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**Folder ID:** 1773927

**Series:** Transition briefing files

**Dates:** 1/1/1981 - 12/31/1981

**Sub-Fonds:** Records of President A. W. Clausen

**Fonds:** Records of the Office of the President

**ISAD Reference Code:** WB IBRD/IDA EXC-09-3952S

**Digitized:** 11/14/2019

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BRIEF FOR MR. CLAUSEN - DEVELOPMENT POLICY STAFF: Appendix II, Appendix III, Selected Readings

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APPENDIX II: FURTHER DETAILS ON POLICY ISSUES

A. Poverty Focus in Bank Lending

1. The poverty focus in Bank lending has two main dimensions: inter-country and intra-country. <sup>1/</sup> The criterion of poverty in Bank lending was manifested first in the inter-country dimension and only later in how lending resources were deployed within countries. In the 1950s, the Bank shifted away from lending to the high-income countries of Europe and elsewhere and concentrated on low-income countries, corresponding loosely to the shift from "reconstruction" to "development". Continuing this trend, IDA came into being in 1960 explicitly to provide concessional resources to low-income countries.

2. The Bank's concern for a poverty focus within countries emerged in the early seventies, following Mr. McNamara's accession as President in 1968. The earliest clear public articulation was given in the 1973 speech by the President to the Governors at Nairobi.

3. It is noteworthy that concessional lending through IDA to poor countries in the 1960s preceded a poverty focus within countries by at least a decade. At that time, donors evidently were willing to provide concessional finance to poor countries without a within-country poverty focus. However, toward the end of the 1960s and in the early 1970s, it became increasingly apparent that even quite rapid growth can occur without substan-

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<sup>1/</sup> The current criteria for the allocation of Bank and IDA resources among countries are discussed in Section D of this Appendix.



tial benefits accruing to the poor. The earlier faith that benefits from growth would "trickle down" to the poor was called into question.

4. Some researchers and commentators outside the Bank went so far as to claim that the growth process actually makes most of the already poor even worse off. Although such assertions are not confirmed by Bank studies, these studies nevertheless support the view that economic growth is by no means a sufficient condition for alleviating poverty. In some countries (e.g. Sri Lanka), considerable progress had been made in mitigating some of the worst effects of poverty by means of social programs, in spite of low rates of growth. In others (e.g. Korea), the poor had clearly benefited from rapid growth, based upon a prior land reform and heavy public investment in education. <sup>1/</sup> More generally, however, the growth process was accompanied by increasing concentration of incomes and wealth, leaving poorer segments of the population relatively untouched. In some cases, particular socioeconomic groups experienced income declines.

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1/ It is interesting to note that in both the examples cited above--Sri Lanka and Korea--the earlier progress has been followed by evidence of difficulties. In the case of Sri Lanka, more rapid growth is now clearly necessary, in the face of the budgetary burden of public services. In Korea, recent evidence suggests a deterioration in the distribution of income, requiring corrective policies complementing those associated with rapid growth.

5. These various concerns have been debated both within and outside the Bank, and the debate continues. No consensus has emerged on the precise terms of the diagnosis, let alone the appropriate policy response. This is to be expected since the issues involved are so complex and so politically charged. Nevertheless, the debate, and the research studies that have illuminated it, has served to sensitize the development community to issues of poverty, growth, and the distribution of its benefits.

6. If a future exists for concessional lending and IDA, it now seems probable that unlike in the 1960s, donors would insist upon a poverty focus to such lending both within and between countries. The charge against development assistance that it represents a flow "from the poor in the rich countries to the rich in the poor countries" is too powerfully emotive (and perhaps too close to the mark so far as the past is concerned) to be ignored.

7. The Bank responded to these concerns by shifting its portfolio to include projects designed explicitly to reach the poor, first in rural areas and later in urban. In rural areas, the strategy was one of increasing the productivity of the poor, mainly by increasing the productivity of the land held by small farmers. No parallel strategy could be developed in urban areas, where the poor typically do not own income-producing assets. Instead, the focus was upon increasing employment opportunities (by stressing labor-intensive activities) and by providing services directly to the urban poor, notably sites and

services and slum-upgrading projects. In both cases--rural and urban--the approach was based upon targeting the direct beneficiaries of Bank projects and upon a range of devices to measure and monitor the progress made in adapting the lending program to reach the target populations. The share of the new-style, poverty-focused, projects in the lending program increased from 8% in 1970 to over 30% in 1980.

8. The new program contains both new-style projects and a shift in the emphasis of the Bank's dialogue with member countries on public policy. Its objective is to assist a broad-based growth strategy, primarily by supporting projects which increase the productivity of the poor, and by appropriate changes in national policy. Given that the approach has been one of increasing productivity and not one of charity there are segments of the population--and perhaps the very poorest ones--who have not been reached directly by Bank activity. These might include the aged and infirm and other particularly disadvantaged groups. It is at present an open question (upon which research is needed) whether or not an international lending institution can directly reach such people.

9. Recurrent costs constitute a major part of poverty alleviation programs, and particularly those which involve the delivery of public services rather than investments designed to increase productivity. Increasingly, the Bank has been willing to finance recurrent costs, but the basic dilemma still remains: how far should the Bank go, so that the programs can at least be



started, and how soon can the responsibility be transferred to government?

10. It is not yet possible to evaluate the full impact of the new-style projects. Evaluation reports for some of the earlier projects show that their economic rates of return are similar to those of more conventional projects. But evaluating projects in terms of economic rates of return and numbers and the income status of direct beneficiaries can be misleading. First, our evaluation techniques at best apply to the direct effects and beneficiaries of projects. There is evidence that the indirect effects may be equally as important. Secondly, many of the poverty-focused projects include components, such as village water supplies, which generate benefit streams that cannot be measured for economic rate of return calculations. Third, there is a problem of fungibility: to what extent did the particular Bank project substitute for a government-financed project which might otherwise have been launched? Fourth, many of the new-style projects are innovative in approach and are designed to be replicable. To the extent that they are replicated and financed through non-Bank resources their impact is much greater and more widespread than their direct effect would suggest.

11. Ideally, it would be desirable to measure the impact of poverty lending and the associated policy dialogue on a country-wide basis rather than only on a project basis. However, such measurement is not now possible, either conceptually or physically, given the limited survey and analysis capability of many countries. The Bank's recently-launched Living Standards Measurement Study may assist in this regard in the future.



12. There are controversies both within and outside the Bank concerning the poverty focus of Bank lending. These controversies are likely to continue (and perhaps even to sharpen) because many of the points at issue cannot be resolved with the information presently available. It is important in this context to continue the efforts to measure the impact of the Bank's lending upon poverty, even though such measurement can only be partial. In particular, information on the numbers of people reached by various services (clean water, slum-upgrading and the like) is of equal importance to estimates of the income-generating effects.

13. Controversy outside the Bank has focused mainly on whether or not the poverty-focused projects have achieved their objectives, usually based on very small samples of actual project experience. It might be expected that these new programs of the Bank will be subjected to increasing outside scrutiny in the future. It would be useful, therefore, to initiate planning for a full and careful review of the Bank's experience with the new project and policy approaches.

14. In the light of the prospects facing many countries in the international economic development described in Part II above, it seems likely that many countries will be concerned primarily with establishing external balance over the coming years. It is essential that they do so, and appropriate that the Bank should assist them through structural adjustment loans (SALs) and other means. The danger, however, is that longer-term goals, including that of alleviating poverty, may get lost sight of (or assigned much lower priority) in the process. Part of the Bank's role

should be to attempt to prevent this and to restate the importance of basic developmental objectives. In economic policy matters, there is rarely a single means to achieving a given end; usually a mix of policies is possible. The Bank should be concerned to advocate those policy measures which contribute to external balance and are consistent with alleviating poverty. In this context, the Bank's experience is that projects designed to increase the productivity of the poor have economic rates of return (and hence make contributions to economic growth) that are comparable to those of other projects in its portfolio.

B. Country Economic and Sector Work

15. The Bank's country economic and sector work (CESW) serves a number of objectives:

- judging countries' creditworthiness and determining the Bank's country assistance strategies;
- conducting a dialogue on, and advising Bank borrowers on, their development strategies and macro- and micro-policies; and
- briefing bilateral donors, the UN system and multi-lateral aid institutions and commercial banks on country economic prospects and needs.

16. The high reputation the Bank has earned in performing these functions derives partly from the quality of the Bank's CESW and partly from the comparative advantage held by the Bank as an outside observer with a crosscountry perspective. The advent of structural adjustment lending (SAL) has placed additional demands on CESW and the Bank has become deeply involved in assisting developing countries in the design of their policy reforms. For this reason it is doubly important that the Bank's economic advice is of the highest quality.

Role of DPS

17. The role of DPS in the Bank's CESW is to help the Regions ensure that the quality of the analyses is adequate, that appropriate techniques are used, and that comparable standards are achieved, and advice of comparable quality given, across countries. To this end, in addition to the participation of specialists in individual country missions, DPS organizes Bankwide panel reviews of all important economic reports and considers the content and priorities of future CESW in the context of country policy paper (CPP) reviews. The DPS also provides periodic reports to Senior Management on the direction and quality of CESW and contributes annually to the review by the Senior Vice President Operations of the rolling three-year plan of CESW prepared



by each region. Lastly, for key missions DPS and/or CPS appoints lead advisors to provide specialist advice and judgment.

Staff Resources Used

18. A third of the Bank's professional staff are economists. In FY81, about 250 staff years are budgeted for CESW, using not only regional staff but also consultants (35 staff years), DPS staff (13 staff years) and CPS staff (10 staff years). In addition, the central support staff provide expertise in macro-modeling, data processing, debt recording, commodity analysis and forecasting, as well as sectoral and policy specialists for mission support. They also provide the broad research and analytical background, and certain types of data (in particular, debt) used in economic work.

Variety of Output

19. The results of country economic and sector work appear in a variety of forms including:

- country economic memoranda which report on recent economic trends and prospects on a regular basis to the Bank Executive Board and external aid groups;
- special economic reports which make a thorough analysis of a particular topic or policy issue in a country; and
- basic economic reports which attempt to pull together periodically all the recent analyses in a thoroughgoing appraisal of a country's development strategy.



As the Bank has increasingly focused on country-specific policy issues, the use of special economic and sector reports has greatly expanded. These reports, however, are usually the formal end-product of a process. Frequently, the important part of the process is the discussion of a draft of the report with the government concerned or the issue of a confidential letter or brief from the Bank to a country's leaders.

Key Issues

20. As the Bank's role as a development institution has expanded, so has the scope of its economic and sector work. With a limited budget, this has given rise to difficult decisions on priorities and great pressure on the staff. The main issues are briefly set out below:

(a) Additional Staff Resources. A review of the operational staff resources required for CESW would be desirable for at least three reasons:

- Many borrowing countries rely heavily on the Bank for objective economic advice. In several cases, expansion of the Bank's technical assistance would have a greater impact on a country's development than increased lending.
- The coverage of CESW has greatly expanded. The core of this work is monitoring of recent trends, evaluation of sector policies and investment programs, and creditworthiness analysis. To this has been added the study of population trends, income distribution,

basic needs and, most recently, structural adjustment and energy problems. All these concerns cannot be covered adequately without additional staff. There also may be a case for a special concentration of work on low-income countries, especially in Africa.

- In some countries, the Bank would transfer resources more efficiently if it were to shift increasingly to sector lending, leaving project details to strengthened local institutions. This would require much more thorough analysis of sector issues than in the past.

- (b) Data Problems. To date the Bank has been reluctant to assist countries to improve their data base, fearing that the task is beyond its resources. More could be done by the Bank both directly and in cooperation with other UN agencies to help and encourage governments to improve their statistical activities. A related problem involves assuring the basic comparability of statistics used throughout the Bank. Internationally comparable statistics used in central bank documents such as World Development Reports often differ from those used in country reports. There is a need to find ways of reconciling such differences, and to make better use of the resources of the various parts of the Bank to build up an integrated Bankwide data system.

- (c) Staff Development. The Bank could give more attention to upgrading the skills of its rapidly expanding staff. No more than three days per economist-staff year are spent on training. As countries increase the quality and coverage of their own economic work, there is a risk that the Bank will be overtaken: we need both to increase the sophistication of our own work, and to concentrate it in more specialized fields.
- (d) Strengthening DPS Capacity for Support. Over the past decade the resources devoted by DPS to the support of country-specific operational work have declined slightly in absolute terms, and by about half in relative terms, as CESW has expanded Bankwide; DPS support has also shifted in composition, toward review and advice at headquarters rather than field participation in missions. We need to consider whether the support being given by the DPS is adequate in quality and relevance.

### C. Structural Adjustment Lending

21. Structural Adjustment Lending (SAL) was launched by the Bank in early 1980 in response to the grave and persistent international payments imbalances of developing countries. Its objective was to complement the IMF's short-term balance of payments support with additional foreign exchange resources to support significant policy measures aimed at adjusting production and investment to the changed international environment. Experience



gained over the last year has clearly indicated that SAL is a very useful lending instrument which facilitates policy reform in critical areas of economic management.

22. The DPS is responsible for reviewing and monitoring SAL operations. From this central vantage point, this note traces the origin and evolution of the concept of SAL, summarizes SAL operations completed and planned, and highlights the key issues that have emerged from the debate on SAL in the Executive Board and among staff.

Origin of the Concept

23. The use of nonproject (i.e., program) lending has been keenly debated since the World Bank was founded. The Articles of Agreement of both IBRD and IDA make clear that lending should be in support of specific projects, except in "special circumstances". Nonetheless, in 1947-1955, program loans accounted for about 40% of total IBRD lending. More recently, in the 1970s, the Board accepted the guideline (but not a target nor a ceiling) that 7 to 10% of Bank Group lending could be in this form, though actual commitments have averaged no more than 6%. The "special circumstances" accepted by the Board as justifying program loans/credits were limited to: natural disaster; unanticipated shortfall in export earnings; a rapid deterioration in terms of trade; underutilized productive capacity owing to a general shortage of foreign exchange; and the need for structural adjustment.

24. The main difference between SAL and "old-style" program lending is the stress on a set of policy actions specifically designed to achieve a manageable balance of payments within 5-7



years and, at the same time, to enable a country to regain its development momentum. While adjusting domestic production and consumption structures to permanently higher energy prices was to be a vital element in the program, measures were also envisaged to promote exports, reduce imports and adapt public investment programs to the altered international environment. A principal feature of a SAL operation is a statement of proposed policies and actions set out in a Letter of Development Policies, normally signed by the Finance Minister. A series of SALs, rather than a single operation, are normally envisaged, since structural policy reforms take time to design and implement.

SAL Operations to Date and Planned

25. Despite the high profile given to SAL, so far only 6 operations have been approved by the Board as of the end of April 1981. The countries are:

Turkey	(\$275 m)	Bolivia	(\$50 m)
Philippines	(\$200 m)	Senegal	(\$60 m)
Kenya	(\$ 65 m)	Guyana	(\$14 m)
Total: \$664 m			

In addition, preparations are well advanced for SAL operations in:

Korea	(\$200 m)	Morocco	(\$100 m)
Mauritius	(\$ 15 m)	Malawi	(\$ 45 m)
		Turkey II	(\$200 m)
Total: \$560 m			

Preliminary work for SAL has also been initiated in Jamaica and Thailand, while repeat operations are being actively considered for Kenya and the Philippines.

Major Issues

26. The format and design of the SAL operations will evolve as the Bank learns from experience. In this evolution, a number of policy issues deserve attention:

- Additionality. At present, SALs generally substitute for project lending. The developing countries need additional resources to finance their expanded balance of payments gaps and to cushion the domestic impact of significant programs of structural reform. Moreover, SAL operations for large countries such as India and Brazil cannot be accommodated unless the Bank's resources are significantly enlarged.
- Limited Coverage. So far, the only low-income country for which a SAL has been approved is Senegal. Poor countries, which need resources the most, are likely to have the greatest difficulty in formulating convincing programs of structural adjustment. This problem can only be overcome with thoughtful and sustained technical assistance from the Bank.
- Policy Conditionality. Developing countries are understandably sensitive about unwarranted interference in their macroeconomic policies. While such sensitivity cannot be avoided altogether, the best guarantee for success is to form alliances with domestic forces working for needed policy reforms. SALs should not be made to carry the entire burden of



policy change in a country; project and sector lending should be made conditional on policy changes that complement the SAL program or they may be used alone if SAL negotiations falter.

- Country Economic and Sector Work. For effective SAL operations, the Bank's economic advice has to be detailed and operational. Staff resources for SAL operations can be increased both through reallocation of existing resources and through additions. Apart from staff members, people with special skills are clearly required for this work.
- Conflict with Poverty Alleviation Work. A recent review of country economic and sector work confirms that the expansion of SAL-related activities has led to the postponement of country-specific studies on basic needs, human resource development and poverty. Moreover, it is debatable whether SAL programs should have a narrow medium-term balance of payments focus, emphasizing export promotion and energy policies, or whether they should embrace longer-term adjustment of production, consumption and investment patterns to high-cost energy, as well as incorporating income distribution and human resource development goals.

- Coordination with the IMF. Several Executive Directors have expressed repeated concern about the blurring of the distinct roles of the IMF and the Bank in SAL operations, and emphasized the need for close collaboration. It is recognized that the Fund is chiefly concerned with current balance of payments disequilibrium and the Bank with long-term development strategies. It is the grey area in-between and the close link between short- and long-term policies that creates institutional problems. The medium-term balance of payments problems that developing countries face as a result of higher energy costs and a more unfavorable international environment require both short-term stabilization measures and long-term changes in production and investment. Hence the need for much greater collaboration between the two institutions.

#### D. Country Allocation of IBRD/IDA Resources

27. IDA resources have always been available only in fixed amounts; more recently IBRD resources have been approaching statutory lending limits. In these circumstances, both IBRD and IDA resources are subject to rationing. The rationing process consists of defining restrictively the eligible set of borrowing countries, and of allocating resources to these countries on the basis of their relative need, creditworthiness and capacity to use the capital effectively for social and economic development.



Eligibility for IBRD and IDA

28. The eligibility conditions set out in the Articles of Agreement of the IBRD are quite broad:

- inability to obtain adequate funds from other sources on reasonable terms;
- creditworthiness; and
- assurance that IBRD loans will be used productively (Article III, Section IV).

IDA's basic eligibility criteria are:

- being a "less developed" member of IDA;
- inability to obtain adequate financing on reasonable terms from private sources or from the IBRD; and
- assurance that IDA's funds will be used productively (Article V, Section I).

In IDA's initial years a few middle-income less developed members benefited from credits, but since 1964 , eligibility has been limited to lower income countries as determined by a per capita income guideline, adjusted annually for inflation. That guideline now stands at \$680 in 1979 prices.

29. Certain countries are eligible for both Bank and IDA funds. These "blend" countries have some, but only limited, creditworthiness for IBRD borrowing and are also eligible for IDA under the per capita income guideline.

Allocation of IBRD and IDA Funds

30. The criteria determining country allocations of IBRD and IDA funds are extensions of the eligibility guidelines. Two additional factors are population size and portfolio considera-

tions. The aim, other factors being the same, is to equalize per capita allocations among countries, regardless of their total population. The poverty criterion reflects the principle that the poorer a country the greater its claim on World Bank resources. For IDA, the application of the poverty criterion has led to an allocation of 90% of the FY81-85 lending program to countries below \$390 per capita income even though the cutoff level is now \$680 at 1979 prices. "Performance" has become a very important factor in determining both IBRD and IDA allocations; and, since early 1980, above-"normal" increases in lending allocations have been given to countries that appear able to undertake effective structural adjustment programs.

31. IBRD allocations are further constrained by creditworthiness considerations, at three levels: the borrower must have reasonable overall creditworthiness for its projected debt, including planned IBRD lending; the IBRD should not account for an unduly high proportion of the total debt service of any country; and no borrower should account for an unduly high proportion of IBRD's portfolio. Similarly, the need to achieve a reasonable geographic distribution of IDA resources has led to limiting India's share in IDA to 40%, a per capita level of lending very much below the average of other IDA recipients. Lending to a number of other low-income borrowers is constrained by their limited absorptive capacity. In a few cases allocations are also influenced by special Bank policy considerations.

The Allocation Process

32. For the past several years, allocation levels have been recommended to management jointly by DPS (PPR) and the Programming and Budgeting Department, on the basis of the considerations described above and a "normative" calculation. The latter is based on population, per capita income and a numerical measure of performance. The performance rankings are in large part subjective and therefore controversial and sensitive. The key elements in determining performance ratings are the quality of economic management (particularly in respect of growth, balance of payments and debt), progress in poverty alleviation, and receptivity to Bank advice.

33. On the whole, the allocation process has worked well. Both Senior Management and the Regional Offices have come to accept it as a useful management tool. Combined with the management review of Country Program Papers (CPPs), the allocation process helps to reconcile the objectives of equity among countries, development efficiency and financial prudence in allocating IBRD/IDA resources.

Outstanding Issues

34. Issues of eligibility and allocation are related to the magnitude of available funds, and currently this is a matter of considerable uncertainty. Whatever the outcome of the present efforts to increase World Bank resources, the following important questions about eligibility and allocations will have to be addressed in the near future:



- Criteria for lending to higher-income countries. This issue is still pending before the Board. The paper "Criteria for Bank Lending in the 1980s" (R79-179) proposed that the "trigger-point" for rigorous analysis of a country's eligibility for IBRD should be determined by its income level relative to the developed countries, rather than by the absolute standard currently in practice. A guideline was suggested of 30% of OECD North per capita income. At 1979 prices this corresponds to \$2,850 (for 1979) compared with the updated absolute "benchmark" of \$2,200. These questions should be freshly examined. The criterion finally agreed upon would have to take into account the likely future volume of IBRD resources, the relative needs of the various country groups and the availability of other sources of external capital. This analysis could have significant implications for the size of the Bank.
- Portfolio constraints. Portfolio considerations constrain lending to several large borrowers. In view of this and the emergence of China as a potential major borrower, a review of current policies on portfolio concentration would be desirable.
- Allocation for China. A realistic appraisal of the Bank's allocation for China must await the outcome of the proposals formulated in the Board paper on "Possible Expansion of IBRD-IDA Lending" (Dec. 18, 1980).

Meanwhile, alternative scenarios for China on the assumption of much more limited resources are being examined. It is evident that China, like India, will have to be held substantially below its "normative" level because of its large population.

- Sharing allocation decisions with the Board. The Board has shown a desire to be involved in the allocation process - helping to set the broad policy guidelines if not the individual country programs. The latest occasion on which such wishes were expressed was the Board discussion, in March 1981, of the paper on "Bank/IDA Lending Program - Allocation Among Income Groups, Sectors and Regions," which contains a general description of allocation principles. This question is bound to arise again.

#### E. The Policy Planning Process

35. Policy making is often the most difficult and the most competitive function in any organization. The Bank is no exception. There are many unpredictable events which require a quick policy response, yet it is also necessary to anticipate future policy needs and to prepare systematic analysis and research to deal with them. Again, there are many units which vie for a role in policy making. Often the real challenge is to ensure that the final decision making can become a participatory process. There is also a need to strike a delicate balance between the expectations of the borrowing members (all developing countries) and of the creditors (mostly developed countries), between in-

ternal interests and external pressures, and between conflicting points of view on complex issues among an international staff.

36. The Bank has tried to resolve these dilemmas by systematizing some parts of the policy planning process over the last decade. This note outlines the present system, how it has worked, and some problem areas that remain.

#### Evolution of the Present Policy Planning Process

37. Before 1972, the policy planning process had little formal structure. With the rapid expansion of the Bank during the early 1970s--in particular, with lending moving into a number of new areas--it became necessary to establish more formal procedures for the formulation and review of policy papers:

- the Policy Review Committee (PRC) was set up under the chairmanship of the President, with key Vice Presidents as members;
- a staff-level committee (PRC staff), with flexible membership, was set up to provide Bankwide interdepartmental review before policy papers were sent to the PRC; and
- the Policy Planning Division was established under a new Policy Planning and Program Review Department to serve as the secretariat for the PRC and to monitor the production and review of policy papers.

38. Over 70 policy papers have now gone through the Policy Review Committee. These papers have been recognized as of high quality; most have been published. They have dealt with development issues (such as how economies develop), operational issues



(project design and implementation and sector lending guidelines), and with finance and external relations issues (such as IDA allocation criteria, local cost financing, and lending to high-income countries).

Some Problem Areas

39. On the whole, the policy planning process has worked fairly well in providing opportunities for systematic thinking on Bank policies and for Bankwide participation in the review of policy issues. Several policy innovations have been made in the past ten years. However, it would now be desirable to review the entire policy planning process, to be sure it is geared to the development challenges of the 1980s and to address a few specific problems:

- We have been more successful in responding to ad hoc, short-term needs than in anticipating long-term requirements. It is becoming necessary to prepare a long-term Bankwide policy work program to address the role of the Bank in the 1980s.
- The fora for Senior Management review and decision making have recently multiplied and become somewhat fragmented, particularly over the last two years. Instead of most policy issues being discussed in the Policy Review Committee (which represents all parts of the Bank), policy matters are now discussed in five different fora (see attached table). These are:

BANK POLICY MANAGEMENT FORA

<u>POLICY FORUM</u>	<u>CHAIRMAN</u>	<u>MEMBERS</u>	<u>SECRETARIAT</u>	<u>FORUM FOR STAFF REVIEW</u>	<u>YEAR ESTABLISHED</u>
1. President's Council	President	<u>20 members:</u> Senior Vice Presidents, Operations and Finance; Executive Vice President, IFC; Director General, Operations Evaluations; all Vice Presidents	No formal secretariat. Minutes usually maintained by the Personal Assistant to the President.	None	1966
2. Policy Review Committee	President	<u>21 members:</u> All members of the President's Council except Treasurer, Controller; Directors of Policy Planning and Program Review Depart- ment, Development Policy and Project Staff, Division Chief, Policy Planning attends as Secretary, (By invitation, the Director and concerned staff of the Department responsible for the paper being reviewed)	Policy Planning Division	Membership adjusted to suit subject but normally includes all Regional Project Directors, all Regional Chief Economists, Directors, Development Policy, CPS Policy Staff, PPR and concerned DPS/CPS Departments	1972
3. OVP Group	Senior Vice President, Operations	<u>8 members:</u> Vice President, CPS, six RVPs, Vice President, DPS, Other relevant staff may attend by invitation	Office of the SVPO (PPR provides briefing memoranda on selected policy papers.)	PRC-Staff Review on selected policy papers (see item 2 above)	1978
4. Finance Committee	President	<u>7 members:</u> Sr. Vice Presidents, Finance and Operations, General Counsel, Secretary, Vice President Programming and Budgeting, Treasurer, Controller, Director Financial Policy and Analysis Department (VP DPS by invitation)	Financial Policy and Analysis Department	None	1979
5. Personnel Management Committee	President	<u>6 members:</u> Sr. Vice Presidents, Finance and Operations, Vice President, Administra- tion, David Summer (Consultant), Director, Personnel Management Department	Personnel Management Department	None	1979

- President's Council
- Policy Review Committee
- Finance Committee
- Operational Vice Presidents' Group
- Personnel Management Committee

Problems sometimes arise because each policy group has a different secretariat; some have very restricted membership; some have no arrangements for a prior staff level review; some have no arrangements for adequate dissemination and follow-up of decisions. The long-term interests of the Bank require greater coordination and institutionalization of the policy planning process.

- There is also a need for systematic policy audits to find out how far new policy initiatives have in fact been implemented and with what results.

#### Alternatives for the Future

40. Effective policy formulation mechanisms in several organizations have at least three common features:

- a centralized decision making mechanism, directly under the chief executive, with the close participation of key policy making units in the institution;
- a central policy staff, with a clear mandate to prepare, implement and monitor a long-term policy work program, along with an inbuilt flexibility for quick response to short-term policy issues; and



- a decentralized system of preparation and review of policy papers so that relevant policy options can be debated throughout the institution and then distilled for Senior Management through the central policy staff.

There are many alternative ways in which the policy planning and review process could be reorganized, consistent with the above objectives. A special task force may be needed to review the existing situation and to suggest various alternatives for the future.

F. The Bank and the Management of External Debt

41. Foreign borrowing by developing countries rose rapidly during the past decade. Excluding capital surplus countries, their debt outstanding rose from \$68 billion in 1970 to \$439 billion in 1980. This has created concern about the level of indebtedness of many developing countries. The main issues for the Bank are: a) how to preserve its own financial soundness while expanding its portfolio; and b) how to help developing countries manage their debt and protect their creditworthiness in ways which best preserve their ability to satisfy their external capital needs.

Perspective on Debt

42. The following are the central facts about the current situation:

- The 22% annual increase in nominal debt outstanding during 1970-80 was largely due to inflation. Deflated by import prices, the increase was 7.6% per annum.
- The increase in debt has been fastest among oil-exporting countries; for oil-importing developing countries as a group, export earnings rose as fast as debt.
- Debt service ratios have increased because average terms have hardened. This is due to an increase in the share of debt owed to private creditors in the 1970s (from 45% to 67% of the total for all World Bank borrowers); and to the rise in interest rates on nonconcessional debt, partly on account of inflation.
- For oil-importing developing countries, the unweighted average ratio of debt service to export earnings is still less than 14%. This group includes many low-income countries that have low ratios because they are not creditworthy for conventional borrowing, as well as a few middle-income countries that have followed very conservative borrowing policies.
- In the 1980s, most developing countries will remain very dependent on nonconcessional capital; it is therefore of great importance that their creditworthiness be maintained or strengthened.
- This is likely to be achieved in part by restraining borrowing below levels that would otherwise be desirable. Nevertheless, the number of countries encountering serious debt management problems can be expected to increase in the 1980s.

The Bank's Concerns

43. The Bank is concerned with debt management problems at several levels:

- in determining country creditworthiness for IBRD lending;
- in helping its borrowers to avoid debt servicing problems, and providing them technical support when they are engaged in debt-rescheduling exercises; and
- in assessing debt management problems in the context of its global economic analysis.

Country Creditworthiness

44. Creditworthiness depends on the same factors as development: the quality of human and natural resources, the effectiveness of social and economic institutions and of economic policies, the adequacy of domestic savings and the ability to meet import requirements and external debt service through exports, aid and borrowing. The Bank's economic work addresses all these concerns. But, since debt service must be paid in foreign exchange, narrowly defined creditworthiness analysis focuses on external debt and the balance of payments.

45. The Bank devotes substantial resources to collecting, processing and analyzing debt information. Projections of exports, import requirements, capital and debt-service flows are made and analyzed, and their sensitivity to plausible alternative assumptions is tested. These analyses are used in both the development of country strategies and the assessment of the quality of the IBRD loan portfolio.



46. At the end of 1980, outstanding IBRD loans accounted for about 5.5% of the total debt of Part II borrowers and IDA accounted for another 2.7%. The Bank has been able to avoid repayment problems by:

- limiting the amount of IBRD lending to countries with low creditworthiness, in particular to low-income countries, most of which are considered eligible only for IDA;
- making it very clear that it will not participate in debt rescheduling, and protecting this preferred creditor status by limiting its share in the debt service of IBRD borrowers;
- being able to provide additional resources to countries that have resolved, or are undertaking to resolve, their debt management problems; and
- noting the value to borrowers of a sound repayment record.

#### Proposals for Debt Relief

47. The current constraints on new grants and concessional loans and the growing volume of developing country resources absorbed by debt service have prompted calls for wider relief of official debt to assist developing countries. For the least developed countries, debt relief can be viewed as a retroactive adjustment of the terms of prior lending. Some creditors (Canada, Sweden) gave total relief to all least developed countries and

others (Germany, Japan) partial relief (or equivalent measures) to some countries. Outstanding debt affected totaled \$4.9 billion; significant additional benefits would stem from further action by major creditors - especially the United States and France. However, generalized debt relief is not an answer to the poorest countries' need for sustained aid; for most other developing countries, it is also precluded by their need for new loans on commercial terms.

48. There is growing international concern for improving debt management capabilities in developing countries, and for ensuring that, when debt-rescheduling becomes necessary in specific circumstances, it should restore the debtors' creditworthiness and enhance their growth prospects. The Paris Club provides for an orderly restructuring of external obligations, but typically over fairly short periods (12-18 months). Creditor countries favor such a "short rein" to promote caution in seeking new credit, but debtors complain that, when debt difficulties are deep-seated, existing arrangements constrain them to a continuing process of debt renegotiation.

49. A recent resolution of UNCTAD's Trade and Development Board calls for the Executive Heads of the IMF, Bank and UNCTAD to work out effective procedures for coordinating responses to requests from developing countries for assistance in debt renegotiations. The position of the Bank and the Fund is that formal consultation procedures are unnecessary, but informal consultations could usefully take place. The Bank and Fund are concerned



that, if UNCTAD were to promote a broad and generalized approach to rescheduling, this would reduce the ability of developing countries to attract needed capital.

50. A recent staff paper presented to the Board (but not discussed) proposed that the Bank should:

- take a more active role in offering technical advice to countries engaged in debt negotiations and in participating in renegotiations like the Paris Club, to ensure that debt relief is consistent with the long-term development needs of the debtor;
- take actions to have debt problems discussed in Aid Groups in the context of overall development problems; and
- give more assistance to countries at their request in the fields of debt reporting and debt management, and assist in the identification of corrective measures.

#### Outstanding Issues

51. Some issues remain on which the Bank needs to develop its policy position. Given the greatly expanded role of private lenders, should the Bank consult more closely with them about the economic policies and prospects of our members? What role should the Bank play toward proposals to consolidate private flows, through a "safety net" or other facilities? How can it best assist its borrowers to improve their debt management and maintain their creditworthiness?



52. The Bank must also continue to refine its analysis of credit risks and of the appropriate degree of risks in its own portfolio--particularly as constraints on IDA and IBRD resources may lead to a greater concentration of lending to middle-income oil-importing countries, and to negative net resource transfers for some borrowers. In this process, it must carefully reconcile its positions as general development advisor, as policy advisor to individual countries, and as the single largest creditor of developing countries.

G. The Bank and the North-South Dialogue

53. The DPS maintains a watch on global economic issues, including those that are prominent in what is called the North-South dialogue. This note summarizes the main issues in the current global negotiations and their implications for the future role of the Bank.

Global Negotiations

54. Since 1974, the developing countries have pressed hard for a global compact between the North and the South, aimed at a massive transfer of resources to the developing world and greater equality of opportunity in present and future international economic arrangements. Despite obvious political and economic differences among themselves, the Third World countries have hung together in a shaky coalition in the belief that they could jointly negotiate a new Magna Carta of economic rights in the UN framework. The developed countries, on the other hand, have insisted on an issue-by-issue approach in specialized fora

where they have greater control over the final outcome. There is especial reluctance on the part of the developed countries - in particular the United States, the United Kingdom and Germany - to agree to a discussion of international monetary and financial issues in the UN forum. These countries are not prepared to accept the developing world's position that the "negotiated contract" - if something like it ever emerges - would be binding on all parts of the international system, including the World Bank and the IMF. The developing countries hope that the North-South summit at Mexico will resolve this issue and that the UN global negotiations will commence before the end of this year.

Content of the North-South Dialogue

55. The precise content of the demand for a new international economic order has remained undefined so far but certain items on the current global agenda can be identified:

- The developing countries continue to seek a "massive transfer of resources" from the developed countries. The 0.7% target adopted for implementation during the Second Development Decade has been included in the International Development Strategy for the 1980s adopted by the UN last year. In addition, several proposals call for a substantial and more equitable recycling of international surpluses; more automatic resource transfers; larger program assistance; and greater channeling of resources through "reformed" Bretton Woods institutions.

- On debt, the developing countries no longer seek the total forgiveness implied in their earlier demand. They now urge (a) those developed countries which have not already done so to undertake retroactive term adjustment of all outstanding official debt to all low-income countries; (b) reform of the Paris Club arrangement so that development considerations are introduced into the Club's restructuring of external obligations; (c) and systematic use of international organizations--World Bank, IMF, and UNCTAD--to respond effectively to requests from developing countries for assistance in debt renegotiations.
- In the area of food, the developing countries continue to reiterate the main components of the plan they put forward in Rome in 1974 at the UN Food Conference when they asked for (a) at least 10 million tons of planned food aid, with a program formulated for ten years at a time; (b) establishment of a system of internationally coordinated food stocks to be available to the developing countries during periods of extreme distress; (c) an international insurance scheme to provide automatic assistance to the developing countries in case of a sharp increase in international food prices; and (d) a massive transfer of resources on concessional terms for the development of agriculture in the developing countries.



- In the area of industry, the "Lima target" (adopted in 1975 at the Second UNIDO Conference) of obtaining a share of 25% in world industrial output for the developing countries by the year 2000 continues to be promoted in various international fora. With the completion of a draft plan by the UNIDO to establish an International Industrial Development Bank, this target is now being given an "operational" content. The UNIDO plan calls for the launching of a new institution aimed at making \$15 billion a year available to the developing countries for industrialization.
- No firm position has been taken by the developing countries in the area of energy. The non-oil developing nations continue to support the OPEC's position on the need to (a) index oil prices to the rate of global inflation, and (b) set up a monetary system that would preserve the value of the assets owned by the oil exporting countries. Most developing countries also favor the establishment of an energy affiliate by the World Bank provided that they can obtain a meaningful role in its control and management.
- The developing countries continue to press for a larger share in the management of international financial institutions, a demand that received considerable support and emphasis in the report of the Brandt Commission.

56. The above is only a partial list of issues. Many other items have been high on the Third World agenda, including: setting up a Common Fund for the stabilization of primary commodities; elimination of protective barriers against Third World manufactured goods exports; internationally-administered codes of conduct for multinationals and technology transfers; negotiation of a Law of the Sea, particularly establishment of an international seabed authority; and international monetary reforms, especially the creation and equitable distribution of SDRs. In recent negotiations, the Third World representatives have tended to narrow their agenda to issues concerning resource transfers, monetary reforms, food and energy.

Role of the Bank

57. While the Bank--particularly the DPS and the External Relations Department--has maintained a watching brief on global economic issues, it has not played an active role in the North-South dialogue. If a working consensus is reached on the agenda and fora for global negotiations and if these negotiations start in earnest in the 1980s, it would become necessary for the Bank to develop its policy positions on a number of global issues. The analyses in the World Development Report and in papers for the Development Committee could provide some bases for a constructive dialogue, but more in-depth analysis of global economic issues would be required.



58. In the near future, the Bank has to formulate its own policy posture on a few specific issues which have already been taken up in the global dialogue, particularly by the Brandt Commission Report. These include the following:

- a larger role for the Bank in the transfer of resources;
- redirection of the Bank's lending into sectors demanding immediate attention (e.g. energy and food); and
- changes in the Bank's current voting and management structure and decentralization of its operations.

Bank's Role in Resource Transfers

59. The question of extending the resource base of the Bank was addressed in a comprehensive fashion in a recent paper to the Board ("An Examination of Possible Expansion of IBRD/IDA Lending over Levels Presently Planned for FY82-86 and Means of Financing Such Expansion"), a number of individual papers in response to the Brandt Report, and various proposals submitted by the Bank staff to the Task Force on Nonconcessional Flows. There has been no dearth of innovative proposals. However, the political climate has been extremely unfavorable for a major expansion in the Bank's resource base. There are several issues on which the management will need to develop its own strategy fairly soon:

- The rising criticism of multilateral assistance, and some emerging preference for bilateral channels.
- Whether a change in the gearing ratio of IBRD is appropriate or whether efforts should be made to raise additional resources through special windows and borrowing devices.



- The extent of financial leverage the Bank should seek by using devices like cofinancing with private banks, use of guarantee powers, etc., with whatever amendments this requires in its present procedures and, if need be, in its articles.
- In short, what is our future strategy for concessional assistance? Recent problems with IDA raise some fundamental issues. Is the present three-year negotiation cycle the ideal mode for future replenishments or is some form of automaticity possible? Considering the new inflationary climate, are IDA terms set over 20 years ago still appropriate? Is there room for an intermediate facility for more creditworthy IDA countries?
- What balance should the Bank Group seek between middle-income countries and low-income countries, given the diminishing share of concessional resources?
- In view of the criticism about the seeming "bigness" of the Bank, should there be a substantial decentralization both in decision making and in physical location of some activities? Should we also encourage some diversification of international financial institutions?

Bank's Lending Priorities

60. A change in the focus of the Bank's lending would be greatly facilitated by additionality of resources. In principle, the Bank is able to give even greater priority to sectors

such as energy and food production and programs like SAL operations, but doing so would involve reducing some high-priority projects or programs, particularly those addressed to poverty alleviation, if total resources remain fixed. The enlargement of the Bank's resource base and refocusing of lending are, therefore, essential to avoid serious conflicts among contending priorities.

#### Bank's Institutional Structure

61. The most difficult issue on the North-South agenda is whether the present institutional structure of the Bank is appropriate for the 1980s and 1990s. It would be an understatement to suggest that a consensus is now lacking on this issue either in the Board or among management and staff. Changes in management structure and decision making may be easier to handle than changes in the voting structure. Some creditors (particularly the US) increasingly feel that the Bank does not serve their bilateral interests well, whereas some developing countries see the Bank as too closely aligned with developed countries' policies and interests. Again, major structural changes may make it difficult to raise additional resources from existing creditors, yet potential creditors (OPEC) would be discouraged if no changes were made. These issues have already come up in connection with the Energy Affiliate.

#### Bank's Role in Policy Dialogue

62. The Bank's nonlending role may become even more important in the 1980s, especially if its financial resource base remains



constrained. The contribution that the Bank makes through its research, analysis, country economic and sector work, World Development Reports, objective analysis of North-South issues, technical assistance to consortia and consultative groups, and policy dialogue with the UN and other external agencies could be fairly decisive in the next decade in building up a climate of ideas for orderly change in the international economy. The Bank has considerably expanded this nonlending output in the 1970s but a coordinated strategy for the 1980s, with increasing emphasis on technical assistance, has yet to take shape.

Future Role of the Bank

63. In view of these emerging issues, it is essential that the Bank draw up and implement a long-term program of policy analysis which focuses on the future role of the Bank in a changing global environment.





## OFFICE MEMORANDUM

Appendix III  
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TO: Research Committee

FROM: Shankar Acharya, Research Adviser, VPD

SUBJECT: Board Discussion of the Research Report

DATE: March 31, 1981

1. The Board discussion occurred on March 17. Ten Executive Directors spoke. The Research Report was unanimously acclaimed by the Board as "thorough", "informative", "instructive" and of "high standard and quality". I am told, by those who have attended earlier meetings going back to 1973, that this was the friendliest Board discussion of the Research Program.

Size and Quality

2. There was unanimous support for the Research Program, and considerable support for further increases in its size. The majority of speakers were, however, leary of the research subsidiary idea floated in paragraph 6.30.

3. Several speakers praised the quality of achievements of the research program over the last 10 years. They pointed out that it had some outstanding achievements to its credit, such as the research on Income Distribution and Poverty. Because of the widespread influence of the Bank and its leadership role in development, Bank research was deemed essential and of great value. Several speakers also commended the frankness of the internal evaluations of completed research projects.

Operational Relevance/Applications

4. The Board commended the efforts of the Research Program to impart greater operational relevance to research and to see that research results provided guidance on lending operations, monitoring and evaluation and related work. The establishment of Research Steering Groups was strongly welcomed in this context. Speakers however hoped that continued efforts would be made to increase interactions between research staff and operational staff. Speakers supported the emphasis being given to "Applications" and would like more such work to be done. The hope was expressed that this should not reduce the "regular" research program. A major reason cited by several speakers against the concept of a research subsidiary was that it might widen the gap between research and operational staff.

Dissemination

5. The Board appreciated the increased efforts of the Research staff towards dissemination and hoped that there would



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be further efforts in this direction. The 'World Development Report' and 'Research News' were commended in this context. Speakers pointed out that dissemination should be not just to academics in LDCs but also to administrative and planning personnel. A greater potential role for EDI was also mentioned in this context.

#### Collaboration/Institution Building

7. Board members strongly supported efforts at collaborative research and institution building in the LDCs. In this context the idea of secondment of research staff to LDCs and bringing of LDC staff to Washington for fellowships was welcomed. Some members hoped that greater efforts could be made to train researchers and develop research infrastructure in LDCs, perhaps as part of the lending program. It was hoped that continued efforts would be made towards coordination of research with other international organizations and institutes doing development research.

#### Composition of Bank Research

8. While commending the research program, some members wondered about the reasons why the proportion of research on Agriculture and Rural Development was low compared to the "1973 guidelines", as well as to the sector's share in Bank/IDA lending. There was also some question on the "lower than guidelines" proportion of research on Income Distribution. It was explained that it was partly a problem of classification (e.g. some of the research under Development Planning and under Human Resources could just as easily be classified under Income Distribution or Rural Development), and partly of availability of interested staff with good proposals.

9. In view of the changes in the international situation and in the role of the Bank since 1973, Board members expressed a desire for some reorientation of the research effort. The two areas in which they would like to see a significant increase in research effort are energy (conservation, technology) and global issues (regional cooperation, interdependence, global adjustment, international development cooperation). Board members also expressed the wish for a greater research effort in relation to structural adjustment lending so that better guidance could be provided to operational staff, not only on the macro, but also at the micro-level of specific industries. Some members also expressed a wish for more research in the areas of "economic ideology" and "socio-economic and socio-political factors in development".

SA/AV:lt





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