THE WORLD BANK GROUP HISTORIAN'S OFFICE

ORAL HISTORY PROGRAM

Transcript of interview with

ERNEST STERN

December 16 & 29, 1994, January 5, 1995

By: Jochen Kraske, Louis Galambos & David Milobsky
Q: How did Operations look to you when you first came in? You must have identified your strong and weak areas.
A: You attribute more rationality to these processes than actually exists. And it was a long time ago.
Q: That's what historians do. We impose rationality on a chaotic universe. Why don't you just kind of walk us through a little bit.
A: I would be misleading you if I tried to lead you through this in any kind of systematic fashion. Of course I knew how the office operated, but only quite generally. I had been a Regional Vice President for less than two years.

If I can characterize what I did, I would say I transformed the office from a quality-control center into a chief operating officer's office. We tried to develop the Vice Presidents into a management team for Operations, which was concerned with the whole gamut of operations issues from career development and personnel issues to budget, to relations to research and policy formulation and to the systemic issues in operations themselves.

Q: From an Operations point of view, you must have roughly prioritized the problems in your mind. To be an operational officer you have to have a sense of what you need to do immediately. Now, you had a pretty good view of that.
Earlier, you mentioned that there was some mushiness out there in the organization as far as the loan policy was concerned.

A: There was a lot of mushiness out there. But I can't tell you which of a dozen possible subjects at the time we took in any order of priority. The office continued to provide a review function for projects going to the Board but the focus shifted from procedural to substantive issues. We tried to strengthen and systematize the operational framework. We tried to improve the forecasting of disbursements by developing disbursement profiles by sector and country based on actual experience so that estimates of disbursements -- which influenced our borrowing requirement and our liquidity position -- were not simply somebody's wishful thinking but we were never able to break project staff of their excessive optimism. Invariably, they argued that this particular project would defy all past experience. We tried to get the managers to focus on supervision and implementation problems by holding regular problem project reviews and requiring managers to be more systematic in correcting project problems identified in their portfolios. In a related area, we focused on the serious deficiencies of our borrowers to comply with audit covenants under loan agreements. That led to proposals (not very well executed I
must say) for strengthening audit training and the auditing profession in the member countries, which had been identified as a major cause of the problem.

We tried to streamline the procurement process by raising limits, which had not been raised for a long time, below which simplified procedures could apply. We also introduced the Statement of Expenditures and Revolving Accounts, designed to accelerate disbursements.

There was a lot of housekeeping to be done on the operational side. The Bank had grown very rapidly and not much attention had been paid to either systems or management. I thought it was timely to consolidate and to devote more attention to common understandings of and response to problems; to strengthen the management of operations instead of treating the problem of each unit, or each project, as unique.

The Bank's personnel system also was very weak and there was limited senior management support for improvements. With the very active support of the VP Personnel and Administration, we initiated improved practices in Operations, some of which later became Bankwide. We introduced regular meetings with the Operations Vice Presidents to discuss staff performance and identify candidates for promotion. We also jointly reviewed annual
merit increases and regularly selected staff and managers for rotation. We developed unit based training systems which was a rather neglected area in the Bank. But we did not make adequate progress in this. I introduced the first Operations wide senior management Retreat. The first couple were a little stiff, because they were new to the group and in fact a good number of people did not know each other well, but they came to be well accepted and helped to foster a team spirit. In true Bank fashion "Retreats" quickly became very popular at every level of management, until Mr. Conable, who expressed doubts about their utility, objected to the cost of holding retreats off-site.

On the management side, we also made great strides in the area of budgeting. Even within the constraints of an excessively complex and distorted budget system, we greatly simplified the process and reduced the burden on staff.

I don't know whether you know the details of the Bank's budget process but we used to keep accounts in units called "staff weeks." Nobody knew what the monetary value of a staff week was since there was no differentiation between a staff week of the most junior professional and the most senior. But it was a unit of measurement, and all associated costs were described as ratios to the staff weeks, e.g. a travel ratio, a secretarial support ratio etc. Immense amounts of time, and
emotions, used to be spent on arguing about these "cost coefficients." It was the most arid exercise imaginable because the data did not reflect costs; they were not controllable by managers; and there were no benchmarks of "normal" costs. I soon stopped taking the system too seriously and refused, at the Operations level, to discuss budgets or work programs in terms of these cost coefficients. I told the President to allocate whatever budget he, on the advice of the Budget office, thought was appropriate for Operations and I would allocate it among the Regions and OPS. I promised, in return, that he would never get a budget appeal from me or any of my units, and that Operations always would submit its final budget proposal within the approved guidelines. Mr. Clausen was receptive to this approach. In turn, the Operations Vice Presidents received their allocation (but this was in dollars, not staff years) based on work done by my budget officer (Mr. Ruddy) and asked to return with their work programs. This saved a lot of time compared to the approach of having everyone submit their work proposals without guidance on budget totals and then have to argue the total down with every line manager subsequently. As a result we were able to avoid lengthy budget discussions that took place in other parts of the Bank. If adjustments to the budget envelopes were needed, they were made based on
past performance and work plans, rather than debating the magnitude of "staffweek" coefficients or whether somebody needed another secretary.

Eventually, the "staff-week" budget system broke down and the Bank now is on dollar budgeting. The simplification of the approach in Operations, did not go far enough, but it was a step in the right direction. With a central budget office which was very conservative, and never developed the details on how a simplified system could work Bank-wide, there were limits to how far a single unit could go.

To sum all this up, we tried to introduce modern management practices in Operations

Q: This "staff-week" system sounds like a labor theory of value but --

A: It wasn't even as sensible as that. A staff week, mind you, was not one week of a person's time. It was one week of staff time -- regardless of the level of staff involved. If something cost 10 staff weeks, it could be 10 staff weeks of a department director, which is X, or 10 staff weeks of the lowest research assistants, which could be Y. There was absolutely no way to know. And neither leave nor other benefits were accounted for. So staff weeks had no cost equivalence or relevance at the unit level nor did they reflect skill use.
Q: Did that date from the beginning of the Bank?
A: No. I believe this was McNamara's contribution. I don't know if he personally developed it, but it certainly emerged in his period.

Q: That's fascinating. It was the first attempt at any kind of cost control in the Bank.
A: True, but it really didn't control costs. Nobody knew exactly how much a staff week cost. Anyhow, that's all gone now but it took a long time to fade. I take some credit for helping the process along.

Q: So you, in effect, imposed a dollar budgeting scheme while they were still using staff weeks?
A: Yes. I had to. Although short of a Bank-wide reform, the two systems co-existed uncomfortably. People used to come in and argue, "My coefficient for supervision is 9.2 staff weeks." I didn't know what to do with that. Am I supposed to say that's too much, or too little? Who knows? The debates were endless. There were coefficients for supervision, travel, project preparation, clerical support. A lot of people spent a lot of time applying coefficients to arrive at a dollar figure for the budget. But I was not that patient since the coefficients were merely historical relations of dubious relevance and the staff weeks had no relation to costs.
Q: So you pushed these administrative details lower in the hierarchy while you concerned yourself primarily with dollar allocations.

A: Yes, basically the Vice Presidents and I decided to focus on how much output could be produced for a given dollar budget. Essentially, I said "Here's the budget envelope, now put together a work program."

Q: Would it be possible to say that you implemented a program of controls which was consistent with the theory of the '72 reorganization, because it pushed these things down further?

A: Yes. But even today the process of delegating budget authority down to the line managers is not yet complete.

Q: That's very interesting. Now, when you implemented a better control system and a better evaluation system, that doesn't make everybody happy, does it?

A: No.

Q: What happened? What went wrong?

A: Well, it made some people unhappy. I don't know that anything went wrong.

Q: Out in the Regions for instance. They must not have been overjoyed with this?

A: It varied. Some Vice Presidents supported these kinds of changes and the direction of decentralization of details
while focusing more centrally on the strategic issues. Others didn't. We always had a very mixed bag. There were some who still saw me as the new boy on the block and a pain-in-the-neck; there were some who supported it and participated effectively. There were also some who believed in it and tried hard, but didn't do it very well.

The Bank's Vice Presidents and, indeed, its managers in general were never selected on the basis of any proven managerial track record. The person who replaced me in South Asia, David Hopper, was a very good agricultural economist but he didn't care much about management. The person who ran Latin America, Mr. Barletta, who later became President of Panama, was a very nice person, a good economist and very knowledgeable about Latin America but, like Hopper, management was not his strong suit.

There were others in Operations who welcomed the delegation of authority and the efforts to standardize and systematize. For instance, the people who did the financial planning projections welcomed the standardization of disbursement profiles. I also believe that the tightening up on supervision and follow-up on projects in difficulty, generally was welcomed.

Q: Now, as an operating officer, what did you do when you got resistance to this? What could you do?
A: You can't do much beside advocate and persuade because it's hard to fire people. I did, in my years at the Bank, fire two Vice Presidents, but it's difficult at that or any other level.

Q: As VP for Operations, when did you get a sense that you had the Operations that you wanted? When did you feel it was running in a Stern fashion?

A: You've got to understand what this job was. We are not the private sector. Corporate culture was weak; corporate strategy was diffuse; personnel management was very much in a public sector mode; individual agendas were strong. So getting cohesion and concensus takes a lot of persuasion, a lot of education and a lot of constant maintenance. Furthermore, the channels through which one operates aren't always effective because you can't talk to the staff directly on a consistent basis. I had to work through managers who might or might not be fully convinced, no matter what they say or don't say in a meeting. It's a slow process. To this day, the dissemination of management changes is very slow. The Bank has gone to full dollar budgeting but there still are units which budget in staff weeks.

Q: Really?

A: We now have delegated the budget firmly down to the Vice Presidents, for sure. It's their budget now; it's their
business plan. But there are Vice Presidents who don't delegate it down any further. They sit on large contingency funds in their front office and dribble out the budget funds. That complicates unit management and responsiveness, frustrates staff and shows a distrust of subordinate managers.

It does take a long time to get things done here, but, by and large, I thought we had made good progress in a number of areas. We established more explicit discipline associated with our lending, and a more standardized set of allocation criteria with a more explicit component for country performance assessment. We'd improved personnel management.

Although these accomplishments were notable, the most interesting development during this period was the growth of adjustment lending. The Bank gradually took a seat at the policy table and participated in discussions of the general policy framework. This was new to the Bank and took a lot of time. We tried to do it as a team, learn from what happened in Latin America, South Asia, or Africa. Mr. McNamara was very interested in these operations. He also was very much involved in sector and country allocations, and he reviewed every project that went to the Board. No President has done that since.

Q: When you began to tighten the system of control and
evaluation of performance, did information arise that highlighted problem areas that you had not seen before?

A: Sure.

Q: What were some of those areas?

A: For instance, pulling the portfolio supervision reviews into my office helped to emphasize the importance of effective implementation. It helped managers to develop action plans to remedy problems and established a basis for monitoring the follow-up. It revealed that staff and managers knew they had bad projects—projects which had received very poor implementation ratings—yet hadn't done anything about them. Project completion dates were extended routinely even though there were no or little disbursement. We established operational directives which limited the number of extensions we could give to loans and gradually cleaned out overaged loans which were tying up funds which could be used elsewhere. Poor project design was not readily recognized. There is great reluctance in the Bank to call a loss a loss. Very few people feel comfortable saying "this thing just won't work. Sorry, mistake."

Shortly thereafter, Lew Preston arrived and he said the Bank is the most undermanaged institution he had ever seen. On the whole, I think that's still true. However, in the earlier period, I think the Bank was woefully undermanaged.
Q: Right. And it was growing rapidly.
A: And it was growing rapidly.
Q: Hmmm. The main thrust of the McNamara strategy was on growth and expansion of the mission.
A: Aside from policy issues, which we can leave aside for a moment, the things that surfaced were management strains. The size of the Bank and the scope of its activity had outgrown its management practices. Yet management was not seen as an important internal priority, nor was management ability seen as an important criterion for promotion. And although Mr. McNamara was very interested in management issues, he relied heavily on the budget as a management tool. In the best of systems that is not enough; and we did not have the best of systems.

Also, as the volume of business grew, the Board became increasingly concerned that all countries be treated equally. There was more emphasis on how Bank policies were applied; more demand for reviews of individual sectors; more emphasis on learning through evaluation and dissemination of the experience.

Q: What was your relationship to the Board at that time?
A: In the late '70s?
Q: Up to the end of McNamara, let's say.
A: I think my relation with the Board has always been
pretty good. In McNamara's time, he dominated relationships with the Board. He was rarely away for long and made it his business to be back for Board meetings whenever possible. That changed with his successors. As a result, Senior Vice Presidents got to chair Board meetings. Also, Board committees proliferated. So, after McNamara, I got more directly involved in Board meetings than I had been before, but I think the relationship was always pretty good.

Q: Could you talk a little bit now about how that changes under Clausen? What happens now?

A: Well, you have a very different person. Clausen was not a fighter like McNamara, he was not as aggressive substantively or as dominant. Also, he was not as well connected to the political establishment, the Executive and the Congressional establishment, as McNamara had been. He wasn't a Washington insider and, unlike McNamara, he didn't have a development agenda of his own. I didn't know McNamara before he came to the Bank, but I imagine that by the time he arrived he had a pretty clear idea of what he wanted to do. That wasn't true with Clausen. He saw himself more as a manager, relying on the Bank's professional staff to develop substantive issues and proposals. He was much more willing to let his senior managers do their thing as long as they consulted with him on major issues.
Q: What did he tell you when he came on board? Did you have a sit-down with him and go over what you were doing?
A: I don't remember a single comprehensive review session. In the usual Bank fashion, we had prepared very large briefing books. No President ever read through them. The new President was brought up to date gradually on ongoing activities.

Q: Well, it was also that the Bank was still geared to McNamara's style.
A: We did sit down and talk about what Operations was all about. I'm sure we went over some of the briefing material. Early on, Mr. Clausen created a President's Council. He was used to a more structured approach to senior management than McNamara. McNamara was more selective. If he wanted to talk about agriculture, he called three or four people that dealt directly with that area. Clausen was more hierarchical. He expected his senior staff to handle most of the details.

McNamara also had senior management meetings, but those were not seen as a collegial decision-making body.

Q: Right. Everyone knew who made the decisions.
A: There wasn't any question about that. Clausen also knew that he was going to make the final decision, but he was much more participatory, more influenced by the debates in the President's Council, and he was very patient. Ultimately
though, he had no problem with saying "This is how we are going to do it." His management style was just different. He was more concerned with staff motivation and morale. He introduced extensive staff surveys to the Bank because he thought it was important to morale and to help identify management issues. He wanted to establish a better internal communications system based on his experience at the Bank of America. The World Bank didn't have an internal communications system.

Q: Well, you did have one, but it was very informal.
A: Yes, well, it was the local grapevine. It wasn't a management initiated communication system.

Clausen was also interested in some of the management issues. He promoted the development of career planning for future managers, and he expressed serious interest in our computer technology improvements.

Q: So was he accustomed to having a chief operating officer so that he could deal with external matters while the chief operating officer ran things on a day to day basis.
A: He certainly was very comfortable with the Senior Vice Presidency structure. He had no problem delegating authority to the senior staff. He expected you to report. He didn't want to be surprised, but he certainly had no interest into going into McNamara's depth of detail. But, you should be
aware that the Senior VP Operations was not the equivalent of a CEO in a corporation. Not all of the tools needed to serve the clients were in Operations. Operations was one business function - the largest and the most important to the borrowers - but the other functions also reported directly to the President.

Q: In the President's Council sessions was he good at synthesizing what was being said? Did he listen to the debate and was he interested in having the debate? He must have brought these debates to some closure. Was he good at this? How far did he get involved in the substance of the things?

A: His meetings tended to be long. He wasn't very good at shutting people up; he was too polite and too patient to terminate debate even when the issues had been well defined. Yet, sometimes he became impatient and then he could shut a discussion down very effectively. In the final analysis, I think it's fair to say that, after those discussions, he really relied on the senior officers who were responsible for the core areas -- management, finance, and operations. I don't think a lot of formal decisions were taken in the President's Council.

Clausen did meet with a subset of people -- a kind of executive committee -- to do career planning, discuss a World Development Report or consider strategic or complex
issues. This group included the two Senior Vice Presidents, the General Counsel, and the VP, Administration and Personnel, supplemented by others depending on the topic.

Q: So your role was strengthened under Clausen?
A: Definitely.

Q: Because he delegated a lot of the details to you.
A: Yes -- to me and to others. Certainly my influence increased a lot under Clausen. I don't know that I did much more than I did before, but relatively it was more important since the President was involved in fewer issues and in less detail.

Not only was Clausen relatively uninvolved with project work, but he also did not deal as directly with the Board; relying more on staff to handle questions. Until Preston came, the Senior Vice Presidents attended every Board meeting, (depending on the subject -- Finance, Economics or Operations) and sat next to the President. Mr. McNamara frequently supplemented staff responses; Mr. Clausen left that pretty much to the Senior VPs.

And since we had also reorganized a bit, between Economics and the Operational Policy Staff, I was drawn more into policy discussions with the Board than before. And I was much more involved in Board discussions dealing with the budget since Operations was a large component of the budget.
and the work program i.e. the volume and distribution of lending, always was of great interest.

Q: Now that McNamara was gone, who was the Bank's point man in its relationships with Congress?

A: We had a difficult time with the IDA negotiations after Bob left. Our influence on The Hill and with the Administration, under the Republican Administration, was greatly diminished. Mr. McNamara may not have been universally loved on The Hill, but he was a widely known and respected figure. He had good contacts on both sides of the aisle. Mr. Clausen, while no stranger to Congress, had quite different relations. They derived from his position at the Bank of America; McNamara as a former Secretary of Defense and a close friend of the Kennedy's had been more of an insider. In addition, our relationship with Treasury deteriorated a bit under the Reagan Administration.

The Reagan Administration questioned the Bank's very purposes. They undertook a basic study of the institution which, to their surprise, concluded that the Bank served the U.S. interest. Nonetheless, the senior Treasury officers were skeptical and not very supportive. It was a very difficult political time. The assumption that the Bank acted in the U.S. interest, which had been accepted for a long time, was under attack. The administration felt that the Bank was too
involved in activities which should be handled by the private sector; that it did not pay sufficient attention to its mandate to be a lender of last resort. They didn't want the Bank to become involved in too many areas.

Politically, it was a very rocky time in our relations with the U.S. Government. While Clausen had been appointed by a Democratic Administration, he was a California Republican. However, he wasn't part of Reagan's inner circle.

Q: A couple of other questions about Operations. Were you trying to consciously change the mix of people in the Bank? You said you introduced a new concept of career line development. Were you trying to shift the nature of the Bank personnel in any way?

A: No. I don't think so. That wasn't the objective of the career development stream. We tried to give more weight to management skills in the selection of managers.

Q: It was performance centered?

A: Yes; It wasn't a skill mix problem. Now, operationally during this period, the biggest thing, obviously, was the emergence of the debt crisis.

Q: Yeah. We want to talk about that. Can we talk about the structural adjustment lending first? It's introduction coincided more or less with your arrival here in this office. It took up a good deal of your time, and remained an area
where you had a lot of influence.

How did you see this addition to the Bank's tool kit? Did you think that this was a response to the oil crisis, which necessitated a closer look at the policy framework of these countries? Or did you think that this was a welcomed long-term and necessary enlargement of the Bank's agenda and mandate?

A: We proposed structural adjustment lending three years before the debt crisis started. And yes, it did arise out of the oil crisis, and its impact on the developing countries. It was the beginning of defining concerns with the structural aspects of balance of payments adjustments rather than focusing solely on the macro-economic aspects. The concept that structural problems were at the core of the balance of payment difficulties facing many developing countries was not common then. The solution to balance of payments problems was generally believed to be macroeconomic adjustments. Our original concept was to help countries take action in advance of a deterioration in the balance of payments. In addition, the Bank had rarely made quick disbursing financing available because it was not the Bank's task to provide balance of payments support. And we went to great lengths to continue to emphasize the difference between balance of payments financing - which the IMF provided - and the financing of
structural adjustment. To provide a loan for general import financing, to encourage and support policy changes, was quite a new concept in the World Bank.

There were a lot of factors involved. It was a period when balance of payments problems were looming. The oil price increases had changed the import capacity and the economic prospects of the oil importing countries dramatically. Commodity prices were depressed. Although there was substantial global liquidity - the result of having to recycle the increase in revenues of the oil exporters - some countries were experiencing serious external financing problems. Moreover, it was clear that the volume of external borrowing could not be sustained and that major changes in domestic production, prices and exports would be required. The Bank, although it identified some of these problems in its country economic reports, was not well placed to deal with those kinds of issues at the operational level. It was a period when project finance was not the appropriate tool to help deal with the central issue facing the developing countries. Aggregate capital flows became much more important and the commercial banks became a major source of external capital by sovereign risk lending. The share of financing by the official institutions dropped sharply in the middle income countries. While macro-economic issues became the
primary concern, and general sovereign-risk lending the principal type of financing, the Bank didn’t have a seat at the policy table. It was consulted sometimes by oil exporters about how to handle their sudden increase in revenues, and occasionally by major oil importers about the problems facing them but it was not systemic. Nor did the Bank have any instruments to assist with these problems and its country analytical work did not provide an adequate basis for advising on the policy distortions which, at the national and sectoral level, impeded a rapid response to the changed external circumstances.

Here, to get back to an earlier question, my experience in AID was relevant. This absence of a basis for policy discussions with central policy makers had been a growing concern with the policy staff and, indeed, with Hollis Chenery. In other areas, such as income distribution, labor utilization and the capital intensive bias of the incentive structure, or price distortions affecting productivity in agriculture or industry, the inability to follow up in an operationally relevant way was felt increasingly. It was a view I shared strongly - that the Bank needed to be more directly involved in operationally relevant economic advise and take account of the policy framework in deciding on its volume of lending to a country. AID was never able to insist
on very strict or precise conditionality in most countries because, to a very large extent, allocations were determined by political and foreign policy factors. Seriously linking AID allocations to policy change was difficult. But AID always had a seat at the table with the senior policy makers simply because it was a representative of a major power with a large assistance program. Discussions with a Finance Minister on specific issues were routine. At the Bank, on the other hand, while there were occasionally meetings with the Finance Minister and other core policy makers, much of the contact was with line ministries. Even when there were discussions of larger policy issues, based on an economic report on the country, with the Finance Minister, these tended to be general, with little link to the scale or composition of the lending.

And, it was becoming increasingly clear that successful, sustainable projects required improvements in sectoral policies and the incentive framework.

This was also the period when evaluation became important. Our studies revealed patterns of economy-wide issues (prices, access to credit, fiscal policy) adversely affecting project performance, but which could not be dealt with at the project level or even with the sectoral ministry concerned. And this, in turn, led the Bank to consider the
value of more comprehensive reviews of country portfolio.

All these strands contributed to our decision in 1978 to propose structural adjustment lending.

Looking back, I don't think anybody could have articulated how adjustment lending was going to evolve in the 1980's. The initial memorandum only sketched it out generally. We did not have any idea of what it was going to do to the Bank. Some of the issues that were raised in that memo -- such as higher political profile for the Bank and its potential costs -- did materialize but we certainly did not foresee how fundamentally the involvement in structural adjustment lending would change the Bank and its operational culture. Nor did we foresee the scope of the benefits to developing countries of our work on structural adjustment issues or the role which would derive from that in the debt crisis.

The introduction of Structural Adjustment Lending in the Bank was controversial for many different reasons. Executive Directors were concerned that we were infringing on the Fund, that we did not have the staff capacity to deal with these issues; that the Bank should stick to its fundamental role of project financing. They were also uncomfortable about the potential political risks, the changes it implied in our relations with borrowers and the possibility of increased
risk to the Bank's repayment record.

Q: That was mainly the Part I countries.

A: Yes, although there weren't many strong Part II country supporters. As you know, before the debt crisis, there were very few takers for this product. Nonetheless, the debates in the Board continued for a couple of years. Many of the staff, particularly the project staff, did not like Structural Adjustment Lending either. They saw it as the culmination of McNamara's campaign to reduce the role of the technical staff. And indeed, over time, structural adjustment lending boosted the role of the economists greatly -- more than intended perhaps. And project staff saw adjustment lending as a "soft option" both compared to the precision required in projects (at least those with a physical component) and to the ability to measure results. They also doubted that the Bank would be willing to enforce its conditions. Partly these reactions were based on a romantic view of project financing. There were plenty of project conditions which were not met; the quantification of benefits often was inaccurate and, by this time, substantial lending was not for physical works.

Structural adjustment lending was a product that evolved more or less along the main lines that were intended, but in much greater depth and with a much wider scope than anybody
had foreseen. The earliest operations were primitive by later standards - both in the precision with which objectives were stated and in the scope of the policy issues addressed. Our understanding of the scale of distortions was weak, as was our analytical base about sectoral policy problems. And, because of our lack of experience, we did not appreciate how difficult it was - politically and administratively - for countries to implement necessary policy changes.

Q: It's related in a way to the changes you are introducing in Operations. It reflects a view of systemic problems. There's a pattern coming out.

A: Certainly a fundamental point was that our project work was suffering because we (the Bank) were not dealing with the right people. Generally, those who were responsible for project design and implementation -- the people we dealt with -- were not the people who decided on the policy framework which determined electricity prices, prices for agricultural products, fuel taxes, irrigation water charges, or the market system for agricultural or industrial output. Therefore, on the fundamental issues of domestic resource mobilization, (efficiency issues), the allocation and the pricing of scarce resources, (role of markets and incentives) and the framework for private investment, we were not talking to the decisions-makers. Loan agreements often could not be
met (due to lack of counterpart funds or changes in the administered price structure, or import controls), because these issues were outside the scope of the projects and as a systemic issue with the central policy makers.

Q: Why were the borrowers reluctant to participate in SALs at first?

A: That was very puzzling at the time and, of course, a bit embarrassing considering the controversy in the Board, with shareholders and among staff. We saw a major set of problems, and we had formulated a new lending instrument against a good deal of opposition and in the face of a fair amount of skepticism and only to find few clients interested. The only explanation I think was that governments are generally little interested in the major and painful policy changes before they face a crisis. Originally, we had conceived of structural adjustment lending as a prophylactic approach - preventing balance of payments problems - and believed that attraction of quick disbursing loans would suffice to interest governments to act. We were wrong. Remember, this was a period of substantial world liquidity, so those countries which could have been eligible for structural adjustment lending weren't necessarily short of money because they could borrow on market terms from commercial banks.

In short, the governments were not willing to deal with
structural problems which they themselves had not fully identified because there wasn't a crisis yet. That was the fundamental point. Furthermore, their own analyses of these issues were still pretty embryonic -- their analytical capacity was not then what it is today -- and neither were we as well equipped as we are today to spell out the issues, the policy concerns and the costs of the policy distortions.

Q: Maybe we should talk about Africa at this time. This also occurred roughly at the time when you came into this office. At the 1979 Annual Meeting, the African Governors asked the Bank to do an assessment.

A: Yes, we responded promptly. The first report was done by Stanley Please, and this was followed by a report by Elliot Berg.

Q: Did you welcome the Africans' request. Was this something that you had perhaps even promoted?

A: No. I didn't engineer it. Those early reports, both the original Stanley Please report and then Berg's report, improved our understanding of Africa. I think it set in motion a chain of events which eventually led to the Special Program for Africa (SPA) -- the very successful effort to improve coordination among donors in support of a clearer set of priorities in individual countries -- and Africa Revisited, which is the latest report in the series focussing
on Africa's problems. Even then, (in 1979/80) it was widely accepted that Africa's progress was far from satisfactory. The world's problems hit Africa the worst. The oil crisis, commodity price declines, and droughts hit them the hardest. The early Bank reports didn't emphasize governance issues as much as we do today, but implementation capacity and institutional weaknesses certainly were addressed. This was the beginning of a series of studies which explored why external assistance was not having the desired results in Africa. Looking back, it was really the beginning of a healthy process of discussion and thinking.

Q: It seems to me that there are two problems that come up right at this time -- the debt crisis and the African situation. Both could reflect problems in the economic analysis.

A: Well, actually the debt crisis broke in the Fall of 1983 and its full scope was probably not clear for another year or so. But in neither case do I think there was much wrong with the economic analysis per se. What these reports started to do was to highlight the non-economic aspects of African development. We had not taken a very different approach to Africa in our operations than we took elsewhere. These reports, and those that followed, focussed on the fragile political structures in Africa, the embryonic nature of the
African political systems and that they were not really well equipped to develop consensus on economic issues.

The weaknesses of African institutions had certainly been known for quite some time. However, the implications of this widespread weakness had not been appreciated fully. The very large presence of expatriate advisors in Africa reflected the great paucity of local technical skills, but also an unfortunate habit of the donors, maintained for too long, to do things for the Africans. They were not prepared to rely on the domestic abilities - weak though they were - and consequently reduced the sense of accountability and increased dependence. One of the early reports on Africa already identified the problem of too many expatriates and too much technical assistance; today, that problem is more widely recognized and understood.

The Africa reports encouraged people to consider the need to build Africa's economies from the bottom up. You couldn't substitute for domestic capacity by foreign advisors, functioning at the top. It was not the economic advice that was wrong. It was how that advice was being applied in local conditions. How were aid flows used? What kind of projects did they start? What institutions were built and how were they nurtured? The importance of these issues was not well understood in the early days of the Africa work,
by us and by the whole donor community.

Q: In a sense, of course, many of these concerns had been present already. I remember the discussions that went on when all these countries became independent, when people said, well, how are they ever going to manage? But somehow they have been forgotten in the meantime.

A: I don't know that the illusion of success lasted very long. Many inherited existing and functioning institutions. This was particularly true in East Africa--Tanzania, Uganda, and Kenya. These places started with a pretty good administrative structure, civil service, etc. On the west side, the French also left behind a decent administrative infrastructure. These institutions worked well at the beginning, but they began to deteriorate. Tanzania essentially ran its institutions into the ground; Uganda ended up with Idi Amin who left no administrative systems in place. Certainly people were aware of these problems before the Bank's reports; but the reports helped to understand why simply providing money and expatriate advisors was not enough; indeed why sometimes it even was counterproductive. The institutional infrastructure was too weak to absorb aid effectively; to adapt the advise, the project designs, the technology, to local conditions.

Q: I (Mr. Kraske) still remember coming to you with these
proposals for structural adjustment loans in Africa and your response was that SALs were not created for Africa.

I always found this position a bit hypocritical. On the one hand, we had Elliott Berg and sons of Berg identifying all these policy, institutional, and governance problems, yet we didn't use the tools we had to deal with these things. We didn't make the most of our seat at the table.

A: Well, I do not think that position was hypocritical. I still am pretty skeptical of the utility of structural adjustment lending in Africa - precisely because of the reasons we have been talking about. I think structural adjustment lending was designed as a tool which works in an economy where you have reasonable functioning institutions, an effective civil service, and an economy with at least some of the tools to manage fiscal and monetary policy and a banking system. The Africa Region was attracted to the quick disbursing aspect of adjustment lending and seriously underestimated, even ignored, the difference in time between a loan which disburses in 18-24 months and the need to build institutions in addition to changing policies.

Q: You don't have to have the other kinds of conditions?

A: These are, of course, matters of degree. But, I still believe that SALs are a very poor tool to build institutions from scratch, or to implement civil service reform. I think
the record is very clear on that. And, I think it is clear to me - and I know to others - that the very extensive use of structural adjustment lending in Africa -- after the post 1987 team in Operations was more permissive than I -- was neither very effective on the macro side nor very germane to the institutional issues. It became precisely what we had not wanted it to become, general balance of payments support and the long-term dependence that implies. It is true, however, that some of the structural adjustment loans to Africa were, in fact, useful in some countries. The depth of the policy distortions turned out to be very grave --in agriculture, trade, subsidy payments, interest rates and credit -- and in some cases adjustment lending helped to bring about needed changes. Nevertheless, it has been very hard for African governments to implement SAL conditions or to sustain adjustment programs. It was hard for the governments to sell it domestically; to develop a consensus. There's no easy means of dissemination. The private entrepreneurial sector was small. The agricultural sector, and the poor, inchoates and not very articulate participants in the political process. It often was hard to get the Parliament or the other Ministries on board. The implementation problems were different than elsewhere. While SALs did some useful things in Africa, particularly when the crisis got deeper and the
balance of payments problems got larger, I remain convinced that structural adjustment lending is better suited to more advanced economies with more developed economic systems.

Q: I thought we could go into the debt crisis at this point. And I've read one of the other interviews, in which you say that you saw this coming yourself. Why did so few people see this coming?

A: I am not sure I ever put it that way. But, just last week, the Mexican peso hit rock bottom, and all of the intelligent people in New York -- professionals in the financial markets -- claimed to have been misled. "They told us they weren't going to devalue," they said. I don't think it took a lot of foresight to see that the Mexican peso was overvalued. The current account deficit was large and unsustainable and short-term foreign borrowing was increasing sharply. If the fundamentals are out of line, and no remedial action is taken, any overvalued currency will crack sooner or later.

Q: Right.

A: I've never known a Finance Minister who said two months, one month, one week, one day in advance, "I'm going to devalue tomorrow night." Yet, the entire financial community claimed that they didn't know there was a problem. The debt crisis was the same way. In those days, nobody believed that
countries could go bankrupt -- Walter Wriston of Citibank was famous for that assertion. Nobody knew what that meant, but many people accepted it as an article of faith. Debt service ratios exceeded 25 percent, - a level previously thought to have been an upper limit - but no one seemed to care. Everyone expected exports to continue growing more rapidly than debt service and debt to be eroded by inflation. It was a classic speculative bubble.

The world was very liquid in the late 70's, and everybody was looking for places to invest funds. The developing countries were willing to borrow instead of adjusting their consumption to their reduced purchasing power and they seemed to offer respectable returns. All the traditional analytical benchmarks got swept away. "Old fashioned, " they said.

In retrospect, I don't think that the origins of the debt crisis were very complex, although there were several contributing factors. There was a concerted attack by the G-7 on inflation. The concerted nature of the attack came as a surprise. And the effort was successful. Bankers had discovered the floating lending rate which shifted the interest rate risk from the lender to the borrower. I don't think it was fully understood - certainly not by the borrowers - what this implied in a non-inflationary
environment with relatively high real interest rates. Interest rates which, in real terms had been zero or negative on fixed interest loans, became positive. At the same time, the anti-inflationary policies slowed growth and reduced demand for exports from developing countries. Consequently, commodity prices turned down.

Q: You had sensed this coming from the late '70s forward?
A: Yes, although I was hardly alone. But the mood was all in the other direction.

Q: No one was asking the Bank for help?
A: Before the debt crisis broke, cautionary comments about debt service capacity really were ignored and so were efforts to improve resource allocation, particularly in the oil-exporting countries. When Mexico got in trouble, it was initially seen as a liquidity problem to be handled by the IMF rather than a structural issue. It was seen as a temporary balance of payments issue. When discussions started on concerted financing for Mexico, the Bank was invited but it was pretty proforma. We were not expected to play a major role in the negotiations and we did not. Our financial flows derived exclusively from project disbursements. And since the pace of the disbursements was not under our control, it was neither a catalyst for, nor a suitable component of, the overall financing package. We did not have the basis for the
quick disbursing lending in support of policy reforms.

Q: They didn't invite you because they wanted no help at that point?
A: No. In those days, the discussions were based on the premise that Mexico's debt crisis was a liquidity problem, not a structural problem.

Q: In your own view it was not a liquidity problem, but a structural problem.
A: Yes. And so it was.

Q: What did you try to do in response to that?
A: Analysis of the causes of the crises started early. And as the full scale of the problem emerged, and alternative solutions were explored, it became clearer that more than a cash flow problem was at issue. This was still long before the debates on the proper sequencing of policy change and, indeed, well before the full scope of the policy distortions was well understood. We started in Mexico with a collaborative effort to liberalize the trade regime - reducing tariffs and quantitative restrictions - and a number of sectorally focused policy operations. David Knox was Vice President of the Latin America region then, and Pieter Bottelier the economist in the country department did an outstanding job in working with the government to begin to address these structural issues. However, it took about a
year and a half of collaborative research and negotiations to persuade the Mexicans to begin to open up their economy, and to increase competition in order to enhance productivity. These measures were part of a series of policy actions necessary to improve the efficiency of the economy and enhance, over time, their creditworthiness.

It was in this period that Structural Adjustment Lending became an operational tool. The issues the Bank sought to address in those days - trade liberalization, price decontrol, the internal market, the foreign investment framework, energy pricing - became topics of discussion between the Bank and the IMF, and with the U.S. Government. The U.S. Government played a major role in the debt crisis from the outset because of the massive systemic risk to the banking system, particularly in the U.S. and Japan. Gradually, the Bank's SAL commitments -- size, timing and conditionality -- became a key part of the refinancing effort.

This put greater leverage behind our conditions as our participation in the total financing package became increasingly important to the commercial banks. Initially the focus was on the money; but gradually the substance of our conditionality was seen as important and became preconditions for releases of commercial bank funds. SALs also drew us into
the top group of people who were trying to manage the debt crisis in the major governments and central banks. We were part of the Baker Plan and Brady Plan packages. The Bank was also drawn into discussions with the CEOs of the commercial banks who were arranging the refinancing, and later the debt reductions. When we used our guarantee authority -- for the first time since the Bank's early days -- we became involved in the pricing of guarantees and the associated loans.

These substantive issues, which involved the Treasury Secretary, and the Chairman of the Fed; G-7 Finance Ministries and Central Banks, and the commercial banks forced the Bank and Fund into closer cooperation. Initially, this caused some friction. It was hard for the Fund to accept another institution into discussions it had seen as its preserve, particularly since the staff of the Bank did not have the experience with the discipline and discretion these delicate issues often required. And it took a while for the Fund to accept the importance of the structural factors and their effect on productivity, competitiveness and the sustainability of the balance of payments equilibrium. Their outlook changed over time. The Bank staff had an equally difficult time in adjusting to the collaboration. They were less disciplined analytically and often felt very free to explore alternative designs - even when negotiations on a
package already were in progress. And, in the beginning, they had an inadequate appreciation of the importance of stabilization. Sometimes they seemed to offer borrowers the softer option. But their attitudes and approach also changed over time.

Q: Did Clausen become more hands-on in this period, dealing with the banks and so on?

A: Well, Mr. Clausen believed in delegation. But this was a subject of considerable interest to him and one about which he knew a great deal. In those days, from time to time, we did a lot of telephoning around to persuade banks to join the refinancing package or the rescheduling package. Mr. Clausen's contacts with senior bankers was useful there, as was his understanding of the objectives of the commercial banks - And he was deeply involved in the discussions with the Treasury and the trilateral discussions between Treasury, the Fund and the Bank. I did a fair amount of that as well. By then there was a group of us who handled those matters, including a number of people from Finance -- Joe Wood, David Bock, and one or two others. They were involved in the reschedulings from the Bank's financial perspective. They spent a lot of time on these issues, particularly when we started to use guarantees, and they handled the technical aspects of negotiations with the banks. Our involvement in
the debt problem substantially changed our relations with the financial community. Up to then, our relations were primarily with our underwriting firms supplemented by the occasional co-financing arrangement with commercial banks. In the debt crisis, the World Bank was dealing with a group of people in the U.S., Europe and Japan with major exposure to developing country sovereign debt.

Q: This was also when the B-loans came out.

A: Mr. Clausen always was a great fan of co-financing. And as you know, co-financing has always attracted the interests of financial minds in commercial banking, particularly in the U.S. and Japan. It was seen by the private banks as an inexpensive way of reducing the risk of sovereign risk lending to developing countries. But, it never really worked because the World Bank never offered any real security to the commercial banks. We were reluctant to share our preferred creditor status by associating commercial bank lending legally with ours (a formal cross default clause). The informal arrangements we offered only committed us to make "best efforts" in case of rescheduling. When the debt crisis broke, it proved generally impossible to protect the co-financed loans. The commercial banks understood pretty well the limited "enhancement" we were offering.

Q: They could pretend that you offered security?
A: No. We never gave the commercial banks any comfort other than a "best effort" to exempt them from rescheduling. This was a time of high liquidity before the debt crisis, and commercial banks were not shy about taking on risk. The Bank had always been trying to get the commercial banks to co-finance World Bank projects, but it never became very big business. After the debt crisis broke, we were unable to protect any of our co-financed loans. So that was the end of that.

We did for a while, put a B-loan program in place which involved payment sharing with the banks. But this was badly designed - it gave away too much since we agreed to go pari passu in payments with the commercial banks. This clearly was a mistake of mine. We tried too hard to develop a more attractive co-financing package and we went too far. I stopped the program before it got too far. We did persuade a few Central banks to reduce capital requirements for banks on co-financed loans - but in general, it had little impact.

During the debt crisis -- particularly when the emphasis was on refinancing -- there was a lot of pressure on Japan to assist. Their Export-Import Bank substantially liberalized their financing terms for loans in support of Bank programs or projects -- for example, such funds were untied. They made major contributions to refinancing packages in Mexico,
Argentina and Indonesia. It was considered co-financing with the World Bank, and accounted for that way by us and by them, but it was co-financing in the loosest possible sense. The loans financed Bank-supported programs, but there were no legal links to our loans.

Q: How did the debt crisis affect the Bank's relationship with Treasury? Baker was obviously playing a very big role in this issue.

A: During the debt crisis, the Bank and the Treasury had very good relations, particularly once our adjustment financing and guarantee operations made us important components of the financing packages.

Q: I thought that, initially, the U.S. showed very little interest in the debt crisis.

A: I am not sure that's right because the crisis was concentrated in Latin America, so the U.S. was interested in that angle from the beginning. And there was perceived to be a systemic risk to the banking system in the U.S. -- and indeed elsewhere. Mr. Baker was an activist on the subject and he welcomed a larger, more direct role by the Bank.

The first debt deal in which we played a large role was Chile's. They had a good economic program but a poor political reputation. It was the first time we used (or proposed to use) the Bank's guarantee. We had used our
guarantee authority once before in a small way in an iron ore mine project in Brazil. We extended a guarantee which Brazil had gotten from the European Coal and Steel Community from nine years to ten years so they could obtain longer maturity financing. It's an interesting twist because the Bank's Articles of Agreement actually assumed that we would be operating mostly on the basis of guarantees. But guarantees had not been used since the very early days. I had always been attracted to guarantees as a means of mobilizing private capital -- and so we had proposed to resurrect it as part of our co-financing approach. The proposal for Brazil was approved because it was very small, but in general, there was a good deal of opposition to guarantees. Although under Articles, we have to charge the face value of a guarantee against our capital, just as a loan, there were many people who feared the risk of guarantees based on national experiences where guarantees had been issued off balance sheets. Others opposed guarantees on the grounds that it would be a less effective way of influencing project design or implementation or provide technical assistance to our borrowers.

It was very hard for the commercial banks, led by Manufacturers Hanover, to put a deal together for Chile. We considered, together with Manufacturers Hanover, the use of
our guarantee of a portion of the roll-over financing. The U.S. was very dubious about the use of our guarantee authority because they felt the banks ought to bear the risk of the refinancing. I remember a long luncheon we had with Mr. de Larosiere, Managing Director of the Fund, Mr. McCouch from Manny Hanny, and Mr. Mulford, the Undersecretary of the U.S. Treasury. Mulford was extremely skeptical. His line was "Why can't the market take care of this? Why should the World Bank share in the risk?" But the bankers were very emphatic that without official enhancement the financing could not be arranged. Later that day, Mr. Mulford agreed that the Bank could issue a guarantee for the commercial banks' financing. That was the first time we used that structure. Subsequently, we used it in two Mexican reschedulings.

Q: This idea is coming from your office?
A: Nothing comes from one person. But I was an advocate of the use of guarantees, made it an instrument we could discuss with the commercial banks as an instrument to keep banks in the refinancing package - which became increasingly difficult -- and in persuading the U.S. Government. There was a special team in Finance to help deal with debt related issues.

Q: You mentioned the relationships with Treasury and I have an old friend that I knew when he was an economic historian, named Al Fishlow.
A: Oh, yes.

Q: When the Fishlow situation broke I was sort of stunned. Would you like to talk a little bit about that?

A: You mean, how he almost became chief economist?

Q: Yes.

A: Al was a very capable person. He was well connected with the group we were talking about the last time -- the development economists outside the Bank. He was very knowledgeable about Latin America and had a very good reputation. However, the external world had changed markedly and Al was seen as too radical for the Bank. A good deal of opposition developed to him.

Q: Where did that opposition come from?

A: From the new U.S. Administration.

Q: This happened even before McNamara left?

A: No. We had gone through a list of candidates while McNamara was still here. He favored Al but he made no appointment. He believed, correctly in my view, that the appointment should be the prerogative of his successor. So, when Tom Clausen arrived, the candidate list was ready, and I guess Clausen knew Fishlow from California. They had a common interest in Latin America where the Bank of America was very active; so it wasn't just a name to him. And undoubtedly, McNamara conveyed his preference to Clausen.
Q: Can someone use that as a defining incident in a power relationship, or is it just an aberration?
A: Defining incident for whom?
Q: Of a particular power relationship between a significant donor and the institution?
A: It happens.
Q: Are there any other similar incidents that you can think of?
A: Well, senior outside appointments are not that frequent. But, for instance, the Japanese have a strong view whenever we appoint the Director of our Tokyo office, who always is a Japanese, or when we appoint a new Vice President for Co-financing, who has always been Japanese.
Q: Do they get their way?
A: For these positions - generally.
Q: When you had to find someone to replace Fishlow, did the U.S. get deeply involved? Was Anne Krueger on the original list of candidates?
A: Yes, I am pretty sure she was. She certainly was in the same professional league. To tell you the truth, I never knew what the ideological difference between the two was supposed to be.
Q: Someone did.
A: Someone presumed they did. What it was, I don't know.
But to answer your question - I don't think the U.S. retained an interest in the appointment process after the Fishlow incident.

Q: Did it make any difference in terms of the operation of the Bank?

A: I don't know. I've never seen Al operate in this context so it's hard to say. There is a large administrative component to the job which not everyone from the academic side is comfortable with. I have no idea how Al would have reacted. Anne certainly left strong opinions about her management behind her.

I never understood that either. It is true that she was a very determined woman with strong opinions. But I think those are virtues. She was a very good analyst. She restructured the research program, after Chenery's 12 years tenure. Chenery's research style stressed quantitative, macroeconomic modeling much more than Anne's did.

And the research priorities changed, and as Anne tried to make research more operationally relevant, some people on the economic staff felt alienated. A lot of people complained about her management style. But in my view, Anne did a lot. She was a great asset to have around during this period when we focused increasingly on adjustment operations, trade liberalization, macroeconomic conditionality, and relations
with the Fund.
Q: The changes she introduced, did they fit together with the things you were doing in order to get control of operational policy?
Q: Yes. Anne and I had a very good working relationship. We tended to think alike about many issues -- the conditionality and the relevance of research.
Q: Compared to Chenery, she was much more proactive from an operational perspective.
A: Absolutely. Except for a few big countries, Chenery tended to look at countries as part of patterns of development. Anne was much more interested in dealing with the nuts and bolts of actual national economic systems. That's certainly true.
Q: We've described a situation in which you've got an awful lot on your plate at this point. When does the environmental issue really get on your scope? Can you fix that relative to the change in leadership?
A: Well, I don't know. McNamara had an environmental advisor. When was that?
Q: '72.
A: His name was Lee or something?
Q: James Lee. He appointed him after his Stockholm speech.
A: This issue had been around for a while and it became
more important as time went by. Gradually, we put more rules in place to make sure that our projects did not degrade the environment. But, in McNamara's time, we did not go beyond this damage limitation approach. The systemic issues -- national environmental plans and national environmental legislation were not yet part of the operational framework. We were not very proactive.

During Clausen's period, some of these bigger Bank projects got a high level of external attention. But I don't believe that we fully understood the scale of the problem, both in terms of the public relations and the substantive issues. Barber Conable was much more proactive and open on this subject. I think he took it on, in part because of the criticism and, being more politically sensitive, he wanted to be sure we dealt with it. However, he also was genuinely sensitive to the issue.

Q: Between, '81 and '86, did you introduce any kind of changes as far as the review of projects?

A: Yes. During that period, we consistently tightened up procedures. Operational guidance on resettlement issues, on the treatment of indigenous people, on the environmental impact of dams, were formulated during this period. Some of these operational guidelines were seen as the most advanced at the time, and were models used by the regional banks. At
that time, a lot of people felt that they went too far, but some are still seen as fully appropriate today. However, while we expanded the Environment Department, we had not added environmental staff to the regional staffs, to enhance their capacity to identify environmental issues early on in project design. I don't mean to suggest that we were innocent of the problems, but the Bank was slow in recognizing the environment as a special subject requiring special staff, special skills, and special supervision. It was seen more as an issue which could be left to the operating staff, if the policy framework was appropriate. We were too slow to understand fully the complexities of environmental policy.

Q: If you look back over the programs up through '87, which of those programs have been the most successful in reducing poverty?

A: Certainly McNamara was very much into what we are doing today -- primary education, health, population, urban issues. He considered these areas the foundation of a successful poverty-oriented policy -- and so they are.

A lot of poverty-oriented work was done during McNamara's time. He was very much interested in the building blocks -- population, health, education, nutrition, urban redevelopment. McNamara was very aware that the basic
objective of development was to reduce poverty. He is the one who developed the concept of absolute poverty, which is still used as a benchmark. We started with relative poverty and the equity issue. But, McNamara in one of his speeches, developed the concept of absolute poverty, defined as people who were below a minimal living standard. It built on the "basic human needs" concept which was very popular at the time. So the analytical focus on poverty reduction were put in place during Mr. McNamara's period. I do not believe Mr. Clausen changed that explicitly but there is no doubt that the debt crisis shifted the Bank's attention to structural reforms.

Nonetheless, the focus on poverty, its causes, and approaches to its alleviation had its own momentum. We produced a WDR on primary education (a subject Mr. Clausen attached a great deal of importance to); and work on other factors of special relevance to low income groups continued. But the roots were in the earlier period.

Q: You have now implemented a lot of programs to tighten control and evaluate policies. What did you consider the most successful of those programs?
A: Among the poverty programs?
Q: Yes. Yes.
A: Well, I, I think I have two candidates for poverty programs which won't appear on any of the Bank's press
releases. One very important thing we have done for poverty and poverty reduction is adjustment lending, because, no matter what anybody says, development was financed on the backs of the poorest segments of the population, namely the rural population. They got nowhere near fair terms of trade. They were manipulated -- whether it was in Africa through the marketing boards, or in India through the controls of the grain movements. Every country had a different system, but the net result always was the same--large amounts of income were diverted from the poorest parts of the population by keeping the prices of their products artificially low. At the same time, subsidies and social services benefitted the better off. Breaking the pattern, getting world market prices for farmers, redirecting budgetary expenditures, has made a major difference to the rural areas and to the well-being of countless people.

By addressing those price distortions, we have done a good deal to promote investment, entrepreneurial activity, small scale enterprises and employment opportunities by reducing or eliminating the strong bias toward capital-intensive investments. We helped many countries onto a pattern of sustainable growth, with a much broader participation by people in that growth. But I realize that this isn't the common view.
The second program that I think has been the most successful is the restructured extension service program. That program has benefitted more farmers per dollar, (and even in absolute terms) than any other. I believe that it has had a hugely positive impact on the income of participating farmers in India, Africa, Indonesia and elsewhere and has changed fundamentally our conception of how public services can be delivered effectively.

Certainly there were many other activities of great importance. Simply putting the poverty issue on the map has done a tremendous amount. We can see it in a number of countries where the percentage of people in absolute poverty has dropped as the economy grew because of complementary measures by governments. We contributed the understanding of the population issue and the spread of family planning programs. We highlighted the importance of social safety nets, while substantially improving the targeting of subsidies on the neediest. Many nations increased their capacity to deliver social services to the poorest more effectively.