Uruguay Round that ends this year is our latest and absolutely crucial opportunity for further integrating the global marketplace, for removing barriers to vigorous, orderly competition. In those negotiations, almost all nations can replicate on an international scale the progress so many developing ones are making for themselves.

Their concerted effort will be, again, the product of visible hands, but in service to and in partnership with Adam Smith's "system of natural liberty." His vision of the wealth of nations is one we can now extend to the community of nations. He would welcome that opportunity and urge us to seize it.
Africa's crisis is the common and urgent concern which brings us together. Africa's long-term future is the challenge we meet to address.

The hour is late, and the problems are daunting. But the remedies are not beyond our reach. ... If we join forces and resources for a sustained, new push. ... If we coordinate our actions as we have cooperated in the fruitful consultations that have already brought us far. ... And if, as I will discuss shortly, we unite to create a global coalition for Africa that can insure stimulus, focus and oversight for the hard, exciting work that lies ahead.

I see that coalition as providing a new catalyst for African development. A high-level group of respected and representative individuals who can command attention in the region itself, who can galvanize and maintain support from outside and who can monitor progress, identify priorities and advise on tactics as long-term strategies unfold.

I will return to this idea later. I hope we will be able to explore it at length in our discussions. Before examining this proposal, however, we need to remind ourselves of the African setting and the ways it is changing.

The Continuing Crisis

Africa is in deep and continuing crisis. Economic decline over the last decade has brought average per capita income down by 25 percent and has shattered the hopes of tens of millions of ordinary people for decent lives and a better future.

Weakened by destructive outbreaks of drought, famine and civil war, the region's food supply is now inadequate for one out of every four Africans. That nutrition gap widens as population continues to grow more than twice as fast as agricultural productivity.

Not only did many countries fail to improve their health and education services in the 1980s; some even saw their earlier achievements reversed. And as social indicators stagnated, the natural environment decayed at

On top of these human and physical ills, internal and external financial woes have forced many African governments to practice crisis management in place of development.

With export volumes static or in decline in most countries, imports have had to be cured. Yet external debt has climbed faster than in any other developing region. At $134 billion in 1988, it roughly equaled Sub-Saharan Africa's combined gross national product. Debt service takes nearly half of all export earnings.

The Window of Opportunity

If those statistics told the whole story, of course, we would be meeting only to conduct a post mortem inquiry. Instead, thanks to the invitation of the Netherlands government and the thorough preparatory work that Minister Pronk has supervised, we come to Maastricht as partners for new progress.

The senior partners in this endeavor are and must always be Africans. It is they who have taken "arms against a sea of troubles" and who will carry the heaviest burden from now on. Already, many are proving themselves ready for and equal to the challenge.

In the last grim decade, in fact, many African countries set out on the road of economic policy reform, toward the goal of growth. Cutting government spending, raising taxes, overhauling or disposing of public enterprises and realigning exchange rates, they are lowering the obstacles to private enterprise and raising the prospects for vigor in international trade and investment, for efficiency in administrative and social services.

They have not been alone. Since 1987, the international donor community has channeled support for their reforms to 22 low-income, debt-laden African nations. And as experience has shown the need for specific social policies to protect poor and vulnerable groups through the travails of adjustment, both African governments and their outside supporters have worked together on measures to lessen or make up for those costs, even from the outset of reform.

These changes are powering a hopeful transformation in Africa, as elsewhere in the world. They herald a new beginning, a new realism and
sense of responsibility on the part of government, a needed revision of
discredited ideas and a renewed reliance on the ability of ordinary people
to control their rulers and shape the future.

The Need for a Long-Term Strategy

This revitalization is full of promise. To effect a lasting turnaround in
Africa, however, it needs to be channeled into strategies for long-term
development.

Africa's crisis arises from profound and multi-faceted problems. Stop-gap
measures can only deal with the symptoms and only for a time. Real
remedies must go as deep as the roots and must be as extensive as the ills
they have to overcome.

Thus, while the ingredients or long-term strategy may be much the same
from one country to the next, each mix of those elements must emerge
from and respond to the special context of individual societies.

Africans have to articulate their own formulas. They know best the
economic, political, social and even cultural dimensions of their dilemma
and their potential. They know their own needs and aspirations. They
are best positioned to mobilize the resourcefulness of citizens and com-
munities behind a coherent development strategy.

They must have generous, committed outside support for the long haul,
but they must take not only the first steps but the responsibility for
continuous, forward motion as well.

The Emerging Consensus

The rethinking that has brought Africans to the starting line of a new
marathon has also had its impact on their international partners. Donor
agencies and foreign advisers—including the World Bank—have had to
accept their share of the responsibility for the failures of the past. From
that recognition, we must proceed as well to a change in the way we think
and act so that we can contribute fully to the restoration of Africa's
fortunes.

Together, Africans and their friends are already nearing the kind of
consensus on long-term strategy that was so useful to progress in East and
South Asia in the 1960s and 1970s. This conference, indeed, is another
valuable step in that search for a common attitude and the commitment that can flow from it.

The Bank's long-term perspective study and some of the other documents before you elaborate the major elements of a long-term strategy for Africa. I will highlight some of them.

First, there is a consensus on the importance of a human-centered development.

People are both the ends and the means of development. Therefore, programs to provide universal access to health care, family planning, education, food security, safe water and income-earning opportunities deserve top priority.

In the commitment to develop Africa's human resources, special efforts must also be made to include women in the mainstream of society. Not only should they play a more productive economic role; they should have the standing and support as well to exercise their full rights in nurturing their own potential and that of their families, communities and nations.

Second, economic policy reforms must continue to strengthen the environment essential for growth in the productive sectors.

Farmers, workers, entrepreneurs and communities need the right incentives at work to mobilize their energies fully. Moreover, policies and programs formulated to achieve growth must ensure that it proceeds in a sustainable manner, husbanding natural resources as long-term assets at the same time that it strengthens human skills and capacities to make public and private institutions more self-reliant and well-managed.

Third, Africans should explore and exploit the opportunities for trade and cooperation among themselves. They have markets, economies of scale and shared resources to expand and valuable lessons of both successful and failed attempts to guide new pragmatic efforts.

Fourth, additional financial resources will be needed to support recovery and growth programs in Africa during this decade and to reduce Africa's burdensome external debt. These must come both from within African countries and from the development community.

The resources will have to be carefully used and accounted for to ensure that key investments and recurrent expenditures are financed. In the absence of good governance and an enabling environment, additional resources will not suffice for the task that lies ahead.
That is one of the useful lessons we have learned from listening carefully to each other and from sharing our own experiences and mistakes. What else has helped us come this far toward consensus?

First, the decade of the 1970s taught us that basic needs cannot be met without macroeconomic stability and specific incentives to promote growth and productivity. Second, the 1980s showed us that correcting macroeconomic imbalances is not enough; reform must go hand in hand with construction and reconstruction of human and physical infrastructure.

The Bank’s own learning process was spurred by a deliberate decision by our Board and management to seek inputs from Africans, as well as donors other than the Bank, in preparing our long-term perspective study. These inputs have had profound influence on both the content and tone of the Bank’s report, particularly in the areas of regional cooperation, governance and the approach to modernization.

Areas for Further Consensus-Building

Clearly we have made significant advances in achieving consensus. But we cannot expect unanimity on all points.

The African countries are diverse. Their problems are unique and difficult. Inevitably, the perspectives of donor agencies and governments vary. Even in areas on which considerable agreement exists, there are bound to be some differences in the emphasis given to particular problems and their solutions. And in other areas, such as the role of the private sector, the pace and mechanisms of exchange rate realignments and trade liberalization, adjustments in public sector wages and the high cost of doing business, and the form and speed of family planning programs, we still have a way to go to arrive at consensus.

I am convinced that in most of these areas, the differences are likely to be differences of degree, not fundamental debates over objectives or instruments for reaching them. It is essential, therefore, that we create fora for open and frank discussion in which we can listen to and learn from each other. Only in this way can we move forward to the kind of operating partnership that is required.

The Case for a Global Coalition

Consensus building is not merely an intellectual exercise. It demands political will and commitment. It is for these reasons that the proposal
for a global coalition for Africa made in the Bank's study and elaborated in the issues paper prepared by Minister Pronk is so important. It does, however, as he has so rightly pointed out, require a groundswell of political support from Africans themselves.

One way to generate that essential support is for us, in the course of this discussion, to attempt to define the make-up and mission of such a new entity in the development community. With that goal in mind, I will offer my own ideas to elicit your reaction and suggestions.

I envisage the global coalition for Africa as a very untraditional advisory body—a once-a-year gathering of distinguished thinkers and decision-makers from among both past and current leaders of governments of Africa, its private sector, the non-governmental organizations active in the region, and from the international donor community. The annual gathering, prepared by a steering committee of some 15 representative figures, would rely on reports from existing and perhaps some new working and study groups, rather than on time- and resource-consuming preparatory conferences. Such a coalition as proposed would provide a framework to discuss, to monitor, to explore and to mobilize support for promising initiatives within overall long-term development strategies.

As you know, the long-term perspective study lays out some major objectives necessary to achieve sustainable growth and these include:

- doubling the growth rate of agricultural output;
- halving the fertility rate of couples by 2010;
- curtailing environmental degradation;
- increasing aid flows by 4% per annum;
- doubling expenditure on education and health;
- holding debt service levels constant or declining in absolute terms.

Progress towards these objectives would be monitored and evaluated for the Sub-Saharan Africa region as a whole and for individual countries, and the objectives themselves could be modified and refined. The role and performance of donor countries in support of these objectives would also be reviewed. The coalition would, in effect, stimulate progress toward national and region-wide objectives by putting some accountability into the search for and maintenance of consensus.
As an informal overseer, with an expert focus on these objectives, the coalition would place itself in the key role of monitor and catalyst. As it observed implementation, it could identify problems and suggest remedies for them. Beyond inspecting progress, however, it could also certify the usefulness of putting additional international resources into specific promising activities and projects.

The goal is action—action based on consensus and consensus based on cooperative inquiry. I believe that such a global coalition for Africa, drawing on the most knowledgeable advice, concerting a wide spectrum of views and focusing impressive intellectual resources on significant issues in a timely way, could maintain and nourish the emerging consensus on Africa. It could give momentum to long-term strategies and help insure that support goes to the objectives and programs most likely to make those strategies successful.

The World Bank would welcome such guidance and stimulus. Individual governments and other multilateral agencies, I imagine, would also benefit from joining the coalition and from its findings.

Those who have the most to gain are those who have the most to contribute: The governments and the people of Sub-Saharan Africa. The global coalition for Africa must be their instrument in service to their needs and their goals.

I hope this conference can help to put such a new mechanism in their hands and that together, we can set to with a new will and a new way to build the healthy, hopeful future that, in Africa, has been too long postponed.
7. Priorities for Development in the 1990s

Nigerian Institute of International Affairs, Lagos
November 27, 1989

It is an honor to be a guest of the institute of international affairs and a privilege to address such a distinguished audience in Africa's most populous nation.

As an officer of the World Bank, I especially welcome the opportunity to see firsthand the economic transformation now underway in Nigeria and to learn more from you about the progress being made and the problems still to be overcome.

My immediate purpose, however, is to share with you some thoughts about the challenges facing the developing world in general and Sub-Saharan Africa in particular during the coming decade. While I will focus on the fight against poverty and on issues of environment and population within that context, I present them as facets of the broad development crisis that is moving into a decisive phase, especially in Africa. The choice is between progress or stagnation.

Let us be realistic. The years before this century ends will determine whether or not Sub-Saharan Africa can realize its potential or must forfeit its future. And that choice between progress or stagnation is entirely up to the leaders and the people of the continent.

The World Bank and the rest of the international community have important but basically only supportive roles to play. We are far more than bystanders, but far less than prime movers.

I will try later to be specific about the Bank's past experience and future plans, but I want to be clear from the start: the authors of Africa's future are and will be Africans.

The Background to the Crisis

To see the way forward, it should help to begin by looking back. In much of the developing world, the past 10 years have been in many ways the most difficult decade in history.
Certainly, some developing countries have made extraordinary strides. The rapid economic growth from Korea to Indonesia, the expanding presence in world markets of nations such as Thailand and Mauritius offer inspiring examples of hope and achievement.

But the 1980s have been a frustrating decade for most developing countries. More of them have suffered setbacks than have experienced success. To them it has been a “lost decade” marked by economic reverses the consequences of which will be felt well into the 1990s.

In Africa specifically, 1981–86 were years of decline. While there are some exceptions, the economic crisis facing Africa is characterized in country after country by weak agricultural growth, a decline in industrial output, poor export performance, climbing debt and deteriorating social indicators, institutions and environment.

Can this grim history be reversed? I am an optimist and I speak for an optimistic institution.

In fact, the long-term study on Sub-Saharan Africa that the Bank released last week, titled “From Crisis to Sustainable Growth,” sets as a “minimum target” economic growth rates of 4 to 5 percent a year from 1990 onwards.

Those are not utopian goals. They are attainable ones.

*The Poverty Dimension of Development*

Economic growth, of course, is not a stand-alone proposition. While the Bank spends a great deal of time analyzing economic data and worrying about macroeconomic growth, the test of development, in the end, is not changed statistics but improved human lives.

And the grim truth of the developing world is that too many people in it remain prisoners of poverty. Today about one fourth of the total population of the developing world, nearly one billion people, survive in conditions of extreme deprivation.

Moreover, a majority of the poor are concentrated in two regions—South Asia and Sub-Saharan Africa. Reliable social indicators of well-being such as life expectancy, child mortality rates and access to schooling point clearly to the prevalence of poverty in these two regions.

The contrasts with the industrialized world are stark. Life expectancy in Japan is 78 years. It is only 57 years in South Asia and just above 50 in
Sub-Saharan Africa. The rate of child mortality in Sweden is less than 10 per thousand. In Africa, it is more than ten times as high.

While every child in the United States goes to school, more than 100 million children in South Asia and Sub-Saharan Africa have no access even to primary schooling.

On the one hand, these statistics conceal significant differences within regions. On the other, they reveal the disproportionate impact of poverty on women and children.

**Overpopulation and Gender Bias**

At present, many of the poor are concentrated in specific locations—in rural areas with high population densities such as the gangetic plain of India and the Island of Java in Indonesia or in resource-poor areas such as the Northeast of Brazil and the Sahel.

In Africa, along with specific zones of over-population, the overall status of women is a major contributing factor to poverty, a gender issue that deserves special mention.

In many parts of Sub-Saharan Africa, women represent about 50 percent of the population, as much as 60 percent of the labor force, grow about 80 percent of the food and yet earn about 10 percent of the money income and own only 1 percent of the assets.

These economic facts translate into real hardships: incidence of extreme poverty is highest among women and children. Malnutrition and poverty that are gender biased result in increased infant mortality and morbidity.

**The Benefits of Improving the Status of Women**

There is no question, then, that improving the condition of women would reap major benefits in social terms. And such progress would likely bring considerable economic rewards to the countries involved as well.

What can be done? First, women need opportunities to improve their economic positions through increasing both their assets and those assets’ productivity. In other words, more equitable treatment as producers and wage-earners.

Second, they need better access to basic social services, to education, health, nutrition support and population-related programs, for example.
These concerns are emerging as key areas of Bank work. Nations which undertake their own programs to make women equal partners in development will find the Bank a willing partner in such promising—and overdue—endeavors. And, in this regard, I would like to commend the efforts underway in Nigeria through programs such as "better life and rural women" which aim at improving women's access to productive assets and social services.

**Progress against Poverty**

Where such social initiatives have figured in broader development strategies, the record often shows poverty in retreat. Among the achievements of the past decades, we should never forget, are steps that did significantly improve the quality of life in many regions and many aspects. Africa, which was initially keeping pace with that wider progress, is not the most dramatic exception to the rule.

In the developing world as a whole, consumption per capita not only increased by almost 80 percent between 1960 and 1980, but many of the poor also moved out of poverty. In Brazil, for example, a country with one of the most unequal distributions of income in the world, the incidence of poverty fell from about 40 percent in 1960 to just over 20 percent in 1980.

During the decade of the 1970s, poverty in Pakistan fell from 65 percent of the population to less than 45 percent. And Indonesia took only fourteen years in the 1970s and early 1980s to reduce its incidence of poverty by a remarkable 34 percentage points.

Improvement with respect to social indicators are even more impressive. Throughout the developing world, indices of life expectancy, child mortality, nutritional intake and educational attainment have shown significant improvement.

To take just one example, life expectancy in the developing world increased from 49 to 57 years between 1960 and 1980. This is vastly superior to the performance of the developed countries in the early stages of their industrialization.

Moreover, certain developing countries have made especially impressive strides and are now approaching the achievements of high-income countries. In China, a country with more than one quarter of the total developing world population, life expectancy reached 65 years by 1980.
Even through the recession and crises of this decade, the available evidence indicates that the bulk of the world’s poor—those living in South and East Asia—have continued to increase their incomes. Reductions in child mortality, increases in enrollment rates and improvements in other indicators have also continued in these regions.

**Poverty on the Rise: Africa and Latin America**

Not all the news is good. In most of Latin America, except in Brazil as I indicated earlier, and in Sub-Saharan Africa, in fact, poverty is now not on the decline but on the rise.

In both regions, incomes flopped during the 1980s and, judging by both direct and indirect evidence—including information on wages and diet—the well-being of the population of these two areas eroded as well.

Indeed, the poverty question is probably the most critical question facing Africa today.

If the recent trend of economic growth in Asia is sustained, the number of poor there will drop considerably in the next decade.

The number in Africa—by contrast—will expand dramatically. Not far ahead, we can see a major change coming in the distribution of world poverty: Africa emerging as the region with the greatest concentration of poor of the world.

Already, one African in four subsists on average with less than 80 percent of the calories needed every day to sustain a healthy, productive life. By the end of the next decade, however, the food gap could be anywhere from two and a half to five times as severe as now unless human fertility declines steadily and agricultural output rises by at least 4 percent a year. This information is set out in our long-term perspective study on Africa.

With the region’s labor force due to expand by 380 million people between next year and the end of the century, not only must economic growth run ahead of population to keep poverty from rising but educational investment must expand and improve as well to fit new workers for modern work.

Nigeria’s new national open apprenticeship scheme is one imaginative approach, but it must be matched across the region by increases over the decade of some 60 percent in the proportion of GNP devoted to improvements in primary education alone.
Nor will economic growth, progress in agriculture and industry, advances in education, improvements in social services and the status of women be sufficient—even in concert—to insure sustainable development and diminishing poverty. For those objectives to be met, Africans must also put more attention and effort both into managing the natural environment and into controlling the population explosion.

Let me address those two subjects—though they are intimately linked—in order.

**The Environment Question**

Looking into the 1990s, we can all see that improving the quality of life in developing and industrial countries alike depends on doing much more to conserve our global environment. That goal, however, cannot be won by choking off the hopes of poor people and poor countries.

We must protect the environmental quality of life in the fullest sense—by extending economic choice and opportunity, by ensuring strong economic growth and by reducing mass poverty in the developing world.

Africa is a continent of environmental challenges, all of them difficult. Rain that falls mostly in erosive downpours puts greater stress on vegetation than in temperate areas.

And to start with, the continent's soil resources are poor. According to an FAO study, only 19 percent of Africa's soils have no inherent fertility limitations. Fifty-five percent have severe or very severe constraints.

The risk of prolonged droughts, moreover, is high on two-thirds of Africa's land area. The Sahel faces the additional problem of unusually wet or dry periods persisting for one or two decades. And if these difficulties were not enough, the Tsetse fly prevents widespread introduction of cattle in much of Central Africa.

In the past Africa's farmers had developed traditional agricultural methods, particularly shifting cultivation, which were well adapted to these problems, but the increased pressure on land is resulting in overgrazing of fallow land and overuse of farmland with consequent declines in yields. At the same time, fuelwood needs are met by attacking the forests. Vegetative cover decreases. Erosion accelerates.

Reflecting these developments, three problems have commonly emerged across the continent. The first is deforestation. The FAO reports that
Africa's 703 million hectares of undisturbed forests in 1980 were being cleared at the rate of 3.7 million hectares a year—or 0.6 percent. Local rates ranged from 0.2 percent for the vast Cameroon-Congolese forest and up to 4 percent a year in West Africa. Deforestation outstripped the rate of new tree planting—by 29 to 1.

The second problem is desertification, affecting Africa's drylands. An assessment for 1983 suggests that in these areas, 80–90 percent of the rangelands, 80 percent of the rainfed croplands and 30 percent of the irrigated land may be affected at least moderately.

Of the dryland population of 118.5 million, 92 million lived in areas affected by desertification, 52.5 million of them in severely affected areas.

The third problem is soil erosion, which is widespread in all areas of Sub-Saharan Africa. It is perhaps most serious in Ethiopia, where top-soil losses of up to 296 metric tons per hectare have been reported on 16 percent slopes, but even moderate slopes can erode rapidly when unprotected by vegetation.

In West Africa per hectare losses of 10–21 metric tons have been reported on slopes as gentle as 0.4–0.8 percent, and of 30–35 metric tons on 1–2 percent slopes. In drier areas, wind erosion is significant, and even more serious in the medium term is the gradual decline in fertility of all types of land.

These problems have a direct and clear impact on agriculture, the region's dominant economic activity; the poor performance in this sector over the past 10 years partially reflects the impact of environmental degradation. If that impact intensifies, it will frustrate all hopes for sustained growth and poverty reduction.

The Population Issue

Nowhere is the connection between poverty and the environment more dramatic than in population policy. Rapid expansion of population endangers growth in individual incomes and improvement of the quality of individual lives.

This is not only, or even primarily, an aggregate problem of "too many people."

The real concern is that excessive population growth puts heavy, sometimes intolerable, strain on the pressure points of urban and rural envi-
environments that are least able to bear it. The consequence is to further undermine the ability of hundreds of millions of people to escape from poverty.

The solution to this exceptionally difficult and sensitive problem does not lie in attempts at massive social engineering by governments or by the international community. Population figures reflect decisions by millions of individuals and couples as they confront the everyday realities of life: work, health, the survival chances and economic prospects of prospective children, their own old age.

But we can help to make available to women, and to men, the ability to make decisions which will meet the needs of individual families, and serve the wider society as well.

No single step will provide the answer.

Approaches must be adapted to each country's circumstances. Direct support for family planning programs and policies is essential, and must go hand in hand with action to increase productivity and welfare—especially for women—through better access to education and health services, better jobs, and higher incomes.

Greater access to family planning information and services can be provided through many different channels: through primary health care services, through the private sector and through voluntary organizations.

Countries such as Indonesia, Zimbabwe and Botswana have demonstrated that family planning programs work—not only as an instrument of population policy, but as a way to improve the welfare of everybody—men, women and children.

Indonesia's family planning program has grown from a coverage of 50,000 couples to over 17 million couples in less than 20 years. Zimbabwe and Botswana have stressed human resource development, along with family planning. As a result, many of their people are educated; health services are widely available and mortality is among the lowest in Africa.

Other countries with active family planning programs have been equally successful. We must expand these examples of success more broadly, particularly in Africa which presently has the highest rate of population growth in the developing world.

I know the African proverb: "Every extra mouth comes attached to two extra hands." But when I contemplate 500 million new mouths needing
food and one billion new hands needing work in Africa 20 years from now, folk wisdom brings only cold comfort.

The pressure of a doubling population on fixed and often fragile natural resources and on a social and political infrastructure already under heavy stress is a prescription not for development, but for disaster.

As I said at the start, I believe that calamity can be averted. I know that the World Bank is ready to work with Africans to turn the tide and to build stronger foundations for sustainable development.

**The Bank’s Role**

That readiness has already changed the Bank’s priorities. Having once—and for a long period—concentrated primarily on investments for infrastructure, we added agriculture and education to our portfolio, then urban development and population projects. In this decade of the debt crisis, we have also come to play a major new role in assisting the strenuous process of economic policy reform that is transforming the environment for growth in many countries, Nigeria not least among them.

Your structural adjustment program is one the Bank has been proud to support both with loans and an ongoing policy dialogue. We find the early results—including the substantial recovery in agriculture—encouraging. Your recent actions to alleviate some of the social costs of adjustment also deserve recognition, especially considering the continuing decline in oil prices and the drastic pressure that has put on government resources and per capita income.

Beyond the Bank’s support for productive change in the macroeconomic policy environment, we have moved recently and rapidly to integrate concern for the natural environment into every project we undertake, every country strategy we help to formulate. And as part of our longstanding commitment to addressing the population issue, we will substantially increase our lending in the next decade for the delivery of effective family planning services and for investments which will improve opportunities for women.

For population, health and nutrition alone, we expect to increase our lending to $800 million for the next three years, compared to $500 million for the past five years. Having approved more than 100 projects with significant environmental components in the fiscal year that just ended—over one third of all Bank projects—we also plan major increases
in loans for forestry and anticipate lending $1.3 billion for free-standing environmental undertakings over the next three years.

Although the Bank Group—with record lending and commitments of over $21 billion last year—is the largest single source of development assistance, let me conclude by repeating the point I made at the start.

**Conclusion: Self-Reliance**

We can be catalysts for change; we can be valuable technical advisers; we can be financial supporters who lead others to join in financing growth. But only the governments and the people of the developing nations can be, in the last analysis, the planners and the executors of strategies for growth.

The choices in Africa and in the developing world are in the hands of those whose future hangs on those choices, on the decisions to be made and carried out over the next decade.

Restoring growth, reducing poverty and protecting the environment are the central challenges of the 1990s. Whether we succeed or fail will depend to a large extent on the commitment of both developed and developing countries to further strengthen their cooperation to meet the growing demands of interdependence.

In ongoing international deliberations on trade, debt, environment, there are encouraging signs that such cooperation is being forged. Favorable changes, created by improved East-West relations, are also taking place in the global political environment, and in the 1990s should provide a new impetus to development cooperation.

The next decade will be a testing period for the long-term viability and sustained growth in many developing countries. The African continent, and especially Sub-Saharan Africa, faces exceptional difficulties. The causes of its economic malaise are deep and persistent, and it will continue to need special attention from the donor community.

I believe it is well within our power to make the 1990s a decade of progress if governments seize the opportunities it presents and heed the lessons of the 1980s.

Those lessons are that we must put people first on our strategic agenda for development, giving priority to addressing the needs of the poor and building an environment that enhances the human potential, not degrades it.
The World Bank, working closely with its members, is fully committed to that goal. You, however, own your future. You will be the ones to decide its shape and to realize its promise. I have no doubt that you will meet that challenge. To quote a Nigerian proverb: "A man cannot battle with the multitude but the multitude can cope with any situation." I have confidence that, standing together as a nation, you will be able to confront successfully the economic problems of the next decade.
Regional Perspectives
8. Partnership for Sustaining Africa's Development: The Agenda Ahead

General Assembly of the United Nations, New York
September 12, 1988

On behalf of the World Bank, it is an honor for me to address this Committee of the Whole during its mid-term review of the United Nations Programme of Action for African Economic Recovery and Development.

The 1986 Special Session of the General Assembly that launched this Programme was an extraordinary event, the first such session devoted to the development problems of a particular geographic region. Most importantly, it underlined the resolute commitment that the African countries themselves are making to the vital task of economic recovery.

On this essential foundation, Africa and the international community are building a unique partnership. Increasingly, for their part, African governments have undertaken major policy actions to meet their responsibility under the United Nations Programme of Action. On its side, the international community is showing the will to honor its obligations to increase and sustain support for Africa's response to the challenge of economic renewal. Economic turnaround, once just a vision, is, I believe, moving step by step toward reality.

After some initial remarks about the Bank's assessment of progress to date, I will focus my remarks on the major challenges that still confront us, and on the main features of the agenda for future collective action to broaden and consolidate recovery, and to achieve sustained long-term growth without which there can be no release from poverty.

Progress So Far

In many countries of Africa, the last decade was one of decline, and the trend of many key economic indicators still gives cause for deep concern. For Sub-Saharan Africa, GDP declined in 1987, reversing the modest improvement of 1986. The likely positive overall growth of 1988 will hardly be strong enough to stem the prolonged decline in per capita income. Sub-Saharan Africa's terms of trade fell in 1987 to the lowest
level since 1974. Although limited recovery is in prospect for 1988, particularly for mineral exporters, the medium-term outlook is not favorable. In a number of hard-hit countries, moreover, internal and regional conflicts have often disrupted essential transport routes, swelled the refugee population, and hampered long-term policy formulation.

Despite such setbacks, many countries have begun to implement far-reaching adjustment programs which hold the promise of reversing Africa's economic decline. The excellent report prepared by the Secretary-General spells out many aspects of this effort. Programs have been aimed at more effective mobilization of domestic resources. They have sought rationalization and better management of public expenditure programs, and institutional reforms. And they have included improvements in incentive systems to encourage more efficient public and private sector production. Some indicators of the degree of effort undertaken are:

- a reduction in real effective exchange rates by one-quarter since 1980;
- a 20 percent decline in fiscal deficits as a share of GDP since the early 1980s; and
- liberalized agricultural marketing by nearly half of African governments.

These reforms are now beginning to bear fruit. Some preliminary evidence suggests that those countries undertaking reform are beginning to perform more strongly than those which have yet to do so. For example:

- among reforming countries, GDP growth has risen from 1 percent in the early 1980s to 4 percent in 1986–87, while countries not undertaking adjustment have remained near the 1 percent level;
- fiscal deficits have declined three times faster in adjusting countries than in the others;
- inflation that has accelerated without reform, has slowed in adjusting countries; and
- between 1980 and 1987, food production grew twice as fast among countries that had liberalized agricultural pricing and marketing, compared to those with highly regulated systems.
To sustain and broaden this encouraging progress, African governments need the committed, continuing support of the international community. That backing must serve primarily to bolster these courageous policy reforms, not donors' short-term commercial and political interests.

In July last year, the Managing Director of the IMF and I presented to donors an agenda for action aimed at easing the burden of reform in debt-distressed countries in Sub-Saharan Africa and establishing the basis for gradual economic recovery. I am pleased to report that our initiative has borne fruit. The Paris Club has offered extension of debt rescheduling terms. The actions of several donors to cancel ODA debt outright have been followed by agreement in principle within the Paris Club to a menu of options to provide additional official debt relief to the poorest debt-distressed countries.

Similarly, let me note the agreement reached last December to provide co-financing amounting to $6.4 billion—3 billion dollars in new money—to debt-distressed countries undertaking adjustment as part of the World Bank's Special Program of Assistance for Africa. There have been other major steps forward. Donors have added resources to the multilateral institutions—the completion of the eight replenishment of IDA at a level of $12.4 billion, the tripling of the IMF's Extended Structural Adjustment Facility to 9 billion SDRs, and the Africa Development Bank's capital increase. Within IDA, the share of financing going to Africa has increased to almost 50 percent, and net disbursements to Africa have grown from 1.1 billion dollars in fiscal 86 to 1.6 billion dollars in fiscal 88.

We can, therefore, take encouragement from the progress made by African nations and from the growing support their efforts have received from outside. Together they represent a message of hope for the peoples of Africa and for the prospect of reversing the decline of living standards.

Yet so much remains to be done. The challenge to all of us in the international community is immense.

Encouraged as we all can be by what has been achieved, this is a time to renew our resolve and focus it on the years ahead. So let me turn to some of the essential elements of the agenda ahead and to the supportive role the Bank intends to play.
The Agenda Ahead

Let us be guided, for the future as in the past, by the critical objective which must underlie all our efforts; that is, restoring economic growth in Africa. For without growth, sustained progress in improving living standards and reducing poverty cannot be achieved. We in the Bank would emphasize four main areas where African governments must concentrate their efforts and donors must target their support.

First, commitment to growth-oriented adjustment must be unwavering. Governments must, of course, decide the scope and pace of reform that they can undertake. But if growth is to be restored and sustained, even stronger efforts at structural economic change will be needed by some countries already implementing reforms, and a bold start will be needed by those which have yet to begin.

The issue is not whether adjustment is necessary or whether it is at odds with economic development. Far from it—the two are inseparably linked. As Edmund Burke said 2 hundred years ago, "A nation without the means of reform is without means of survival." Countries do, however, have a choice between an orderly adjustment program and a haphazard one. And the experience of many countries has shown that an early and orderly adjustment will produce fewer social costs than a delayed and haphazard response. Indeed, adjustment programs benefit the poor by eliminating policy-induced distortions—for example, in wage controls, marketing arrangements, and credit allocation. Policies that reduce distortions in agricultural producer prices are, perhaps, the most notable example of adjustment actions that favor the poor.

However, we must have no illusion about the difficulty of the task which African governments face. Nowhere has the external environment been so hostile to national efforts to restore growth as in Africa. Nowhere has the relative magnitude of the imbalances, whose correction is an essential condition for longer-term growth, been so large. And nowhere have the crucial tradeoffs implicit in the reallocation of resources from consumers to producers raised such acute issues of social cohesion and equity. We must pay profound tribute to the courage of those governments which have embarked on programs of reform whose potential for medium-term benefit must be carefully weighed against short-term social and political costs.

Second, we must reinforce the concerted partnership necessary to combat the grim reality of hunger facing millions of Africans every day. As the Bank's recent report on food security underlined, progress is required
on two essential fronts: improving agricultural production and increasing incomes to widen access to food.

We must continue to give priority to supporting African governments' efforts to revitalize agriculture, which requires policy reforms in both industrial and African countries that strengthen production incentives. In addition, governments need to reinforce support to productivity improvements at the micro level, including measures that focus agricultural research, strengthen participatory extension systems, and rehabilitate and develop rural infrastructure.

In all of these areas, the Bank is expanding its own initiatives. Working with other donors and agencies, we stand ready to fund comprehensive food security programs. The Special Program for African Agricultural Research continues to be a priority area for Bank support, and participation in our agricultural productivity initiative, based on the training and visit system of agricultural extension, has more than doubled in the past year. It now covers some thirty African countries.

Third, we must do more to integrate environmental rehabilitation and protection measures into the mainstream of economic policy. Hunger and lagging economic development are directly linked to environmental degradation. This has been the central message of the report of the World Commission on Environment and Development prepared under the distinguished chairmanship of Prime Minister Bruntland of Norway.

The Bank has taken concrete steps to build on the report's many insights and suggestions, particularly in areas of priority interest to Africa, such as deforestation and desertification. Sustainable development requires greater emphasis on these issues and continuous effort. Some countries have made an impressive start—Madagascar, for example. With Bank assistance, they are designing national environmental plans and integrating them with more traditional development planning.

Fourth, let me focus on Africa's main development asset—its people. In recent years, the need to protect vulnerable groups affected by the transitory costs of adjustment has been a prime social policy concern. Ghana's PAMSCAD program, supported by several donors including the World Bank, is an important example. We should not confuse the disease of overall economic decline and deteriorating social conditions with the remedy of structural adjustment. At the same time, we should recognize that reform programs certainly involve difficult tradeoffs. We have learned much about the need to protect poor people in that process. We must do more to put the lessons of experience into effective practice.
But beyond that, we must strive to more fully integrate social policy and the growth effort. Improved health and nutrition, education and training, access to family planning services, and full involvement of women in the development process, all contribute strongly to economic progress. At the same time, they open the way to our common goal: improved human welfare. Our aim must be to see real progress in reducing mortality and morbidity, in broadening access to relevant basic skills, and in reducing the rate of African population growth, which, unchecked, will undermine efforts at sustainable development. In these areas, the non-governmental and other grassroots organizations have a major role to play as partners with governments and donors. In its operations, the Bank is working to strengthen this three-way cooperation.

Effective use of human resources is not just a matter of social policy. It is a matter, too, of reinforcing domestic institutions for development and tapping the creative energies and productive skills of individuals in the private sector. Along with the Bank, the International Finance Corporation (IFC), the World Bank’s private sector affiliate, will continue and intensify its development support in this field. Already it has launched a series of initiatives specifically aimed at African businesses, particularly in the small- to medium-scale range. The IFC is helping with project preparation, the provision of training and technical assistance, and the financing of private sector projects. Finally, MIGA, the newest affiliate of the Bank, should provide new impetus to private foreign investment in productive ventures especially in natural resource development.

The agenda for economic renewal and sustained development in Africa is long and difficult. But let us be in no doubt of its importance for Africa as well as the global community.

After too many years of poor economic management and consequent instability, Africans have taken up the cause of their future with admirable realism and determination. The winds of economic reform and adjustment are sweeping across African nations from the Atlas Mountains to the Kalahari. This great endeavor, which now encompasses virtually the whole continent, must be supported.

The international community has made a commendable start through their Special Action Program of the Bank for Africa, through the replenishment of the concessionary resources of the Bank and the Fund, and through the announced action of major OECD countries on debt relief. This support must be sustained.
Many of Africa's current problems have their origins elsewhere. Over the last six years, Africa has lost far more from the drop in the prices of its commodity exports than it has gained from the totality of the aid and external assistance that it has received. The rate of economic growth in the industrialized countries, and access to their markets, have also had a pronounced impact on the health and vigor of African societies.
As a practitioner of the art of development, I have enjoyed the privilege over the years of observing the fluctuating fortunes of many countries in many settings. So it is a particular pleasure to talk to a group which has been closely analyzing Indonesia's progress towards economic takeoff. If I may, I would like this evening to discuss the role of the private sector in development, drawing on your experience in Indonesia.

This region is home to some of the world's fastest growing economies. A combination of encouragement to the private sector, and government respect of its own limitations, has helped to sustain rises in incomes and improvements in social conditions in Indonesia, Malaysia, Singapore, and Thailand, among others. These societies have demonstrated their willingness and ability to adjust to fluctuations in the economic climate. They have kept their doors to the world open. Now several countries in the region are clearly crossing the threshold to industrialization.

Indonesia has participated in the region's vigorous advance. Prompt and well coordinated macroeconomic policy adjustments have characterized the country's policy. In particular, you have shown here in Indonesia how much potential can be unleashed by altering the balance between the state and private sectors. The government of Indonesia has firmly committed itself to bolstering private initiative, realizing that it will be the main source of medium-term growth and employment. These objectives have been plainly set out in your current five-year growth of the private sector and allow greater private participation in the economy.

As in many other developing countries, several obstacles have impeded the private sector's growth and development in Indonesia. Incentives were distorted; ownership policy and other regulations unduly restricted private initiative; physical infrastructure and social services needed strengthening; and the financial system was not geared to supporting greater private activity.

Your government has made impressive strides towards removing these obstacles. On the macroeconomic front, policy has emphasized budgetary
caution and has boosted the competitiveness of the nonoil economy. The tax base has been extended to increase revenues from sources other than oil. Trade policy reforms have lowered import protection by eliminating import license restrictions on a vast array of manufactured goods and by rationalizing and reducing tariffs.

On the regulatory front, policy has shifted from controlling to encouraging private investment. Investment licensing has been transformed by simplifying and accelerating investment approvals, switching to a negative list, and opening new sectors to domestic and foreign capital. Ownership regulations governing foreign investment have been relaxed substantially and other restrictions on foreign investment have been removed. Maritime reforms have bolstered competition and increased efficiency in a vital part of the economy.

Recognizing the crucial importance of the financial system to a robust private sector, reforms have begun to sweep away barriers to entry and to eliminate subsidized directed credit, while bolstering prudential regulation. The first steps have also been taken towards reforming public enterprise by systematically reviewing their performance and future plans, by introducing market principles into their operations, and taking some initial steps on divestiture and liquidation.

The result is a fundamental transformation of conditions for the private sector. Despite setbacks suffered during the 1980s, Indonesia has entered the new decade with smaller macroeconomic imbalances and with an economy which is more buoyant and resistant to external shocks. Non-oil GDP growth averaged 5.5 percent between 1986 and 1988, and exceeded 7 percent in 1989–90.

Underlying this recovery has been a strong private sector response to government deregulation, which has raised nonoil exports and expanded and diversified productive capacity, thereby substantially improving the prospects for sustained growth. The private investment boom is particularly striking, and the continuing strength of domestic and foreign investment augurs well. The new banks and financial intermediaries springing up in response to the improved climate for financial services are vivid examples of reform in action.

The continued improvements in social conditions are particularly striking. By promoting rapid private sector growth, by transferring resources from capital-intensive, inward-oriented public investments, and by focusing spending on poverty, Indonesia continued to cut rural and urban poverty in the 1980s. The proportion of the population living in poverty
from 29 percent in 1980 to 17 percent in 1987. The continued reduction of poverty has been a remarkable feature of Indonesia's adjustment, particularly during the 1980s when the country undertook major stabilization and adjustment in response to severe external shocks. At the same time, health, child mortality, and longevity improved and access to primary education was secured for virtually all Indonesian children.

I am sure that Indonesia in the 1980s will be seen as one of the most successful cases of structural adjustment combined with poverty reduction. Indonesia early demonstrated flexibility and careful judgment in difficult circumstances. Today, however, all over the world we are witnessing an historic shift away from state intervention in economic life and towards private initiative.

A defining theme of economic life, and therefore for development, in the 1990s will be the search for the best balance between the state and the private sectors. Naturally, the balance will be different at different times and places. But it will always involve three elements: building and enabling environment which encourages the private sector; allowing the private sector to participate in activities previously reserved for the state; and ensuring that state enterprises operate commercially by applying competitive pressures and private management techniques, and by divesting state ownership where appropriate.

The point is not one of dogma. The point is one of efficiency. Governments are acknowledging that, on the whole, productive enterprises are best left to the private sector. Governments are accepting that their strength lies in supporting the private sector rather than substituting for it.

This great, historic change of sentiment is a reflection of experience and a response to hard realities. The debt crisis sharply curtailed access to external finance which had often cushioned inefficient investment and consumption while domestic savings were neglected. Government finances were increasingly strained as the losses of public enterprises mounted and subsidies grew while taxation languished. The costs of trade protection increased as the pace of technological change quickened, world trade expanded rapidly, and consumers were better informed. It was no longer possible to ignore the environmental costs of ill-considered investments. And public sector managements became overstretched as the demands of the state burgeoned.

When the iron curtain finally rose across Europe, we saw these forces starkly exposed in the East. Economies were shrinking, shortages of all
sorts growing, hyper-inflation threatened, and wastage was evident all around—in Poland's half-million unfinished homes, in Czechoslovakia's overmanned industries, in the Soviet Union's inability to distribute food to its citizens. The whole of Eastern Europe is gripped by a massive economic and environmental crisis, one of the main causes of which was the misallocation of resources inherent in central planning which ignored market prices. But Eastern Europe is not unique. Too many countries in Sub-Saharan Africa and Latin America are grappling with excessive government involvement in their economies.

Indonesia has avoided many of these pitfalls and has been in the vanguard in reforming its policies towards the private sector. As a result, it is entering the 1990s having successfully reduced macroeconomic imbalances and with a resurgent private sector that is expanding and diversifying the productive base.

Yet in many ways the task has only just begun. With per capita GNP of about US$500, Indonesia is still a relatively low-income country. And while substantial gains have been made in the reduction of poverty, millions of people remain poor or close to the poverty line.

Raising living standards, eradicating poverty, and laying the foundations for self-sustaining growth are the central challenges of the 1990s. As President Soeharto said in his Budget Speech of January 7: "The experience of other nations shows that the transition to the take-off stage is a critical and difficult period."

But I believe Indonesia has two valuable assets on which to draw in meeting these challenges. First, its strong record of economic management and the impressive results achieved to date provide a solid basis for maintaining policy reforms. Second, Indonesia is fortunate in being part of the world's economically most dynamic region.

Growth is fundamental. The key to rapid and sustained growth lies in exploiting opportunities from international trade and investment. Despite the disappointing results so far from the GATT round, Indonesia has enormous scope to expand exports of nonoil products, especially manufactures.

To expand its share of world markets, Indonesia will need to sharpen its competitive edge and tap new opportunities. This in turn will require continued skillful macroeconomic management, rapid consolidation of deregulation to foster efficient private sector expansion, and continual evolution of the new supportive and supervisory role of the public sector.
Sound macroeconomic management will remain an important prerequisite for stability and sustained growth. At the same time, eliminating remaining trade and investment distortions will encourage sustained growth of private investment and ensure that productive capacity is created where Indonesia is internationally competitive.

Public sector policy needs to evolve with the shifting priorities of the new decade. The key task for the public sector will be to create an enabling environment which supports efficient private sector development. The emergence of a large and diverse private sector points to the need for more modern and streamlined corporate, land, and labor laws and regulations governing private activity. Prudential supervision should be reinforced to ensure the soundness of the financial system, and financial institutions should be encouraged to improve their technical and managerial expertise. For private sector growth to be sustainable, increased attention must also be paid to the careful use of natural resources such as land and water, and to avoiding environmental pollution and degradation.

Investing in infrastructure, human resources, and skills, and in reducing poverty and regional inequities, will continue to be an important element in the public sector's creation of an enabling environment for the private sector. At the same time, however, government should push ahead with increasing private participation in activities such as power, telecommunications, roads, and water supply which previously were the domain of the public sector. Care must be taken to ensure that the public interest is protected while profitable opportunities are made available to private investors, although I fully recognize that reconciling these objectives is not easy.

So complex and comprehensive a set of policy adjustments requires a parallel evolution of institutions, whether they be political, social, or economic. Administrative reforms can help establish a systematic process to increase the public sector's ability to adapt to this changing role. Improvements in the quality and management of institutions can be complemented by making them more accessible to the public and responsive to needs. And, appropriate decentralization of institutions can help make them more effective.

Recognizing the benefits from tapping the potential contribution of the private sector to economic development, the Bank is now placing much greater emphasis on private sector development around the world. Some of the highlights of the Bank's program are:
In 1988, we launched a private sector development action program. The number of operations with private sector development components has risen by a third. Between January 1989 and June 1990, 100 projects contained elements designed to improve the business environment.

The International Finance Corporation (IFC), the member of the World Bank Group which specializes in assisting the private sector, will take equity shares and make loans in participation with others to spread commercial risks. The Corporation can also contract to provide financial advice and services to investors.

A new member of the World Bank Group, the Multilateral Investment Guarantee Corporation (MIGA), has been created to guarantee various non-commercial risks borne by private foreign investors.

The Foreign Investment Advisory Service (FIAS), a joint MIGA and IFC organization, will help to identify investment opportunities and assist governments in improving investment codes and conditions.

A new Cofinancing Vice Presidency in the World Bank will seek to encourage private sector development projects. We have started work on a number of techniques which would make private involvement in major development projects commercial and bankable.

Our strategy is reflected in our assistance to Indonesia. Over the years the World Bank and the International Development Association have supported Indonesia with loans worth $16 billion in 200 operations. Since 1987, the Bank has made four adjustment loans totalling $1.2 billion to support the government’s adjustment efforts and reforms to improve the environment for the private sector.

Moreover, since 1971, the International Finance Corporation has approved $720 million of loans to, and equity investments in, Indonesian companies.

By way of closing, Mr. Chairman, let me return to Indonesia’s experience and ask what we can learn specifically that would be of value to other countries. Let me suggest three lessons.

One is that governments must commit themselves steadfastly to reform and carry the people with them. Change is rarely painless, and the room for maneuver in many developing countries is limited. Fundamental
change takes time. But change is essential and a clear vision and steadfast commitment is needed to maintain the momentum of reform.

A second lesson is that a stable macroeconomic framework has critical importance. Private enterprise will function most effectively if prices, budgets, and exchange rates are reasonably predictable. Governments will also be better able to devise and implement policy in such circumstances.

And third, we should remember that the public sector will continue to have a vital role to play even as it restricts its involvement in direct production. The public sector has to establish and maintain the regulatory and institutional frameworks that encourage sound private sector expansion. Prudential supervision of the financial sector and environmental regulations are cases in point. Moreover, the public sector can and should provide essential public services. Family planning, for example, has been an important factor in Indonesia’s economic success. Infrastructure, education, and health care are other areas where the government will continue to play a leading role, although the scope here for the private sector will grow.

Mr. Chairman, in his recent budget speech, President Soeharto said: “From the very outset we realized that equitable distribution without growth will only mean sharing poverty. Growth without equitable distribution means sharing injustice. And, without stability it will be difficult to have an equitable distribution and growth.

We should not pretend that pursuing this admirable strategy will be simple. Development resources will be tight during the 1990s. Official bilateral development assistance is virtually stagnant worldwide, and commercial bank lending to developing countries is recovering slowly, if at all.

So the pressure on resources means that the private sector must become the main motor of growth. There has been a tendency to underestimate how much private capital can be mobilized in even the poorest countries, given the right incentives. Moreover, domestic policies that inspire foreign confidence will open the doors to overseas capital.

But the importance of the private sector is not merely that it will unlock the door to capital—domestic or foreign—but rather that it will unleash the energies and entrepreneurial talents of the people to the maximum. Winston Churchill once said: “Some see private enterprise as a predatory target to be shot; others as a cow to be milked; but few are those who see
it as a sturdy horse pulling the wagon." Given adequate but not excessive rein, it is this sturdy horse which I believe will continue to provide momentum to Indonesia's economic progress and sustained growth.
It is truly a pleasure to be here with you today. This institution, the House of Commons, is a vivid symbol of democratic government. Year after year it has shown how freedom is nurtured by free elections and forceful, passionate debate.

In the past you have been a beacon for other nations that hoped for such freedom. Now as people in Eastern and Central Europe come closer to achieving the ideals of free government and free market economies, this body and governing bodies throughout the industrialized world will have to debate how best they can help see that process through to a successful conclusion.

It is impossible to understate the magnitude of the transformation we are witnessing. I want today to talk particularly about Central and Eastern Europe. But revolutions in Eastern and Central Europe have effectively changed the terms of political debate for all countries. No longer can we seriously think of two options for nations: one option of strong centralized authority; the other of free political action. Eastern and Central Europeans have forcefully opted for the latter. This is not simply a matter of replacing a few individuals in government or changing ideologies. Eastern Europeans have tossed out the authoritarian model. And that political change has fueled the economic change toward free market economies. The desire for a democratic and pluralistic system is setting the pace for economic change.

I want to share with you today my thoughts about Eastern and Central Europe—both enthusiasm for the process that is underway and my concerns about the problems that threaten to hold back and perhaps even stop this transformation. It is not just that we were too euphoric about the speed with which this transformation could be accomplished. That is undoubtedly true. The much greater risk is that without more concerted and determined support by the international community, the whole process of reform could fail.
These are clear lessons to be drawn from the experience we have already had. To start with, economic and social problems have seemed to multiply with every step towards a market economy. Every new step turns out to be more difficult and complex than had been expected. To this must be added the external shocks that these countries have had to endure, such as those precipitated by the Gulf War and the collapse of the Soviet economy.

Beyond this has been our underestimation of the weakness of the economic structures that these new governments inherited. The central planning system, with its inefficiencies, permeated the entire economic structure. Reversing that process, as Poles often say, is like turning fish stew into an aquarium. In this environment, it is difficult enough to undertake stabilization measures because their social consequences require careful and sensitive management. But the structural transformation is far more difficult. That involves more than just massive levels of new investment in machinery and equipment. It involves the development of new institutions in both the government and the private sector, and a new approach and mentality that is in consonance with a competitive and free market system.

Finally, we are discovering that the adjustment programs in Eastern and Central Europe are seriously underfunded. Several new governments inherited a large external debt; most have unstable economies. The levels of external assistance originally envisaged by western donor countries and the multilateral institutions will not suffice in the face of external shocks and the consequent deterioration in external trade, and the continued heavy burden of external debt.

In his New Year message this year, Vaclav Havel vividly described the hard realities that have confronted his Czech and Slovak countrymen and women. But he could have been speaking for all of Eastern and Central Europeans when he said, the heritage of the past few decades has proven worse than we could possibly have anticipated in the joyous atmosphere of those first few weeks of freedom. Each day brings new problems, and each day we realize how interrelated they are, how long they will take to solve, and how difficult it is to establish the proper order in which to deal with them.

Four Central Challenges

Let me describe in more detail four central tasks in the process of transforming these societies:
First, it is essential to create price competition. Buyers must have the flexibility to offer a higher price for a product they wish to purchase, and sellers must have the flexibility to offer a lower price for a product they wish to sell. That, after all, is a central feature of market economies.

Second, new firms and businesses, developed and built by private enterprise, must enter the marketplace to compete with the existing monopolistic firms. Unleashing this competition is also fundamental to a market economy. It will take time for competitive markets to develop, but there are certain actions that can be taken immediately to help it along. The restrictions of centrally planned targets, which dictated who would sell what to whom, can and should be removed immediately. Artificial barriers to trade and competition can be removed immediately. Poland, Czechoslovakia, Hungary, and now Bulgaria have moved quickly in this area. Finally, by opening domestic markets to competition from international trade, countries can quickly develop competition in goods that can be readily traded across borders.

Third is transformation of existing state-owned enterprises. Rapid privatization is the preferred course, but the difficulties in doing this have become clear as countries have embarked on the process. Original estimates of what could be done have been scaled back. In Poland in 1990, for example, the original goals of the government had been to privatize 150 state enterprises through public flotations on the stock exchange. By mid-year, the goal had been reduced to 75. In the end, only 5 were privatized in this way.

Faced with these difficulties, the governments have had to be flexible and creative. Hungary's approach offers a good example. It has four different mechanisms for privatization. In one, active privatization—mainly of large firms—is undertaken at the initiative of the State Property Agency. The second track allows enterprises to initiate the privatization such as buyouts proposed by enterprise management and/or workers. The third track is retail privatization or the sale of mostly small retail outlets and shops. This has moved quickly, as have similar programs in Poland and Czechoslovakia. Fourth, the State Property Agency recently announced a program of buyer-initiated privatization, under which the Agency will consider proposals by potential outside buyers.

Other countries in Central and Eastern Europe have also responded in new and innovative ways to the challenge of privatizing rapidly a large share of their economies. Programs under development include the well-known "voucher scheme" being developed in Czechoslovakia, the
“Participation Funds” being developed in Poland, and the similar “Ownership Funds” proposed for Romania. The goal of each is to transfer in a quick and fair manner a large share of state-owned assets to the citizens of the country. But as the details of these schemes have been worked out, the practical difficulties in implementing such schemes have become clear. They so far have not proven to be a quick short-cut to privatization.

While privatization of the bulk of the state-owned enterprises is the ultimate goal, the governments have increasingly recognized that this will be a long and complex process. In the meantime, public enterprises continue to function and must be managed. In many cases they will need to be restructured to operate in a competitive environment. Furthermore, as in all market economies, in certain sectors state-owned enterprises have a proper role to play. These firms will need to be as efficient as possible. In still other instances, it will never be possible to privatize certain of the enterprises, as their worth to an investor would be negative. Such firms will need to be liquidated. Years of effort will be required before these tasks are completed.

The fourth task of reform is reorientation of the role of the state. There will have to be a complete change in attitude and approach, from a mentality that the state should control all transactions, to a mentality that the state’s primary role is to create an enabling environment under which transactions can take place on the basis of free economic choice. In many ways it is this last area which may be most difficult to carry out, since it requires not only new institutions, but more fundamentally a new attitude. Eastern Europeans have made a promising start, but time will be required to ensure that the change in approach has been institutionalized and made irreversible.

Let me repeat here an important point. Economic transformation in Central and Eastern Europe is deeply embedded in the political process. Leaders need to do much more than select optimal technical solutions. They need to relate economic change to the principles and ideals that their people have embraced, even while the immediate cost in living standards is high. We must understand and appreciate the difficulty of this challenge. Let me emphasize: Bold, imaginative leadership is the only path forward under such conditions. External support for such leadership is both necessary and deserved.
Requirements for External Financial Support

The West has recognized the critical importance of these political and economic transformation programs and that they cannot be allowed to fail due to lack of external support. For this reason, western countries, along with the multilateral institutions, have pledged substantial technical and financial support. But it is now clear that the earlier estimates of the financial support that would be required have been overtaken by events.

On the basis of analytical work done in the Bank of the projected current account deficits of six East and Central European countries, we estimate their external financing requirements at roughly $9-10 billion a year, merely in order to achieve a moderate rate of growth sufficient for them to reach their 1989 levels of GDP per capita by the late 1990s. This estimate excludes scheduled amortization payments on debt which average another $11 to 11.5 billion a year until 1995.

Where will this money come from? We expect World Bank and IMF disbursements to average about $4 billion per year through 1995. Identified disbursements from other official and multilateral sources should average close to $3 billion per year. There is thus a gap of at least $3 billion a year up to 1995 for additional balance of payment support in accordance with the relatively low growth scenarios that I have outlined. There is in addition the need to restructure and refinance the heavy burden of debt amortization payments. The very important Paris Club agreement with Poland will reduce debt amortization payments by an average of $5.5 billion up to 1995 but there are other East European countries where this heavy burden of debt will continue to constrain reforms.

It is essential to understand that these larger financing requirements and the resulting worrisome gap in external support are not the result of half-hearted reforms. Eastern and Central Europe have shown a genuine commitment to reform. The reasons lie elsewhere. Let me explain.

First is the inherent difficulty of the transformation process. I have already touched on this. As the weak condition of the economic structures has become clear, estimates of investment needs have risen and estimates of the time required have lengthened.

Second, trade with the USSR has collapsed. Under the previous system, the countries of Central and Eastern Europe were led to a high level of dependence in their trade with the Soviet Union and on each other. In
terms of exports, the Soviet market alone accounted for from 20 percent to 50 percent of their total worldwide exports. Their exports to their CMEA partners ranged from 33 percent to 80 percent of the total worldwide exports. The impact was therefore severe when the unforeseen economic difficulties in the Soviet Union led to a sharp drop in trade this year. We estimate the collapse of trade with the Soviet Union and within the CMEA will reduce trade volumes by between 33 percent to 60 percent for the individual countries of Eastern Europe in 1991.

All of this, of course, comes on top of a sharp deterioration in the terms of trade with the Soviet Union, which we did anticipate. Briefly, East and Central Europe used to sell overpriced manufactured goods to the Soviets for oil and raw materials. Now that the trade is valued at international prices, we estimate Eastern and Central Europeans will suffer a trade loss of $5 billion this year alone.

There are natural complementarities between the economies of the Central and Eastern European countries and the Soviet Union. Trade between them is highly beneficial to both. Over the long run, and as the economy of the USSR stabilizes, we expect these natural complementarities to reassert themselves. But in the short run, the collapse of trade with the USSR has been an important shock to these economies. Some way must be found to compensate for it. Consideration would be given to innovative tripartite schemes, where western loans provided to the Soviet Union would be used to finance the purchase of goods from the countries of Eastern Europe.

The third unexpected development is the Gulf Crisis. The effects of this crisis on the economies of Central and Eastern Europe have been large. Some have been on-time, for example the seven-month rise in oil prices. We estimate the cost of this to the economies of Central and Eastern Europe was about $4 billion. But some are more permanent, such as the loss of export markets in Iraq that were previously important to several of the economies of Eastern Europe. We estimate the cost of these nonoil effects to total about $5 billion in 1990–91, with these costs continuing into future years as well.

As a consequence of these unanticipated shocks, coming at a time when these countries are in the midst of their reform programs, the decline in output in these countries has been especially severe. The cumulative 1990–91 declines we now estimate will total from 12 percent to 16 percent in the cases of Hungary, Poland, Czechoslovakia, Romania, and Yugoslavia, and perhaps almost 30 percent in the case of Bulgaria. There
are measurement problems in these estimates, in that they do not capture private sector activities well, nor do they really reflect differences in product quality. However, there can be no doubt that there has been a sharp and massive and disturbing decline in total output.

Our projection of $9–10 billion in balance of payments support, I must caution, is conservative. It assumes matching 1989 real per capita income levels in the late 1990s and the recovery of real consumption per capita levels also no earlier than towards the end of this century. If we wish to accelerate growth and consumption and reach these levels by 1995, then financing requirements would be significantly higher. We estimate a total of about $5 billion more per year.

A reassessment of the financial support these countries require is critical right now. The original estimates have turned out to be too low, in part due to unforeseen events. The programs as they now stand are vastly underfunded, and yet promise only a very modest recovery in growth. It is not clear how long such a situation can be sustained before the social tensions become unbearable.

What the World Bank Has Been Doing

The World Bank has, of course, been actively involved from the start in assisting the authorities of Central and Eastern Europe in the implementation of their reform programs. What is perhaps easiest to point to is the overall level of lending that the Bank has approved in support of these programs. In our fiscal year just completed, the Bank approved a total of $2.9 billion in new loan commitments to the six countries of Central and Eastern Europe that are members of the Bank. We expect lending to continue in the range of $2.5 to perhaps $3.5 billion per year over the foreseeable future, made up of about 15 to 20 discrete project operations per year. Taking a perspective of five years or more, this would mean the Bank will be the largest single provider of funds to these countries.

In addition, and more importantly, the Bank has perceived its most important contribution to be in the area of technical assistance and advice to assist these governments in the design and implementation of their programs. This has been done through the regular economic and sector analytical work of our staff, but also, most intensively and clearly, in the context of the specific loan operations we have provided these countries. The following are some examples of what we are doing to tackle the four tasks I mentioned above.
First, the programs that we have supported have envisioned an early and rapid liberalization of prices. Specifically, price liberalization was a key area of the Polish and Czechoslovakian Structural Adjustment Loans (SAL); and of similar loans for Bulgaria and Romania that are now under preparation. By comparison, a more phased approach to price liberalization has been followed in Hungary and has been supported by a World Bank SAL.

Ending imposed barriers to competition, both domestic and international, has also been a key element of these early reform efforts. The Bank has worked closely with the authorities in defining the precise actions necessary to remove the imposed barriers to competition. The dialogue on this has been particularly close in the area of barriers to competition from international trade. Specific actions in these areas were key elements of the SAL operations in Poland, Czechoslovakia, Hungary, and—prospectively—in Bulgaria and Romania. In Yugoslavia, there was a promising start on such a program in 1990, but the current political difficulties have put this program on hold.

The Bank has worked particularly closely with the authorities in assisting them in the development of their privatization and enterprise restructuring programs. The overall framework for these programs was addressed in the initial SAL operations for each of the countries. But as I noted above, implementation of these programs will take time. Two Bank operations, one just approved by our Board for Poland and Hungary now in an advanced state of preparation, focus directly with the authorities in establishing detailed, practical and implementable programs to achieve their privatization and enterprise restructuring objectives.

As part of the Bank’s support to these restructuring programs, I should also note two other areas where the Bank has been active: establishment of a social safety net and financial sector reform.

As I have mentioned, establishment of a viable social safety net has to be a key element of the overall reform programs. Both in the SALs and in specific project operations, we are helping the governments in the establishment and implementation of workable programs that are designed to protect vulnerable groups in social and economic adjustment. The $100 million Employment Promotion Project for Poland is among the first of these, and will assist the government of Poland in establishing a network of employment centers that provide information on job opportunities, retraining services, and distribution of unemployment benefits.
In the area of financial sector reform, many of the countries are starting from scratch in developing viable, market-based, financial institutions that are critical to the functioning of competitive markets. The government has an important regulatory role to play in this sector especially since existing financial institutions are burdened with a large portfolio of loans of questionable worth. The Bank is working with the authorities on appropriate financial sector reforms. Specific operation in this area include the $66 million Financial Systems Modernization Project for Hungary, and the $200 million Financial Institutions Development Loan for Poland.

The last, but perhaps most important task is the need to redefine what the role of the state will be in a new market-based system. Governmental authorities must accept that the role of the state is not to control directly all transactions but rather to create a proper enabling environment in which transactions can be carried out on the basis of free choice. The Bank has been working with the authorities to define precisely what it means in practice.

**The Role of Others**

I can say most emphatically that we will do our best to continue addressing these tasks and to increase our levels of funding. But others will have roles to play too. The industrialized nations must do everything possible to promote trade. The financing needs I mentioned are high in part because of export barriers imposed by the West. This applies particularly to agricultural products and certain industrial products such as textiles and steel. Trade is crucial to building a viable economy and it is certainly not in the long-term interest of the western economies to impose such constraints on trade. And in the short-term, such constraints are increasing the risks the reform programs of Eastern Europe are facing.

An additional urgent issue is speedy resolution to the debt overhang problem that several of these economies face. Resumption of normal commercial financial flows will not occur until these problems have been resolved in some realistic and sustainable way. As I mentioned, there has been an important start on this in the case of Poland. Bulgaria, Hungary, and to a lesser extent Yugoslavia, all face significant debt burdens. How they should be best resolved will differ by country. Hungary, for example, has chosen not to request a rescheduling of its debt. So far at least it has enjoyed sufficient access to the markets to sustain its program (although not without avoiding a steep drop in output). For Bulgaria, on the other
hand, it is difficult to see how a sustainable situation will be possible without some reduction in the stock of debt owed.

Yet a third step is the provision of more capital. The new European Bank for Reconstruction and Development has a role in that. So do bilateral donor agencies. But most important in the long-term is direct foreign private investment.

In the long-run it is only the private sector that will be able to provide financing on a sustainable basis at needed levels. The transformation programs being attempted in these countries will only succeed if these countries have obtained access to private sources of external finance. And this finance will need to be in an appropriate mix of loans and equity.

Many things will be required for this. One, as was noted above, is to alleviate their external debts. In addition, the countries will have to adopt policies conducive to private sector investment. Restrictions on foreign investment are obviously inconsistent with the encouragement of such investment.

The need for direct private investment is of course clear in areas where the private sector is expected to pay a dominant role, such as industry, agriculture, retailing, and banking. But it will also be important in areas that are traditionally the responsibility of the public sector. This includes such areas as transport, water and sewerage, gas networks, power, and the environment. The investment needs in Eastern Europe in these areas of government responsibility are simply too massive to rely on official sources of finance alone. At the same time, all parties wish to avoid the mistakes of the past, where lending by private commercial banks to governments for general budgetary support or for ill-conceived projects led to the debt crisis now afflicting these countries.

New and innovative approaches and mechanisms will be necessary to deal with this problem. One possible solution is financial structures that split up the various risks, and assigns those risks to the party best placed to manage them. Thus contractors and commercial lenders would bear the commercial risks, such as cost overruns on the construction of the projects. Governments, through a guarantee, would bear the consequences of changes in public policies, such as those arising from controls on power tariffs or the imposition of exchange restrictions.

Other schemes are possible, and appropriate in particular situations. More generally, there is a need to establish an "umbrella" framework of
some sort, under which private funds for appropriate investments can be mobilized. What is appropriate in a particular case will vary; what is important is that the options be approached with an open mind, and adapted as required.

The World Bank has long experience in the implementation of traditional public infrastructure projects. It also has the capacity to deploy both direct funds as well as guarantee powers in support of innovative structures for the financing of them. The International Finance Corporation of the World Bank Group can provide loans or guarantees to, and take equity positions in, private sector entities that might be established to implement such schemes. The recently established Multilateral Investment Guarantee Authority of the World Bank Group can guarantee the investments of private foreign entities from acts of governments that would appropriate these assets. Recognizing the important role of the private sector, the World Bank Group is taking steps to further strengthen its catalytic role in promoting the inflow of private capital.

The challenge of Eastern and Central Europe is one that the international community must face collectively. Its implications go far beyond the fortunes of Eastern and Central Europe and will undoubtedly shape economic policies elsewhere in the developing world. The agenda of reform has been set by a new generation of political leaders who have chosen the path of freedom over authoritarianism. In view of the political momentum that has been generated, I feel confident that the East and Central Europeans will not falter in this endeavor. The Bretton Woods institutions are making a major effort. It is vital that the rest of the international community does not shirk its responsibilities. This transformation cannot be allowed to fail.
It is a pleasure to meet with you today at the annual business conference of ICARE. I think that the institution to which I belong, the World Bank, and the prominent financial and business enterprises represented here today share many common interests—and must discharge many common responsibilities. Foremost among our joint concerns is restoring economic growth in Latin America. That is why I have entitled my presentation this afternoon “Overcoming the Latin American Economic Crisis.”

The continuing crisis in Latin America is a matter of grave concern to us all. It has imposed great hardships on the people of your region and, of course, it has had an adverse impact on the global economy as a whole. One might characterize the present situation in most Latin American countries as one of

- negligible per capita GNP growth;
- depressed per capita consumption levels;
- low investment;
- high external interest payments, which drain away limited domestic savings; and
- high inflation.

This serious situation has persisted since 1981 and, as you know, so far there are only a few signs of resumed growth in Latin America. However, in the last two years there have been some areas of progress both in Latin America and at the global level, notably:

- GDP growth in the OECD countries has moved from a negative rate in 1982 to 2.6 percent in 1983 and 4.8 percent in 1984, the latter led by a real growth rate of almost 7 percent in the U.S.
Many heavily indebted countries have affected a substantial improvement in their external balance. For example, the aggregate current account deficit for all middle-income developing countries was brought down from $93 billion in 1981 to $28 billion in 1984. Among the ten largest debtors, the swing was even more dramatic, from current account deficits which totalled $110 billion in the period 1980–82 to deficits which totalled $10 billion in the period 1983–85.

In association with IMF programs, rescheduling agreements have been negotiated involving more than $160 billion in commercial bank debt. Many of these have covered debt maturing over several years, including the multiyear serial rescheduling agreement with Chile, signed on November 1. In some respects, progress in completing such agreements has been frustratingly slow. But, whatever one feels about the progress to date, at least a collapse of the international financial system has been avoided.

These successes must be set against a number of continuing problems in Latin America. First, for many countries in this region, much of the progress in reducing current account deficits has resulted from a severe compression of imports and reductions in consumption, investment, and growth. For many countries, debt to export ratios have not actually improved.

Second, many Latin American countries have not been very successful at restoring internal equilibrium through appropriate fiscal and monetary policies. Not enough has been done to reduce inflation and restore incentives for domestic savings and investment. And third, despite major efforts at stabilization by many countries, their access to external capital on a voluntary basis has not yet been restored.

The experience of these last few, difficult years has taught us all several things. In no way is the debt crisis a short-run problem amenable to quick fixes. We are not dealing with the kind of balance of payments disequilibria which can be corrected by a traditional program over two or three years, after which normal credit relationships are restored. We have all learned how vital it is to be innovative and flexible in dealing with debt problems, and to handle them case by case. And we have seen that, although almost all developing countries have been severely hurt by external developments, the degree to which particular economies suffered and the speed with which they have recovered has been strongly influenced by their own economic policy decisions.
What, then, is to be done to overcome the economic crisis in this hard-hit region of Latin America? I would like to address that broad question in three parts:

- First, the international economic outlook. The prospects for Latin America will be significantly affected by economic developments in the industrial countries. What can we expect?
- Second, the Latin American region. The issue here is: What policies are needed to restore growth?
- Third, the international financial community, notably the commercial banks and the Bretton Woods institutions. How can they contribute to the recovery process in Latin America?

First then, the global economy. Its direction depends primarily on the policies of the major industrial countries. I think that there are three areas where improved policies are fundamental for sustained recovery. These are the reduction of fiscal imbalances, particularly in the U.S.; the reduction of structural rigidities in labor markets—a particular concern in many European countries; and resisting, if not reducing, protectionism.

Given good progress in each of these areas, the World Bank projects that GDP growth in the industrial countries over 1985–90 could average 3.5 percent a year. In the developing countries, assuming a resumption of adequate net flows or external capital, we see a potential for export growth of 6.7 percent a year, and a GDP growth of 5.5 percent a year overall. With this kind of growth pattern—and assuming real interest rates average 2.5 percent—debt service payments of the developing countries as a percentage of exports would decline, even though outstanding debt would grow at about 5 to 6 percent a year.

We believe the potential is there, provided the three policy areas I have mentioned evolve in the right direction. Unfortunately, this is not the case at the present time. Indeed in recent months we have seen a rising sense of apprehension about the economic outlook and, in particular, the debt situation with the threat it poses to the well-being of the developed countries and to the health of the global economy. Why?

An obvious consideration is that economic growth in the industrial countries has slowed down and will probably register about 2.5 percent for the whole of 1985, about half of last year’s figure. As a result, there has also been a marked slowdown in the growth of exports from devel-
oping countries. In the case of nonoil developing countries, for example, we expect their exports to increase this year by less than 2.5 percent in value terms, compared to 9 percent in 1984. Another adverse factor is the downturn in commodity prices, which have fallen back to the extremely low level reached during the depth of the global recession in 1982. For many commodities, including copper—a special concern for Chile—it is clear that secular changes in supply-demand balances have occurred which mean that significant recovery in price levels are unlikely.

The situation with fiscal imbalances is still very serious. The American deficit remains extremely large, resulting in substantial borrowings by the U.S. Treasury and thus keeping interest rates higher than they need be. Yet a couple of recent events hold some promise. The U.S. Congress seems more determined to tackle the deficit issue, having recently agreed in principle to some medium-term deficit reductions. Also we can take heart that the five largest industrial countries, meeting in New York on September 22, agreed that they would pursue greater convergence of economic performance. This should mean that, as the U.S. reduces fiscal stimulus as part of a deficit reduction plan, Europe and Japan will commit to more expansionary economic policies.

As for the international trade picture, we can see how continued slow growth and sustained unemployment in Europe, plus the growing trade deficit in the U.S., have strengthened protectionist pressures. We read about new barriers, or the threat of them, almost every day. Nonetheless, the situation is not entirely bleak. We can be encouraged by the increasingly firm posture of the U.S. administration against protectionist measures, evidenced by recent decisions on cooper and shoe imports.

It is also gratifying that there is greater movement toward initiation of a new round of GATT multilateral trade negotiations. And we can hope that the recent depreciation of the U.S. dollar will reduce the pressure for more protection against imports from developing countries. The truth is that many industrialised countries need to take measures of structural adjustment in the fields of trade and industry which are often as difficult, and painful, as the measures applied in developing countries.

In fact, the depreciation of the U.S. dollar is one of two recent events that should help to ease the burden of developing country debt. The other encouraging event is the sharp fall in nominal and real interest rates over the past year, although they still remain high by historical standards. Part of the renewed anxiety about debt may in fact reflect fear that an
excessively rapid depreciation of the U.S. dollar—before substantial progress has been made in reducing the U.S. fiscal deficit—will trigger a sharp resurgence in U.S. interest rates. This would likely provoke another recession, thus aborting the chances for renewed economic growth. But recent developments make this scenario less likely, and, on balance, the international outlooks is now more encouraging than just several months ago. The governments of the developed countries certainly bear a heavy responsibility to ensure that international economic recovery can be sustained and strengthened.

As I have already indicated, developing countries can substantially shape their own economic outlook. And this can be achieved even though economic policy in the industrialized countries has such a large impact on the world economy. What are the “right” policies for the developing countries? At this stage, it is very evident that many Latin American countries are suffering from “adjustment fatigue” and have reached the limits of policies which compress imports, consumption, and investment. It is clearly necessary to enter a new phase in coping with the debt crisis. The objective is twofold: first, restoring growth without jeopardizing external balance. That calls for a strategy of “adjustment with growth;” second, restoring this continent’s normal access to international credit.

Access to international credit is an essential objective, because for a long time to come Latin America must be able to tap savings in capital-exporting countries so as to finance its own economic development. The continent will remain, and indeed should remain, a net borrower. Any other scenario is inconsistent with the imperative of growth. The corollary of this is quite clear. It is that, if the countries of this region want to grow as rapidly as possible, it is in their long-term interest to help maintain a viable international financial system. To repudiate obligations to that system is to significantly damage opportunities for long-term growth.

“Adjustment with growth”—it slips off the tongue easily enough, but what does it imply in terms of appropriate policies in Latin America? Perhaps four rhetorical questions will help at this point:

- First, is there a necessary conflict between adjustment and growth? I pose this as a question because some of you may be inclined to think so.
• Second, how can growth resume when there are such limited resources available for investment? Some argue that the burden of debt service, which drains away such a large part of domestic savings, makes growth impossible.

• Third, in the present international climate, is export-led growth really feasible? As I mentioned earlier, protectionism in the industrialized countries is a persistent worry.

• Fourth, can growth take place with high inflation? I ask this question because inflation is such a familiar part of the scenery of this continent.

To rephrase my first question: Are adjustment or stabilization programs which are dedicated to achieving a viable external balance necessarily inimical to growth? Let me tell you why I believe they are not.

• First, it should be understood that adjustment is inescapable when external financing is curtailed and exports fall. In the short run, this adjustment usually means cutting imports. In this first stage, the only choices involve how to cut imports, and almost all choices mean lower consumption, lower investment, and slower growth. But for many countries this first, harsh phase of adjustment is now over.

• Second, over a medium-term horizon, adjustment with growth is possible. Reallocation of production toward exports, switching consumer demand away from imports, and improving efficiency throughout the economy will create an economic structure which can expand without causing unsustainable current account deficits.

Throughout this process of restoring growth, sound macroeconomic policies which are integral to stabilization programs remain essential. Fiscal discipline is required to ensure that public borrowing does not crowd out private investment. Monetary discipline is needed to forestall an inflationary environment which kills savings and investment in productive assets. And a realistic exchange rate is needed to ensure that export growth can outpace import growth.

The second question I posed, you will recall, was how to restore growth when investment resources are so severely constrained. In this connection I would make five points:
• First, despite the fact that a large part of domestic savings will be needed to service Latin America's huge debt, there is still considerable scope for increasing domestic savings and hence investment. But this requires disciplined public budgets and a set of policies—especially on interest rates and exchange rates which encourage private savings and discourage capital flight.

• Second, given Latin America’s resource constraints, enhancing the efficiency of existing capital stock is critical. Indeed, an essential element of structural adjustment must be the search for greater efficiency. A great deal can be done in the area of public enterprises, where inefficient operations and low productivity are widespread. The Mexican Railways’ physical productivity has been raised 30 percent with the assistance of the World Bank. Similar improvements in productivity might be achieved in a great many public enterprises or sectors in the region. From many public corporations, divestiture—perhaps with foreign participation—may be the best route to greater efficiency.

• Third, better investment is perhaps more important than more investment. So much of public investment in Latin America during the late decade was not guided by sound economic criteria. Among medium- and large-sized Latin American countries, Chile is notable for having established a screening process for all public investment proposals of significant size.

• Fourth, the points I make about greater efficiency and better investment in the public sector can also be made about the private sector. Dismantling regulatory controls, eliminating price distortions, and establishing a liberal trade regime should have high priority in a program to increase private sector efficiency.

• Fifth, a far too high proportion of savings is regularly drawn into the public sector to finance the inefficiencies and deficits of which I’ve been speaking. Because budget deficits must be financed by internal borrowing, we witness real interest rates like 6 percent per month in Argentina or 25–30 percent per year in Brazil. Such high rates far exceed the likely rates of return of most potential private investments. Private investment is crowded out by public deficits at a high cost to an economy’s overall efficiency.

And now my third question, about the feasibility of export-led growth. Certainly, the outlook for primary commodity exports, which are impor-
tant to Latin America, is not promising. We expect annual trade growth in copper, coffee, sugar, bananas, and cocoa, for example, to be 1.5 percent or less. Even the forecasts we have for trade growth rates of 3 to 5 percent for beef, corn, and soybeans fall far short of what Latin America requires.

The truth of the matter is that export-led growth must come primarily from manufactures. This is a formidable task for most Latin American countries, requiring quite radical shifts in the incentive systems and, in most cases, in physical and service infrastructures. Many countries of the region must reform their trade regimes so as to strongly discourage investment in non-competitive, import-substituting industries and encourage investments in export industries. I know it takes political determination, and it takes time, but it must be done.

Exports are vital for several reasons. First, as already stressed, they are vital to improving debt-servicing capacity and in restoring creditworthiness. Second, while budget deficits are being cut and interest rates are high, exports provide one of the few, and in some countries the only, sound source of growth in output and employment. Third, since they add to the volume of production and hence make possible economies of scale, they stimulate improvements in productivity.

In fact the historical record shows that policies to promote exports have worked in Latin America when they were tried in earnest. Let me cite a few examples. Between 1975 and 1978, Argentina’s manufactured exports grew almost 40 percent annually. In Chile manufactured exports grew at an annual rate of 34 percent from 1975 to 1979. Both Colombia and Mexico enjoyed periods of about 35 percent growth in manufactured exports in the early 1970s.

Of course, the threat of protectionism is a serious worry for a strategy of export-led growth. But recent evidence shows that Latin American manufactured exports can grow much more rapidly than the OECD economies as a whole. For the two years ending in the first quarter of 1985, Latin American exports of finished manufactures to the U.S. grew at the astounding rate of 81 percent per year. Although this was admittedly from a low base, it was a more rapid growth than enjoyed by the vaunted newly industrialized countries of Asia!

My fourth question was about the impact of inflation on growth. It may be true that, in theory, a stable rate of inflation, combined with index systems such as we have seen in Latin America, does not undermine development. But the fact is that “stable inflation” cannot be achieved
Dramatically fluctuating inflation rates result in distortions in and uncertainty about price relationships, seriously damaging efficiency and destroying the confidence of savers and investors. There are many other reasons why inflation matters, not least because people believe it matters. The monthly inflation rate is in effect a barometer for confidence in government performance. And when that confidence is low, growth suffers too.

There is one more economic policy issue on this continent about which I want to make a forceful plea. I cannot overemphasize the importance of a healthy, buoyant private sector to Latin America's future. Many governments have expressed their intentions to free up the private sector so that it can play a full role in development. Yet in practice many of the same old controls and obstacles remain in place. I don't think this situation can continue, because frankly the moment of truth has arrived. In most countries in Latin America the public sector is much too large and much too inefficient and far too costly in terms of its drain on national budgets. In many sectors, private enterprise is quite capable of doing a better job both in economic and social terms.

I see a growing consensus in the developing countries as well as in the international community that structural adjustment programs must:

- on the one hand, address the need to reduce the excessive presence of the public sector in national economies, diminish the influence of politics in decisionmaking, and overcome conservative and bureaucratic resistance to change;
- and, on the other hand, introduce heavy reliance on profitable, competitive private enterprise regulated by the markets as the most effective road to wealth creation and economic growth.

The essential elements of this approach are twofold. First, there must be practical programs that reduce government intervention in the economy and that encourage entrepreneurship by permitting the play of real market mechanisms and competition. Freeing up prices, stimulating competition, and rewarding efficiency are all policies which pay for themselves time and time again. Living in a closed world of controls, regulations, and protection is self-defeating. And so is an environment which is indifferent to private investment, whether domestic or foreign.

Second, support for these changes can come through a coordinated program providing financial and technical assistance by the commercial
banks, by the IMF, and of course by the World Bank Group, which I should remind you includes our "risk-capital" affiliate, the International Finance Corporation. In particular, within a supportive country policy framework, we will give a vigorous thrust to our operations with regard to corporate restructuring and privatization, and promotion of private investment.

Such programs can be initiated in a number of important developing countries that have major debt problems. It is not necessarily new investments that are at the top of the agenda, but often rehabilitation of existing infrastructure and the modernization of maintenance and support systems conducive to attracting and facilitating private investment. To succeed in these endeavors, there must be strong leadership in the country willing to cooperate with the international, official, and private financial community. As businessmen prominent in Chile's affairs, I am sure this part of my message to you does not fall on deaf ears.

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I have spoken about the policies required in the industrial countries and in the Latin American region. So now I wish to examine the role which must be played by the international financial community in assisting this continent in the process of adjustment with growth. This is a timely issue, for following the Annual Meetings of the World Bank and IMF last month in Korea, both institutions were given a clear mandate to help mobilize more international support for your efforts to resume growth.

Commercial banks hold the great majority of Latin America's debt of over $360 billion. Since the onset of the debt crisis in 1982, they have generally provided new funds only in the context of concerted—or involuntary—lending packages in association with IMF programs. But, because growth has not been restored, it has become increasingly difficult to arrange new money packages for Latin American countries. In 1984 commercial banks increased their exposures in Latin America only about 0.7 percent, and indications are that in 1985 the net change will be negative.

This trend must be reversed. Although commercial borrowing cannot be a major source of funds for investment and growth, it must at least make a positive contribution. This is clearly in the interest of the banks themselves as well as the indebted countries. But as the term "involuntary lending" implies, the relationships between the heavily indebted countries and the commercial banks have not been easy. In the past three
years the IMF has played a crucial role in facilitating reorganization of debt and net flows of funds.

The international financial institutions can continue to play a useful role vis-à-vis the commercial banks as Latin America moves into the phase of adjustment with growth. The IMF will continue to monitor sound macroeconomic policies which, as I have said, remain critical. But we expect the World Bank programs will assume added importance as emphasis shifts toward growth-oriented policies over a medium-term horizon. This is the area of our expertise and the appropriate target for our long-term lending.

For this reason our strategy in Latin America must rest on two foundations. First, we must assist you formulate satisfactory programs of adjustment and more rapid growth. That’s a requirement for attracting other lenders! Second, we must help you mobilize the external resources necessary to sustain these programs. This has been an explicit policy objective of the World Bank even before U.S. Treasury Secretary Baker made his important proposals in Korea last month. In essence, he described a three-part scenario, where the developing countries implement adjustment programs in concert with enhanced lending from the international financial organizations and from the commercial banks.

We very much welcome this initiative, and the intention to increase the resources of the World Bank it implies. It will enable us to do a bigger and better job in helping countries along the path of structural adjustment. Already, in recent months, we have taken a number of important initiatives in Latin America, such as the following.

In Colombia we have made a $300 million loan in support of a trade adjustment program. On the basis of a medium-term program which we worked out with the government, and the IMF’s endorsement of its short-term stabilization program, more than 200 commercial banks have agreed to restore Colombia’s access to credit, providing a more secure basis for continued growth. Another example is in Costa Rica where our structural adjustment loan was both supportive of the government’s trade reform plans, and instrumental in mobilizing additional external resources for the government. And in Uruguay, we are now in the process of negotiating and arranging a private cofinancing operation which will help with multiyear rescheduling of Uruguay’s debt.

Closer to home, here in Chile a recently approved structural adjustment loan will support the government’s 1985–87 program of economic adjustment and recovery. It represents the cornerstone of the Bank’s
present lending strategy in Chile, supporting a gradual restoration of economic growth while the country services its external debt.

This structural adjustment loan, along with World Bank guarantees of commercial loans for road sector development, helped assure the success of Chile's negotiations with its commercial creditors. It represented the culmination of joint discussions and analyses with the Chilean authorities, and in close cooperation with the IMF, on measures required to improve export incentives, generate strong domestic savings, begin to rehabilitate the finances of the industrial and banking sectors, and increase productive employment. Our loan and guarantee package addresses, therefore, the major structural obstacles to sustained economic and social progress in the country.

The process I have described is complex and fraught with difficulty, but I hope the linkages are clear:

- To restore growth without further jeopardizing their external balance, the Latin American economies must go through a difficult process of adjustment.

- To move onto a track of adjustment with growth, Latin America must mobilize new resources for investment and use them as prudently and efficiently as possible.

- The process of resource mobilization requires continued flows of external capital. This in turn requires well managed economic recovery programs, focusing on export-led growth and thus giving each country the potential to enhance its own creditworthiness.

- Improved export performance depends on a well functioning system of international trade. Hence the need to use all possible means to roll back protectionism.

I must repeat: the agenda is not easy. It requires commitment from all sides. From debtor governments. From industrialized countries. From commercial banks. And from the international financial institutions. We at the World Bank are ready to help in this task.
A visitor to India—even one honored as I am by your invitation to discuss economic policy issues—is probably best advised to keep his eyes and ears open and his mouth shut. I am sensitive to the double risk I take today. For I intend to presume on your hospitality with some observations and suggestions. I do so because you have accorded to me the privilege of delivering the Shri B.F. Madon Memorial Lecture which aims at bringing certain important economic and financial issues into the domain of public discussion.

Returning to France from the Soviet Union some fifty years ago, André Gide concluded his impressions of his visit with a lament that his hosts “did not want information from us, but praise.” I have come today to offer both—in the conviction that India deserves not only congratulations but constructive criticism as well.

After all, no nation in this century faced greater challenges in overcoming and rising from poverty and backwardness than did India at the time of Independence.

The task of converting an intensely poor, overwhelmingly agrarian society into a modern nation state and of preserving democracy and social justice at the same time was, and is, formidable.

So important and inspiring was your undertaking that concerns about India’s development dominated the early thinking in what has become known as “development” economics. Indeed, India’s problems became synonymous with the problems of the developing world. And from that time to this day, India has held a special place in the hearts and minds of those who care about development.

Not surprisingly, the early evolution of the World Bank coincided closely with the development of post-independence India. The first of the Bank’s nearly 300 loans and credits to India (and the first to any Asian nation) was made in 1949. The contribution made by India to the theory and
practice of development has been immense, and the World Bank has often acted as a conduit to pass on the lessons of Indian experience to other countries and other continents.

Both India's debates on strategy in the 1950s and 1960s and India's actual accomplishments, had a significant influence on the Bank's perceptions of the roles of irrigation, power, transport, and other infrastructure investment in the development process, as well as agricultural research and extension. Our long and constructive association with India has brought much of value to the philosophy of the Bank, to its emergence as a development institution, and, not least, to the high quality of our staff.

It was in India that the World Bank began the inventive, vital practice of coordinating external resource flows from the donor community to developing countries through aid consortia or consultative groups. India's need for concessional assistance was a major impetus behind the birth of IDA. And Indian experience with technological change in the "Green Revolution" led to another Bank initiative, the creation of the Consultative Group on International Agricultural Research (CGIAR).

Finally, in the realm of ideas, we must not forget the influence of Pitambar Pant's original contribution to planning for poverty eradication—a contribution that anticipated much of the subsequent work on basic needs and food security.

India is important in the story of development, not just for what it stimulated others to do, but for what it has achieved itself.

India's Performance

By many measurements, India's performance over the past four decades has been remarkable. When Indians took control of their own destiny, they inherited a country which had been suffering a long period of stagnating, if not declining, per capita income and falling per capita food grain production. At the time of independence, nearly 85 percent of the people lived in villages and were involved in traditional, low-productivity agriculture. The industrial sector was relatively small and dominated by agriculturally-based production. Only about 15 percent of the population was literate, and the majority of primary school age children did not attend school. Nutritional levels were inadequate, communicable diseases common, and mortality rates high.
Despite these tremendous handicaps, India has since managed to accelerate the growth of output and per capita income. It has sustained positive rates of growth of per capita foodgrain production and become self-sufficient in foodgrains. The government's ability to use its large foodgrain reserves to prevent severe hardships during the recent drought is convincing proof that the secular rhythm of drought and famine has been broken. At the same time, the industrial structure has been broadened and deepened. And, especially considering the starting point, remarkable progress has been made in improving indicators of social well-being. Indians have launched massive programs to bring social services and productive employment to the poor. And, perhaps one of the most important accomplishments since independence has been the creation of a cadre of highly skilled men and women in the sciences, engineering, social sciences, the arts, management, and public administration. Such trained manpower is the envy of other developing countries. It should be an example to some industrialized countries as well.

All this has been accomplished while preserving a vibrant democracy, without the sacrifice of national unity or foreign policy goals.

While India has not enjoyed the spectacular growth of some East Asian countries, its long-term per capita growth rate has been relatively steady and significantly positive. It has, moreover, exceeded the average of all low-income countries by a substantial margin. Between 1965 and 1986, India's per capita income grew by 1.8 percent per annum, while the (unweighted) average for all low-income countries was about 0.6 percent.

In the 1980s when the growth of many countries, including such high flyers as Brazil and Mexico, has been hobbled by debt crisis and inflationary episodes, the underlying growth rate of India's economy has accelerated into the 5 percent to 6 percent per annum range, well above the trend of growth. This progress is a tribute to prudent macroeconomic management and to overwhelming reliance on domestic, rather than foreign saving, to finance India's development. And self-help has not spelled economic isolation. During this period India has also shown that its industries can compete successfully in world markets.

Yet, despite this impressive record, Indians and their friends abroad feel a profound sense of disappointment and unease about the future. The goal of eliminating poverty seems as far away today as it was 40 years ago. The more rapid growth of the economy in recent years, the massive schemes of job creation and asset acquisition by the poor, the strong and effective food distribution system, which moderates the effects of a bad
harvest, have probably produced a percentage decline in the population below the poverty line. Yet, the sheer number of people living in absolute poverty, some 280 million by official estimates, remains staggering.

While substantial progress has been made in building a modern economy, much remains to be done. Too much of India’s industrial sector remains inefficient and technologically backward. Too few products meet international standards of price, quality, and reliability. Some of the output of the major basic or strategic industries—steel, petrochemicals, coal, and non-ferrous metals—is so expensive that it raises the cost structure of the entire industrial sector. High prices tax consumers and discourage exports. Despite massive investment programs, bottlenecks in transport and persistent power shortages hamper industrial growth.

**Prospects and Priorities**

The two fundamental reasons for the persistence of poverty in India are: The continued high rate of growth of population and the fact that the economy has not grown fast enough and long enough to provide above-subsistence income earning opportunities for the poor. If real GDP had grown at 5 percent per year since independence, rather than at the historical rate, per capita income would be approximately 47 percent higher than it is today. If, in addition, the population growth rate had been only half a percent lower than it actually was, i.e. 1.7 percent, per capita income would be over 60 percent higher. Assuming income distribution did not worsen during this period, then only 10 percent of the population would be below the poverty line today, instead of about a third at present. On these assumptions, the ranks of the poor would have been cut by about 200 million people.

The government of India has made “Virtual Elimination of Poverty by the year 2000” one of the principal goals of its development strategy. Hitting or even approaching this target will require sustained economic performance substantially above historical norms. Simple projections assuming distribution-neutral growth, indicate that rapid progress would require per capita income growth in the 4 percent to 5 percent per annum range. At present rates of population growth, GDP growth would have to sustain rises of 6 percent to 7 percent per annum.

Increased efficiency will be the key to achieving and sustaining such momentum. The traditional Indian approach to increasing growth has been to aim for higher levels of savings and investment. But India’s gross national saving, at 23 percent of GDP, is already high for a country at its
level of per capita income. Together with resources from abroad of about 2 percent of GDP, the domestic saving rate has been sufficient to sustain investment of about 25 percent of GDP. At the present implicit ICOR of 5, a rise in the investment rate to 30 percent would be required to sustain 6 percent growth. However, further increases in efficiency, say to the point where the ICOR falls to 4, could make a 6 percent growth rate attainable at present level of saving and investment. Our judgement is that policy improvements, especially those that eliminate the most serious price distortions, can make efficiency gains of this order entirely feasible.

We must recognize the wide remaining gap between India’s economic performance and its potential. Let me give you just a few examples of the type of policy-induced inefficiencies or resource misallocations that I believe have impeded India’s growth:

- India established a formidable structure of non-tariff barriers to imports and perhaps the highest import duty structure in the world in order to protect its emerging industrial sector. While industrial diversification proceeded behind this shelter, the protection has resulted in the development of capital-intensive industries, rather than the labor- and skill-intensive industries in which India’s comparative advantage would seem to lie. Analyses carried out by World Bank staff indicate that highly protected sectors are about three times as capital intensive as moderately protected sectors and five times as high as those with low protection. Over half the fixed capital in manufacturing is found in highly protected industries, but less than 20 percent of the employment. Moreover, in an energy-poor country, the policy has encouraged energy-intensive industry. The sectors with high levels of protection use 160 percent more KWH per unit of value added than moderately protected industry. Also it has protected producers, and a small group of high wage employees, at the expense of consumers.

- India attempts to encourage agricultural development by subsidizing the price of electricity to farmers. This practice, however, results in overuse of electricity and overuse of water. Moreover, as a financial burden on the state electricity boards, it preempts resources for maintenance and much needed system expansion.

- India also seeks to protect employment and preserve capital by restricting the closure of unprofitable, capital-depleted enterprises and by making it difficult for employers to shed excess labor. As a result, there are now about 200,000 so-called “sick” units. These firms take
markets from more efficient producers and are a drain on the financial system (sick firms account for about 10 percent of outstanding bank credit to industry). Policies inhibiting exit and other forms of adjustment not only discourage entrepreneurs from creating new employment. They also constrict technological innovation and have thus contributed to the stagnation of formal sector employment.

- Finally, a large sector has been a key element of India's development strategy. Yet, in part because of the complex set of often conflicting objectives that public enterprises are asked to pursue, parastatals in the manufacturing sector perform poorly relative to their private sector counterparts. They are characterized by excessive labor costs due to overmanning, higher investment costs, and lower levels of capacity utilization. Not surprisingly, and not uniquely in India, I might add, public enterprises have been a substantial budgetary burden.

Given the substantial scope for efficiency gains, it is gratifying to see some important changes in the right direction. One example is the gradual dismantling of the highly bureaucratic system of licensing investment. Another is the removal of many of the impediments to competition in domestic markets. The strong bias against exports caused by the heavy protection of domestic industry has been reduced to a considerable extent. The success of these policy changes is evident in the acceleration of industrial growth and the expansion of exports of manufactures.

Beyond these first steps, further movement is needed. Rationalizing the public sector deserves priority. Reforming inefficient public enterprises, or privatizing them, is a complex task and one that will win no political popularity contest, but it has to be done. The public sector must concentrate on those things that only it can do well. Only if this maxim is followed can the enormous ingenuity and drive of the private sector be unleashed and with it the latent dynamism of the economy.

International trade should also play a much larger role in the growth process. There is enormous scope for export growth, contrary to any notions of export pessimism that may still linger even after the experience of the recent rapid growth of exports. The world market is not a constraint: It has grown enormously since the 1950s and after a lapse in this decade, it continues to grow. India's share of world trade is so small, about half a percent, that even a several-fold increase would hardly be noticed. In addition to the much higher level of imports that greater export orientation would permit, there would be an increase in resiliency to external and internal shocks. Reducing the strong bias against exports
inherent in the present trade regime by moving toward a more moderate and transparent tariff-based system of industrial protection, would also force greater efficiency at home.

There is enormous potential for foreign direct investment in India and, potentially, enormous benefits to India from such investment. In addition to providing capital flows—the reflow of which depends on the success of the enterprise, rather than on amortization and interest schedule—there are gains in the form of transfer of technology and management practices, increased employment, and improved export links. Let me recall here the words of Gandhiji; "I do not want my house to be walled in all sides and my windows to be stuffed. I want the cultures of all the lands to be blown about my house as freely as possible. And I refuse to be blown off my feet by any." India has now gained sufficient economic strength and maturity to be able to benefit from foreign investment without feeling threatened by it. However, while procedures and regulations governing foreign investment have been simplified, it is still more difficult to invest in India than in most other developing countries.

As Indian planners emphasized many years ago, poverty alleviation admits of no substitutes for rapid growth. The evidence suggests that faster growth "pulls up" the poor rather than, as some fear, pushing them deeper into misery. But the positive impetus provided by rapid growth must be accompanied by measures to increase the ability of people to participate in and benefit from the growth process. Those measures include intensified efforts to build the stock of human capital through investment in health, nutrition, and education. They also require employment creation and asset transfer schemes. And there must be assurance that the works built by such programs and the assets acquired by the poor provide permanent rather than transitory benefits. These programs should be productive and, after a reasonable start-up period, independent of subsidies.

We in the Bank have come to realize that direct programs to redress poverty should be an integral part of development policies. It is important to engage all parties in this effort to the fullest extent possible. The government, the private sector, NGOs, and international agencies all need to be energized to grapple with the many facets of India's massive and complex poverty problem.

Over the longer run, the greatest impediment to poverty alleviation in India may be the relentless pressure of population on the resource base. Despite intensive efforts, the goal of reducing the birth rate of 25 per
thousand has not been achieved. The population growth rate has leveled off when it should still be declining.

India’s population is swelling by 16 million people every year. Population pressure and severe poverty in some areas of the country, especially where rainfed agriculture is the norm, are leading to deforestation, endangering the future livelihood of the poor. Unless population growth can be constrained and new approaches to watershed development initiated, the poor will continue to attempt to satisfy their short-term needs at the cost of long-term damage to the environment that sustains their lives.

Stemming population growth will require innovative approaches to family welfare, taking into account community preferences, and greater attention to the role of women and to their education.

The words of advice and encouragement I have offered you are undoubtedly not new but they merit repetition and re-emphasis. I would stress that I speak in a spirit of pragmatic conviction, not ideological fervor. What matters is what works, what promotes a nation’s own goals and aspirations. This is the only standard against which economic policies may be fairly judged. In my talk I have tried to measure India’s progress against its own goals and to offer some modest suggestions about how policies can be altered in order to narrow the distance between reality and promise. Many developing countries, and some developed ones as well, are moving in the directions to which I have pointed. Many are recording beneficial results. India’s own experience—the acceleration of growth, the success of exports, and the decline of poverty during the 1980s—adds to the weight of other evident in other settings.

I do not think of the forty years of the great Indian experiment as one in which a single development strategy held rigid sway. Strategy and policy have evolved from plan to plan as part of the process of learning from both success and failure. This process of evaluation, reappraisal, and course correction is evidence of the underlying pragmatism and strength of India’s policymakers and the resilience of its political system. This process of adaptation and change must continue as India moves ahead into the eighth five-year plan and the closing decade of this turbulent century. I am very confident that the goals which India’s leaders have set for the end of this century will be attained if each one of us follows the advice that Mahatma Gandhi gave some sixty years ago. He said in 1927: “A true soldier does not argue as he marches, how success is going to be
ultimately achieved. But he is confident that if he only plays his humble part well, somehow or other, the battle will be won." I should like you to know that the World Bank will be a staunch and steadfast ally of India in that battle.
I cannot help but feel a great sense of emotion as I speak to you on what is for me a momentous homecoming.

I was born in this city. This is where I went to college and where I spent some of my formative early years. The last time I spoke publicly here was some forty years ago in an intervarsity study debate. They say you can take a person out of Lahore but you cannot take Lahore out of him. So it is with me. I am very pleased and proud to be with you today.

Friends, I have thought long of what I should say to you. I could give you bland and soothing advice on how you might choose splendid careers. Instead, I have decided to share with you my personal assessment of where Pakistan stands today, forty-three years after its creation, and what challenges lie ahead—especially for you, the younger generation of Pakistanis, as you embark on life’s odyssey.

In my early years as a student, my friends and I shared a glorious dream. That dream was based on Allama Iqbal’s vision of a separate Pakistani nation. I remember, as a boy, going to Allama Iqbal’s funeral in Lahore, and being given a card which bore some verses he had written just a few hours before his death. They began:

Sarod rafta baz ayed ke na ayed
Naseem az hedjaz ayed ke na ayed....

His words and writings, which first sounded the clarion call for the formation of Pakistan, were to us truly like an inspirational wind from Hedjaz, rooted in the great tradition of Muslim humanism and solidarity.

Thereafter, it was the indomitable will of Quaid-E-Azam Mohammed Ali Jinnah that led to the political realization of Pakistan. I remember Mr. Jinnah coming to Islamia College, Lahore, to address students in 1946. Dressed in an immaculate white double-breasted silk suit, his message was terse:
“Educate yourself,” I recall him saying, “Do not let yourself be diverted from that task. Nothing will be more important for the new nation of Pakistan than an educated and professionally qualified group of people.”

His vision of Pakistan was of a modern, economically and technologically advanced, socially cohesive, open and outward looking nation. We need to ask ourselves: To what extent have we measured up to those earlier expectations? To what extent has the dream been realized?

Let us look at the balance sheet of the past forty-three year's performance. On the credit side, there can be no question that Pakistan today is far more economically advanced than the predominantly rural and poverty-stricken society of 1947. It has a much more developed financial and industrial system, and social and economic conditions are clearly better than at Independence.

Most of the economic progress can be attributed to two extended periods of economic growth: First, during the 1960s under the leadership of President Ayub and, second, in the 1970s and early 1980s the earlier years of President Zia Ul Haq. For the rest, the record of economic performance has been checkered, characterized by stop-go cycles and, at times, worse.

On the debit side, Pakistan’s economy has been weakened in recent years by structural factors which governments have been unwilling or unable to tackle resolutely and comprehensively. For a country at its stage of development, Pakistan has a very low savings rate and a dismal record of domestic resource generation for investment. Infrastructure has decayed, and some indicators—for example, education, and the status of women—are reminiscent of some of the poorest African countries.

As if all this were not enough, exports have failed to keep pace with external obligations and the balance of payments is severely strained and, in recent months, the gulf crisis has greatly aggravated the country’s economic difficulties. I regret to say that without tough action, Pakistan will undoubtely face before long an economic crisis of unprecedented severity.

Such a crisis cannot be cured by additional foreign aid, whether bilateral or multilateral. In my view, Pakistan is already excessively dependent on external assistance. Aid, especially from multilateral institutions, has a legitimate function in development. But it can easily become a crutch which inhibits raising domestic resources. In any case, there should be no doubt that Pakistan’s ability to attract substantial foreign assistance
will depend critically on its willingness to put its own house in order, quickly and effectively.

Now let me turn to the social items on the balance sheet, where the prognosis is much more disquieting.

First, I feel that the conduct of Pakistani society today is much more "personalized" and much less "institutional" than at Independence. Pakistan inherited some strong institutions at its inception—a professional civil service, a respected judiciary, and a firm administration of law and order. True, these bodies and institutions needed to be recast to serve an independent nation rather than a colonial power. But they did provide an orderly and predictable framework for the conduct of people's lives.

Since Independence, however, the integrity and effectiveness of these institutions has steadily eroded and we have failed to develop new political and economic institutions that could adequately respond to the needs of different groups in a growing, developmentally-oriented society. Consequently, Pakistani society today increasingly functions within a framework of personal rather than institutional relationships.

Second, we have become a deeply divided society—divided by religion, by sect, by place of origin, and by every other difference, imaginable or unimaginable. I find to my dismay that familial or provincial or sectarian differences are stronger rallying cries than love or tolerance or the spirit of solidarity which founded this nation. If we continue to divide by religion and dogma, or we continue to think of ourselves first as Sindhis, Punjabis, Pathans, or Muhajirs, rather than as Pakistanis—then we begin to see the writing on the wall, and it does not portend well for the future. I am reminded of the comic character Pogo who went into battle looking for the enemy and when he reached the battlefront, he shouted: "We have found the enemy—and it is us!"

Third, we have become a "violent" society. When I grew up, the stray incident of violence—mostly in the villages and most related to conflicts over women, property, or livestock—was big news in the papers. It was quite unlike today when firearms are freely available and a few citizens can take the law into their own hands and impose their will on others, when the resolution of disputes through violence has become commonplace, and organized thuggery can go virtually unnoticed. You, Mr. President, recently gave us some frightening figures on the loss of life caused by ethnic violence in the Sind province. The point is not just that people should not live in fear of violence, the point is also that a society
cannot devote itself seriously to development if it is consumed by violence.

Fourth, we have become a society beset by deep social ills. The most serious threat to social stability is growing drug addiction. Its ravages should not be minimized. They go far beyond a threat to public health standards. In countries such as Colombia, drugs threaten the very foundations of democratic government. I am also dismayed that little social stigma attaches any longer to bribery and corruption. They appear to have become more or less acceptable as a way of life. Not so long ago, the strongest deterrent against corruption in public life was the fear of ostracism from one's peers and friends rather than the fear of criminal prosecution. Maintaining standards of social morality is a far more fitting subject for public debate than arcane issues of religious dogma and sectarianism.

Fifth, we have become a confused society—confused about our past, but even more confused about our future. The history of Pakistan's political evolution, in which the army and civil service have been leaders, has understandably caused controversy about the type of government the country should establish. On the economic side, Pakistan's founding fathers failed to elaborate any clear approach to economic management. On societal issues, Pakistanis seem more preoccupied with questioning their neighbor's conscience and religious beliefs than with worrying about the moral and social standards that should govern everyone's behavior.

This confusion cannot be dispelled by merely harping back to models that existed long ago and endeavoring to replicate them without change under the very different conditions of today. These problems can be resolved only by responding to the problems of today with solutions that are equally contemporary. Consistency with the spirit and tenets of Islam is hardly, if ever, a problem because Islam is a religion about life, not abstraction. It recognizes and accepts change, and its principles have a universal character.

Confronted by the confusion and chaos of the present, I detect a tendency amongst Pakistanis to live in the past and to romanticize it—to look at the mausoleums of the dead and to talk nostalgically about the "ancient glories of bygone Muslim eras" (koi qartab kay khandaar kay kay dayhay higazi ameeron kay ghar in kay daykhay).

Certainly, the past yields its lessons. But what bears more reflection is not the glories of Islam in the seventh or the eighth century, or the
Muslim renaissance in Spain and North Africa some 800 years later, or even the splendor of the Ottoman empire not so long ago, but the causes of their decline and fall. And make no mistake, some of the same signs of a house divided which we see in Pakistan today led to the disintegration of those glorious ancient regimes. For this reason, if no other, we must confront present reality—and it is in many ways a tough reality—come to terms with it, and begin building for the future.

As we look to the future, Pakistan again enjoys a great opportunity. The country has the prospect of political stability under a democratically elected government with a mandate for five years. Mr. President, no future historian could ignore your personal contribution to helping to re-establish democratic government and the rule of law in the country. It remains for the elected representatives of the people to undertake the comprehensive economic and social reforms essential to restoring national cohesion and sustainable economic growth.

The new government has two major national responsibilities. One, as I have suggested, is to tackle serious economic problems which could deteriorate into a crisis if left unattended. The other is to provide good governance.

What do I mean by “good governance”? To begin with, I mean less government—especially in the economic and social fields. For Britain, Mrs. Thatcher defined it as a change “from a dependent to a self-reliant society, from a ‘Give-it-to-me’ to a ‘Do-it-yourself’ nation.” It means more delegation and decentralization of authority—from central government to provincial governments, from provincial governments to local bodies, and from local bodies to nongovernmental and community organizations. The approach in the 1990’s must be for the people to take tighter hold of their own destiny and to reduce their dependence on government.

Good governance also means tolerant government—tolerant of differences in political, religious, and sectoral beliefs, and of personal conflicts. It means a government that respects dissent, protects the independence of the judiciary, and ensures that justice is done.

Good governance means an open government—a government that preserves and protects free speech and a free press, and is subject to free public discussion. Such public discussion requires institutions that can inform the people and help them reach rational judgements. Unfortunately, this is not always possible in Pakistan. Our mosques no longer function as madressahs, our schools and colleges have in some cases
become centers of political agitation instead of learning, and independent citizens' institutions and channels of communication are few in number.

In addition, good governance means compassionate government—government that is genuinely committed to improving the lot of the poor. While Pakistan has made progress in alleviating the worst of poverty, there continue to be severe problems of infant mortality, low life expectancy, and a very low literacy rate. These require a renewed effort to promote social sector development, and particularly to bring women more directly into development.

Finally, I mean government that is prepared to govern when it needs to govern. It must not flinch from taking hard decisions to stimulate national renewal. Fundamental economic reforms to stave off the economic crisis that looms ahead. The reinforcement of law and order and of due process to ensure that justice is done without fear or favor, and the fostering of institutions needed for good governance.

This, in my view, is the agenda for good governance before the democratically elected new leaders. At the top of the agenda is the need to heal and bind up the wounds of the nation, not deepen them. This is the time to recognize that political opposition is a positive part of democracy, no matter how rancorous the past. It is for those in power to stretch out the hand of conciliation and invite all Pakistanis—including those in opposition—to join hands in a spirit of national consensus and deal with the urgent threats to our country's well-being and solidarity.

What must be done? Pakistan must boldly implement structural reforms that will shift economic and social management increasingly to the private sector, and to nongovernmental organizations of the people. It is the people who are—and should be—the beginning and the end of development, governmental or private. More than ever before, developing human resources and strengthening Pakistani institutions—political, social, and economic—ought to be one of the new government's most pressing priorities.

Experience in the developing world over the last half-century provides incontrovertible evidence that well-motivated proponents of development have been over-zealous in expanding the role of the state in economic affairs. This has brought about an excessive centralization of decisionmaking, greatly inflated the bureaucracy, and stifled the private sector. Pakistan is no exception to this general trend. In this over-regulated environment, the private sector has also not behaved responsibly—
it has tended to evade laws and regulations rather than observe them. This must change. The business of government is to provide that right environment for other businesses, not to manage them. Winston Churchill once said: "Some see private enterprise as a predatory target to be shot. Others see a cow to be milked. But few are those who see it as a sturdy horse pulling the wagon."

It is this sturdy horse that must now be harnessed to the national wagon.

I suggest formulating a social contract which will facilitate these structural reforms. A social contract would spell out the rights and duties of the state and the rights and duties of the groups which constitute Pakistan. A social contract would underpin a national consensus derived from understandings between the center and the provinces and between the provinces and local bodies, between business and the government, between landlords and tenants. Given the political reality in Pakistan, the armed forces must also be part of the social contract. The crux is that without consensus—without such institutions—it will be much harder to secure the revenue and investment essential for long-term development, especially social development.

This is a fitting occasion for me to pay a tribute to Syed Babar Ali for his personal contribution in demonstrating how an enlightened private sector can be a vibrant force for development. He is the true architect of Lahore University of Management Sciences (LUMS) and through perseverance, and a sense of commitment, he has translated the glimmer of an idea into a high quality national institution. The private sector and community organizations should be strongly encouraged to establish similar institutions in other disciplines—in natural sciences, medicine, economics, and computer sciences. Some of the finest educational institutions of North America are funded by endowments from public spirited citizens and private institutions rather than handouts from the government.

Pakistan cannot remain isolated from the rest of the world. Pakistan cannot be a small island in an ocean of change. Pakistan needs the rest of the world, and needs it desperately. It needs markets, technology, and, most important of all, recognition as a responsible and responsive state making its full contribution to a peaceful and prosperous community of nations.

A Chinese proverb says: "It is more useful to stand before a window than before a mirror." It means that a person who stands before a mirror tends
to look only at himself, whereas the man at the window looks at the world outside and is therefore better able to see his place and role in life.

Many of you here today stand at the threshold of new careers and new professional responsibilities. I hope you too will look outward and rise above the parochialism and prejudices that have stifled initiative in the past and curtailed national solidarity.

And that brings me back to what Quaid-E-Azam had to say to the students on that summer day in 1946. The more we analyze the process of development, the more we begin to understand the central role of education in building a vibrant and growing society. It is the quality of human resources and of institutions—and there is a very close link between the development of human capital and institutional development—which nurtures nations. We should see the contribution of an institution such as the Lahore University of Management Sciences in that perspective.

As we move into the 1990s, it is clear that Pakistan's economic prospects will depend heavily on unleashing the entrepreneurial talents of people in productive activities—in agriculture, in industry, and in commerce. We are too small and too underdeveloped a nation to expect to generate this growth entirely from within. A large part of it must come through business and trade with the outside world. It is essential, therefore, that Pakistan develops management and technical skills to use efficiently the scarce domestic and external capital that becomes available.

We are living in a world in which old political and economic systems are changing rapidly. Our world is moving towards economic liberalization and more open trading systems. Technological change is affecting all aspects of production and marketing. Increasingly, production for world markets will require innovation and skill-intensive solutions to ensure competitiveness. The potential contribution of institutions such as LUMS in equipping a new generation of Pakistanis to perform these tasks is immense.

The generation that struggled for the creation of Pakistan is rapidly fading away. You—the youth of this country—are the guardians of this future. As a nation of immigrants, we are a melting pot of many peoples, many cultures, and many religions. You must rediscover the pride that we once felt in the rich tapestry of this country's regional and cultural differences, and be the technicians of a new renaissance that illuminates it with the spirit of tolerance and love for our common heritage. We must all learn to live together or we run the risk of perishing together.
The ideals which the founders of Pakistan sought are as valid today as they were half a century ago. I believe it was St. Exupery who explained that ideals are like stars. We may never reach them but, like mariners on the sea, we can chart our course—and I might say, the course of the nation—by them.

In the days when we struggled for Pakistan, the students frequently recited a verse: “You will perish if you do not mend your ways—oh Muslims of India. You will not figure even in the legends of the land.” (na samjh gay to mit ja gay ai hindi mussalmano tumhari daastan tak bhi na hogi dastanon men.)

Mr. President, I firmly believe that today one can substitute the word Pakistani for Hindi, and it would be equally relevant. I am confident that all of you here—our current leaders and you, the graduating class, whom I consider to be the next generation of this nation’s leaders—will provide the enlightened leadership and good governance that will bring Pakistan closer to fulfilling the dream we all had half a century ago.
The Private Sector
I am honored in having this opportunity to speak at Chatham House. You will have gathered that the institution I represent, the International Finance Corporation, is part of the World Bank Group of institutions. From that you may have assumed that I am going to talk to you about the need for more official aid to the developing countries.

In fact, you may relax. Although the developing countries do need more official aid, that type of aid is not my direct concern. That's because the International Finance Corporation is specifically engaged in promoting development in the third world—not by means of official aid but in association with private enterprise, domestic and foreign.

Today, there are, broadly, two schools of thought about the role of private enterprise in the so-called third world. There are those who feel that development and private enterprise are like oil and water—that they don't mix. This view is honestly held by politicians and academics in both the developed and developing worlds. They see economic development in the third world as something which can be dealt with only by governments on the one hand and by official aid from the industrial world on the other hand. Then there are those supporters of the private sector—not all, but I believe too many—who seem to think that all government intervention is misguided and that private enterprise, and particularly foreign private enterprise, can continue to operate in the developing countries in the future as in the past.

To me both these views are based on out-of-date concepts, of the world we are living in and of private enterprise. Let me, therefore, try to sketch for you a picture of the world as I see it, and then go on to suggest how private enterprise can best fit into it.

Much is said these days about efforts to achieve a new international economic order. In fact, although it isn't the one that has figured so much in the dialogue between North and South, a new economic order is already with us.
It reflects the political changes of the last 25 years, which have produced a host of new independent countries each with its own economic needs and aspirations. It reflects, even more, perhaps, the fact that the frontiers of human knowledge and technology have advanced farther and faster in those years than in any comparable period in history. Man has landed on the moon, but he also now grows vegetables in Senegal which are flown to Europe to be sold. Nuclear technology has spread to the developing countries and a small desert kingdom in the Persian Gulf has the highest income per capita in the world.

Altogether the world has become a smaller and less tidy place. All hitherto accepted economic relationships, whether West and East, North and South, or transatlantic, and all existing trade, investment, and international financial patterns, are now being questioned and are in the melting pot.

But if I were to pick one of the most significant features of today's world as I see it, that feature would be the steadily increasing importance of the developing countries as factors in the international economic scene.

In one way, the emergence and activities of OPEC have brought that fact literally home to us all. But other things have been going on, although they haven't made the headlines. For instance, in the 25 years from 1950 to 1975 the GNP of the countries of that world grew by nearly 6 percent per annum in real terms or 3.1 percent per capita. The industrial countries, at a comparable stage of development, took much longer to advance as far; their per capita growth was only about 2 percent. Joint industrial ventures between the developing countries themselves are appearing with increasing frequency, and even developing countries' multinational corporations have emerged.

Overall, this achievement of the developing countries is the outcome mainly of their own efforts and the use of their own resources. Nine-tenths of the investment in the developing countries in this period was generated internally.

What are the implications of this evolution, even revolution, in the world economy? Patterns of trade and payments have been transformed and there are new emerging poles of economic and financial power. While trade with industrial countries is still the dominant influence on economic activities in the developing countries, trade with other developing countries is increasing; more than 20 percent of developing country nonoil exports and more than 30 percent of developing country manufactured exports now go to other developing countries.
The fact is that the balance of the world economy has been tipped. Time was when the third world danced to the pipes of the industrialized world, but today that world is increasingly showing a capacity to devise its own tunes and its own steps. Yet if the scales have tipped it is a fact that they cannot function unless each side is connected to the other, for they are interdependent.

Interdependence between the industrialized countries and the developing world is, of course, nothing new. But today, the new economic order I spoke of has brought with it a new type of interdependence—not one between a few advanced countries and their overseas territories but between sovereign nations in the industrialized world and no less sovereign nations in the third world. Consider one or two examples of this new interdependence.

The industrialized world largely relies on some developing countries for its oil and on others for a large proportion of its food and raw material needs. It also increasingly looks to the developing countries to provide growing markets for its manufactures. Twenty-five percent of the exports of the European Community go to the nonoil producing countries of the third world, a figure which rises to 39 percent if the oil producers are included.

The developing countries in turn look to international banks and other institutions in the industrialized countries to recycle oil revenues, and to the industrial countries not only for funds but also for the technology and expertise they need to support their economic expansion. No less, they look to the industrial world to provide some markets for their own growing manufactures.

In these changing patterns of production, trade, and investment, one can readily discern the emerging outline of a more integrated international economy. That we are moving in this direction should not be a matter of either surprise or concern. This process of change is rooted in economic history. It is not all that different from the sequence of events which led to the economic emergence of continental Europe and the United States during the second phase of the Industrial Revolution.

The new economic system and its evolving relationships should lead to greater international specialization and division of labor, and this should serve the interests of the world community at large. The only problem is that this restructuring of the world economy is taking place at such an unprecedented pace that it inevitably creates tensions and serious problems of adjustment.
This problem can be resolved if approached with understanding and goodwill, by planning ahead, and by recognizing that for neither industrial nor developing countries is the world now one of free choice, in which one half is able to accept or reject financial and commercial dealings with the other half. If nothing else, the current economic recession should have taught us that the industrial world cannot prosper in isolation from a developing world pervaded by stagnation, and vice versa.

I have an uneasy feeling that the attitudes displayed in international economic relationships all too often still reflect assumptions and attitudes rooted in the past and not really shaken by the transformation of the world economic scene; that, altogether, many of us are not all that much wiser, or better managers of our international economic relations, than we were in the past because we have been unable, perhaps even unwilling, to understand that transformation and its implications.

Some of you may think that I’ve painted my picture in unduly clashing colors. But even if you do, I’m sure you will agree that all is not well in international economic relationships.

I do not believe that those relationships can be improved by exhortation, or for that matter by threats or even tight bargaining across a conference table. That is impossible as long as the present atmosphere of confrontation continues to prevail. Somehow we have to create a new environment in the international economic scene. To try to achieve relationships based not on ideological but on practical considerations; not on confrontation but on cooperation in trying to work out how the world can best and most equitably make use of its human and material resources for the common good.

Whatever progress can be made towards the creation of that new environment must come from a growing recognition by both sides of the mutual benefits to be derived in the long run from the growing interdependence of the world economy. And that recognition must be followed by a painstaking exploration of concrete policies and measures that will serve to alleviate the frictions arising from the process of change without attempting to reverse it.

Let us ask ourselves what are the requirements of the North and the South respectively, and what benefits they might expect to gain from a more harmonious process of transition and adjustment in the world economy.
The industrial countries are primarily interested in assured sources of energy and raw materials to maintain their present standards of living. These standards cannot be taken for granted if a major proportion of the proved reserves of energy and several key minerals are to be found in the third world. Even more important in my view is the fact that the most rapid growth in the markets for the manufactured goods of the industrial countries is likely to be found not at home but abroad.

The developing countries want capital, technology, management expertise, and, as I said earlier, access to industrial country markets for their own manufactured production. I spoke of the rapid progress made by the developing countries in the last 25 years. But this progress—and it has been progress—has only touched the fringes of their economic problems and their economic potential. To make any substantial dent in those problems or to really begin to realize that potential, needs greater technical and financial resources than even the richer developing countries can find themselves.

For those resources the developing countries won't be able to depend on official development aid alone. For the last 20 years there hasn't been enough of that to go round. Today, the gap between available official aid and the needs of the developing countries is widening. One reason is that the aid flows from the industrialized world have declined, in real terms. Another reason is that the absorptive capacity of the developing countries has grown, and worldwide inflation has increased the cost of many types of projects which many countries in the third world see as essential to their development.

There are several areas where the needs and interests of the developing and developed countries coincide and where the flow of capital and of trade would be mutually beneficial. Mineral development is, of course, a case in point. The experts tell us that cheap and economic reserves of fossil fuels are likely, at current rates of depletion, to be exhausted within the next 50 years. Yet some 30 developing countries are known to have untapped sources of oil. Similarly, economically accessible reserves of copper and nickel are said to be adequate only for 30 years—although one would never guess this from current market prices. Yet in the third world there are many deposits of copper, tin, nickel, and other minerals still to be developed. Recent World Bank estimates have shown that the gross investment needed in the mineral sector in the developing world, including the costs of maintaining existing production capacity, could be of the order of $95 billion over the next decade. Even the
most advanced developing country can't find that kind of money on its own.

There are other economic challenges in the third world. There are a number of countries in Africa which are potentially rich in both renewable resources such as agriculture, forests and fisheries, and non-renewable resources such as minerals, and which are just beginning to enter the development phase. In the years ahead, the African continent could well prove to be the most rewarding new frontier for the deployment of capital and technology.

The more economically advanced developing countries will also present opportunities for accelerated progress and productive investments. For example, they will need help in developing large and complex projects requiring sophisticated technology.

Where is the money for these and other development projects to come from?

To fill the gap between official development aid and what they need many developing countries have turned to loans from the international marketplace. It is estimated that the Euro-Currency Market has grown nearly five-fold since 1970 and the developing countries have been significant—though not the major—users of this market. Total external indebtedness of the developing countries to private creditors—almost entirely financial institutions based in the industrial countries—now exceeds their indebtedness to official sources of credit.

This brings me to private enterprise and how it can fit into the realities of today's world, and of today's third world in particular.

In many countries in that world private enterprise is already contributing to development. Often on the foundation of an economic infrastructure largely created through official assistance, the private sector in most of the developing countries provides by far the most employment, as it is the most important producer of income. Altogether, the private sector, representing both domestic and foreign capital, accounts for about 75 percent of the gross national product of those countries.

Given these facts I believe the question we should be asking ourselves is not whether private enterprise can contribute to development. Instead, I suggest, there are two other questions: "Is private enterprise capable of making a greater contribution?" And, if the answer is yes, how can that be done?
Let me say at once that it cannot be done on the basis of a continuing belief by private investors that the world is still their oyster or a continuing belief by governments that private investors are no better than robber barons. For myself I believe it can only be done if, as I've suggested in terms of the world economic scene, a new relationship can be created within the developing countries between government and private enterprise. That may sound like a very tall order, so let me spell out a bit what I have in mind.

We all know that in the developing world the local government and private enterprise have often been at odds. The government may have felt that the private sector has followed investment policies which have distorted national economic development. As regards foreign private investment the government may have wondered whether its contribution has compensated for its economic and social costs. For its part, the private sector has felt that government policies have distorted the market and have obstructed the achievement of maximum profits for private investors. Foreign investors, in particular, have seen government attitudes as irrational or discriminatory, or both, and have asked whether their earnings have compensated sufficiently for the risks and uncertainties they have faced. The result has been, at worst, direct confrontation between government and the private sector, and even at best strained relationships rooted in a continuing crisis of confidence.

The effect of this situation has been to reduce the contribution that the private sector is capable of making to the development of the third world—for it stands to reason that the contribution cannot be fully made in an atmosphere of latent if not open hostility between government on the one hand and the private sector on the other.

There have been various attempts to defuse this kind of situation. Efforts have been made to draw up codes of conduct to govern relations between governments and private investors, with the accent on foreign investors. There have been greater efforts by foreign companies to train local personnel and to provide for a larger local share in management and policy decisions. Not least, in face of third world dislike of wholly-owned foreign enterprises, there has been an increase in the number of joint ventures and other forms of investment providing for some degree of local ownership and often control.

All such developments are welcome, but to my mind they do not go very far towards creating a new relationship between government and private sector.
One feature of today's world economic scene is that it is one of mixed economies in which the public and private sectors are, or should be, complementary rather than competitive. Friction between the public and private sectors is not unknown in the industrial countries, but we continually witness efforts by each side to arrive at a consensus on their respective roles in production and distribution. There has not been the same degree of effort to achieve such a consensus in the developing countries.

Let me suggest some essential ingredients for it.

I shall take first the potential private investor, foreign or domestic, in a developing country. Many more calculations than the interests of shareholders now need to be taken into account. Such an investor needs to be sensitive to the economic, and the social, priorities of the local government and to its natural anxiety that the benefits of any private enterprise should contribute effectively to national progress.

For its part the local government needs to be sensitive to the need to create a setting in which private enterprise can best make its contribution. This is to say, it should recognize that, against a background of general political and economic stability, to the extent that it can assure such stability, much will depend on the fiscal, monetary, and foreign exchange policies it pursues. More than that, a government should adopt, and adhere to, a clearly-stated set of ground rules to provide a coherent and assured setting within which enterprise can contribute to the general welfare. What does all this add up to?

First, that whether in terms of the transfer of resources or of the effort the developing countries must make themselves to meet their basic needs, the task of development is so vast that it calls for the fullest possible deployment of all available resources. In other words, any developing country which either ignores or overlooks private enterprise is depriving itself of a valuable aid to its economic and social progress.

Second, the private sector in the developing countries, fuelled either by domestic or foreign investment, or both, can only contribute effectively to that economic and social progress if it can work in an environment in which government sees private enterprise as responsive to the needs of society and private enterprise sees government as willing to provide the framework within which that response can most effectively be made. In short, that the existence of a community of interest, even of a sense of
partnership, between them should be recognized by government, and by the general public, on the one side, and by the private sector on the other.

You may think that the kind of world economic relationships I've been talking about, and, within them, the kind of relationships between the public and private sector in the developing countries, are unattainable. I am not so pessimistic. I come from a developing country. I have spent the last 20 years visiting most of the developing world no less than the industrialized countries, and I am convinced that these new relationships can be created—if only because it is to the common interest that they should be.

Here let me say a word about Britain. In the past, British ideas and British capital provided economic development in the United States, in Latin America, and in all the countries which are now members of the Commonwealth. Today, after a long and hard pull, and for a variety of reasons, it looks as if Britain, a leading source of technology and expertise, and with her special knowledge of and historical ties with the developing countries, will be able to play an increasing and invaluable role in creating the new confidence I've just mentioned.

This is a task to which we in the International Finance Corporation (IFC) are also addressing ourselves. We have been in the business of supporting the growth of private enterprise in the developing countries for 21 years—with our own money and by mobilizing other funds.

The total cost of the 295 projects we've assisted in 62 countries has been nearly 2 billion dollars. Those projects have been jointly owned by foreign and local interests, or wholly owned by local interests—the latter are the majority. They've never been wholly foreign-owned. Two further points. We make sure that every project we support is acceptable to the government of the country concerned, and we insist that it should be consistent with the development plans of that country.

In other words we have, as a matter of policy, been practicing what I've just been preaching. Now we are able to look forward to doing much more. Our 107 member-country shareholders have agreed that IFC's share capital should be increased by $480 million over the period 1975–82—the first time our capital has been increased since IFC was established in 1956. The fact that 86 of our shareholders are developing countries is evidence that they look to private enterprise to make a contribution to their economic and social progress.
With our new resources we will be able both to broaden the geographical area of our activities and to widen their scope and diversity. We plan to pay special attention to the needs of our poorer member countries for finance and expertise.

But I believe that the real importance of IFC is not primarily as a source of finance and as a financial intermediary. Rather, I believe that importance lies in the fact that we are a unique partnership owned jointly by all the principal developed and developing countries. We have no national or international axes to grind.

But if IFC is unique, that fact means that it has a special responsibility for playing its part to create the new economic and investment environments I've been talking about. We do not claim to have the blueprints for how this is to be done. In fact, we are going to ask our member countries, including Britain, one of our original and principal shareholders, and our financial and business partners for ideas on what more we can do and how we might do it.

For, when all is said and done, we exist to be of service both to our national shareholders and our private partners and to work with them and between them towards a more equitable and so more stable world economic order.
I think most would agree that we stand on the threshold of the new decade of the 1980s somewhat uncertain as to what it will bring. I am equally certain that most would agree that we have for at least the past decade and a half been going through a period of rapid change during which the question "from what to what" has yet to be fully understood. This is not a particularly American phenomenon—it is global and its impact has entered into almost every facet of our lives. It has been a time in which the word "interdependency" became so widely accepted as to be almost a cliche. It has been a period of post-colonial nationalism which has affected the most basic economic and political relations and alignments between nations. It has been a period which had to invent the concept of "North-South" relations which only begins to express what we have come to recognize as the rising and potentially explosive aspirations of the majority of the world.

It has been an era of conflict to which we still clearly see a resolution. Private foreign investment was not spared the conflicts which surrounded every other aspect of international relations and although the storms have subsided somewhat from the early 1970s, the controversy still continues.

Actually, there are two parts to private foreign investment: direct investment and portfolio investment. The former is generally associated with the activities of the multinational enterprises and the latter with private financial institutions.

This evening, while I will treat the subject of private capital flows to developing countries generally, I will concentrate most of my attentions on direct private foreign investment. While portfolio investments loom very large in terms of the total transfer of resources to developing countries, much of the controversy has been and continues to be centered around direct investments—in particular around the specter of the multinational corporation.
The nature of the conflict is well known and had surfaced in public and in international debates under the names of codes of conduct, transfer of technology, divestiture, etc. The question here is: What is the importance of the controversy? Is the future of private foreign investment all that important?

Let us start with a point of general agreement that if the developing countries are to progress in the near future even to the point where the worst excesses of their poverty can be successfully overcome, they will need vast amounts of capital. It is also generally agreed that the developing countries cannot possibly raise all of the capital they need internally—that some portion will have to come from the industrialized countries. The point is that today, over 60 percent of the capital flows to the developing countries—including bilateral and multilateral assistance—comes in the form of private foreign investment.

There are few nations today that are so self-sufficient as to say that they do not need foreign investment—not just for the capital, but for the attendant benefits it can bring. China was long cited as the ultimate example of the “self-reliant” approach to development, but even they now recognize the contribution that import of capital and technology from abroad can make to their development. It is not without significance that two countries such as China and the U.S., with such vast differences in their political outlooks, can find in direct foreign investment a common ground for establishing mutually beneficial relationships.

The heart of the controversy is not whether private investment is needed, but on what terms and for what purpose.

The truth is that foreign firms from developed countries remain an important source of capital, technology, and management and marketing techniques for developing countries, a fact, by the way, that I sometimes feel—especially when comparing our experience in the International Finance Corporation and some of the learned political and economic journals—is better understood and appreciated in the developing countries than it is in the more advanced countries.

Not only is private foreign investment an important component of total capital flows to developing countries, but the trend is that it will become increasingly important—witness the fact that private investment as a
percentage of total investment flows increased from 40 percent in the early 1970s to 60 percent in 1977.

There have been important shifts in the composition of private foreign investment. Portfolio investments have been expanding rapidly, particularly Euro-currency credits, so that in the past seven years they have increased from about half of the total private investment flows to slightly over 70 percent. Parenthetically, I should also mention that the developing countries have been taking over half of the publicized Euro-currency credits in recent years. By contrast, the IMF reports an almost uninterrupted decline in the real value—that is, measured in 1979 dollars—of direct investment flows to nonoil developing countries, while the OECD data (with somewhat different coverage and definitions) shows stagnation of direct investment in real terms.

Even so, the total existing stock of direct investment is still an important factor in the economies of some developing countries. According to the latest figures, the total stock of direct investment in the world is estimated at about $300 billion, of which roughly one-quarter is in the developing countries. However, the stock in developing countries is by no means evenly distributed. In 1975, one-quarter of the total was in the OPEC countries and another 40 percent was located in ten other countries. Of the total stock of direct investment in the developing countries, Brazil, Mexico, Venezuela, Indonesia, and Nigeria had the largest, in fact, the lion's share.

It is also a fact that in some of these countries, foreign controlled enterprises accounted for a substantial share of economic activity. In Brazil, for example, foreign enterprise controlled 29 percent of assets in manufacturing. In Mexico, 27 percent of manufacturing sales were made by foreign controlled enterprises—which, by the way, is similar to the proportion in France and Germany.

The decline in the importance of direct investment, at least as measured by capital flows, is somewhat surprising, because it has always been felt in the past that direct investment will flow into expanding markets. The middle-income developing countries have been the most rapidly growing markets of the 1970s and have been the main recipients of direct investment. Their GDP grew at 6 percent per year between 1970 and 1976, a rate they expect to maintain over the next ten years, while the industrial countries grew at only 3.2 percent during the same period.
What had not been taken into account was that several fundamental economic and political changes had occurred in the 1970s which led to the decline in the relative importance of direct investment.

First, international economic conditions have been unsettled, to say the least, throughout the 1970s and, since investors want stable conditions before risking their capital, this put a strong damper on investment activities. The advent of floating exchange rates alone may have added an element of risk that could have discouraged some investors.

Second, the depreciation of the U.S. dollar has been a fundamental factor in helping reduce the flows of direct investment. While the dollar has not depreciated in an absolute sense relative to most LDC currencies, it has depreciated in terms of purchasing power parity in many cases. A dollar does not buy as much as it once did, particularly in countries such as Brazil where direct investment has been the most prominent. This is particularly important in those cases where the development of the local capital goods industry has reached the stage in which foreign investors increasingly rely on procurements paid for in local currencies.

The increase in oil prices in 1974, and concomitant OPEC surpluses is another factor explaining the decline. The OPEC countries used their resources to take increasing control of oil exploitation, which had been an important component of direct investment. These opportunities have been severely restricted.

Finally, the attitude of developing countries themselves toward direct investment changed in the 1970s.

The developing countries are now less interested in direct investment for the capital it brings and more interested in the technology and management skills that may be transferred. This change is directly related to and, in fact, made possible by, the availability of capital from other sources, particularly the rise in the Euro-currency markets and the increasing importance of international financial institutions. In part because the developing countries had these alternatives, and because they felt more capable of doing things for themselves, their bargaining power vis-à-vis foreign firms increased and many took the opportunity to extend their controls over foreign investment by limiting foreign ownership, encouraging phaseouts, providing for export and other performance requirements, and establishing repatriation limitations. While the relative importance of these factors has varied from case to case, they have all contributed to a dampening of the investment climate.
Multinational firms have increasingly adapted to the changing conditions and desires of developing countries. They have adopted new forms of investment and technology transfer to meet the desires of host countries. They have given up requirements for majority ownership and have entered management contracts, licensing agreements, production-sharing agreements, and other new forms of involvement. In general, multinational corporations have moved away from restrictive provisions of investment agreements, such as restrictions on exports. Thus, while capital flows to developing countries may have declined in real terms, there is some evidence that the flow of technology and other types of assistance might have increased.

In the future, I expect there will be an expanding need for involvement by firms from industrialized countries both in investment and technology transfer to developing countries. The need will be particularly important for the development of natural resources, both renewable and non-renewable.

The share of developing countries in the production of most minerals has been growing, and their share in mineral reserves is significantly greater in most cases than their share in production. Over 60 percent of known copper, bauxite, and nickel reserves are in LDCs. Beyond known reserves, there is reason to believe that the prospects for exploration in some of the major minerals are better in developing countries than in the industrialized world.

The situation is very similar in the case of energy reserves where foreign technology and capital will be especially important resources for developing countries. With the current and expected prices for energy of all types, the possibilities are particularly good for large increases in the exploration for and investment in the exploitation of new energy sources in developing countries. There are reasonable prospects of developing oil resources in 38 non-OPEC developing countries.

Total investment in nonfuel mineral development in LDCs could exceed $50 billion over the next five years, with perhaps half again as much to be invested in oil and gas development.

While a significant share of the needed external capital to develop the mineral resources of the developing countries will come from international institutions and governments, it is absolutely essential that private firms from the industrialized countries are actively involved. The technical knowledge, marketing skills, and equity capital that must be supplied by international mining and oil companies will be essential if the
job is to be done. This does not discount the emerging competence of public and private firms in developing countries in these areas. In fact, we may look forward to increased involvement by these firms in fuel and nonfuel mineral projects in the developing countries.

The opportunities in the development of renewable resources, while not as obvious, are equally numerous and important for the developing countries. Forest products, fishing, and agriculture all are areas to which foreign investors can contribute capital and technology. In agriculture, in particular, there are broad areas of cooperation between firms and cooperatives in developed countries and those that are emerging in developing countries as agriculture is increasingly commercialized. The prospects for investment and technology transfers have only begun to be explored in processing, marketing, storage, and the supply of inputs.

Of course, there continue to be opportunities in manufacturing. There are newly emerging industries in all developing countries that can use assistance from foreign firms. Export-oriented industries require marketing skills and access to foreign markets, as well as technology to be competitive on world markets. Capital goods industries are being developed in some of the more advanced developing countries and need technology from firms in developed countries. Manufacturing industries in the low-income countries may benefit from the assistance of firms in more advanced developing countries.

What I have sketched out is only the briefest outline of the possibilities and opportunities for direct investments in developing countries. And while the prospects are encouraging, we must turn over the coin and look at what risks are attached to these opportunities, and how they are expected to evolve in the near future.

Just as the recent stagnation of direct investment has been due mainly to certain fundamental economic tendencies and forms described earlier, future risks of direct investment will depend on basic policies of both developed and developing countries, which will establish the environment for investment, trade, and economic development.

The risks of investment will be intimately bound up with future changes in trade policy. It is impossible to conceive of a healthy growth in direct investment without continuation of a liberal trading environment in both developing and industrial countries alike. The emergence of protection and restrictions in industrial countries will lead to countervailing restrictions in developing countries and a general shrinking of markets.
This presents the most serious threat to the growth of direct investment. The emergence of protection not only would directly affect export-oriented direct investment, but it would have wider effects by making the transfer of dividends and capital difficult, and seriously slow market growth.

Emerging disputes among developed and developing countries over the distribution of benefits constitute another area of risk for direct investment. As has been noted, developing countries have increasingly bargained with foreign firms in order to increase their benefits from the investments. These bargains have taken many forms, including restrictions on ownership, changes in taxes and royalties on investments to exploit raw materials, elimination of certain restrictive practices associated with technology transfers, and positive performance requirements, such as export requirements. Home countries of investing enterprises have begun to react particularly to the performance requirements in the belief that they represent unacceptable shifts in investment benefits in favor of the host country. While these actions and reactions have not yet reached the stage of "investment wars," similar to the trade wars of the 1930s, there is a growing risk that must be contained.

Possible future changes in the established terms and conditions of existing investment, of course, also continue to be a source of risk. However, it is my feeling that such changes are now less prevalent. There seems to be a stabilization of policies toward direct investment by developing countries, reflecting, perhaps, the stagnation of investment and the reaction of the industrialized countries to which I have referred. Several countries, in the wake of political changes and economic crises, have liberalized the treatment of foreign investment.

I do not wish to suggest that many developing countries are likely to adopt a laissez-faire policy toward direct investment. Even conservative governments are bargaining with foreign firms over the terms of direct investment. At the same time, socialist governments increasingly recognize the benefits from inflow of foreign private investment and technology transfers, and are exploring mechanisms to facilitate such flows. IFC has been a pioneer in this area; it encouraged and facilitated foreign private investment in Yugoslavia, and we are well placed to do so in other countries.

The risk still exists, of course, that political changes will bring to power governments that deny any benefits from foreign private direct investment, and that as a result, will expropriate existing assets. It has some-
times been argued that expropriation always will be beneficial to the expropriating country because it will be able to avoid servicing of the foreign capital. This approach, which may be called the "economics of stealing", of course, denies any consequences from the expropriation with respect to future capital inflows. Such consequences would be disregarded, of course, so long as it is felt that foreign investment has no benefits, or that the inflow will be affected for only a short period of time.

It is surprising how short are the memories of foreign investors after expropriations occur. But it is also clear that there are consequences that have to be taken into account.

Ultimately the risks of foreign investment from changes in terms of the investment (including expropriation and intervention by the host government) depend on the bargaining power of the parties, and whether the initial bargain is viewed as being acceptable to all parties. As bargaining power changes, terms and conditions will change so long as the original bargain was not thought to be fair to the party whose power has increased. That is what has happened in recent years. The bargaining power of host countries increased as U.S. firms have lost their virtual monopoly in certain areas as a source of private capital and technology for developing countries. Having viewed the past terms as being inequitable, the developing countries have moved to change the terms and conditions, thus increasing the perceived risk of direct investment.

A number of proposals are being made in academic and political circles as to possible approaches for reducing the conflicts between the North and the South, and thus the risks that have arisen over the problems of foreign investment.

Included in these is an international insurance scheme designed to create an environment of confidence for investing companies, host governments, and home governments alike. There are also proposals to strengthen existing bilateral insurance institutions.

Work continues on proposals for international codes of conduct which could be adhered to by both multinational enterprises as well as host governments.

Finally, there is a variety of proposals to establish international institutions to provide finance as well as some degree of investment protection to both investors and host governments. These range from the establish-
ment of specialized mining banks to much broader multilateral GATT-type organizations which would act as international policemen in all matters touching upon foreign investment.

My own conclusion is that the international community is not yet ready to accept the self-discipline that is inherent in the successful operation of these proposals.

One of the contributing factors is that the developing countries feel keenly that the present international system, both in monetary and political matters, is dominated by the industrialized countries. As you well know, they are trying to change the existing balance of power in international forums, through the introduction of the NIEO, UNCTAD trade terms, etc.

In this environment, I feel that the best hope for progress is to first work through existing international institutions, such as the IMF, World Bank, and IFC. These organizations can operate as “neutral” third parties which both sides can use with confidence in trying to seek mutually beneficial solutions to common problems. They can also operate as repositories and dispensers of financial and technical resources that have been internationally pooled. This, at least, is a starting point.

The second possibility, under present conditions, is for more bilateral efforts to establish arrangements designed to encourage and facilitate investment between home and host governments. The most promising avenue, it would seem to me, is along the lines of establishing agreements which would constitute bilateral treaties providing the groundrules to be adhered to by investors, and host and home governments with respect to general regulations governing foreign investment and rules of conduct. These bilateral arrangements cannot be one-sided. The developing countries would have to guarantee the safety and fair treatment of foreign investments, the home governments would have to take measures to assure that their investors adhere to the rules. They would, in all likelihood, have to establish some machinery and arrangements to oversee the operations of their investors, and the investors would, in turn, have to act abroad with the same degree of social and legal responsibility as they do in their home countries.

Having said this, I still feel that the outlook is promising. Not because the conflict has lessened, but, for one reason, because the economic scope and need for greater collaboration between the North and the South—and especially for greater foreign investment in such fields as mining and energy—is increasing. The center of foreign investment is shifting—
shifting away from the prewar focus on utilities communications and manufacturing—into areas that are critical to both the North and the South.

It is because of this heightened perception of mutual benefits to be obtained from foreign investment that I would venture to say that the risks of direct private foreign investment are probably less today than they were a decade ago.

Paradoxically, I reach this conclusion because of the strengthened position of the developing countries. The importance of portfolio investments, increased competition between sources of capital and technology within the industrialized countries, the rising capabilities of the developing countries to do more for themselves, and the rise of South-South trade, have increased their bargaining power at the investment table. With a more evenly balanced investment climate, which I feel most multinational companies have come to recognize and accept, the developing countries have a level of confidence which did not exist even ten years ago. Add to this the fact that developing countries are now more keenly aware not only of the benefits of foreign investments but, as importantly, how to direct and employ them in ways that make a lasting contribution to their economic development objectives. The climate for foreign investments is a more open one than it was only a few short years ago. Lastly, the increasing opportunities for foreign investment should improve the atmosphere for both sides for a more positive and healthy attitude towards investment in the developing countries.
May I express my appreciation to the Management Forum for giving me this opportunity to share my thoughts with you on the investment opportunities in developing countries. I am delighted to be in this distinguished gathering and in this beautiful, winter wonderland setting for our meeting.

I should like to talk about investment opportunities in a broad context—in strategic terms if you will—and to give you my perspective of what the relative positions of the developing and European economies will be in the near future as a measure of where investment opportunities will be found.

The last quarter century has been a period of unprecedented growth and prosperity. In Europe, in particular, the economic growth in the last 25 years has exceeded that of the previous 100 years.

The phenomenon of European economic growth is clear and demonstrable. The causes, the factors, in all of their detail, which brought it about are not. Yet it is important at this particular time that they be better understood—especially if one believes, as I do, that Europe, and indeed industrial countries in general, are at the threshold of a new era of economic relationships.

At the root of the sustained economic expansion in Europe was the devastation left in the wake of war. The process of economic rebuilding was initially supported by the inflow of capital and assistance from across the Atlantic.

But it seems to me that a key factor which provided the momentum was the remarkable expansion and liberalization of European intracontinental trade and investment. This carried Europe through the first phase of its recovery.

During the late 1950s and early 1960s when the integration and expansion of domestic European markets began to slow down, another boost
was given—European business began to move internationally, not just in areas where they had old colonial ties, but with their major focus on other industrial economies. Later, as you may recall, as a result of Ostpolitik, this interest was extended to the Eastern European economies.

We now come to the period of the past five or six years during which the gains, so readily attained during the 1950s and 1960s, have seemed harder and harder to achieve—the brisk trade winds that gave such a heady feeling to European business seem to have settled into doldrums.

The problems that face business in Europe and elsewhere in industrial countries are fairly clear: inflation, exchange rate instability, declining investment and productivity, shortage of skilled labour, and of course all the resulting social strains.

The prescription as to how to overcome these problems is much less clear. There is a growing perception that basic structural changes have occurred and that new approaches, new relationships and possibly new institutions will be required to deal with the problems that have emerged.

Be that as it may, it seems to me that one ingredient has emerged in recent years which should be given more attention. There have been important changes in the position of developing countries in the world economy and the growth prospects for the developing and developed countries now appear very different from what they did some years ago.

In Europe, and in most of the industrial countries for that matter, there is a growing feeling that the forces which coincidentally fueled the postwar boom are rapidly become spent—that the boom is over.

Shifts by the labor force into more productive employment, barring outside influences, have stabilized. The pentup postwar consumer demand, both here and in other industrialized countries, is no longer as strong as it was. The major reductions to trade barriers within Europe and with other industrialized countries have already occurred. Population growth has leveled off and many countries have either zero or negative population growth rates. While the frontiers of innovation and technology seem to be ever expanding, it seems to get harder and harder to apply them to industry, to finance their cost, and to reap their gains in increased productivity. Most importantly, European markets, while still growing, are doing so at a much slower pace. Over the next decade, only the optimists foresee a real growth rate in excess of 4 percent per annum.
In the developing countries, the scene is somewhat different. The have also grown—if anything, more impressively—over the past twenty-five years. Income per capita has risen by over 3 percent since 1950 and total domestic production has risen between 5-6 percent per annum.

Their trade has been booming—they recorded a 600 percent increase over the last decade—and their domestic markets are expanding rapidly. They absorbed nearly one-third of the growth in the exports of manufactures of the industrialized countries over the last fifteen years. More recently, the demand from the developing countries for the manufactured exports of the industrialized economies has been amongst the most buoyant elements in the recent recession. They now take about one-quarter of the total exports of the developed countries. Investment, largely internally generated, has been exceptionally strong, especially in the more advanced developing countries, and has been growing in the 1970s at almost 9 percent per annum.

Turning now to the prospects for growth in the developing countries, they seem quite promising especially for the middle- and upper-income countries. The studies undertaken in the World Bank suggest that the developing countries are likely to continue to grow over the next decade at their recent high rate of around 6 percent per annum, provided the growth rate in the industrial countries is at least about 4 percent, and provided, furthermore, that there continues to be a corresponding increase in the flow of trade and investment between the developed and the developing countries.

This is admittedly a broad and somewhat optimistic view of the development process in the future. It clearly rests on many imponderables. Moreover, it makes no distinctions between the poorest of the developing countries who are just beginning to take the first hesitant steps towards building up a minimum capability for economic self-reliance, and those others who have managed to develop a sophisticated industrial and technological base, and whose manufactures are now competing with those of industrial countries in international markets. However, the fundamental point is that both the potential and the means for achieving rapid gain now exist in the developing countries.

They have large pools of unemployed labor, a pool that is becoming increasingly educated and skilled. They have a substantial part of the world's known reserves of energy, and of many important minerals such as copper, bauxite, nickel, and tin. There exists an enormous potential
for renewable natural resources such as agriculture, forestry, and fishing in the continents of Africa and Latin America. The future development and continued availability of these resources on an orderly basis is in the interest of the world community at large.

However, it is not just the growth prospects of the developing world, but rather the linkage in the economic fortunes of the North and the South to which I would particularly like to draw your attention.

World trade tends to grow proportionately with the increase in the pace of economic activity in industrialized countries. It fuels the demand for commodity imports from the primary producing countries and gives the impetus to manufactured exports, which are so important for the larger and more economically advanced developing countries such as, for example, Brazil, Egypt, India, Mexico, the Philippines, and Korea.

The reverse is also now increasingly true. The maintenance of import demand in the developing countries can slow down the recessionary forces in the industrial countries—as it appears to have done in the more recent past. Moreover, accelerated progress and growing markets in the developing countries hold out the promise of new opportunities for trade and investment to the European economies. If these opportunities are effectively seized, they might just provide that added dimension, or new frontier, which periodically in the past the European economies have needed to maintain continued economic momentum.

If this happened it would demonstrate vividly how far we have come towards an interdependent world economy. Whereas linkages between the North and the South have always been recognized, the relationship has been perceived essentially as one of dependence of the developing countries on those that are industrialized. It used to be said therefore that when the industrial countries sneezed, the developing countries developed pneumonia. It is still not widely understood how rapidly these relationships are changing and that we are all being propelled, because of fundamental economic forces, to a more balanced and true interdependence in the not too distant future.

I do not want to give you the impression, however, that I merely look at the silver lining of investment and of development potential in the developing countries without observing the dark and, at times, threatening clouds of political and economic instability that overhang the investment climate in some countries. The light at the end of the tunnel to which I have been pointing could well be the train coming from the other direction.
As investors and businessmen, your decisions must obviously be governed by the degree of confidence, and the prospect of reward, that you can foresee in any situation.

I believe that while the opportunities for investment in the developing countries will be more abundant in the future, they will not be universal. We must accept the fact that, as in the industrial world, political problems and economic crises will continue to occur in certain developing countries and will have to be considered in making investment decisions. As businessmen you cannot afford to be less prudent, nor exercise less caution in the future than you do today—even though the investment options may be greater.

The organization I represent, the International Finance Corporation, is deeply involved in the process of adjusting to the new environment for international investments. We feel that through our investment activities and our continuing dialogue with both governments and investors we can help find ways as an intermediary to ease the way through the difficult transition period and help construct a better investment environment in the developing countries—one that encourages cooperation rather than confrontation between government and foreign investors.

As an institution which is development-minded and, at the same time, profit-oriented, we are always seeking new ways and forms of investment agreements which are fair, which benefit all parties, and are responsive to their changing needs.

Our record to-date is good—our losses even though we have invested in difficult situations are small. Our return on both equity and loans, which, by the way are not government guaranteed, compares very favorably with that of other investment institutions.

We recently received a strong vote of confidence from 10 of our member governments who approved a substantial increase in our capital which will allow us to double our operations within the next five years. In this respect we feel that the Corporation itself is just beginning to emerge as a more viable opportunity for European investors to consider as part of their investment strategies.

IFC has great flexibility in how it might operate—as a direct investor and lender, as a catalyst helping to mobilize through syndications other investment funds for investment projects, and as an intermediary to resolve potential difficulties between investors and host governments.
Its objective at all times is to further the cause of development in a world economy that is rapidly moving towards close interdependence. Europe is an important source of capital and technology but, more important, European institutions and enterprises have historic links with large segments of the developing world and a special knowledge of conditions in developing countries. We in IFC look forward therefore to working closely with you in the coming years, in seeking productive and profitable opportunities for investment in the developing countries.
International Finance
17. Euro-Currency Lending and Developing Countries

Financial Times Conference, London
March 20, 1974

In recent months, some publicity has been given in international financial circles to the views expressed by the International Finance Corporation on Euro-currency markets in its last Annual Report. May I state at the outset that what I have to say today represents strictly my own personal views, and not those of the Corporation, or of the World Bank Group of which it is a part. Moreover, although my subject is Euro-currency lending and developing countries, the remarks that I am going to make have a much wider application.

It is almost trite to say that there is a great deal of uncertainty about the future of the Euro-currency market. After all, the Euro-currency market has been no stranger to either change or uncertainty in the past. In its short existence, it has charted a very turbulent, though an eminently successful, course. However, I believe that today—more than perhaps ever before—the Euro-currency market stands at the crossroads.

The Euro-currency market was an offspring of controls—perhaps better characterized as an illegitimate offspring—for it was born as a reaction to the introduction of monetary and capital controls in the United States. Its further development—and particularly the expansion of lending to developing countries—was shaped by the introduction of restraints on import of capital in the European countries. Now ironically, the Euro-currency market is being buffeted by the winds of freedom.

With the dismantling of controls in the United States, and the corresponding easing of restrictions on capital imports in major European countries, the question is being increasingly asked: “Will the Euro-currency market survive?” Moreover, if it does survive, what will be the future relationship of developing countries to this market?

If I correctly interpret the general consensus, the prevalent view is that the Euro-currency market is here to stay. Many think that it has found its place in the sun. There is less consensus on just what that place is. Where, in fact, does it fit into the international financial constellation?
What will be its relationship with the New York market? Will there be any major shift in its developing country orientation?

**An International Capital Market**

I think it is true to say that the Euro-currency market represents the first truly international capital market since the end of World War II, insofar as access to it has been confined not just to investors and borrowers in a few key industrial countries, but has increasingly been extended to the developing countries. The market has become truly worldwide. Euro-lending to developing countries was no more than 10 percent of total lending in 1970; it probably exceeded one-half of total lending in 1973.

Although the Euro-currency market could fairly be characterized as an international capital market in terms of its clientele, and even more so in terms of its record of resource mobilization and allocation, it is still far from meeting the tests of a mature market which might serve the world's large and diverse capital needs adequately and economically.

Nowhere are the deficiencies of the market more evident than in the periodic jitters to which it is so prone. The fears in some quarters that, following the removal of controls in the United States, financial business would shift 'en masse' to New York are merely a symptom of this problem. Of course, they are also, by contrast, a tribute to the state of development of the U.S. financial market.

There is no doubt that the United States has today a highly sophisticated and integrated market—for short, medium, and long-term funds, including risk capital. It commands the confidence of investors because of its comprehensive regulatory framework. There is a great deal of capital mobility between various segments of the market, and the breadth and depth of the secondary market assures liquidity to the investors. As a result, the function of financial intermediation is performed economically. In simple words, money is managed cheaply and safely.

Against this background, it is not very comforting to read in the financial journals that there is still a future for Euro-banking because there continue to be reserve requirements in the United States, plus such encumbrances as Regulation Q or Regulation M, which add to the cost of borrowing there. Similarly, it is not a satisfactory position that the future of the Euro-bond market should hinge upon whether withholding taxes are, or are not, payable in the United States.
The Future Role and Purpose of the Euro-Currency Market

It is fair to ask in these circumstances—"What is, or should be, the raison d'être of the Euro-currency market?" Can it endure merely as a device to get around the vagaries of monetary and capital controls in key industrial countries? Must it feed purely on the economic and financial vicissitudes of individual countries and domestic capital markets? Should it not have a more credible purpose—its own place in the sun?

I believe that it should, and that it can.

The strength of the Euro-currency market is precisely that it is not hamstrung by the constraints of national policy. By the same token, its purpose should be to become the central marketplace for the international flow of capital. To fulfill this purpose, however, it needs to evolve some frameworks of regulations for Euro-currency institutions so that investors have continuing confidence in the health and soundness of their money managers. It also needs the development of a wider range of financial instruments and techniques which are suited to the requirements of the investors, and the particular circumstances of the borrowers. In the area of long-term capital, in particular, it still needs to develop the specialization and professionalism which characterizes some of the more sophisticated domestic securities markets. In brief, confidence and professionalism are the key elements which will determine the future role and prospects of the Euro-currency market.

Consortium Lending

The great technological breakthrough of the Euro-currency market was in the area of bank consortium lending in the form of syndicated medium-term loans. There is a proper place and justification for this form of lending but it cannot be regarded as the panacea for all of the world's credit needs. The heavy reliance on this instrument during 1972 and 1973 to meet short, medium and long-term requirements for a wide variety of purposes was not the most efficient method of financing, and is fraught with potential danger.

In recent years, there have been important technological developments in industry and mining, which have led to an increase in project size, and to much larger capital requirements for individual investments. Mining projects of $300–$400 million, and steel and fertilizer projects of $100–$150 million are no longer uncommon. Large amounts of funds will also have to be marshalled for energy projects based on nonoil feedstocks. It
is not prudent that capital-intensive investment of this type be financed at floating interest rates, or over a period of 6-10 years which will not permit an adequate gestation period.

The solution to this problem does not lie, furthermore, in merely lengthening the maturities of syndicated bank loans. That tends to weaken the financial position of the lending institution by increasing the mismatch in the maturity profile of its loans and deposits. It also fails to provide adequate relief to the borrower because other features of the loan, such as the floating interest rates, are unsuited to his requirements. The answer lies rather in strengthening the genuinely long-term segments of the Euro-currency market—this means principally the Euro-bond market, although there is perhaps even greater scope in the long run for concerted action in the area of Euro-equities. It is in these parts of the Euro-currency market that there is great need for improvement, especially in the institutional ability to offer, on a competitive basis, the financial services required by investors in both primary and secondary markets.

The argument is sometimes advanced that both lenders and borrowers in the Euro-currency market proceed on the assumption that the syndicated bank loans will be rescheduled on maturity. However, these are shaky pillars on which to build such a large edifice of credit. Given the enormous shifts in Euro-currency flows, there is some question as to whether the financial institutions will indeed be in a position to revolve the loans in adequate amounts, and on reasonable terms, in a time of financial crisis.

It is also sometimes said that since much of the Euro-currency lending is to governments and to public institutions, the lending Euro-institutions are more concerned with the country risk rather than with the use to which the funds are put. This might well be true, but I question the ability of some lenders to evaluate country risks as the result of a fleeting visit to the capital of the country concerned, or on the basis of cursory investigations into debt service capacity, which are generally short on hard data and long on faith.

How can there be any satisfactory basis for risk evaluation when many of the borrowing countries do not themselves have any firm information on the basic elements that are likely to determine their future debt service capability? Also, how can there be a satisfactory risk evaluation by any single institution when there is no detailed or reliable information about the operations and exposure of the Euro-currency market as a whole?
While I personally do not anticipate serious creditworthiness problems arising from the Euro-currency debt presently outstanding in the developing countries, it would be fair to say that the faith in the market will be properly tested only after 1975 when the repayments on loans provided in 1972 and 1973 begin to mature in sufficiently large amounts. The Euro-currency market will then enter a more critical period which will test more rigorously the creditworthiness of both borrowing countries and lending institutions.

The Emerging Picture

Despite my feeling that excessive reliance on the instrument of the syndicated medium-term bank loan has hindered, and continues to hinder, the proper evolution of the Euro-currency market into a diversified and mature capital market, I remain optimistic about its future. This is principally because it is now possible to see more clearly than before the essential elements which can help define the future role and prospects of the Euro-currency market.

First, there is now the definite prospect of a steady growth in the flow of new resources into the Euro-currency market. In the past, the flow of funds into the market was largely the result of changes in the economic conditions and financial controls in key industrial countries. Now one can foresee that some part of the enormous surpluses which will accrue to the oil producers will be channelled to the Euro-currency market. This should be true irrespective of the assumptions one makes about the amounts that might go to the U.S. market, or the role which the international financial institutions might play in recycling resources to finance the balance of payments of deficit countries.

The potential resources of oil-producing countries are so large, and their interest in diversifying their investments are so obvious, that Euro-currency institutions should be able to mobilize a part of these resources if they provide, efficiently, safely, and competitively, the financial services that will be required.

Second, even if many of the U.S. multinational enterprises turn back to the U.S. market as a result of the removal of U.S. controls, there is now a good prospect that there will be new borrowers in the Euro-currency market able to make productive use of the new funds. These will include European institutions and enterprises which are faced with the need to make large new investments in the energy field as well as governments...
and institutions in developing countries whose financial requirements have greatly increased following the rise in petroleum prices.

I do not see the Euro-currency market as the ideal venue for direct balance of payments financing. The large amounts raised recently in this market by the industrial countries have created the expectation that balance of payments recycling might become an important function of this market.

It might well do so, but I cannot help feeling that the criteria for such financing cannot best be devised in the marketplace, that the role of financial institutions in such financing is quite limited, and that it makes little contribution to the long-term development of the market. The future of the Euro-currency market, in my view, lies essentially in meeting genuine investment requirements rather than in direct balance of payments financing.

Actions for the Future

What can be done to secure this future more firmly—to ensure that the potential opportunities for resource mobilization and allocation in the future will be fully seized by the Euro-currency market?

High on the agenda for the future is the need to evolve a regulatory framework for the market. Any reference to 'regulation' immediately raises in the mind of financial institutions in the market the spectre of extensive bureaucratic controls, while it conveys to official authorities a vision of banks fleeing to havens such as Nassau, the Cayman Islands, and the like. I am confident that something less painful is feasible.

To begin with, there is clearly scope for much more "self-regulation" by the Euro-institutions themselves through their existing organizations. But there is more to it than that. While some Euro-currency institutions have stand-by lines with parent institutions, the market as a whole desperately needs a "lender of last resort." If there occurred a run on the banks—and this cannot be ruled out completely—even the failure of a small institution would be enough to impair seriously the market's reputation and prospects of future growth.

There is an urgent need, therefore, for national authorities—acting individually or cooperatively—to establish some minimum reporting requirements and liquidity standards for Euro-currency institutions, in conjunction with a carefully defined commitment to provide support to them in a period of emergency.
If a modest regulatory initiative is coupled with a commitment to provide financial support, in foreign exchange terms, it should not bring about an exodus of Euro-currency institutions to various hide-outs. On the contrary, it would add a new dimension of confidence to the institutions operating in the market and greatly strengthen their ability to attract resources in competition with other domestic capital markets.

The second area in which a major effort is needed is the further development of the Euro-bond market. The doldrums into which this market has recently plunged signals the need for some determined house-cleaning. This includes, in particular, the improvement of issue procedures and a reduction of issue costs in the Euro-bond market and the development of a broader and more orderly secondary market.

With progress in these directions, the prospects for the Euro-bond market are by no means bleak. I see much greater interest in the future on the part of oil-producers to invest their resources for longer periods, and at stable interest rates, through the Euro-bond market, provided the securities are marketable and liquid. As regards borrowers, I see the possibility of the Euro-currency institutions performing the same role in bringing the LDC's into the Euro-bond market which they performed during 1972 and 1973 by introducing them to consortium bank lending.

This is obviously not a diet for weak appetites. There is a challenge here for the true security market-oriented institution which can sensitively appraise the market, aggressively push its placements, and then function ubiquitously as a market maker. The banking sector of the Euro-currency market is well-developed, it is in the market for negotiable financial instruments—both short- and long-term—that further advances have to be made.

And this brings me to a third issue which clouds the future of the Euro-currency markets—namely, the effects of growing world inflation and receding economic growth. Clearly, the impact of the unfolding world economic picture could be more adverse on the Euro-currency market than on the more established and protected domestic capital markets. I should like to highlight two points in this connection.

If the Euro-currency institutions are to make a bid for the surplus resources of the oil-producing countries and other funds, they must be prepared to introduce new financial instruments and techniques, including indexing, which offer investors not only a hedge against currency risks—such as that provided by the composite currency units already introduced into the market—but also some protection against inflation.
Furthermore, the need for a better appraisal of lending risks, and for some regulatory framework and support for the market, will be more important than ever in the type of stagflationary environment which now looms in prospect.

Let me turn finally to an aspect which is closer to my own parochial horizon—the role of international financial institutions in relation to the Euro-currency market.

I believe that the international financial institutions are today virtually the only source of comprehensive information on the creditworthiness of the developing countries. Whenever these institutions undertake project financing, this is done on the basis of a thorough appraisal of both the investment and the borrower. This is one of the areas in which Euro-currency institutions are vulnerable. The increased association of international financial institutions with Euro-currency institutions in joint financing and syndication for the benefit of developing countries can provide a more reliable basis for risk analysis, and sound decision-making, by both the lending institutions and the responsible authorities in the borrowing countries.

In brief, as the Euro-currency institutions move into the much more difficult economic environment of 1974, they truly stand at the crossroads. They can continue to maintain the lifestyle developed during the period when they were sheltered by protective barriers applied in the United States and elsewhere, but that path only leads to eventual penury. Alternatively, they can learn to fend for themselves in a much more competitive environment and accept the additional responsibilities and constraints on their operations which the new situation calls for. If they do so, it will be a sure sign that they have come of age.

The gauntlet has been thrown across the Atlantic. The question is—will the Euro-currency market pick it up?
It is a great pleasure for me to speak here today at the International Banking Summer School. The school has established itself as an important forum for analyzing contemporary banking and financial developments over the years and provides a unique opportunity for bankers of many countries, representing many financial institutions, to exchange views and share experiences. Such an exchange of views is critical to better understanding of the challenges that are now facing us. I would like to share with you some thoughts on the external financial needs of the developing countries and analyze some of its consequences for the future. I shall concentrate on the financial requirements of the oil-importing developing countries because they have been, and are likely to be, the major borrowers in international capital markets. In that context, I shall take up the role of the multilateral institutions, such as the IMF and the World Bank, in this process.

Ten years ago, the financial requirements of the developing countries were either a governmental matter or a subject of only academic discussion. Today they are major borrowers in the international capital markets. Indeed, these days there is hardly a discussion of commercial lending without some mention of the developing countries.

The significance of financial flows to developing countries can best be seen against the background of a global economy which is characterized by growing economic interdependence. This is a consequence of both rapid economic growth and trade expansion between countries. The expansion of capital flows is just one aspect of this growth in global interdependence. The more important role of trade in countries, the greater their vulnerability to external events, and, of course, the greater the need for an efficient process of financial intermediation to enable countries to adjust to adverse economic developments without sacrificing domestic growth. An efficient intermediation process, in turn, provides a mechanism for channelling the savings of one group of countries where they are in surplus to those countries where domestic investable resources are limited and where these savings can be more productively utilized. An efficient intermediation system is thus essential for the
growth of capital flows and of trade—the two principal factors that have been the major engine of economic growth in the postwar period.

The 1960s were a period of rapid trade expansion and economic growth for most countries. The developing countries benefited from the growth in industrial nations, from the stability in their financial markets and from the trend towards increasing trade liberalization. Financial flows to the developing countries grew rapidly. They were initially in the form of official development assistance and accounted for 10–20 percent of the total investment in developing countries. They were thus an important addition to the limited domestic resources of these countries, enabling them to expand their development programs and accelerate their rates of growth.

By contrast, the 1970s witnessed sharp changes in the world economy, with a profound impact on the economic position and prospects of the developing countries. The fourfold rise in oil prices in 1973/74 led to major shifts in the balance of payments position of all countries—industrialized nations as well as oil-importing developing countries. Both of these groups recorded large current deficits, while a small group of oil-exporting countries achieved large surpluses on the current account. The industrialized nations, with their large and diversified economies, adjusted rapidly to these changes; by 1975 they had completely reversed their deficits. This was achieved partly through a rapid expansion of exports to the oil-exporting nations and partly through an adjustment—a decline—in the rate of growth of their economies.

For the OIDCs, the impact of the events of 1973/74 was far more severe and long-lasting. The rise in oil prices added substantially to their import bill. Moreover, their export prospects deteriorated with the economic slowdown in the industrialized nations. With economies that were far less diversified and typically dependent on a few primary goods, the OIDCs could not adjust rapidly to the balance of payments changes. They were also opening up on the new markets of the oil-exporting nations. As a result, the current account deficits of these countries which had averaged $7–8 billion between 1970–73, or 2 percent of their GDP, rose to $39 billion in 1975, or over 5 percent of their GDP. Thus, trade and the growing international interdependence, which had seemed like an engine of growth in the 1960s, became a double-edged sword in the 1970s. It made the OIDCs particularly vulnerable to adverse external economic developments over which they had little control.
To facilitate, and in some cases perhaps to forestall, a process of adjustment to the new balance of payments situation, financial intermediation on a vastly larger scale than previously undertaken was called for. As we now know, the financial market proved remarkably successful in financing the greatly expanded financial needs of OIDCs. Financial flows to OIDCs grew rapidly in real terms and financed current account deficits of over 3.5 percent of GDP during the period 1974–78. The main channel was phenomenal expansion of lending from commercial sources. No less than 90 percent of the increase in net lending in real terms to the OIDCs between 1974–78 was accounted for by lending from private sources, in particular through the vastly increased use of the Eurodollar market. This tremendous increase in commercial lending to the developing world—perhaps one of the most striking developments in financial markets in the 1970s—gave the OIDCs time, and the opportunity (which not everyone took) to adjust to the new external economic conditions.

For most of you, this is familiar history. However, I would like to point to certain important features of that recycling process which have a lesson for both today and tomorrow.

First, the growth of commercial lending did not benefit all OIDCs; it benefitted primarily the middle-income OIDCs. These countries, which have only 40 percent of the population of the developing countries, accounted for 98 percent of all debt contracted from private sources. The low-income OIDCs—the so-called poor countries—because of their limited creditworthiness, remained almost exclusively dependent on official sources of funding. Although lending from official sources, particularly from OPEC, grew rapidly in the wake of the oil price increase in 1973, it failed to keep pace with inflation in the years after 1975. Thus, the poorer developing countries, with their limited domestic resources and less adaptable economies, benefitted least from the expansion in private capital flows.

Second, although the middle-income developing countries benefitted greatly from the rapid expansion in commercial lending, their external debt and debt servicing obligations rose rapidly. Their indebtedness rose from $64 billion in 1973 to $186 billion in 1978. Moreover, the terms on which they borrowed were considerably harder than resources they had previously raised from official sources. For example, while the average maturity of a loan from official sources was close to 27 years in 1975, it was barely 8 years from private sources. Also, the bulk of the loans was
on a variable interest rate basis. This created volatility in their debt service obligations and, of course, with the rise in real interest rates in recent years, it greatly increased the burden of these obligations.

Let me now turn to the situation as it has evolved since the second sharp increase in oil prices in 1979. By 1978, the current account deficits of the OIDCs had fallen to about 2 percent of GDP, a level not unlike those experienced in the years prior to 1974. However, with the doubling of oil prices in 1979, the deficits of the OIDCs increased sharply once again—by 1980, they were nearly $70 billion, or 5 percent of their GDPs. In real terms, these deficits were not much higher than at their peak in 1975. It is therefore perfectly legitimate to ask whether the recycling process which had worked so effectively in the mid-1970s would do so again in the 1980s.

Unfortunately, there are important differences between the two periods, and it seems clear that the adjustment process is likely to prove more difficult this time. While some short-term easing of oil prices is always possible, and, as you know, there is at this moment a virtual glut in oil markets and a drop in price, it seems to us that in the longer term, and indeed even in this decade, oil prices will rise in real terms.

This is, of course, a very different script from the nearly 25 percent decline in oil prices, in real terms, which took place between 1974–78. That was a key factor in easing the adjustment process at the time. Moreover, the oil-exporting countries are exercising more careful resource management than was the case in the early seventies, and it is therefore unlikely that they will increase their imports of goods and services as rapidly as they did after 1973. Finally, the major industrial countries continue to experience severe problems in reactivating production and economic growth, while keeping inflation under control, and an early change in this situation does not appear likely. All of this will hamper the ability of the developing countries to adjust to the new situation through an expansion in exports. A more fundamental adjustment in the new era of high energy prices and scarcity is therefore required in both industrialized and developing countries. This will clearly take sustained efforts on the part of both governments and the private sector, and, above all, it will take time.

The middle-income developing countries, which after some initial stumbling did quite well in the 1970s, now confront more serious obstacles in fitting into the recycling process. In part, their capacity to borrow has been weakened by the overhang of the debt contracted during the 1970s,
and this is especially true of that small and select group which was able to borrow heavily and maintain the momentum of its economic growth. The international banks, with their increased exposure in developing countries and their heightened awareness of the prevailing economic uncertainties, have become much more sensitive to issues of country risks to their capital and gearing rations, and to the risks of maturity transformation. Moreover, the developing countries are increasingly facing competition in international financial markets from developed country borrowers. After the 1973/74 crisis, the industrial countries were able to adjust through increased trade rather than through net borrowing from the oil funds. Now they are relying to a much greater extent on net borrowing.

The prospects of the poorest oil-importing developing countries appear the most serious because so far there has not been the upsurge in commitments of official development assistance—official recycling, if you will—that accompanied the payments crisis of the early seventies. Aid policies of industrialized countries are hamstrung by domestic anti-inflationary programs and budgetary limitations, while oil-producing countries—although in principle quite forthcoming—have so far been unable to provide relief to the poorest countries on a sufficiently broad scale.

In short: Developing countries have every reason to be seriously concerned about the prospects of effectively recycling the renewed surpluses that are accruing to the oil-exporting countries. Increased capital flows to the developing countries are now needed not only to finance their investment programs, but also to adjust to the changed international trade and energy environment.

The challenges which the international community faces in the 1980s are serious and complex. In the main, they stem from the consequences of rapid change. The growing interdependence of the world economy is but another facet of the strides in transportation and communications technology which are binding this globe ever close. Rapid changes also breed uncertainty and fear. The more we believe we know about the working of the economic and financial system, the less effective a job we seem to do in managing it. The answer clearly lies in recognizing the limits of each country's economic power. No one country or group can today successfully adjust in isolation. The industrial nations need desperately to restore financial stability and revive their economies, but they cannot do so by raising protective barriers or by adopting monetary
policies that syphon capital away from others. The developing countries similarly cannot escape the process of belt-tightening in a resource-constrained world and adjusting to an energy-scarce environment. There is a need for a growing sense of partnership so that we can share in the growing fortune of each other rather than wring our hands at each other’s misery. The financial markets are today the clearest barometer of this lack of international cooperation; of the prevailing fear and uncertainty with respect to each other’s financing and monetary policies; and of the diversion to resources and uses that might be politically safe but are not necessarily the most productive.

The multilateral institutions, particularly the Bretton Woods institutions, will have a role to play in strengthening intermediation and the adjustment process. The creation of the Bretton Woods institutions in 1945 was a recognition of the need to adopt a collective approach to the global economic problems—a need which is no less today than in 1945–46. These institutions can play a central role by acting as the forum for discussion of the financial issues, by serving as a bridge between nations, and by providing finance and policy advice to the developing countries. Both the IMF and the World Bank have taken important steps to meet these needs.

The IMF has moved impressively. Recent initiatives taken by the Fund have vastly increased the resources it can make available to the developing countries. Commitments to these countries could reach up to 20 billion SDRs annually in the next few years, compared with net drawings of only 3 billion SDRs for developing countries between 1976–80. Moreover, the IMF, through the conditionality of its credits, its growing interest in supply side issues, and the lengthening of the terms of some of its credits, can make a major contribution to helping developing countries tackle their structural problems.

The World Bank, too, has a critical role to play in the adjustment process of the 1980s. The Bank has, over the 1970s, become an increasingly important factor in the intermediation process and a growing source of direct financing to the developing countries. In our last fiscal year, the Bank committed nearly $9 billion, contributing on a net basis between 8–9 percent of all borrowings by developing countries. Moreover, the Bank makes an almost unique contribution to the developing countries by providing them long-term fixed rate funding in an environment increasingly characterized by shorter variable interest rate financial instruments. The Bank is also the largest source of multilateral concessionary lending to the poorest developing countries. Through its affiliate,
the International Development Association, over $3 billion worth of credits were committed to these countries in our last fiscal year.

In addition to its own lending, the Bank plays an important role as a catalyst in attracting other sources of funding to the developing countries. In 1980, over $4 billion of funds from other sources, both official and private, were linked with Bank projects. In recent years, there has been increasing emphasis on cofinancing with private commercial sources of funding. This has provided these institutions with an opportunity to acquire attractive and high-quality assets, and encouraged lending to the developing countries.

While the role of the Bank in transferring financial resources to the developing countries will be an extremely important one in the 1980s, its role as a source of policy advice and technical assistance on problems of development is likely to be even more important. At no time has there been a more pressing need to ensure that the developing countries adopt sound domestic policies to undertake essential structural changes and make best use of their limited resources. Lending by the World Bank must assist developing countries formulate specific programs in the field of consumption and investment that will enable these countries to pursue their development programs without serious disruption. The problems facing these countries are neither short-term nor temporary. Availability of financial flows can postpone necessary adjustment—it cannot eliminate them. The longer the necessary changes are delayed, the more difficult they are to deal with.

The World Bank is attempting to reorient and strengthen its own activities in directions that would respond more effectively to current economic conditions. One of these is the increased priority being given to energy lending. Although the sharp rise in energy prices has placed a great burden on the balance of payments of OIDCs, it has also greatly increased the profitability of domestic energy production. Studies undertaken in the World Bank have concluded that the potential for investments in the energy sector in the OIDCs could be as high as $275–300 billion during the period 1980–85.

Finally, the World Bank will need to play an active part in promoting a more open and dynamic economic climate against which the developing countries can adjust. The World Bank, through its analysis of global issues, and with a membership that includes both developed and developing nations, is in a unique position to promote the global partner-
ship that must prevail if the adjustment process is to be effectively managed.

It can do so if it has not only an economic mission, but also a political constituency. The Bank is an intergovernmental institution. It operates on consensus. It needs the support of all of you from different parts of the world.
Thank you very much for inviting me to join you at this very timely and important Roundtable Conference. My congratulations to the Finance Ministry of Japan, Oxford University, and our own Economic Development Institute on gathering such a distinguished group to wrestle with such a challenging subject.

"A university should be a place of light, of liberty, and of learning," said Benjamin Disraeli. It is as well that we have come to this great university city, and to historic Eynsham Hall, to ponder on the matters before us. These matters call for the application of the best learning. Liberty ensures the freest exchange of our ideas. And heaven knows we need light to shed upon the shadowy complexities of the subject.

The implications for the developing countries of trends in the industrial capital markets are complex indeed. I therefore want to focus clearly on what the implications are for one particular group—the heavily-indebted developing countries.

Before an audience as informed as this, I know I need not retrace the history of how the crisis arose. Suffice it to remind you that those who now labor under the impact of the debt crisis were those countries that were earlier the beneficiaries of the force then driving international capital flows; the recycling of petrodollar surpluses.

Today the situation is different.

The financial markets continue to serve an intermediation function, but they are driven not by recycled petrodollars but by the twin U.S. deficits—trade and budget. The country of the world's premier reserve currency is facing serious major imbalances in its economy. United States' Treasury bonds have taken the place of Eurodollar deposits in attracting capital from abroad. America, however, does not stand alone. There are other important economies with significant imbalances. And
we have to realize that there are no quick imbalances. And we have to
realize that there are no quick mechanisms for correcting these imbal-
ances for some time to come. Until equilibrium is restored, these imbal-
ances will be a major source of instability in what are now global financial
markets. And that kind of instability is one of the several elements
making today's financial markets so volatile and unsettled.

Let us look for a moment at the root causes of this instability.

First, large U.S. dollar financial assets are held outside the U.S. by
non-U.S. investors. The managers of these assets tend to base their
investment decisions on expectations of currency fluctuations and inter-
est rates movements. Based on these expectations, billions of dollars are
shifted from one currency to another, from one financial instrument to
another, and from one market to another.

Second, in major industrialized countries, enormous pools of savings are
now mobilized and managed by institutions and money managers. This
concentration has reduced the number of players in the market. We now
have a limited number of powerful financial institutions instead of the
tens of thousands of individuals whose differing preferences and re-
sponses brought a natural balance to the market. These institutions have
the computer-based programs and information technology to enable
them to shift resources quickly and frequently, unlike the old-style
investors, who tended to take their time, thereby triggering and fostering
market-making and stabilizing forces in the markets.

These institutions now hold a huge portion of the world's savings, and,
by their investment decisions, they have greatly contributed to a
securitization of assets. Domestic and international lending is no longer
dominated by syndicated credits, it is increasingly being done in nego-
tiable and marketable instruments. Junk bonds have replaced commer-
cial bank credits in financial mergers in the world's largest economy.

The truth is that with the emergence of a global financial market,
volatility in domestic markets can no longer be controlled by domestic
monetary policies, and there is no international regulatory agency to
oversee large offshore financial markets. Investors and borrowers are
having to learn how to manage risk under conditions of great uncertainty
and instability. Their response, of course, is the rich array of financial
instruments which will provide such excellent grist for your intellectual
mill this week—swaps, futures and options, hedging techniques, and
diverse variations on the theme. However, despite the ingenuity with which financial engineering is being applied, most financial institutions feel exposed and vulnerable—and perhaps no one more so than commercial banks. It is no accident that in the United States only one commercial banking institution is rated Type “A”, and most money center banks do not enjoy even an “A” rating. It is not surprising therefore that most commercial banks are not concentrating on expanding their domestic banking business, and have lost their appetite for any new lending to the developing countries which they—and in many cases their regulatory agencies—see as an area of high risk. It is somewhat ironic that, so far, the institutions that have suffered the most in terms of an erosion in their market standing, have done so principally because of losses and write-offs on their domestic loan portfolio rather than in the international portfolios. Nevertheless, this is the setting—the capital market environment—in which we have to cope with, and solve, the debt crisis.

The debt crisis is now entering its sixth consecutive year in an atmosphere of deepening pessimism. As you well know, 1987 was a difficult year for the international debt strategy. Eroding economic performance in several of the major debtor countries weakened creditor confidence and support for them. Developing countries have had to deal with weakened and vulnerable financial institutions. And the decision of many commercial banks to bolster their defences against potential losses on their developing countries’ portfolio, added to the already bleak outlook for 1988.

There is now a widespread perception that the debt crisis is worsening, that the present approach is not working, and that something radical needs to be done to solve what has now become one of the most serious economic and financial problems of our time.

I share the prevailing feeling of concern. The debt problem has become a major obstacle to the resumption of an orderly development process. This crisis is essentially a crisis of low growth in the debtor countries. It is also, however, a crisis for the creditors whose assets are now priced by the New York markets well below their face value. In other words, one end of the ship is badly holed, and those at the undamaged bow will find no salvation in ignoring the damaged stern. All hands must be put to the pumps if the ship is to be saved.

To know where we go from here, we have to understand at what point we have arrived. Frustrated and fatigued as we are, we have to realize that some important gains have nonetheless been made in the past five years.
To start with, there is more general acceptance that the measures to be taken to help solve the problem of heavy indebtedness must respond to the shared interests of both debtors and creditors. In other words, there is an acceptable way and an unacceptable way of dealing with the crisis.

The unacceptable way is for either the debtors or the creditors simply to walk away from it—for the debtors to deny the debt, or for the creditors to deny their own interest in helping the debtors to regain their creditworthiness. Neither course can, in the long run, help either party.

To the credit of all parties, a rupture in the relationship between debtors and their creditors has largely been avoided. This stands in contrast to the experience of the 1930s which was marked by generalized defaults, loss of access to external financing altogether, and prolonged periods of arrears before relationships with external creditors were restored.

The essential aspects of debtor-creditor relationships have been maintained largely because both parties have shown a willingness to act and to bite on their respective bullets.

The gains from this approach to the international community, and in particular to the international financial system, are incontrovertible. The system threat to the international financial system has been eliminated. We have thus far, at least, escaped a global recession that could well have been precipitated by a serious disruption in the functioning of the international financial systems.

For their part, the commercial banks have markedly strengthened their position. The banks have been able to increase provisions and loss reserves, as well as shareholder equity. At the same time, through various means, their capital exposure to the heavily indebted countries has been substantially reduced, even for those institutions that were most heavily exposed.

As regards the heavily-indebted middle-income countries, many of them are implementing wide-ranging structural adjustment programs to restore growth and creditworthiness. This typically involves a far-reaching redistribution of available resources from less to more productive uses. Fiscal and external trade imbalances have to be reduced; internal and external price regimes reformed; the public sector restructured and revitalized; and the resources and energies of the private sector stimulated.

These programs are not without social and political costs. And we are talking about countries that are relatively poor to begin with. But the
reform programs are absolutely indispensable. As Edmund Burke put it two centuries ago: "A nation without the means of reform is a nation without means of survival."

Several developing countries such as Mexico, Uruguay, Chile, Colombia, and Bolivia, have made remarkable progress in undertaking far-reaching reforms that are designed to stimulate the growth and efficiency of the domestic economy—these are essential underpinnings for a sustainable growth program.

We must recognize therefore that the fundamentals of the international debt strategy, as articulated by Secretary Baker in Seoul in 1985, remain valid today. The Baker Plan recognized both the financing requirement of the debtors and the need for them to implement growth-oriented policies. What was innovative was its emphasis on growth while undertaking adjustment.

The Baker approach held out the not unreasonable hope that a combination of strong policy adjustments by the debtor countries aimed at a return to sustainable growth, a steady and adequate inflow of underpinning capital from commercial banks and multilateral institutions, and support from a buoyant global economy, would progressively diminish the debt burden.

But most of the heavily indebted countries have not experienced an adequate rate of economic growth. Indeed, in many countries per capita income is still lower than a decade ago.

As we reported last month, when we published our annual World Debt Tables, largely because of inadequate growth, most of the debt indicators for the heavily-indebted developing countries have worsened. The sole improvement has been in the fall of interest-to-export ratios due to the decline in interest rates.

Thus the debt and development crisis in these countries is still very much with us.

Why is this so?

There seems to me to be three basic reasons: The first is the extremely slow growth in the industrial economies. It has, on the one hand, dampened demand for developing country exports and, on the other hand, reinforced resistance to any alleviation of protectionist measures against certain major developing country exports. Its effects have been particularly severe in the case of primary products where there has been
a sharp and protracted deterioration in the terms of trade of primary producers. The average dollar prices in real terms of developing countries' exports other than fuel, fell by another 10.5 percent in 1987 following a 15 percent fall in 1986. These price falls have greatly reduced the amount of resources available to the producing countries for investment and depressed their growth rates of output and per capita income.

The second reason is that fresh financing flows have simply not been adequate to these countries' needs. Quite the contrary, there is a large resource outflow from the heavily indebted countries at a level that is clearly not sustainable. There is no way that the monumentally difficult task of adjustment can go forward effectively while resources needed to sustain even a minimal growth rate continue to dwindle. In the last two years, the commercial banks have been net recipients, not providers, of fresh money to the heavily indebted countries. Undeniably, they confront increasing obstacles to an increase in exposure but there is a long-term commonality of interest between at least the large money center institutions and the indebted countries in maintaining a reasonably stable and predictable flow of bank credit, preferably in support of adjustment and in association with the multilateral institutions. Otherwise, their growing provisions for loan losses are bound to become a self-fulfilling prophecy.

The third reason is that the adjustment process has been uneven. Some countries have managed to sustain the process once launched. Some others have let it sputter and, in a few cases, die.

These, as I see it, are the reasons why the crisis persists. How long it will persist is a tough question to try to answer. But one thing is certain: there is no shortage of proposals on how to end it. To paraphrase Winston Churchill: Never in the field of financial relations have so many experts claimed so complete a monopoly of good sense in treating so complex a problem.

What troubles me is that just about every one of these proposals assumes the form of a single overall solution. Virtually all of them have as their centerpiece an institution—multilateral or otherwise—through which governments are expected to put their credit on the line. There is a fatal flaw in this: under present circumstances, governments are not prepared to put their credit on the line. And even if they were to, it would be to little avail unless the mechanism was market based, and the way was found to ensure that the indebted countries persevere with the adjustment effort.
The poet, Carl Sandburg, said of himself: “I am an idealist. I don’t know where I’m going, but I’m on my way.”

I’m afraid that a lot of the idealists with simple solutions to the debt crisis may not know where they’re going either.

For the heavily indebted countries to work their way out of their indebtedness problem, they must, in our view, achieve a 4-5 percent annual GDP growth rate over the next five to seven years. This is critical, for without it there will be neither the economic margin nor the political will to service external debt and restructure the economies.

To achieve this objective, the debtor countries must continue the effort to improve macroeconomic management and adjust the structure of their economies. This has to be done not for the sake of foreign creditors in the first instance, but because the enhancement and efficient use of domestic savings is an essential step towards the restoration of a sustainable process of economic growth.

The dimensions of the debt workout are such that substantial additional resources will be required for an adjustment period stretching over five to seven years, at the least.

Let us be very clear about the implications of this. Effective adjustment is a key element for an effective growth strategy but financial resources are equally essential if growth-oriented adjustment policies are to succeed. The financial resources are needed not only to tide countries over the difficult adjustment period. They are needed also to fund high priority investment projects that have languished over the past five years as investment in the indebted countries has fallen sharply. A significant amount of net capital inflow has been an essential part of the debt strategy from the beginning. It has become even more so today, and new ways must be found to provide it. If the volume of direct lending is not commensurate with growth objectives, the shortfall will have to be covered by a reduction in debt service.

By our reckoning, the total external financing requirements of the 17 Baker countries will be consistent with the projected growth rate, and will be no less than $70-80 billion over the next five years.

It is equally clear that, whatever form they may take, these additional capital inflows should be reasonably stable and predictable—which highlights again the need for a medium-term approach to the problem.
We need also to plan the debt restructuring and financial packages in support of these adjustment programs with a two- to three-year horizon.

How can these resources be mobilized? We must be realists. What we have been witnessing recently is a widespread retrenchment by commercial banks.

Under present circumstances, there are clearly limitations on the amounts of new money that we can expect to be mobilized. And that limited amount will not be enough to do the trick. This is why we have to turn also to debt reduction alternatives, such as interest capitalization. We should recognize the critical importance of strong market-based mechanisms to arrive at mutually agreeable, negotiated, settlements. For example, the great value of the Mexican exchange offer, in my opinion, is as much in the opportunity it provides as an exit instrument as in its debt-reducing feature. The time has indeed come to develop more innovative approaches in this area.

This brings me to the role of the World Bank. The Bank is prepared to take appropriate risks of a catalytic nature within the guidelines of prudent management. Like all other key players on the debt scene, the Bank has to take a more active approach, and it will indeed do so with a view to supporting collaborative workout strategies in all cases where such a workout would rely upon credible adjustment programs.

Since 1982 we have become the largest single source of new money to the so-called Baker 17. Our commitments to these countries were in excess of $33 billion during the period FY 81–87. Of that amount, almost half has been committed in the past three fiscal years alone.

We believe that we can play an important catalytic role in the search for market-oriented, negotiated solutions, wherever the strength of adjustment programs and countries' circumstances warrant our extended support through various forms of credit enhancement. Our focus in many countries will remain on catalyzing new money, and you are certainly familiar with the various steps we have already taken to facilitate the contributions of the lenders, including commercial banks.

We are also prepared to move in support of appropriately structured, market-based, debt reduction schemes as a complement to concerted new lending. Our involvement in such schemes will be to facilitate, not force, negotiated agreement between debtors and creditors, and we will only use our credit enhancement capabilities when it will clearly yield significant benefits to the country concerned and make a major contribution.
to the overall financing plan. Our overriding objective is growth, and in those cases where new money is not forthcoming to fuel that growth, we will do all that we can to avoid a breakdown in relations between the debtor and its creditors.

We have a wide range of possible instruments available to such negotiated schemes, and we can easily envisage a selective involvement in supporting defeasance schemes, such as buybacks and debt-equity conversions, through carefully tailored approaches to credit management. But we cannot do it alone. The Bank is prepared to be a lead player but not the only one. The commercial banks and the providers of aid are lead players too and our collective interaction is crucial to the solution of the problem.

In summarizing, let me try to capture my message in a few sentences.

We are today coping with the debt crisis in an international financial environment which is very different from that in which the crisis originally arose. We will not cope successfully with that crisis by fighting yesterday's wars. We have to look at the world as it is now and adapt the means at our disposal to solving the emerging issues of today and tomorrow.

A crucial problem of our time is to resolve the twin issues of debt and development. Effective adjustment and adequate resource flows are both essential conditions for sustainable growth and a successful debt workout in the heavily indebted countries.

We have so far not been able to achieve an adequate rate of growth in the heavily indebted countries. And we have to recognize that the present new outflow of funds from the indebted countries is simply not sustainable.

Adjustment alone, therefore, will not resolve the twin problems of debt and development. I also do not see a Santa Claus on the horizon ready to bail out the banks, or for that matter the indebted countries. Even if there were to be such a masterstroke of international generosity, it would not, by itself, engender a sustained growth process in the indebted countries.

And yet the financial markets do afford the opportunity to chip away at the problem and if all of the actors concerned—the indebted countries, the creditor governments, the commercial banks, and not least the
multilateral institutions—recognize the need for joint and collective action, it will make an important difference.

I believe this is beginning to happen.

I also want you to know that the World Bank will play its part—by being prepared to take calculated risks, by encouraging innovative financial engineering, and by supporting determined efforts at economic reform—and endeavors to make sure that it does in fact happen.

I know that you will spend a good deal of your time this coming week exploring ways of encouraging new patterns and forms of capital transfers to the developing countries. I believe the old order of commercial bank lending has ended irretrievably. I see from your agenda that you envisage for the future a more prominent contribution from direct investment, and trade and project-related lending to total flows. I share the sentiment but these factors alone will not resolve—at least in the foreseeable future—the problem of channeling an adequate volume of financing for development to the indebted countries.

We need to address the issue of how long-term sources of funding in the western world can once again begin to see the developing countries as an area of acceptable risk and reward for investment. Performing a catalytic role to that end is the challenge to which the World Bank and its agencies will increasingly dedicate themselves.
The Debt Crisis
The World Bank and the Crown Agents have enjoyed a long friendship, and we have always greatly admired the professionalism, the experience, and the integrity you bring to bear on the broad range of services which you provide to more than 100 countries. At a time when development aid resources are all too scarce, applying it in a manner that will produce the maximum benefit to the developing country and its peoples is of supreme importance. I know that the Crown Agents have taken good account of the growing emphasis now being placed on increasing the return on existing resources, especially the rehabilitation and maintenance of plant, and on improving the management of existing and new resources. This focus has afforded you growing opportunities to provide the high services for which you are renowned, and for which both client countries and funding agencies have cause to be grateful.

I want to share with you today some thoughts on the debt problem of the developing countries. Before an audience as informed as this, I know I need not retrace the history of how the crisis arose. And we will leave it to the economic historians to mull over why more people did not at the time see more clearly that it was coming. Winston Churchill claimed that political ability was the ability to foretell what was going to happen tomorrow, next week, and next month and next year, and to have the ability also to explain afterward why it didn't happen. But does it take political wisdom, I wonder, to explain why what was never forecast did actually happen? If so, then maybe Wall Street and your meteorological services would be handed over lock, stock, and barrel to the politicians.

To say that we have passed through some very stormy weather of late has a doubly painful ring of the truth for you. In America we have had reason to ponder on the geographical fact that Wall Street is a thoroughfare that begins in a graveyard and ends in the river. This October has certainly been an uncomfortably memorable month. Mark Twain once said that October is one of the particularly dangerous months in which to speculate in stocks. Then he added that the other dangerous months were
November, January, February, March, and on through the entire calendar. He had his prejudices, of course.

But then there are always people for whom now is never the right time to grasp a nettle that needs grasping. To their infinite credit, there are many heavily indebted countries who are indeed grasping the nettle. And that is one of the reasons, perhaps the most important reason, why the systematic threat posed by the debt crisis to the world's financial system has abated. A number of these countries, despite the difficult external environment, have been making substantial progress in implementing reforms to improve the functioning of their economies. Many have strengthened their exchange-rate and interest-rate policies; some, like Colombia, have made good progress in reducing large fiscal deficits and in pursuing more sensible monetary policies. Some, like Chile, have dramatically slowed down inflation.

A number of countries, including the two that I have mentioned, have embarked on comprehensive structural policy reforms that can lead to improved resource allocation and increased efficiency. Trade regimes are being liberalized, public enterprise systems overhauled, the markets' role in allocating resources is being increased, and private savings encouraged. Believe me, it has not been, and will not be, easy for them. But their commitment to press ahead—invariably with the help of the multilateral financial agencies—is very reassuring and can bode well for the future.

A number of promising debt workouts have been initiated in countries such as Mexico, Argentina, and Chile. New financial instruments, and a secondary market, have emerged. Debt-equity swaps, debt buy-backs, and securitization are among the available new options, and if not yet on a scale commensurate with the need, at least we are seeing a beginning. Secondary markets too are thin—only about $10 billion last year according to the IMF—but they are expanding.

Among the highly indebted low-income countries of Sub-Saharan Africa, there too are a few bright shafts of light amid an otherwise pervasive gloom. Many of these countries are making courageous efforts in the most difficult circumstances to implement needed policy reforms. Nigeria, Ghana, Ivory Coast, Senegal, Tanzania—these are but a few of the countries carrying out difficult reforms necessary to improved economic performance and return to sustained growth. Income levels of Sub-Saharan Africa's indebted countries remain depressed below 1975 levels, but sustained adjustment programs can liberate the entrepreneurial and productive potential of Africa's economies and peoples. In the mean-
time, the debt crisis, through which many are now passing, can and must be contained and managed.

We must neither throw up our hands in despair of finding solutions, nor, at the other extreme, allow the progress already achieved to mask the seriousness of the problems yet to be solved in both the middle-income and the low-income countries.

Let me briefly review the more prominent and pressing of these concerns.

First, the many countries that are responding courageously to the pressures to adjust are finding it harder and harder to persevere because of the impact on their efforts of an exceptionally unhelpful external environment.

Consider the problem of slow economic growth in the OECD countries. Growth of GDP in industrial countries slowed from 2.8 percent in 1985 to 2.5 percent in 1986. In Japan the growth rate fell from 4.5 percent to 2.2 percent. Even given the most optimistic assumptions, the average GDP growth rate in industrial countries is unlikely to top 2.4 percent in 1987, a slower pace than last year. That cannot bode well for the increase in demand for developing countries' exports which the latter so desperately need.

We must then add to the negative side of the equation the continuing and intensifying protectionist pressures that threaten developing country access to the markets of both the industrial and their own developing world. In the United States, for example, the increasing current account deficit and the slow growth of demand both build up the pressures for trade restrictions, despite the depreciation of the U.S. dollar. In the European Economic Community, the will to liberalize trade, especially in agricultural goods, is weak and shows no signs of strengthening.

Meanwhile in the surplus countries, currency appreciations are affecting the tradeables sectors, and weakening export demand is putting a nasty drag on growth of output and income. That is not an atmosphere conducive to increased liberalization of their markets. The chill winds of protectionism are blowing, and they blow nobody any good, the perpetrators no more than the victims.

A further major concern is the fundamental difficulty facing producers of primary commodities. Low external demand and increased supplies
have lately sent the dollar prices of primary commodities into a virtual free fall. The average dollar prices of developing countries’ exports other than fuel fell by 26 percent between 1980 and 1986 (35 percent relative to the price of their imports of manufactures). Meanwhile oil had dropped by a staggering 61 percent. Only a few metals have shown any signs of recovery. These price falls during the 1980s have greatly worsened the terms of trade of the producing countries, reducing the amount of resources available for investment and depressing the growth rates of output and per capita income. How, one asks, can the monumentally difficult task of adjustment go forward effectively while resources needed to sustain the effort continue to dwindle?

Compounding the problem is the threat of higher interest rates which in real terms are already above historical levels when adjusted for low commodity prices. It was not only the panic-stricken stockholders of the industrial world who were last week crying out for a reversal of the upward interest rate trend. And yet, expectations are that there could well be a further rise in interest rates. This has not happened so far, thanks to the wisdom of central banking and monetary authorities in the world’s major financial centers, despite the storms that have swept through stock markets in recent days. But it would be idle to pretend that the events of the last few days—even assuming that the situation in security markets progressively stabilizes—will not leave their inevitable fallout: greater uncertainty, diminished confidence, greater caution. The latter is understandable and probably salutory in the current environment but it is bound to reinforce the forces pointing towards lagging economic growth in the industrialized countries.

A fourth major concern must be the sharp decline in commercial bank lending to those who have in the past been used to borrowing from them, and of export credit agency participation. After the onset of the debt crisis, commercial banks rescheduled substantial amounts of debt, made net new commitments of funds, and provided major financial resources to countries that had not rescheduled. But then they drew back, and in 1985 net lending from them turned negative as they significantly reduced their exposure in developing countries relative to their net worth and their total assets.

There are those who interpret some major banks’ recent provisioning against losses as a signal for further withdrawal from lending. Certainly it presages a tougher bargaining position in future debt rescheduling negotiations. There are others, however, who see this loan-loss provi-
The Role of the Bank

The decline in commercial bank lending is an understandable reaction to a difficult situation until one comes to the realization that in fact it can only make the situation worse. A return to creditworthiness in the indebted countries is something we all want. But the banks must come to see that return as the product in part of new lending and not as the precondition for it.

There are two kinds of self-interest, the enlightened and the heedless. Maybe the banks should recall the words of President Roosevelt at his second inauguration half a century ago: "We have always known," he said, "that heedless self-interest is bad morals. We now know that it is bad economics too."

We must not forget, however, that for some countries, particularly those in Sub-Saharan Africa, the prospect of a return to new lending on conventional terms is academic—they cannot afford to borrow. For them the solutions lie elsewhere, notably in the provision of capital on concessionary terms, as I shall shortly emphasize.

The concerns I have mentioned so far are in essence those rooted in the inhospitable external environment in which the indebted countries are seeking to work their way out of their debt problems. There is one major concern however that has its roots in the very efforts that the countries are making.

In many of them, economic stabilization has required sharp reductions in needed investments and social expenditures. And that, in turn, may have weakened the foundations for future growth. A life-threatening fever needs to be brought down. But if the method to bring it down undermines the fundamental health of the patient, the patient has little to hope for.

I am particularly concerned about the impact on the poorest levels of society of severe cuts in social expenditures, and in the latter part of my remarks, I wish to share with you my thoughts on how we can better help governments face this problem and alleviate it.

These, then, are the major concerns that worry us even as we applaud the efforts being made, and the not insignificant progress achieved in the
adjustment process in many indebted countries. We now have a much clearer understanding than we did even three years ago of the real nature of the debt problem.

We know now that there is not a single debt problem but a variety of them, ranging from those which afflict countries which need to increase their debt to resume sustainable growth, to those which afflict debtor nations, particularly those of low-income Sub-Saharan Africa, which cannot increase their debt obligations further. Even within these two broad categories, country circumstances can differ widely. And that means that only a case-by-case approach is truly practicable.

Secondly, we have learned that there is no substitute for adjustment for countries facing debt-servicing difficulties. Let us not forget that in many cases today's difficulties arose out of yesterday's failure to adjust to internal exigencies and external shocks. Nobody could have foreseen how long and severe would be the recession that gripped the world economy in 1980, and it was therefore not surprising that many countries saw no harm in financing current account deficits with debt, rather than reducing absorption. Now the piper has to be paid through a reversal of that process. Now only long-term sustainable growth and therefore the creation of the incentives necessary to secure it can bring a return to creditworthiness.

A third lesson we have learned is that adjustment takes longer than we had expected. We have been discovering the near-truth of Dr. Samuel Johnson's discomforting dictum that: "the chains of habit are too weak to be felt until they are too strong to be broken."

Developing countries—and industrial countries too—found that domestic economic structures had become too rigid from past poor policies for there to be a quick response to improved incentives. Furthermore, the tailoring of the adjustment programs has often failed to fit the size and shape of the problem. In many countries, the magnitude of the initial imbalances and the fragility of the political and social structures expected to absorb the shocks of reform, have made it hard to reduce consumption levels too low for too long.

The fourth lesson is that there can be no practical solution to the debt problem that is not mutually acceptable to both debtors and creditors.
For the middle-income debtors, this basically calls for innovative market-based approaches. But the techniques deployed will succeed only if they are accepted voluntarily and at realistic prices. For the low-income debtors, it will call for financial assistance tuned to the rhythm and strength of their adjustment efforts. What we ask from them in policy reform must be what they can realistically achieve without overstraining the fragile fabric of political stability. What we provide to them must be commensurate with what they need, and can effectively put to use, in support of their efforts to regain sustainable growth and creditworthiness.

These are the lessons we have learned as we now find ourselves in a new phase of the process of solving the debt problem. The widespread gains in efficiency which have resulted from policy reform must now be built upon with an expansion of investment aimed at restoring growth. For only with restored growth can restored creditworthiness be assured.

We are now therefore at a watershed. Either we decide to help the debtor nations build on what they have so far so painfully achieved, or we sit back and let matters drift. In my view, that latter course would be grossly foolhardy and extremely dangerous. It would be dangerous to the debtor countries, and as cynical as throwing a lifebelt to a man overboard in heavy seas and then steaming away.

Drift will also certainly endanger world trade, pushing off into the future the day when the debtor countries can once again afford to be an expanding market for the rest of the world's exporters. And as trade declines, the decline will be given extra impetus as economic isolation raises its protective barriers against the outside world.

The dangers of drift can be particularly felt by individual commercial banks. Not only today's net worth and liquidity can be threatened. Drift risks creating a serious scare that the banking system as a whole is under intolerable strain—a scare that will take its toll indiscriminately of the strong and the fragile alike.

But perhaps the greatest danger of drift is that it will deprive the whole effort of leadership. There will be no front-runners to show the way. Adjustment programs launched with determination will be abandoned in despair. The long and costly but crucial process of restoring growth and creditworthiness to the indebted countries will founder on the twin rocks of indifference and shortsightedness.

No, we cannot afford to drift. We have to help these countries build on what they have already achieved. But being at the watershed, we have
first to accept that the changed nature of the problem calls for revised thinking on how to proceed from here. We have to recognize now the need for a longer-term perspective for the continuation of adjustment and the provision of finance to support it. First, we need to see adjustment as a medium-term exercise, which means giving adjustment programs at least a four to five-year horizon, or even longer if circumstances in a particular country warrant it. Secondly, we have to plan the debt restructuring and the financial packages in support of these adjustment programs with a two to three-year horizon. This does not mean that there must be a formal financial commitment for that entire period. What it does mean is that we have to build in at the start a firm understanding that, from the first year's tranche onwards, further support will be forthcoming where countries continue to sustain their adjustment and reform programs.

Implicit in any longer-term support plan is the assumption that there will be growth in the economy being assisted. For without growth, there is little chance that the political will can be mustered and sustained to carry through the adjustment program. This was clearly the intent of the Baker Plan proposed by the United States Treasury Secretary in the autumn of 1985. But the world environment proved much less propitious than expected, the necessary levels of financial support were not forthcoming, and the vicious circle of low growth-low investment-lower growth was the result.

We have now to break out of that circle by raising the levels of support for those countries clearly making an adjustment effort. The multilateral financial institutions must lead the way, but the commercial banks and the export credit agencies must come along too. We cannot do it alone.

What, then, must our overall strategy be?

First, the industrial economies have to address their own trade, monetary, and fiscal problems, so that confidence can be re-established and they can resume a more adequate rate of growth. Continued large trade and fiscal imbalances, and the exchange rate instability and protectionist pressures to which they give rise, are depressing the growth of the world economy well below the levels we know are needed.
Secondly, the debtor countries have to persevere in their adjustment efforts and be prepared to undertake even more far-reaching policy reforms.

Thirdly, commercial lenders have to match the realism they have shown in provisioning against loan losses with realism about their longer-term stake in world trade, investment, and economic growth. No debt strategy can succeed without their active participation, and success in overcoming the debt crisis is central to their own future and growth. The demands placed upon them now should not be unreasonable, but they should at least ensure that between one-third and one-half of the interest paid by the debtor countries is covered by new money lent to them. That, at least, the commercial banks should be prepared to do. For the fifteen major indebted countries included in the Baker Plan, it would amount to a net increase in their exposure of no more than $10 to $12 billion.

To use the transatlantic vernacular, the banks too need to "get their act together," and make a well-concerted effort to meet the needs of the situation rather than pursue either a confrontational or a divisive course. For let me make it quite clear; the World Bank's own expanded lending program is not intended as a bail-out for the commercial banks. We are prepared to assist wherever our assistance is needed but we do not have the resources or the inclination to assume the debts of others.

What, then, is the role that the multilateral development banks must play? They are already important players on the debt scene. Since 1985 they have surpassed the commercial banks as the major lenders to all capital-importing countries. In the highly indebted countries, their exposure has increased even more. In 1980, the World Bank provided the equivalent of four-fifths of total net lending to the fifteen highly indebted countries upon which the Baker Plan is focussed.

For the immediate future, the World Bank and the other multilateral development banks have a threefold role to play. First, they have to increase their lending to the indebted countries in support of determined adjustment efforts. Second, they must play, along with the International Monetary Fund, the strong coordinating role for which their knowledge of country specifics and their relationships with their players so well equip them. Thirdly, they must act as catalysts in the mobilization of resources from all quarters and in the development of new techniques
and instruments to widen the options available to indebted countries seeking additional finance. To this end, we are always prepared to examine, on a case-by-case basis, the need for credit enhancement in those instances where the World Bank's association and leadership is deemed essential to put together and close a concerted financial package for a country that is seeking debt structuring and new money from commercial banks.

For its part, the World Bank is superbly fitted to play these three roles. It has the kind of close relationship with its borrowing member countries which enables it to get reforms accepted and implemented. It also has the practical experience to help design those adjustment with growth programs which encompass, in collaboration with the IMF, the macroeconomic adjustments on the demand side, and the microeconomic adjustments on the supply side. In the process of bringing the debt problem under control, it is vital that we create an effective supply-side response of increased production and employment to the necessary adjustments on the demand side. We need therefore to help these countries create the kind of policy framework that will open their economies to vigorous private sector development, mobilizing not only their own domestic private resources, both human and financial, but foreign private resources as well. The International Finance Corporation, our affiliate working the private sector, will play an increasingly important role in this endeavor.

Well designed adjustment programs need sustained and adequate support. Here again, the World Bank has an important role to play. We can fill but a small part of the total need, but the volume must and will increase. With the recent decision of the United States administration to join in negotiations for a general increase in the World Bank's capital, we hope soon to be equipped to expand our lending substantially.

The Bank is also well placed to play its coordinating and catalytic role. We will work closely with the commercial banks and export credit agencies to help cut the time lapses between agreement on satisfactory growth-oriented adjustment programs and the provision of the necessary external financing. When financing is delayed, public support for reform wanes, and the pressures for less suitable alternatives build up. The Export-Import Bank of Japan has been authorized to provide flexible, untied, quick-disbursing loans to the highly indebted countries in association with World Bank operations. This is immensely helpful, and I urge other OECD countries to follow suit.
Official bilateral aid agencies and multilateral development institutions are the largest source of cofinancing with World Bank operations. Together they contributed $2.7 billion to cofinancing operations with us in fiscal year 1987. Export credit agencies provided a further $2 billion over the same period.

We will also be busy in the development of new techniques and instruments to expand the menu of methods available to the debtor countries for raising additional finance. We will be encouraging the wider and more creative use of debt conversion to turn debt into equity or working capital. But countries need a strong and sophisticated domestic financial structure if they are to make more use of market-based instruments for financing development. The Bank and the IFC will therefore be helping strengthen these financial sectors, particularly their capital markets.

Our strategy for helping the debt-burdened low-income countries of Sub-Saharan Africa will be no less broad in scope. We will continue to concentrate resources from our concessional lending arm, the International Development Association (IDA), on the growing number of these countries which are making determined and realistic adjustment efforts. The shortage of financial resources is currently throwing these efforts into jeopardy, and the Venice Economic Summit was wise to recognize the need for urgent, coordinated action.

We have proposed an ambitious but realistic international program of assistance, known as the Special Action Program for Low-Income Debt-Distressed African Countries. The Program's broad objective is to mobilize at least $1.5 billion in additional external resources each year during 1988–90.

We are proposing, first, additional bilateral aid for quick disbursement in conjunction with World Bank adjustment-related operations; this will constitute the bulk of the $1.5 billion in extra resources. Additional IDA resources will also be targeted to this group of countries. Second, we are proposing concessional debt relief in the Paris Club of official creditors. Thirdly, we are calling for support for the enlargement of the IMF's Structural Adjustment Facility.

These three key components of the Program parallel closely proposals recently made by the Chancellor of the Exchequer, Nigel Lawson. Our Program has received a very positive response, and we expect to complete
arrangements for its implementation at a meeting in Paris in early December.

At the same time we have to be aware of the need to safeguard those vulnerable groups in Sub-Saharan Africa whose economic welfare may be threatened by the process of adjustment, at least in the short term. The urban poor could suffer from the phasing out of food subsidies. State employees may lose their jobs and therefore their food purchasing ability as civil services retrench and reform. I am pleased to announce that we are establishing within the operations complex of the Bank a special task force on food security for Africa which will draw up, within the next three months, a comprehensive action program aimed at achieving food security for the continent of Africa by the year 2000. I am hopeful that an important product of this initiative will be an improvement in our ability to address the social implications of adjustment programs.

Parallel to this initiative, we are establishing a task force on poverty alleviation focussed on all our developing member countries. Over the past years we have invested significant resources in identifying the main feature of the policy reforms and action programs needed to alleviate poverty. It is our belief that the resources and the political will exist, at least in some of the major countries such as China and the Indian subcontinent, to have the realistic expectation of eradicating the worst forms of poverty by the end of the century. But we need a still better definition of this issue and a more effective application of our knowledge of it to the design of our lending operations. The task force that we have established will define a program for the next five years to that end.

I hope these remarks have helped bring home the huge diversity of the debt crisis and the no less huge demands that are made upon us to help manage and progressively eliminate it. It is not beyond the capacity of the debtors and the creditors and a supportive international community to meet those demands. But intentions must be translated into action. We just cannot afford to drift, for the price of drift is one neither creditor nor debtor, neither industrial nor developing world, can hope to pay.

We therefore have no alternative but to work together. We know in which directions we have to go and what actions we have to take. So let us marry common sense to common purpose and together solve the problem.
I am grateful for the opportunity to take part in this very serious and timely discussion.

If nothing else, the pace and intensity of the talk today has confounded Bagehot's definition of a parliament as a "big meeting of more or less idle people." I hope that you have done any necessary relaxing over lunch, for my own remarks are meant to provoke both thought and response.

In my view, the crisis of the highly indebted middle-income developing countries is entering a new and increasingly demanding phase. Not only to weather it but to emerge from it on the road back to economic health, the debtor states, the commercial banks, and the creditor governments must work more closely together than ever and must set themselves some revised guidelines for action.

Before I put forward my own six principles for the next stage of an international debt workout strategy, allow me to set the scene in relatively quick strokes. And let me at first explain why, for this discussion, I set aside the debt problem of the low-income countries of Sub-Saharan Africa.

Their situation is critical, too, but as they are largely indebted to official creditors, the policy issues they present are somewhat simpler. Moreover, the recent Paris Club accord for a debt relief menu has put in place the principles that can guide further financial support to sound adjustment programs. Logic dictates that the proposed debt relief be extended to all low-income countries that meet the criteria and that this approach not be confined just to Sub-Saharan Africa. Otherwise this will be one more instance of an imaginative political initiative that is prevented from achieving its full potential.

For that initiative, Chancellor Lawson deserves much credit, just as your government and people deserve genuine thanks for their steady, generous
support of the International Development Association and for their official and non-governmental work on behalf of the poorest of the poor.

**The Climate of Uncertainty**

The major middle-income debtors of the developing world face their own set of increasingly daunting challenges. On one side, they confront the challenge of advancing major economic reforms and restoring growth without falling victim either to inflation or recession. At the same time, they must meet current, heavy debt payment obligations and attract large amounts of new outside financing.

Either burden would be formidable in itself. Together, they can be crippling, especially because external financing—a key ingredient for successful reform and sustained growth—is at best uncertain and too often absent. Above all, these debtor nations require the assurance that capital will flow from abroad on a predictable and sustained basis to underwrite their adjustment and growth.

That assurance is missing. In its place is uncertainty, a psychological and political strain compounding the difficulty of designing and implementing sound economic policies. The severity of the problem facing these countries can be seen in the shift in net external resources available to them, from roughly 1 percent of their GDP before 1982 to minus 3 percent today.

A year ago, a World Bank staff review showed that most of the middle-income debtors could—I stress the conditional—grow out of their problems. That forecast was premised on their making progress in structural adjustment, on the industrial countries' ability to achieve stable, non-inflationary growth, and on the adequacy of external financing.

Projections continue to confirm that such an outcome is possible. But the experiences of the last 12 months on a number of fronts—the behavior of interest rates and commodity prices, the availability of financing, and economic performance of a number of countries—must now make our judgement more cautious.

In particular, uncertainty about financing from abroad is putting the skids under reform. And as the pace of policy change falters, the inducements to attract fresh outside capital and credit diminish. The two forces thus feed on each other. If not arrested, this could eventually lead to an impasse in the debt workout process.
Adjustment Must Lead Upward

I believe this peril can be avoided. To do so, however, the debtors’ domestic stabilization and adjustment programs—many of them commendably ambitious—must begin to generate higher levels of investment, incomes, and growth: recovery, in short.

In too many cases, the very real progress in cutting fiscal deficits, introducing new taxes, removing trade barriers, promoting exports, streamlining the public sector, privatizing state enterprises, reforming financial sectors and interest rates, and reducing real income in non-competitive sectors has brought sacrifice but not reward.

For the 17 middle-income debtors as a whole, real GNP growth rates have fallen from nearly 6 percent per annum in 1977–81 to about 2 percent per annum in the past two years, and per capita income has dropped in many of them. In the same period, the level of annual capital investment dropped from $400 to $270, by one-third. In the Philippines, for example, the 1986 GNP growth rate was just two-fifths of the 1980 level, and while the share of the public sector deficit in 1986 had been reduced to less than the 1981 figure, 1986 investment as a percent of GNP was less than half what it had been in 1981. In Mexico, per capita consumption is now 15 percent below the level in 1981, and investment has fallen from 29 percent of GDP to 16 percent of GDP.

In other cases, policy advances on one front have not been matched across the board. Reforms will not yield the best results unless they are comprehensive, consistent, and sustained over time. And some reforms—higher interest rates, for example—can tend at first to choke what is most needed: productive investment from both domestic and foreign sources.

The discipline required is of a very high order indeed. It would call for extraordinary effort in the strongest of societies. And such a level of comprehensive action is even harder to generate and maintain in more fragile ones.

Shortfalls in External Financing

Essential as structural adjustment is to the debt strategy set in place in 1985, external financing is as crucial.

Uncertainty about its availability and adequacy is now undermining adjustment in three ways.
First, the policy managers of the debtor countries are also the debt renegotiators. They are being stretched too thin by frequent negotiations with commercial banks with meager results, in addition to negotiations with multilateral institutions and the Paris Club. They thus have too little time and attention to manage their economies and implement reform.

Second, the actual volume of financial support for adjustment programs is too low. Current levels of lending condemn the highly indebted to protracted austerity, when growth is the prescription most likely to make financial stabilization a success.

Estimates by World Bank staff indicate that investment in the 17 middle-income debtor nations is currently too low by at least $30 billion or 4 percent of their aggregate GDP.

Yet the goal of growth—and I will return to this point shortly—demands the restoration of productive investment.

That is the end toward which reform is bent. It is also the ingredient without which reform can hardly proceed.

The third force hampering adjustment, however, is the behavior of a class of outside investors—the commercial banks. They are turning away from the developing world debtors whom they backed in the 1970s, declaring—and I take them at their word—that the days of large-scale, general balance of payments lending are over.

Some may be tempted to doubt their resolve. I do not, and I hope you will allow me a few minutes to explain why.

The past six years have brought fundamental changes in commercial bank attitudes, strategies, and financial positions. The international financial system is no longer in the highly vulnerable position of 1982. As they built up loan loss reserves, many banks sharply reduced exposures in relation to capital. Debtor countries have adjusted, and the frightening nightmare of complete and total default has faded. Thus, bankers no longer have the same deep concern about the viability of the financial system nor the strong common interest in providing liquidity to the heavily indebted countries.

Moreover, rising international and domestic competition and the introduction of more stringent capital adequacy rules worldwide means that the key to success—and some cases survival—for commercial banks lies in building their capital bases.
The shift from the 1970s to the 1980s in terms of commercial bank strategies has been dramatic. The emphasis on asset growth that characterized the international expansion of many banks in the 1970s has been replaced by an emphasis on asset quality and on higher asset yields. Capital is scarce, and low-yielding or unprofitable businesses are being shed. In the case of a number of banks, this asset shrinkage process is part of an effort to meet the new capital adequacy guidelines.

Competitive pressures on banks are also intense because of the continuing deregulation and liberalization of domestic financial markets. Understandably, commercial bankers have sought to contain the LDC debt issue, to distance their individual institutions from its effects as much as possible, and to redirect capital and management attention as soon as possible to the new competitive challenges.

Equally important, most banks have found that their ability to raise new shareholder equity in the markets is closely related to their exposure to developing countries. The shares of banks with heavy exposure are trading at severe discounts to book value, while in a number of important instances, the stock markets have rewarded those bank managements that have been able to reduce their third world exposure.

The competitive and regulatory winds, in short, now blow against the present debt strategy. That strategy has always been in the hands of the creditor governments. Signals from the governments, however, are at best ambiguous today and are tending to reinforce the basic "every man for himself" attitude that is emerging among commercial lenders.

Governments or their regulatory agencies are pressing banks to increase capital, to provision, to reduce their exposure to developing borrowers, and, at the same time, to continue to participate in the concerted debt strategy. Bankers realize that a shrinkage of the base for new lending will at some point undermine the concerted new money process or at best level it in the hands of fewer institutions. Given the competitive costs of being one of those institutions, most banks have resolved to deal quietly with their own individual self interest as best they can. For many this means withdrawing from the debt workout process.

**Countering Uncertainty**

To counter what could become a downward spiral in the debt strategy, European and other creditor governments must exercise strong leader-
ship. For their part, major commercial banks must urgently display creativity and long-range vision.

I know that both governments and banks are giving thought to ways of adapting and strengthening the debt strategy. From my vantage point, there are six main principles that must now shape thinking about the debt strategy.

Priority for Investment

First, emphasis must now be given to increasing the level of investment in the debtor countries. In 1982, priority rightly went to debt service relief through rescheduling and new money agreements, coupled with IMF-supported stabilization programs. The second phase in the debt strategy was the 1985 Baker initiative to focus on growth-oriented structural adjustment. Today, we need to move to a third phase: restoring productive investment as a key element in the debt strategy.

I believe that the first two phases of the debt strategy have provided the essential foundation for a restoration of growth in the indebted countries. The Baker Plan, in particular, strengthened the debt strategy at a crucial turning point and shifted attention to the need for countries to adjust the structure of their economies to new realities. As a direct result of Secretary Baker’s initiative, many countries have embraced fundamental policy reforms aimed at increased efficiency, trade promotion, and better domestic resource mobilization. The stage is now set for a new phase in the debt strategy, focused on a restoration of productive investment.

Higher investment is crucial; without it, higher growth cannot resume. Moreover, more productive investment is needed to reap the benefits of the stabilization and structural changes that are being or have been put in place by the debtor countries.

And a larger share of this new investment must take the form of foreign direct investment targeted on reinforcing the opportunities that trade and fiscal policy reforms create.

The Medium-Term Framework

Second, the debt strategy must now be cast in an explicit medium-term framework. The need for medium-term structural adjustment programs has been recognized for several years now. Sadly, most financing programs have not followed suit.
In the World Bank we put heavy emphasis on the importance of sustainable adjustment efforts, not simply year-to-year programs. We thus draw up country assistance strategies and financing plans on a rolling three-to-five-year basis.

The reason is simple. Development does not happen overnight. And genuine progress in economic reform must be supported over a multiyear period if the desired results are to be achieved.

I do not believe that the debt strategy can be sustained unless we find ways to marshal the support of all creditor groups on a medium-term basis.

I am under no illusions about the difficulty that such a proposal faces. If anything, there has been a distinct shortening of the time horizons of creditors over the past two to three years. But this myopia is now part of the problem. And it must be corrected.

The Role of Official Lenders

Third, official lenders will have to shoulder a larger share of the burden of providing new investment capital to developing countries in the future. Even for countries able to return to the markets within the next few years, the easy lending conditions of the 1970s are a thing of the past. Commercial banks, which came to account for two-thirds of the external debt of the middle-income countries, will not again be expansive financiers of development.

 Discrimination and Creditworthiness

Fourth, we must find a way to deal with the so-called “tiering” that has taken place among countries, which is also reflected in the secondary market prices of LDC debt. For the reasons I mentioned earlier, banks are committed to narrowing the scope of their lending to developing countries.

The number of banks continuing to participate in new money packages is likely to continue to diminish. More importantly, the number of countries able to raise adequate funds in the private capital markets is likely to continue to shrink, at least in the near term.

This contraction affects the smaller middle-income countries the most—countries where exposures in relation to capital are small and where there
are no strong commercial interests to sustain commercial bank involvement on a broad scale. Indeed, for many of them, even the concerted new money process is in danger of breaking down as a means of mobilizing needed financial support from commercial lenders.

At the same time, there are a number of countries with good prospects of a return to the market. The incentives and the rewards for them to do so must be maintained and strengthened.

A case-by-case approach has been one of the fundamental points of the debt strategy thus far. But this discrimination among countries must be taken a step further to reflect the fact that for many of the middle-income countries, a return to voluntary lending is very far off indeed. If present trends continue, failure to develop new and more realistic approaches for these countries will condemn them to a deteriorating cycle of inadequate financing, slippage in adjustment efforts, eroding economic performance, and mounting arrears.

We cannot continue to allow the debt overhang to frustrate a restoration of productive investment in the heavily indebted countries. Where concerted new money continues to make sense, we must ensure that its amount is adequate and its flow over the medium term is predictable.

In cases where new money cannot be raised in adequate amounts, we must have the courage to find new approaches on a case-by-case basis. In particular, we must not allow the fear of precedent to paralyze our creativity or simply be used as an excuse by those least willing and able to adapt to a new phase in the debt strategy.

**Debt Reduction**

Fifth, debt reduction will need to play a larger role in the next phase of the debt strategy, although within carefully designed and country-specific programs.

For some middle-income countries, the emphasis must continue to be on sustaining the concerted new money process. Large-scale debt reduction is inconsistent with concerted new money; it erodes the base for new lending whether it takes the form of debt equity conversion, exit bonds, debts for debt swaps or cash buybacks. For these countries, debt reduction must be seen as complementing, not replacing, concerted new money and other forms of investment capital.
In other cases, the time may have come to focus on comprehensive, case-by-case debt restructuring plans. Such plans would, of course, only make sense in the context of effective, medium-term programs designed to increase productive investment. But where such programs exist, the inadequacy and uncertainty of external financing cannot be allowed to jeopardize them.

In this context, many proposals have been advanced for new debt facilities or institutions sponsored by creditor governments that would take over the claims now held by banks—at a loss—and provide comprehensive debt settlements.

It is useful, in my view, to keep the debate going in this area. But I am skeptical about the willingness of governments to take on the role envisaged by many of the debt plans now being advanced, particularly those that involve enhanced credit standing as opposed to new claims.

I do not believe that we have yet exhausted either the ingenuity of the marketplace in dealing with the existing stock of debt, or the scope for further regulatory encouragement of voluntary debt service reduction. I will return to this point in a moment.

**Regulatory Adjustments**

Sixth, the search must continue for ways in which tax and accounting regulations can be used to accommodate a smooth resolution of the debt crisis. Large national differences in the regulatory, tax, and accounting regimes have weakened the collaborative approach as far as the commercial banks are concerned. Yet the legal form of most loan agreements binds creditors together in their search for solutions. We thus currently run the risk that the inability of creditors to agree to the form and substance of debt renegotiation will force countries needlessly into arrears and prolonged alienation from international capital markets. Consequently, much greater effort needs to be invested in harmonizing regulatory, tax, and accounting policies to provide appropriate incentive for constructive agreements between debtors and creditors.

There are many possible ways that loan agreements can be altered and many financial techniques that can be employed to avoid the slide into protracted arrears when new money is not forthcoming. Reduced rate loans, portfolio insurance, and interest capitalization have all been proposed as techniques that could be implemented in a constructive way to achieve collaborative solutions. Yet while these techniques are attrac-
tive to some groups of banks, others find them unacceptable partially, if not wholly, due to the tax, accounting, and regulatory regime in which they operate. Creditor governments need to study ways to encourage the use of such techniques. In some cases, policymakers may only need to provide clear guidance in some murky areas; in other cases, the alteration of long-standing policies may be necessary.

Now I recognize that many of these issues can become highly technical and complicated. But there is also an underlying political issue here that calls for strong official leadership.

These six main principles—an emphasis on investment, explicit medium-term financing plans, an expanded role for official lenders in financing new investment, greater differentiation among countries, broadened efforts to reduce debt, and greater regulatory flexibility—are, I submit, the agenda for further development of the international debt strategy. Together they constitute a basis for significantly reducing the uncertainty that currently bedevils the debt workout process and that is sapping the commitment of both debtors and creditors to a sustained, collaborative approach.

**The World Bank's Role**

As far as the World Bank is concerned, we will continue to adapt our country assistance strategies to changing circumstances. Over the past several years, we have dramatically expanded the amount of quick disbursing loans in support of policy reform measures. This has been necessary and appropriate as part of a general effort by all creditors to support countries during a debt workout phase. We will continue to pursue this approach in countries where it is justified by the policy performance of the debtor country and the financing efforts other creditors make.

Let me be clear on this point. The World Bank is prepared to accept a large share of the responsibility and burden of making the international debt strategy work. But we will not take over the responsibilities of other creditors. Unless ways can be found to mobilize an adequate level of resources from the private markets over the medium term, we will inevitably be forced to find new ways of ensuring that our own lending clearly adds to the resources available for productive investment in the borrowing country and is not simply drained away in debt service.
It is for this reason that we have given considerable thought as to how the Bank should respond when comprehensive debt restructuring is required. I have no concrete proposals to put before you today. But we recognize that we are likely to be called upon to provide a large share of the eventual new investment financing in such countries. And we are keen to husband our scarce resources for this purpose.

However, we also recognize that the official institutions may indeed have a role to play in catalyzing debt restructuring agreements and specific transactions that reduce current debt service. We have always said that we are prepared to use our lending and our credit enhancement powers to facilitate financing arrangements that are in the interests of both debtors and creditors, provided that our role is genuinely catalytic and does not shift risks from the private sector to the public sector. This continues to be our position today.

As circumstances change rapidly, our own role and policies must also adapt. Nowhere is this more true than in the area of the possible need for comprehensive debt restructuring agreements in some countries.

**Trade Policy**

In concluding, I would like to emphasize, as the Chancellor did this morning, the essential linkage between trade policy and a successful resolution of the debt crisis. No debt strategy can succeed if the debtor countries are given insufficient access to the markets of the OECD countries. Policies in the developing countries are increasingly set in the direction of more outward-looking, open economies. They are seeking to realize the gains from expanded trade, which include—importantly—greater efficiency in the domestic economy and a greater capacity to absorb and service external capital. For the industrial countries to now restrict access would not only undermine the ability of the debtor countries to grow out of their debt problems; it could well turn back the policy stance of many countries to inward-looking, isolationist approaches to development.

Were this to happen, the whole world economy would be poorer. It must be avoided by OECD trade policies that continue to promote a liberal international trading system.

Moreover, we must not neglect the interdependent nature of adjustment in the industrial countries with the challenges facing the heavily indebted developing countries. The debtor countries today are running
very large trade surpluses and experiencing a massive outflow of capital. Such surpluses and resultant capital outflows are abnormal for developing countries and can be expected to shrink as investment and growth pick up, thereby facilitating the adjustment in OECD trade imbalances between the United States and its major trading partners. How important this effect will be depends, of course, on the degree to which we are successful in reducing the net financial burden on the debtor economies through increased finance for investment or more comprehensive debt restructuring agreements.

Conclusion

Let me end with the hope that the European contribution to a revitalized and redirected debt strategy would include a recognition that the overhang of existing debt remains a serious obstacle to a restoration of investment in the heavily indebted countries. We must find ways to reduce the financial uncertainty facing these countries today, either by increasing the amount of net new financing from all sources to more realistic levels or by moving to comprehensive debt restructuring in countries where new financing is no longer possible.

I hope that your discussions today point this influential group toward that realistic, inevitable choice. The sooner it is faced, the sooner debtors and creditors can begin to move together into the new phase of a workable debt strategy.

The challenges are no smaller than before. The opportunities for collaboration are every bit as great. And the need is mounting.
It is a great honor to take part in these important discussions, especially in such an august setting. Remembering the dictum of St. Augustine—Roma locuta est; causa finita est (Rome has spoken; the case is closed)—I welcome the contribution that the Pontifical Academy of Sciences, through this study week, will make to the work of development.

My own contribution to your inquiry will focus on the role of international capital in economic development and on ways to insure that capital flows to the developing nations bring lasting, productive, positive results.

I speak as an advocate of such resource transfers. I see them as instruments of interdependence that cement the solidarity of disparate nations and peoples to which his Holiness so eloquently referred last year in the Encyclical Letter, Solicitudo Rei Socialis (The Social Concerns of the Church).

At the same time that I stress the value of international capital to the economic and social health of both developing and advanced nations, I put equal emphasis on the need to improve the flow of those resources and their utilization. Debt, while indispensable to the growth of new nations whose domestic needs exceed their domestic savings, has in the words of the Encyclical, “turned into a brake upon development...and, in some cases, has even aggravated underdevelopment.”

**Capital Transfers to Developing Countries**

To promote solutions to these problems, we must begin by examining their origins and their gravity. International lending is no new phenomenon. It financed commerce and discovery in the classical world, industrialization in nineteenth century North America and Russia, as well as the reconstruction of Europe and Japan after World War II.
In more recent times of international financial integration, private capital flows in the 1960s and accelerated commercial bank lending in the next decade produced substantial benefits to investors and creditors on the one hand, and borrowing nations in Asia and Latin America, on the other.

Those transfers—as well as the official, concessional flows to the less creditworthy, poorer nations of Africa and the Caribbean—followed the rule that capital moves to areas where it earns the highest returns and that such movement benefits global well-being as a whole. The corollary to that rule, however, is that those who acquire foreign capital must utilize it efficiently both to generate domestic returns higher than the costs of the imported financing and to increase foreign exchange earnings that at least match foreign obligations over time.

Let me emphasize those points. External capital, which has helped development in the past, remains essential for fostering future growth. Developing nations require smooth, effective means for the global transfer of private capital. Without such a mechanism, they and their partners will both suffer.

The poorer countries will have less capital for investment at home. The wealthier will lose export markets. In turn, the developing nations will be able to export less; the industrial states will have fewer resources to put into concessional flows; and growth on both sides of the equation will diminish.

If the most recent experience in highly indebted middle-income countries teaches us anything, it is that, without the capacity to borrow commercially these countries cannot grow at a satisfactory rate. Indeed, they cannot realize their potential, whether or not they continue to meet their existing debt service obligations. If this is true in the short run, it will be even more so in the medium term, when the absence of outside savings will produce even greater constraints on investments and the growth of production capacity.

Private capital can also perform a useful function in low-income countries, where official flows are and will continue to be of paramount importance to the people's well-being and economic prospects. In the form of direct investments, participation in local ventures, and in some cases loans, private international capital can usefully augment national savings, complement international aid in support of needed investment
in the productive sectors of these countries, and bring the benefits of modern technology and improved know-how and management.

The Debt Problem and International Capital Flows

When the problems of third world debt are so severe, when the actual flows of private capital to most developing nations are in sharp decline, it may not seem realistic to speak with confidence of the workings of the international capital market.

Yet, the fact is that private investments in this decade have continued to flow to a number of creditworthy nations and projects. While commercial banks, in general, have become very reluctant to lend new money to debt-burdened sovereign borrowers, significant exceptions point the way toward better times.

Those exceptions hinge on a number of conditions. One is sustained economic growth in the industrial nations. The global recession of the early 1980s was clearly a factor in bringing on the debt crisis.

The second condition is international cooperation in resolving that crisis. The reality of interdependence makes precisely such collaboration essential.

And the third condition is the commitment of developing nations—no matter the weight of their external debts—to institute the kinds of policy reforms that will help make their economies stable and attractive to both domestic and foreign investment.

It is important to recall that not only were commercial banks in the 1970s overeager to recycle the glut of petrodollars; many borrowing nations and firms were unwise and wasteful in the use they made of funding from abroad.

The debt crisis has indeed shown that reliance on external borrowing should not be excessive for any country. Many of the problems connected with the heavy borrowing by developing countries derived from unrealistic or unsustainable assumptions about future debt service capacity.

But the crisis has also shown that productive domestic utilization of borrowed funds is critically important in order to avoid debt service difficulties. Unless domestic policies and incentives are appropriate, both private and public investment financed with external borrowing will not
yield expected results. Costly resources must be carefully used, but the channel of financing offered by international private capital must not be abandoned.

On the contrary, international financial integration can be very useful to developing countries, bringing to those that have a deficit the benefits of competitive access to outside capital, of a large variety of credit instruments, and of greater capacity to substitute between domestic and foreign assets. To capital-surplus developing countries—and there are already several such nations in South East Asia—international financial integration offers better returns on available funds and wider possibilities of risk diversification. These are benefits that no country should forego.

A Debt Strategy to Restore Growth

A successful strategy for reducing debt burdens in order to restore growth must therefore aim, in part, at strengthening international financial integration. And the evolving strategy—launched in 1985 by Secretary Baker, amplified at the 1988 Toronto Summit, and modified this year by the Brady Plan—does indeed count on the international capital markets and the multilateral financial institutions, such as the World Bank and International Monetary Fund, to play significant roles.

Where it initially stressed resumption of private bank financing for middle-income nations, the strategy has naturally and necessarily evolved to aim as much at reducing the stock of their old debt and the burden of debt service as at generating new money. Similarly, in the low-income countries where official rather than commercial lending represents the bulk of outstanding obligations, the strategy evolved from increasing IDA lending and new flows of concessional resources to action that lightens the burden of non-concessional debt.

In close collaboration with the IMF Structural Adjustment Facilities, the World Bank—through the Special Program of Assistance to debt-distressed African countries—has been in the forefront of efforts to provide increased resources and cofinancing as well as debt relief. Since the Toronto Summit, the Paris Club, as the agency for rescheduling official debt, has set plans in motion with 12 African countries to lower, by various means, the heavy weight of the official debts they owe.

Prospects for Progress

I am encouraged by the distance that both creditors and debtors have already moved, and by the degree of commitment—if not always the
speed of action—within the international financial community. The gravity of the crisis for all parties has been recognized, and the responses, while far from perfect or guaranteed solutions, do show movements in the right direction.

In the middle-income countries, experience is still limited, but the Mexican case presents hopeful indications worth noting.

Notwithstanding the considerable difficulties encountered in negotiating the first debt-reduction package under the Brady plan, its effects seem to be highly positive even in the short term. Confidence in the Mexican economy is improving. Domestic and foreign capital is showing renewed interest in finding investment opportunities in the country.

Flight capital is returning home. Interest rates declined appreciably after the package was announced. The confidence effects of the agreements, and the economic program that frames it, are creating the right condition for successful recovery.

Mexico, however, is a single case. The Philippines, Costa Rica, Uruguay, and Venezuela each constitute a different challenge and require differences in the practical application of the debt strategy. The needs of Costa Rica are different from those of the Philippines. Costa Rican debt, for example, is traded at 85 percent discount and commercial banks seem unwilling to provide new money to this small country. The debt of the Philippines on the contrary, is traded at a 50 percent discount and commercial banks are willing to continue to lend.

In low-income countries, moreover, it has to be recognized that the scope for further relief of concessional debt burdens is small, since these debts represent only about a quarter of the total and servicing them takes up only one-tenth of total payments. Therefore, the primary need is to expand action on non-concessional debt.

In the end, the common objective is to resume sustained growth in indebted countries both to lessen the sufferings of large sections of their populations and to restore the creditworthiness of nations now cut off from international finance.

I believe that if all parties work together in the lightened pursuit of their own objectives, we can make a success of the debt strategy and create the conditions for sustained growth in indebted countries. In a solidarity framework this task requires that all parties concerned assume precise responsibilities.
Conditions for Debt Crisis Resolution

Debtor responsibilities are foremost. Structural adjustment and policy reform is not only necessary to refuel the engine of growth in most highly indebted countries, but it is also what provides added credibility and strength to the request for additional support from the international community. If debt is a political and moral problem as well as an economic one, debtor countries have the political and moral duty to help themselves by creating the internal conditions that can attract outside help and insure its beneficial use.

To create these conditions, most debtor countries must pursue with determination and courage economic reform programs that go to the heart of their structural problems. For without lasting changes in the ways internal resources are mobilized and used, economic recovery will prove to be short-lived, outside help elusive, and its effectiveness limited.

The governments of debtor countries undergoing structural adjustment have an added duty; to recognize and to lessen the impact on the poor of the negative social and economic consequences of reform. When public services are cut and incomes reduced, for example, government authorities must take direct action to cushion the most vulnerable of their citizens and to sustain popular support for change. This is the responsibility that few governments of indebted countries can shoulder alone. They need advice and tangible help to implement programs of targeted support that will meet the needs of the weakest segments of their populations: the poor, the elderly, the children. This challenge is one the governments of donor countries, national and foreign private assistance organizations, and international institutions must meet in a true spirit of human solidarity.

Credit responsibilities are also paramount. Governments of creditor countries can and must offer additional help to debtor country governments undertaking structural adjustment. Much has been done by industrial country governments vis-à-vis the low-income countries of Africa. Yet, much remains to be done even for this group of countries and for others in similar circumstances elsewhere. Extending Toronto terms for debt rescheduling to low-income countries in the Caribbean and Latin America is one way. Action on middle-income African countries’ debt is another.

These are countries that have much lower per capita income than their Latin American counterparts and much higher levels of indebtedness. They deserve more liberal terms in official debt rescheduling and better
treatment in non-concessional debt rescheduling. Resumed flows of concessional resources may be necessary where incomes have fallen so dramatically in recent years.

Finally creditor country governments must support debt and debt service reductions for highly indebted middle-income countries. Support can take many forms, from regulatory changes affecting the behavior of commercial banks to the provision of bridge finance to countries involved in debt reduction schemes, to the supply of cofinancing resources.

Creditor banks also have important responsibilities. As parties to the debt process, they have a substantial stake in the economic and financial future of their clients. They have clear duties vis-à-vis their shareholders and depositors at home, but they also have obligations vis-à-vis the international financial system within which they operate.

Finally, they have a long-term interest in a non-disruptive and non-traumatic resolution of the economic and financial problems faced by many of their developing country clients. While commercial banks cannot and should not be asked to put their assets in jeopardy or take decisions not based on reasonable assessments of country risks, they can be expected to act as partners to client countries which undertake internationally supported and monitored reform programs. In some cases it is reasonable to expect that commercial banks, together with multilateral financial institutions, provide new finance to reform programs and accept debt reduction provisions that involve part of their assets.

Whenever indebted countries are ready and willing to take strong measures to improve their economic performance, multilateral financial institutions have the responsibility to help them, with advice, with funds, and with support in catalyzing additional resources from abroad. The World Bank and the IMF have already shown their willingness to accept a large share of the responsibilities and burden of making the international debt strategy work.

Reviving Private Capital Flows

Yet, even if successful in reducing the debt burden of 20–25 countries, our cooperative strategy would not ensure sustained growth unless it succeeded as well in creating a base for renewed private capital flows. We must recognize, in this context, that international capital markets have changed and so have the perceptions of the key agents in them. A pure and simple return to the conditions of the 1970s, with resumption of bank
lending on a large scale, is highly unlikely. Sovereign lending is going to be limited in scale and range in the years to come.

Commercial banks will continue lending to a limited number of countries, but in the main they will go back to traditional types of financing: trade and collateralized client loans. Moreover, there is no realistic hope for expecting that official flows of capital will substitute for private resources. The maintenance of a modest growth in the real flow of public concessional capital to developing countries will require the active and continued support of all the "friends of development."

I would go as far as to say that prospects for developing countries in the remainder of the current century will be rather bleak unless and until we find new ways of getting private capital to flow back to them on a significant scale and sustained basis.

Developing countries need long-term capital. We should encourage the flow of venture and risk capital towards them. We should, above all, encourage institutional investors to take a stake in their long-term growth through direct and portfolio investments. We must develop new instruments to help these flows. What is needed is, in other words, a lasting change in the patterns of capital flows to developing countries.

This, I am persuaded, will help developing countries, but will also help industrial countries and the world as a whole. Capital flows from surplus to deficit areas are not only a key way to maintain a global balance in international payments, but also to ensure that capital moves towards the highest possible return. Developing countries today, like all countries in their initial stages of development, need to be able to sustain a long-term balance of payments deficit through long-run capital inflows from the industrial world.

To conclude, are there reasonable hopes that this can be achieved and the opportunities for better lives can be offered to present and future generations in today's debt-distressed countries? The answer in my view is yes.

Some countries have already taken decisive steps and are on their way to recovery. Others are following in these steps. None of the possible ways to restore growth should be forsaken for want of trying. This is our collective responsibility.

It is a responsibility we can help to meet by recognizing, as His Holiness John Paul II did last year, "that the right of economic initiative ... is
important not only for the individual but also for the common good.”
Private capital will flow where that right is honored and where, in the
collaborative process of development, enterprise is encouraged as an
instrument of community growth.
Nongovernmental Organizations
Some people think that the World Bank's attitude toward nongovernmental organizations has been like that of the rich man who was interrupted in church.

The rich man was praying quietly: "Oh, almighty God, I am having trouble with my business. Please help me make a million dollars."

But then a poor man in the back of the church started crying and wailing and shouting out: "Dear God, my children are hungry and I have no money for food. Please give me ten dollars."

Finally, the rich man couldn't stand it anymore. He went back to the poor man, took a ten dollar note out of his pocket, held it out to him and said: "Stop it, stop your praying! Take the ten dollars and don't distract the Almighty, I need his full attention."

I am here today to say that the World Bank does not consider NGOs a distraction. We consider NGOs important coworkers with us in a common cause. In particular, they can help us "learn from the grassroots."

The World Bank and NGOs are both dedicated to the same ends—to help developing countries realize their potential and, most basically, to help poor people overcome their poverty.

I want first to give you my assessment of global efforts against poverty. It is in that context that I will talk about NGOs and about collaboration between NGOs and the Bank. My central message is simply that the Bank and NGOs can and must work together.

Both governmental and nongovernmental development efforts have had shortcomings as well as successes. Our progress against poverty, after 40 years of international development effort, has been disappointing.

Some developing countries have substantially reduced poverty within their borders, and virtually all countries have at least made gains in education and health for poor people. But the 1980s have been a terribly
difficult decade for the developing world, and tens of millions of poor people have grown poorer.

Adverse conditions in the global economy have slowed growth in even the most dynamic, well managed developing economies. Weaker and less efficient economies went into a tailspin. Economic growth decline, such as most of Africa and Latin America have seen, spells suffering all around, for poor people most of all.

At the same time, lessons have been coming in from past efforts to reduce poverty. In reviewing the World Bank's experience with direct efforts to reduce poverty since the mid-1970s, we conclude that the Bank's basic strategies have been sound. Small-scale agriculture is indeed the front line of the fight against rural poverty. Investments in human resources—in health, literacy, in managing population growth—yield high returns. And approaches we advocated are helping many countries to cope with urbanization.

But hindsight, that great clarifier, has shown that some of the Bank's poverty-oriented projects were islands of intended equity too small to counteract larger biases against the poor. It is right to build rural roads and develop extension services, but those investments do not pay full returns unless we also lift unfair ceilings on farm prices.

Then, too, some projects suffered implementation problems. In part, we overestimated what governments could do. Many integrated rural development projects overtaxed the capacity of public administration, especially in Africa.

If we are to succeed in overcoming mass poverty, three fundamental changes are needed.

The first—and responsibility here lies primarily with the developed countries—is to make the global economic climate once again right for sustainable development.

Second, the developing countries must pursue economic policies that encourage growth and progress against poverty. This decade's distress has exposed serious inefficiencies in the developing countries. As they work to recover from crisis, many countries are mounting systematic attacks on price distortions, bloated public sector spending, and other impediments to development. Increasingly, these adjustment efforts include measures to protect the efforts of poor people to meet their basic needs.
The third necessary change is to make programs which are supposed to help the poor become more effective.

All three of these changes call for fresh commitment and creative approaches, including new forms of partnership between governmental institutions and the vigorous legions of nongovernmental organizations.

In recent years, NGOs have been multiplying and expanding. In many developing countries, the poor themselves are better organized now than they were 15 years ago when the Bank began to work directly on poverty problems.

In neighborhood associations, women's groups, religious groups, environmental organizations, farmers' organizations and cooperatives, women and men have joined hands to shape their own futures. Growing networks of regional and national NGOs bring the strength of numbers to these grassroots groups. Confederations of the local groups, national voluntary organizations, and think tanks on social issues are mobilizing new resolve and imagination.

As of 1985, NGOs based in the industrial countries transferred an estimated $4.4 billion a year to the developing countries. That sum outdistances IDA, the World Bank's concessional affiliate, and its size reflects the rising influence that NGOs have in shaping public opinion and public policy on international development.

Despite their impressive growth, NGOs still reach only a fraction of the world's poor people. Some NGOs have technical and managerial limitations. NGOs are not involved or knowledgeable about some important aspects of development.

But a number of developing country governments are showing increased interest in NGOs. Where public purses are lean and social needs are high, officials may look to NGOs for help. In some cases, governments have cut back on public services and then asked NGOs to fill the gap. But NGOs are seldom able to carry out social programs on the necessary scale. In such situations, they often become voices of protest, urging that the budget axe fall not on the poor but elsewhere.

Where governments are maintaining past levels of expenditure on poverty programs, some want to channel the resources through NGOs to enhance cost-effectiveness. In the Philippines, for example, officials in the health sector are trying to learn from NGO experience and work in partnership with community health services.
In still other instances—and these are the most promising—governments are encouraging NGOs to help poor people organize to make public bureaucracies most responsive. This is the stated policy of the government of India, for example. If this departure from the past is to become a practical reality, it will require far-reaching changes in attitude and practice among civil servants. It will also require a change in orientation for many voluntary organizations in India.

Some NGOs in the developing countries are strengthening their capacity to analyze issues of economic policy and to speak for the poor in public debate. And the resurgence of democracy in parts of the developing world has made some governments more responsive to NGO views.

NGOs based in the industrial countries are also changing. In the past, they focused much of their public information and lobbying activity on fund-raising. But partly at the urging of their third world colleagues, many industrial country groups are becoming more active in development education. They are extending their lobbying activities to broader development issues, such as international debt, trade, and the environment.

Appropriately, in our age of interdependence and rapid information exchange, international NGO networks that were forged to channel assistance to developing nations are beginning to channel information back to the industrial countries. The insights carried on these people-to-people links bring grassroots experience to the public at large and to decisionmakers who often need such alternative, open channels.

What NGOs report back to the industrial countries sometimes differs from what official development agencies have to say. An institution like the World Bank tends to focus on large-scale, often official aspects of development, such as trade policy, adjustment programs, and major public investments. NGOs focus instead on self-help projects and the struggles of organizations of poor people. From different experiences and perspectives, we get contrasting and even contradictory messages about what needs to be done to make progress against poverty.

What matters is how those inputs affect outlook, and what I want to do now is describe the World Bank's changing view of its relations with nongovernmental organizations.

Over the last decade or so, the Bank has come into increasing contact with NGOs. We met together in many settings, and some NGOs become
involved in Bank-financed operations. But our dealings remained sporadic and ad hoc.

In just the last few years, NGO influence on Bank policies has grown. Some NGOs joined with UNICEF and other international agencies in expressing concern that IMF- and Bank-supported adjustment programs in the early 1980s did not adequately attend to poverty concerns. Environmental NGOs have helped us become more keenly aware of natural resource and resettlement issues. I am grateful to them for that, even though their criticism has sometimes been harsh.

Now we are taking the next step—from listening to NGOs to incorporating their advice in our operations to improve the Bank’s impact on both poverty and environmental aspects of development. And their advice squares with our own experience. It is part of our emerging practice.

Barber Conable, our president, highlighted NGOs in his speech to our Annual Meetings last September. Shortly thereafter, I initiated a Bank-wide exercise to identify specific countries, sectors, and projects in which to pursue a major expansion of NGO involvement in our operations.

The cultural and political significance of NGOs varies from country to country, and the Bank’s involvement with them anywhere will depend heavily on the government’s policy toward such groups. Encouragingly, our staff report that many governments are reasonably positive about NGO involvement in public programs.

We will soon be releasing a list of about 150 upcoming operations in which the Bank’s staff are considering NGO involvement. About half of these planned operations are in Africa; the others are distributed throughout Asia, Latin America, and to a lesser extent, the Middle East. In most cases, the Bank is expecting to work with developing country NGOs, but there are also many situations where it would make sense for industrial country groups to take part.

These planned operations include a wide range of activities of direct benefit to the poor, from agriculture to microenterprise development. In many cases, a developing country government would support NGOs in providing social services. I have asked our staff to look for more situations where NGOs could help us elicit the participation of poor people in planning public projects and policies.

We intend to pay special attention to the quality of these partnership arrangements. We must take care that the Bank not overwhelm small
NGOs with too much money or too ambitious a role. In an experimental effort in Togo, World Bank funding for NGOs aggravated tensions among the voluntary groups. And we do not want official interest in NGOs to lead to overregulation of their activities.

I realize that NGOs have other important work to do. Many will not want to work with the World Bank or the projects we support. But the collaboration we offer cannot achieve quality results without the active, creative, and critical involvement of many NGOs.

The doors of our headquarters and of our resident missions around the world are open. We hope new partners for development, new allies against poverty, will come to see us, even as Bank staff work to seek them out.

We are grateful to those who are already working with us and pleased that some of the developing country NGOs on the Bank-NGO Committee are organizing regional or national NGO consultations with the Bank.

A group of Caribbean NGOs has proposed a meeting on debt and adjustment. They will be setting the agenda. Taking the initiative, they make it more likely that the World Bank will be listening, rather than preaching, to the grassroots.

A few NGOs have been working for some years, with great sophistication, to improve the quality of international development assistance. I appreciate what they have achieved.

As late as ten years ago, what we knew about World Bank operations in many countries depended mainly on bureaucratic lines of information and supervision. Within developing country governments, implementing agencies reported on what they were doing, and country authorities tried to maintain quality control. The Bank supervised the projects it financed, but within the Bank, too, we depended on bureaucratic lines of management.

In today's global village, NGO networks can report a problem in rural Northeast Brazil to São Paolo, to Brasilia, and throughout the world within a week. Where bureaucratic eyes are astigmatic, NGOs provide vivid images of what is really happening at the grassroots.

Translating these messages into action, into help for poor people, is the purpose of the Bank, of the NGO's, and of the teamwork we can achieve.
We have to use it to address the three poverty challenges I outlined earlier.

First, to eliminate mass poverty we will need supportive policies in the industrial countries. These will necessarily include substantial programs of official finance. But people in the industrial countries will not support such a program if NGOs they trust—church or environmental groups, for example—tell them that official development efforts are hopelessly ineffective or sometimes even harmful to the poor.

Within the Bank and other international agencies, we need to encourage systematic feedback from the grassroots and follow-up action.

And if NGOs collaborate with official agencies to improve the quality of aid, I suspect that NGOs will also learn in the process. They may become more candid about their own limitations, more appreciative of the importance and difficulty of what developing country governments do, and more knowledgeable about international trade and finance.

There will be points of controversy between intergovernmental and nongovernmental organizations, but we should be able to speak with less discord on certain basic issues of international policy.

Second, renewed progress against poverty depends on sensitive and successful adjustment programs in the developing countries. NGOs at the grassroots are dealing first-hand with some of the low-income families who have lost jobs or government services due to economic malfunction at the global and national levels.

Some NGOs can give policymakers important insights about the effect adjustment policies have on poor people and suggest alternatives. When a government wants NGOs to help implement social components of an adjustment program, such economic policy discussions become especially important.

NGOs which grapple with adjustment issues may come to recognize that many of the policy reforms that are important for economic efficiency also serve the cause of equity. Price discrimination against agriculture did not come about by chance; it serves the interests of relatively well-off urban groups at the expense of less powerful, poorer rural areas. Wasteful parastatal companies have gone uncurbed, partly because they provide jobs to thousands of politically influential city dwellers.

It is often such relatively well-off people who protest most vocally against adjustment measures. As NGOs deepen their engagement on broad
issues of economic policy, they could help to reduce the bias against the poor which has often been built into pricing policy, tax policy, and patterns of public expenditure.

Finally, in order to renew progress against poverty, we need to make public programs that promise to benefit the poor actually deliver.

The Bank's experience, documented by our Operations Evaluation Department, is that strong organizations of poor people often help public programs respond to the real needs of the poor. With public participation, programs are also more likely to keep working after the Bank's involvement ends.

Many NGOs are becoming dissatisfied with small projects and putting more energy into building organizations of the poor. So we are nearing a promising convergence. Working together, the Bank and NGOs may be able to empower poor people themselves to help make government services more efficient and effective.

Let me close with a specific example, one which Sheldon Annis at the Overseas Development Council has reported. The Mexico City earthquake of 1985 struck the center of the capital, including a large zone of overcrowded low-income housing.

Virtually all the residential areas of Mexico City have neighborhood organizations, and these groups came alive after the earthquake. They resisted moves by landlords and officials to evict tenants or replace low-income housing with other types of construction.

Neighborhood organizations also began to build some housing on their own, sometimes with credit or other assistance from official sources. Thirty neighborhood associations, including 25,000 families, joined forces in a confederation.

The government's reconstruction program, which the World Bank supported, was largely successful, partly because grassroots groups played an active role in shaping it.

In this case, as in so many others, the World Bank and NGOs indeed find themselves in the same parish. We have learned that the commotion at the back of the church is an essential part of the development process. And NGOs may be learning that the World Bank is not as rich, nor as self-serving, as some may have imagined.
The World Bank and NGOs are quite different. And precisely because we are so different, we have a lot to learn from each other—at the global level, at the national level, and at the grassroots level.

By working together, the Bank and NGOs will both be more effective forces in the world's gathering effort to eliminate mass poverty.

Let us act in common on the urgings of Theilhard de Chardin. “The age of nations is past,” he asserted. “It remains for us now, if we do not wish to perish, to set aside the ancient prejudices and build the earth.”
It is truly a great privilege for me to have this opportunity to address so many people deeply versed in the theory and practice of development.

I would like today to explain how the World Bank is beginning to involve people and nongovernmental organizations (NGOs) more directly in its development strategy. But I would like to start by explaining why I believe that more direct popular participation and involvement in social reconstruction, although hardly a novel concept, is the new imperative of our times.

I fully appreciate that this may not seem a propitious moment at which to talk of new imperatives. Television brings the tragedy of the Gulf War into our homes without respite. Tense relations between the Soviet Union and the Baltic Republics have qualified hopes of a new era in Eastern Europe. A more enlightened world order may appear elusive.

Yet it is precisely at such dark moments that we should ask how we can better order our world. Development, after all, is a long-term undertaking. We must be practical visionaries. We must discern in the present the foundations of the future.

In my view, Mr. Chairman, these foundations will be fragile without the empowerment of people. The triumph of ordinary people over authoritarian regimes was one of the most extraordinary features of the 1980s. Throughout Latin America and Eastern Europe, people of all sorts said “no” to dictatorship. Even more extraordinarily, they usually won with little violence.

The forces of popular empowerment cracked the concrete of conformity in Asia and Africa too. In the Soviet Union, the release of popular energies helped end the Cold War, greatly calming the world’s fear of nuclear destruction.

Indeed, the end of the Cold War offers an historic opportunity to shape a new, more people-oriented pattern of world security and development.
If we let this opportunity slip, old manifestations of strife and discord are bound to resurface. The setting this time, however, might not be East-West conflict, but recurrent nationalist and economic friction. If the people's latent energies are not harnessed for development they may escape in sporadic outpourings of discontent and frustration.

The danger is clearly illustrated by the Gulf conflict. The turmoil in the Middle East is further proof—if proof were needed—that the demise of East-West ideological conflict does not automatically spell the demise of national and regional conflicts. These tensions, however, themselves reflect deepseated economic and social problems. While peace and prosperity are fast friends, peace and poverty are mortal enemies.

Economic inequity—the glaring contrast of severe poverty side-by-side with enormous wealth—conspires with a paucity of representative and broad-based governments and with inefficient economic management and civil administration to fuel tensions and conflict.

In such conditions the seeds of militarism flourish. We have seen a massive growth of military expenditures, particularly in the developing world. Military spending absorbs 5.5 percent of the developing world's total gross national product. It is at least twice combined spending on health and education in some of the poorest countries such as Angola, Chad, Ethiopia, Pakistan, Uganda, and Zaire. If developing countries froze their military spending they would save future increases of more than $10 billion a year. Nor are industrial countries blameless. If they continue to reduce their military spending by 3 percent annually they could release $25 billion a year.

These are considerable sums. To put them in some context, total bilateral official development assistance (ODA) from OECD countries runs at about $50 billion a year. Fading hopes for a peace dividend are disturbing enough. The specter of a world devoting ever-increasing resources to military spending is even more frightening.

It is crucial, therefore, that we pay much more attention to how the international community can organize itself to accommodate the emerging empowerment of people. For example, how can global, regional, and national economic institutions begin to address more effectively the fast-growing demands of people in many countries for rapid transformation of their societies to market-oriented principles, for better governance and for poverty reduction?
We have to consider these often dramatic changes in a global context. For instance, the problems of economic transformation in Eastern Europe and the Soviet Union are immense. But these are problems for the whole global community, not just for those countries. I am unsure whether people have recognized how much effort we must all devote to ensuring that the outcome is positive and peaceful rather than disruptive and dangerous.

Or consider Latin America. The transition to democracy in the region is most welcome. Yet these fledgling democracies are imperiled by a severe economic crisis which has persisted for a decade. That too demands greater attention and assistance.

And profound poverty and environmental degradation continue to be at the root of popular unrest and disaffection in much of Asia and Africa. For more than a billion people—a fifth of the human race—who live on a dollar a day or less, these are fundamental causes of insecurity, migration, and strife. For hundreds of millions of our fellow human beings life remains at best, an immense struggle.

There can be no peace or greater stability if these issues are not addressed more forthrightly and in a more generous spirit of international collaboration than has been evident so far. Perhaps the end of the Gulf War will be the specific occasion for drawing the outlines of a world economic order more consonant with rapid contemporary political changes, principally empowerment. The United Nations system, especially the Bretton Woods institutions, will have a crucial role in constructing the underpinnings of a new system.

So what is the World Bank’s experience of promoting empowerment, and how will we strengthen this vital aspect of our work in the future?

The World Bank has learned from its experience of development that popular participation is important to the success of projects economically, environmentally, and socially. Our most important lesson has been that participation and empowerment are questions of efficiency, as well as being desirable in their own right.

In one study, the Bank evaluated 25 projects five to ten years after completion. Strong beneficiary organizations proved to be a key factor in determining project sustainability. Another study of 68 Bank-financed projects found that the economic rate of return was twice as high for projects which had been sensitive to local social and cultural realities.
Admittedly, the Bank’s experience with participatory projects is limited. But it is growing. Participation is most often built into projects designed to help particular communities—agriculture, especially irrigation; urban development and rural water supply; population, health, and nutrition. In virtually every participatory project the Bank has financed, beneficiary participation has contributed to project effectiveness. Communities are more likely to have a stake in, contribute to, and maintain projects which, respond to their needs, knowledge, and initiative.

The Philippines Irrigation Administration is one of the best documented cases of large-scale participatory development. Local people and outside agencies other than the Bank took the lead in transforming what had been a typical top-down bureaucracy into a farmer-empowering bureaucracy. The Bank got involved when the irrigation administration was ready to graduate from pilot projects to nationwide implementation. Farmers have gained a great deal of control over the design and operation of local irrigation systems in the Philippines. Several independent evaluations confirm that participation improved design, raised rates of return, and increased the sustainability of irrigation works.

But participation is valuable for bigger projects as well as community ones. Reviews of the Bank’s experience with environmental issues and adjustment loans indicate that public consultation can help overcome obstacles and build public support for large-scale investments and policy decisions. This approach is working in the Mexico Hydroelectric Project. It is also working in India’s Upper Krishna Dam Project, where the Bank supported the use of an NGO to develop a resettlement plan for people affected by the dam. The NGO assisted with community organization as well as providing training to both local people and government officials.

Our findings are confirmed by other sources. An aid study of 140 irrigation projects showed that participation was a key to success. A Cornell University study of over 150 people’s organizations found that participatory institutions were associated with higher agricultural productivity and improved rural welfare.

All this means that the upsurge of “people-oriented development” offers real potential for efficiently reducing poverty and protecting the environment. But channeling “people power” into constructive development is complicated and daunting. It goes well beyond individual projects or policies to weaving participatory structures into the very fabric of society.
Countries as diverse as Argentina, Poland, and Tanzania are grappling with this challenge. Merely responding to popular pressure does not guarantee success. Popular demands have pushed some governments into deficit spending, deepening debt, and eventual economic crisis. Peru in recent years has been an unfortunate example of the damage populism can do. Governments must have the courage to pursue sound policies and win public support for them.

Today's enthusiasm about popular participation in development should also be tempered by the paucity of successful experience to date. Many government leaders and development experts have long stressed the importance of popular participation. Yet there are relatively few successful, large-scale participatory programs in the developing countries. The literature on participation comes back again and again to about 25 well-worn cases.

The part that foreign agencies can play in promoting popular participation is obviously delicate since national sovereignty has to be respected. Our charter at the World Bank forbids us from intervening directly in politics or basing lending decisions on political considerations. Nevertheless, we do in the interests of sustainable development encourage, to the extent possible, the construction of strong, broadly based social institutions and organizations.

Thus three years ago, at another Washington conference, I explained that the Bank would be reaching out to NGOs. They include a wide variety of people's associations—farmers' and service organizations, religious and environmental groups, and trade unions. While the Bank's primary relationships are with its member governments, we have over the last three years substantially increased our work with NGOs.

We have concentrated on involving NGOs, especially developing country NGOs, in Bank-financed operations. During each of the last two years, NGOs have been involved in about 50 of the projects which the Bank has approved. That is a marked rise from about 15 projects annually in previous years.

Most of the NGO involvement in Bank-financed activities is in the implementation stage, but NGOs are also increasingly involved in project identification and design. We have been most successful on this score in Asia.

Our policy on environmentally sensitive projects requires that borrowing governments consult with affected communities and local NGOs. The
first nine major environmental assessments under this policy have concluded. Even in the industrial countries, efforts to engage the public in environmental assessments have often been superficial or ineffective. In some developing countries, the idea of asking the poor about a proposed highway or dam is a radical departure from past practice. Yet the Bank is pushing in this direction. We have already trained many Bank staff, government officials, and some NGOs.

In addition to working with NGOs on projects, we have extended our policy dialogue with them. NGOs frequently have valuable insights, especially on environmental and poverty issues. The Bank's policy dialogue with NGOs is anchored in the NGO-World Bank Committee, which includes NGOs, mostly developing country groups, from around the world. Advocacy groups from industrial countries have been influential as well.

NGOs have also occasionally provided country policy analysis. In Lesotho, Madagascar, Mauritius, and Rwanda, governments and the Bank have worked closely with NGOs on environmental conditions and programs. In Nepal and Bangladesh, the Bank has asked NGOs for their views on social policy.

Support from international agencies increased the influence of NGOs in some countries. The Bank may urge a more liberal government attitude toward NGOs where their ability to promote development is compromised. For example, two South Asia irrigation projects we approved last year included legalizing grassroots groups. The Bank is helping to find new ways of financing NGOs. Bolivia's emergency social fund provided $40 million to NGOs, mainly grassroots organizations in poor communities.

Certainly, we are still a long way from fully integrating NGOs and grassroots organizations into project planning and policy work. Some NGOs damage their cause by excessive and exaggerated criticism. But on balance, we feel that the Bank's closer links with NGOs have been a significant step towards realizing people-oriented development.

Today, I want to tell you about another step towards this goal. We are identifying 20 Bank-financed projects in which exceptional efforts are being made, or will be made, to involve poor people in decision-making. If these projects achieve their goal, they will add significantly to the developing world's experience of popular participation.
More importantly, we intend to learn from these projects and from other work on popular participation in the Bank and in other agencies. A growing number of developing country governments want to consult with their citizens and back popular initiatives. Practical lessons should result from these projects and initiatives.

At the same time, we are setting up within the Bank a "learning group" of staff to exchange ideas with people outside the Bank experienced in the practicalities of popular participation. Other development agencies—international agencies, governments, and NGOs—have much to teach us about popular participation.

Our particular purpose in all these moves is to find out how the World Bank's operations could better encourage popular participation. The Bank's operational guidelines already incorporate instructions about beneficiary participation; we intend to strengthen and implement them better. We realize that support for popular participation is likely to consume staff time in the agencies we deal with and in the Bank itself. So we will look hard at the costs, investigating how to be more responsive without being much more expensive.

All over the world today individuals seek the power to lead their own lives. We are witnessing an inspirational expression of popular sentiment which often owes little to governments. This fact of empowerment is one of the defining characteristics of our age. Since it is desirable in itself and enables societies more efficiently to realize their ambitions, empowerment must be integral to any new system of international security.

But to embed it irretrievably in such a system we have to meld the general and the particular—the general movement towards empowerment and the particular forms of popular participation which give empowerment and change practical meaning.

For the World Bank, this means broadening popular participation in specific ways to help tackle some of the chief causes of the suffering and unrest which strain the international order—the economic transformation of Eastern Europe, the reduction of poverty in Africa, the alleviation of the debt crisis in Latin America, and the protection of the environment.

Popular participation is after all democracy at work at the grassroots level. Harnessing the people more directly to the task of development is not easy, and it can at times deteriorate into dangerous populism. If I may
paraphrase the words of Mahatma Gandhi, there is no human institution but has its dangers. The greater the institution, the greater the chance of abuse. The empowerment of the people, like democracy, is a great potential force for the future. The remedy therefore is not to avoid this challenge but to reduce the possibility of abuse to a minimum.

If we fail constructively to channel popular energies into shaping a world order, the future may well be frustrated by cold war rigidities, stalled economies, and mounting social dissension. If we succeed, ordinary people around the world could enjoy an unprecedented opportunity to write their own histories in peace and prosperity.