

**Address
to the
Board of Governors
by
A. W. Clausen**

**President
The World Bank
and
International Finance
Corporation**

**Seoul, Korea
October 8, 1985**

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**The World Bank
Washington, D.C., U.S.A.**

Address
to the
Honorable
A. M. Chandler
of the
Senate
of the
State of
New York
in
the
year
1892

Mr. Chairman, Governors, Ladies and Gentlemen: welcome to these Annual Meetings.

We want to express sincerest thanks to President Chun, to the Government of Korea, and to the city of Seoul for welcoming us here. The warmth of Korean hospitality is legendary, and we are delighted and grateful to be your guests in this great city.

We are especially pleased to have had our opening session this morning honored by the presence of President Chun. His thoughtful statement has provided an excellent beginning to our discussions.

And we all should warmly welcome the delegates from our new member nation, Tonga.

This fiscal year we mark the fortieth anniversary of the opening of the doors for business of the International Bank for Reconstruction and Development. We have learned much in these four decades and we have contributed much as well. The progress in development has been impressive, and I want to express our thanks to you, the shareholders, for your constant support and to all those who have worked for your institutions and who have secured so proud a record of accomplishment.

This is the fifth occasion on which I have had the honor of addressing the Boards of Governors of The World Bank and the International Finance Corporation. We meet this year at midpoint in the decade and at the beginning of a period which must mark a shift from the rigors of austerity to the revival of development and growth. At this turning point, I want to review the crisis of the last five years and share with you our expectations for the next five years. Then I want to discuss the ways in which the Bank has responded to the needs of its members during those difficult times, and how the lessons which we draw from that experience

can make our support for the reoriented development strategies of our members even more effective in the future.

The economic turmoil of the last five years has challenged us to reestablish the foundations of growth. It has challenged us to reaffirm the mutual benefit to all nations and peoples of an interdependent world based on a trading system that is truly liberal and a financial system that is truly sound.

The World Bank will play a vital role in the transition from recession to sustained economic growth, a transition upon which hang the hopes for a better life of hundreds of millions of people in the developing nations. That role, and the enhanced financial capacities which our strategy will require, need your firm support.

Let me turn first to how the developing world has fared economically over the first half of the decade, and how it may evolve over the next half.

The first half of the 1980s began with global recession and ended with recovery. It was a period of adversity and adaptation, stabilization and adjustment. Developing country experiences varied greatly according to the circumstances which each country confronted and the policies each adopted. Some were successful, some were not. Some policies worked, others did not. As partners of our developing member countries in this experience, and as analysts of it, we have been able to identify some of the policy approaches that have allowed countries to cope better with these adverse conditions. In short, their experience has helped to shape our actions.

That experience began with the deep and widespread recession of 1981-82 which hit the developing nations particularly hard. Demand for developing countries' goods declined sharply; commodity prices fell; interest rates increased; and debt-servicing difficulties spread and intensified.

As the recession deepened, there was widespread pessimism

about the prospects for many developing countries. For the group, output grew by 3 percent in 1981 and increased by only 2 percent in 1982 and in 1983—which resulted in a decline in per capita income. Growth of developing countries' exports—the foundation of their creditworthiness—was stunted, increasing by only 3 percent in 1981 and in 1982. Developing countries which had borrowed heavily from foreign sources experienced serious debt-servicing problems, and as a result the availability of foreign commercial capital declined abruptly after 1981.

The depth and intensity of the recession revealed major underlying structural imbalances and market rigidities, the correction of which is a prerequisite to restoring equilibrium and growth. The recovery which began in 1984 with improvements in overall developing country output and exports was built upon recovery in the OECD countries and in international trade, major stabilization efforts in many countries, and the beginning of the necessary restructuring of economies in the developing world. Some countries performed it well, and others did not.

Take, for example, the export-oriented economies, which generally adjusted in a timely way. Those in the Far East quite quickly recovered their earlier high rates of growth, so that the overall increase in output for East Asian countries rebounded from about 4 percent in 1982 to about 6 percent in 1983 and just over 5 percent in 1984. A few Asian countries even exceeded their earlier performance. China experienced impressive growth in 1983 and 1984 of about 8.5 percent.

Other countries, such as some of the major debtors in Latin America, delayed their adjustments, and they are still in transition to restored creditworthiness and satisfactory growth rates. With strong support, however, from the IMF, The World Bank, the commercial banks, and official creditors, they weathered their initial debt-servicing difficulties, and their turnaround has been impressive. Output in Latin America increased by more than 3 percent in 1984 after two consecutive years of decline.

For many low-income countries, particularly those in Sub-Saharan Africa, long-standing problems got worse as demand for their primary exports fell. At the same time, they were hit by a series of droughts, and reexamination of their domestic policies and development strategies in light of the changed global environment was long delayed. While a number of countries in Africa began the realignment of their policies and the adjustment of their strategies in 1983 and 1984, much yet remains to be done to deepen, spread, and strengthen this effort. Sub-Saharan African countries as a group experienced an actual decline in output in 1984 for the third year in succession.

The nature of the policy changes needed to promote adjustment and longer-term growth is, of course, dependent upon the specific conditions in each country. Generally, however, those countries that have reduced economic distortions and have permitted economic agents—public and private—to act more freely have experienced more rapid economic growth over time. They have also responded better to external shocks. A critical measure of such policies has been how well they promote economic flexibility. More specifically, most adjustment programs have included the reduction of a broad range of price distortions, a decrease in government budget deficits, and an increase in domestic savings.

It is not surprising, therefore, that countries which have devalued their exchange rates, raised producer prices, reduced consumer subsidies, and installed market interest rates have experienced positive results in their economic performance. The recent experiences with some of these policies in countries as diverse as China, India, Indonesia, and Turkey illustrate this dramatically. These countries were able to improve economic performance at the same time the recession was gripping most of the global economy. In Turkey, for example, during 1980–83, output grew by roughly 4 percent a year, and merchandise exports doubled.

If there was ever any doubt, it is now dispelled on one very apparent reality: the economic performance of developing countries depends largely on their own decisions and on their own

efforts. It is true that continued access to foreign finance, both private and public, can help the developing countries carry out these difficult reform programs and support growth-oriented development strategies. But financial assistance is no substitute for policy reform, nor for the political courage to undertake it.

Finance is, however, a vital partner. Ending subsidies, reducing deficits, and devaluing exchange rates impose costs and hardships on those population groups long accustomed to benefiting from these imbalances. External financial support can soften the impact of these costs and help deliver the economic benefits of rehabilitation and recovery.

This year, at the halfway mark of the decade, our expectation is that, across the globe, progress will continue. In 1985 developing countries may come close to matching their strong growth of 1984. Hopefully, we are standing at the threshold of an economic transition from recovery to sustained growth over the next five years.

A successful transition is indeed our objective. But by no means is it assured. Industrial and developing nations alike must act to adopt policies that firmly set in place noninflationary growth. The last five years and their hard-earned lessons show us what actions are necessary.

The industrial nations, for their part, must move to restore monetary and fiscal balance to enhance their growth prospects and to permit a return to lower interest rates. This would have a direct beneficial impact on the severe debt-servicing problems that are afflicting so many developing nations. Furthermore, the industrial nations must, among other measures, act to ease rigidities in their labor markets to reduce high unemployment and help stimulate new industrial capacity. Stronger economic growth should help these nations to resist protectionist pressures and to build a more open international trading environment. This is essential if the developing nations are to increase their exports and so facilitate their adjustment.

We now know from experience which adjustment and reform initiatives generate the best results. Both developed and developing countries need to pursue with true determination those initiatives applicable to them in the key areas of economic prices, exchange rate and trade policies, and domestic savings and fiscal management. Let me spell out these initiatives and the results they should achieve.

- Economic prices which more closely reflect opportunity costs will enable countries to improve the efficiency of utilization of both domestic and external resources.
- Appropriate exchange rate and liberal trade policies will not only increase export earnings needed to service debt but will also improve domestic efficiency and growth.
- Increased domestic savings generated through market interest rates and more efficient resource mobilization will make possible a larger volume of investments needed to resume the path of rapid growth. These increased savings are also important to reduce the growth in external debt.

In other words, there is a choice of two paths: one leads to the rewards of a successful transition, the other to the penalties resulting from a failure to adjust. These two scenarios are analyzed in this year's *World Development Report*, which I recommend to you all. Here the numbers are set out plainly so that the economic payoff for adjustment and the penalty for inaction are both readily grasped.

There is considerable variation from region to region in these scenarios, but in Africa the situation is especially grave. The depth of the economic crisis in Sub-Saharan Africa constrains the high scenario to one of mere maintenance of the low per capita income levels achieved in 1984. The degree of urgency, the necessary scope of policy reform, and the need for substantial concessional assistance place Africa in a special category to which the Bank and other development institutions must devote a very concentrated effort. We have made a good start with several countries

which have reform programs in place. Meanwhile the list of countries is growing, and we are encouraged.

In putting the pieces together for a successful transition to long-term economic growth, we must include the vital component of capital flows from industrial to developing countries. Whether they be private or official, direct or indirect, such capital movements provide the necessary new resources to finance reform and to invest in the productive capacity of developing nations. Over the last five years, contractions in the flows of private capital have compelled many nations to compress imports to levels below those required to maintain their economies at present levels of output. This has impeded the adjustment process and, if continued, could lead to untenable political and social consequences.

Similarly, the growth of official development assistance has fallen below even minimal expectations. The quick response of donors in providing extraordinary drought relief to Africa reflected the international community's deep humanitarian concern. But the low-income countries, in Africa and elsewhere, face long-term problems of adjustment and abysmal poverty. Their ability to offer even modest hopes to their citizens, to reduce poverty, and to sustain growth depends vitally on a much more robust increase in aid for long-term development.

The transition to sustained growth over the next five years will also depend on a liberal international trading environment, characterized by reduced trade barriers in both industrial and developing countries. Increased access to markets could be achieved through trade liberalization measures agreed in a new round of multilateral trade negotiations under the aegis of the General Agreement on Tariffs and Trade.

So, after five years of experience with difficult global economic conditions, the road ahead for the rest of the decade is well defined. Developing countries, we all agree, must undertake policy reforms, and they must receive adequate capital flows to support their reform efforts. Industrial countries must also under-

take reforms, especially in their fiscal policies. And all countries must actively participate in efforts to liberalize and strengthen the world trading system.

How have we, at The World Bank, responded to help you, our member nations, to cope with the difficult economic environment of recent years? We have responded in many ways, and here are some important examples.

- We have increased our lending in support of overall policy reform by developing new lending instruments such as structural and sector adjustment loans. Since they were instituted in 1980, thirty-two structural adjustment loans totaling more than \$4.5 billion have been made to seventeen countries, and thirty-seven sectoral adjustment loans totaling \$3.8 billion have been made to twenty-six countries. Last year, they together amounted to \$1.6 billion—11.4 percent of our total lending.
- To underpin our analysis of adjustment and to improve our contribution to the policy dialogue with our borrowers, we have increased the resources devoted to country economic and sector work. And we have restructured our research programs so as to focus more attention on trade and debt issues and to improve the quality of the Bank's policy assistance to adjustment programs.
- We introduced a special assistance program in 1983 to increase the rate of disbursements from existing and planned loans and to prevent sound projects from being discontinued for lack of budgetary resources. As a result of the program, additional disbursements to forty-four recipient countries during fiscal 1984 and 1985 amounted to some \$4.5 billion, almost compensating for the shortfall in regular disbursements resulting from the recent recession.
- In the Latin American and Caribbean region, the region most seriously affected by debt-servicing problems, we increased our disbursements from \$1.8 billion in fiscal 1982 to a record \$3.2 billion in fiscal 1985—a 75 percent increase. We have devised

ways, including the use of guarantees, in which we can induce new money into the indebted countries in association with our own loans.

- In response to the deepening crisis in Sub-Saharan Africa, we launched our Joint Program of Action for the troubled region, focusing on supporting those countries undertaking difficult economic policy reforms. With a group of donor nations, we put together the Special Facility for Africa, a three-year program with resources of \$1.2 billion to provide fast-disbursing concessional funds to help move this process forward.
- In our project work, we have greatly strengthened the programs in population, nutrition, and health lending; we have expanded lending in the energy sector; we have emphasized lending for maintenance and rehabilitation to protect past investments; and in all sectors we have increased the attention given to training, technical assistance, institutional development, and management.

More generally, to help countries make the best use of available resources, the institutions of The World Bank have helped members focus on the mobilization and allocation of resources in the public sector, and on ways of strengthening the role of private initiative.

In the public sectors of many member countries, the excessive expansion of state enterprises—entailing ambitious and often uneconomic investment programs, subsidized prices, high costs, and inefficient operations—has placed an unbearable burden on both the budget and the balance of payments. Working with our borrowers and responding to their requests, we have assisted with comprehensive reviews of public sector investments and expenditures. Initiatives to restructure the public sector—such as regulatory reform, more effective use of foreign borrowing, and privatization where desirable—have become an increasingly common element of our country assistance. We have, in many countries, helped with the postponement or elimination of capital-intensive investments with long gestation periods. And we have

been widely involved with programs to improve the organization and management of parastatal enterprises, including the adoption of economic prices.

With regard to the private sector, our structural adjustment loans have supported country efforts to rationalize and improve their incentive and regulatory structures. At the same time, Bank and IDA lending directly to support private enterprise, and lending to improve infrastructure as a basis for expanding private sector production, have continued to be prominent in our operations. As you know, the IFC program is expanding rapidly, with increases in its corporate restructuring assistance, greater attention to the development of domestic financial markets and institutions, and growing activity in new sectors such as energy exploration.

We have strengthened the Bank's catalytic role—encouraging the mobilization and more effective coordination of official aid flows through consultative groups, working to create a Multilateral Investment Guarantee Agency to encourage private investment flows, and developing new instruments for cofinancing with commercial banks, such as the B-loan. Since September 1983, when the B-loan program was launched, thirteen such loans have been arranged totaling over \$1.8 billion. They have helped to reintroduce countries to the capital markets after debt rescheduling improved terms and attracted additional capital. In addition to the B-loan program, the Bank attracts an average of nearly \$4 billion in cofinancing arrangements from official sources and export credit agencies each year, which yield an overall cofinancing average of \$5 billion per year. We would like to see that figure increased.

The Bank's flexible response to country needs over the past several years may be illustrated by the case of Brazil, which faced an adjustment problem of crisis proportions at the end of 1982. Brazil undertook courageous measures to reduce investment and imports and expand exports in order to reduce the current account deficit of the balance of payments. The Bank then more than doubled its lending to Brazil, committing \$4.5 billion during 1983–85; our disbursements to Brazil tripled between 1982 and

1984, reaching \$1.4 billion. The program included innovative sectoral loans to support efforts to accelerate manufactured and farm product exports and to support the adoption of essential reforms of trade policy and agricultural credit. The program also focused on critical infrastructure needs in power transmission and distribution, railways and highways. Loans were also made for rural development and land resettlement. The IFC has helped to finance investment in private sector projects totaling about \$1.0 billion over the past three years, with special emphasis on exports and import substitution.

At the other end of the spectrum from Brazil, but also beset by crisis, were the small, least developed countries of Sub-Saharan Africa. Several special Bank studies of the disastrous Sub-Saharan Africa situation and its causes led us to propose our Joint Program of Action, which has now been widely endorsed by both African and donor governments. The establishment of the Special Facility for Africa, which this consensus made possible, is most encouraging, and donors are to be congratulated for their timely response. But more concessional funds for Sub-Saharan Africa are essential.

These countries continue to face a heavy outflow of funds to service foreign debt, mostly owed to official creditors. Debt service ratios of 40 to 50 percent are not uncommon in Africa. One country, Mauritania, has a debt-to-GNP ratio of nearly 180 percent. Such levels of debt pose a major threat to the ability of these countries to resume growth. Either aid flows must expand much more than presently planned, or the debt service burden has to be reduced by imaginative rescheduling on concessional terms.

The IMF has provided vital support to many African and other low-income countries during the recession. The revolving nature of short-term IMF resources must be maintained, but the capital requirements and the debt repayment problems of these countries remain long-term. Expanded long-term financing will be essential even to maintain net capital inflows.

In several Asian countries, performance has been very good, especially against the background of recession. In those countries the Bank has continued to emphasize traditional project lending for agricultural development, human resource infrastructure, and poverty alleviation, while also supporting adjustment measures. In India, for example, the Bank lent over \$1.2 billion during 1980–85 for developing oil and gas resources—which helped increase the share of domestic oil production from around 40 percent of total consumption in 1980 to about 75 percent in 1985. In China, the Bank lent nearly \$650 million during 1981–85 in support of the modernization program in education, research, and training alone.

As we try to understand and respond to economic events of the recent past, it may be helpful to recall that global interdependence has been very greatly increased by the rapid growth of international trade, capital flows, and debt. While that interdependence tends to increase efficiency and growth, it has also made economic management much more complex. This places a higher premium than ever on confidence—an intangible but absolutely vital ingredient in any country's return to sustained growth.

The international community now must work together urgently to restore the necessary confidence—confidence which events of the past several years have badly shaken.

- Creditors must become confident again that debt can be serviced.
- Investors must become confident that price relationships accurately reflect fundamental economic realities rather than changeable administrative or political biases.
- Developing countries must remain confident that their adjustment efforts will be supported.

Through both our advice and our resources, we in The World Bank can perform an important role in helping to build the understand-

ing and confidence that are now required. Our knowledge and our instruments have evolved in response to your changing experience with adjustment and reform. Many of our members have achieved important, in some cases spectacular, progress, but the fundamental problems—extreme poverty, unemployment and underemployment, low productivity, and low growth levels—weigh heavily on nearly all developing countries. That is a sobering reality which tells us that our work is really only beginning.

The next five years will give us all an opportunity to focus our efforts on solving these fundamental problems. If we build on what has been accomplished in the first half of the decade, and apply what we have learned carefully and consistently, a full transition to long-term development and sustained growth could be within reach by the end of the decade.

Permit me now to explore the operational strategy we have developed to help our members attain these objectives. This strategy rests on twin pillars: assisting our borrowers in formulating satisfactory programs of adjustment and more rapid growth, and helping mobilize the external resources necessary to sustain these programs.

How do we apply this strategy in addressing the problems of the heavily indebted middle-income countries, especially those in Latin America? The strong support provided by the IMF to many of these countries has helped avert the financial crisis which they and the international financial community faced not so long ago. It has bought us valuable time which we should use to best advantage. Continued austerity will need to be an essential fact of life in these countries for some years to come, but our actions must hold out the promise that it will not be a permanent condition of life. To that end, we must all join to create the conditions that will ensure the revival of economic growth through the adoption of comprehensive programs of adjustment.

There is no easy way to achieve this, but there are some basic principles on which the Bank has founded its twin-pillared stra-

tegy of assistance to this group of countries. First is the recognition that we must adopt a long-term perspective in addressing their problems. We cannot live from one debt rescheduling to another. Second, the Bank's role and assistance must be closely linked with those of the Fund, the private commercial banks, the regional banks, and official sources of funding. To succeed, we shall need the unwavering commitment of the indebted country governments to continue with the difficult policy reform programs that so many have already embarked upon. And we shall need a comparable resolve on the part of the commercial banks to stay the course with additional support. Neither the Bank nor the Fund can on their own provide the new money that is needed.

Let me cite by way of illustration some particularly useful and creative applications of our strategy relating to three middle-income Latin American countries, whose principal source of external capital is the private banking system.

In Colombia, the government has initiated a wide-ranging program of trade liberalization. A first loan of \$300 million was approved in support of it, and we expect to make other loans to support this program in this and future years. The World Bank will continue to review Colombia's progress in the trade policy and public investment areas. Our loan and the IMF's review of the country's stabilization program are associated with the provision of new money to Colombia by commercial banks.

Similarly, in a structural adjustment loan to Costa Rica, commercial bankers and other lenders have linked their disbursements to those of The World Bank, thereby using our assessments of progress as a basis for their own lending decisions.

In the case of Chile, a World Bank guarantee and a planned structural adjustment loan have helped to firm up the program of long-term adjustment and diversification on which Chile's future depends, and have helped to complete the protracted discussions on the reschedulings and new money package to that country.

Our collaboration with the IMF in arrangements of this kind has been, and will continue to be, close. Effective coordination between the Bank and the Fund is essential.

The additional financial support that The World Bank provides to such countries must give high priority to strengthening economic management and to utilizing existing productive capacity more fully in all sectors of the economy through well-designed programs of sector investment and adjustment. It must also give high priority to reducing the existing burdens, both financial and managerial, on public sector resources in most of these countries. Governments must recognize that their capacities are overstretched and that their room for maneuver is extremely limited. With our support they must embark on major programs of liberalizing their economies and releasing the prodigious energies of the private sector. In short, we must get down to resuscitating activity at the grass roots where jobs are created and people earn their livelihoods. The Bank has had long years of experience and success in helping countries improve their economic performance at these levels, and we clearly recognize that our future operational activities must reflect this comparative advantage.

Let me turn now to how this twin-pillared strategy of assisting the adjustment effort and helping mobilize supporting resources is being applied to the poorest countries, in particular to the group facing the most serious challenge, namely the countries of Sub-Saharan Africa.

What efforts should our strategy seek to assist? There is a new consensus among donors and African countries alike on the steps that must be taken. The quality of economic management has to be improved to enhance returns to investment in Africa. The framework of incentives for producers, particularly in agriculture, needs to be reformed. The growth of public enterprises beyond their ability to manage resources effectively and efficiently needs to be curtailed. Unrealistically large public investment programs need to be pruned back. The maintenance and rehabilitation of basic infrastructure must be given greater priority. At the same

time, we must pay greater attention to the vital role women play in development as we continue to invest in agriculture, urban development, and education. The urgent issues of population growth and natural resource management must be more forcefully addressed as well. And the right environment has to be created for private investment to make a larger contribution to growth. This adds up to a long-term effort which must attract the effectively coordinated support of all donors.

The World Bank's role, therefore, is clear. We must imaginatively apply our twin-pillared strategy. Through our policy dialogue, research, and technical assistance, we are expanding our efforts to help African governments to analyze the issues constraining their economic and social growth, and to design and implement the actions that will remove those constraints. This means expanding our help to governments to finance and implement programs of economic policy reform. The Special Facility for Sub-Saharan Africa is specifically designed to support governments materially in the difficult decisions they have to take to ensure that the overall flow of resources to Africa is put to the most effective use. That effectiveness depends heavily on improved donor coordination. Here the Bank plays a key role, chairing a total of ten African country aid coordination groups, and plans are under way for the establishment of three more during this fiscal year.

In Africa as much as anywhere in the developing world, we face the simple truth that development is not an abstraction; it is a process that improves the life of people. If the rate of population growth exceeds economic and social progress, the people will suffer because each will have less—less services, less employment, less material resources. This basic calculation of development varies from country to country and from region to region. But in Africa, population growth is so rapid that it is severely constraining development.

Growing faster than that of any other continent, Sub-Saharan Africa's population of about 400 million today could conceivably

treble by the year 2020—that is, if measures to limit population growth are not taken. Even if the problem were faced squarely, starting now, and governments committed themselves to effective programs for reducing population growth, the young age structure of the present population would cause rapid growth to continue for at least another generation. The impact of this inevitable population increase on desertification, urban growth, water supply, agriculture, and energy consumption will be staggering. Needless to say, its impact on poverty will be no less staggering.

The combination of economic and social development with well-designed and implemented family planning programs provides the best hope for achieving significant reductions in the rate of population growth. In both these respects, the Bank has an important role to play—indirectly, through its policy dialogue and its lending in support of economic and social development, and directly, by assistance to family planning and basic health services. That is why we are going to double our lending for population and health in the next five years.

Rapid population growth has made national resource management more urgent than ever. Especially in Africa, where drought has exacerbated the problem, the balance between traditional farming, soil productivity, and forest cover has been upset as the demand for food crops, animal fodder, and fuelwood has increased. Deforestation is accelerating—an estimated 3.6 million hectares are now being lost every year. This means more severe fuelwood shortages, soil erosion, declines in agricultural productivity, and, in semi-arid areas such as the Sahel and the Sudan, more desertification.

There are no quick solutions. These are broad land use problems which cannot be solved by investment in one sector alone. They require an integrated approach to agriculture, forestry, energy, and rural development.

The Bank is now reviewing this cluster of problems, and it will increase its advice and assistance here. In many countries, there

is a need for more information on the magnitude and the consequences of the problem. We plan to work with African governments in support of intensified sector planning activities and the development of long-range strategies to address these issues in an integrated way. The Bank is supporting a new generation of projects under preparation in Mali, Rwanda, and Senegal to help launch this more comprehensive approach toward natural resource management.

Although The World Bank is taking many such initiatives to assist our members, this will not alter the importance of the agriculture and rural development sector, which will remain the mainstay of our lending activity for the foreseeable future. Food continues to be fundamental. The poorest of the poor are usually rural. In the low-income developing countries, nearly three-fourths of the labor force is engaged in agriculture. The room for improving agricultural productivity remains great indeed. There have been dramatic successes in agriculture—India's current food self-sufficiency, the Green Revolution, Indonesia's and the Philippines' rice surpluses. There will be more, and we will help bring them about. Agricultural lending will continue to be our highest sectoral priority, comprising more than one-quarter of our program. And agricultural research will continue to receive heavy emphasis.

Education and urban development are vital sectors which have been neglected in some developing countries because of intense budgetary pressures. They will continue to receive our strong assistance.

There are ample opportunities to increase the efficiency of educational services, through cost-recovery programs for secondary and higher-level schooling, more relevant textbooks, improved curricula, better use of facilities, and reduced student-teacher ratios. Primary education still yields the greatest benefit per dollar spent, yet over 30 percent of primary school-age children in the developing countries (except China) are not attending school. The proportion for girls—whose education has a high leverage on

fertility reduction—is double that. While primary education will remain an important element in our lending, we plan also to support education at higher levels as well, to help alleviate, in some countries, the serious skill constraints in the technical, financial, and managerial fields.

Urban areas in many countries have felt the impact of rapid population growth and migration. Although in 1950 only three cities in developing countries had more than 4 million people, the number of such cities had grown to more than twenty in 1980 and will exceed sixty by the year 2000. In India alone, the total urban population is growing by more than 600,000 each month.

Urban areas can be highly productive. As centers of business and industry, they supply employment to migrants from rural areas and, in most developing countries, account for more than half of GNP. But with the inevitable rapid growth in population, we can anticipate congestion, slums, disease, unemployment, underemployment, and urban management problems of unprecedented magnitude. We will continue to help countries cope with their explosive urban growth—through lending for water supply and waste treatment, urban transport, sites and services, business support, and technical advice to improve urban management.

In the next few years, The World Bank will continue to adapt its lending programs to the changing realities of development. The lessons we have learned from working with our members in recent years are the product of a very special, very productive partnership. They should be shared with others, particularly with some of the other providers of assistance.

That is why we believe that in the future the reorientation of assistance programs must accompany their expansion. Donors will need to give greater priority than in the past to the timely support of programs of policy reform with fast-disbursing funds. They will have to recognize that maintenance and rehabilitation of investments are likely to deserve higher priority than large "visible" investments in new capacity—even when the latter may

bring prestige to the government and sales of machinery and equipment to the donor. Assistance institutions should give strong support, particularly in Africa, to programs addressing basic constraints such as family planning, health, education, agriculture, and natural resource management. They should also support the pursuit of policies which encourage the private sector and foreign direct investment. Moreover, donors will need to collaborate to improve coordination and thereby increase the effectiveness of scarce aid resources.

Our strategy for the next five years has many facets, reflecting the diversity of our membership and the complexity of development itself. But uniting all these elements—from adjustment and project lending to our catalytic role and better donor coordination—is our determination to use what works and to avoid what does not. Our goal is to increase the effectiveness of the assistance we provide to you.

Effectiveness, unfortunately, does not grow from good intentions alone. In our daily transactions of development, we offer advice and encouragement to foster sound economic policy decisions and investments. We back up that counsel with reliable long-term financial support. This complex relationship between the Bank and its borrowers is at the core of our ability to operate creatively and effectively.

Changes in global financial conditions, however, could well disrupt these carefully wrought arrangements. Traditional sources of finance, particularly for the middle-income developing countries, are no longer expanding. Commercial bank exposure, for example, will grow slowly for the foreseeable future. While an increase in private direct investment can provide a partial offset, it cannot possibly expand enough to provide capital flows in amounts that can be really productively used. Indeed, current trends in financial flows give grounds for major concern. Some debtor countries, having undertaken painful adjustment measures, now have productive investment opportunities which would permit export expansion, a rising growth rate, and a gradual restoration of credit-

worthiness. But the debt overhang absorbs significant portions of domestic savings, and commercial banks remain reluctant to increase their exposure. The possibilities of being caught in this vicious circle are as dangerous as they are real.

The multilateral financial institutions are not in a position to offset the shortfall in private capital flows, although we and the regional banks are planning to increase our lending substantially. But the commercial banks cannot turn away from their responsibilities. Stagnation and deteriorating debt service capacities are not in their own self-interest. Growth, strong economies, and growing exports are. These are not possible without their continued participation or without modest growth in their net lending to creditworthy developing countries.

Commercial banks, no more than national governments, can take a narrow view of their own interests. They, no more than our members, can isolate themselves in an interdependent world. They have been vital participants in the past; they must be good partners in the present and remain so in the future.

Meanwhile, for the poorest countries, the outlook for an increase in concessional flows is bleak. It is not hard to see how The World Bank and its regional counterparts can soon be in the difficult position of trying to maintain the provision of expert, impartial advice without adequate resources to back that advice with carefully planned and supervised investments.

Resources—adequate resources—are the fuel for effective development. I have outlined the new lending and policy strategy which we are putting to work, but it must be said that the question of resources will determine how effective it will be. Permit me now to be specific about the capacities of our institutions and how we see their roles evolving in the future.

The IFC has embarked on a course of major expansion. For 1985, total investments represented a 55 percent increase over the previous fiscal year, and we expect that investments in 1986 will

grow a further 15 to 20 percent. To illustrate the vigorous and innovative role the IFC is now playing: the Corporation recently made its first investment in China to help finance a joint venture between Chinese and French sponsors for the production of lightweight trucks. Shares amounting to 10 percent of the equity will be made available to the Chinese public, another first for a joint venture in China. The Corporation has also embarked on a program of energy exploration and is expanding its activities in developing capital markets, in supporting small businesses, and in restructuring companies which have run into difficulties.

The IFC's essential role is to facilitate sound investments by the private sector, domestic and foreign. This kind of investment can and should play a larger part in the process of development in most of our member countries. But a growing role for the IFC requires more capital for the Corporation, and we are all pleased that the IFC's Board recommended last year a doubling of the IFC's capital base to \$1.3 billion. Now nearly 71 percent of the member nations' votes have been cast in favor of the increase, only 4 percent short of final approval. Endowed with the additional capital, the IFC will be better equipped to attract more private capital into ventures where such funding otherwise would not go—the very essence of the IFC's catalytic role.

Africa is a case in point. The IFC plans to support over 100 projects in Africa over the next five years at a total investment of \$2.8 billion to \$3 billion. In partnership with the UNDP and the African Development Bank, and with the help of a number of donor governments who have offered support, the IFC plans to establish a new Project Development Facility which will identify, appraise, and arrange financing for private sector investments in Africa.

After wide-ranging consultations with our members, we believe the time has arrived to strengthen still further our efforts to promote international investment. Bilateral efforts by individual nations on this front can be enhanced with still stronger multilateral support. Accordingly, we are submitting to you now a resolution to establish a Multilateral Investment Guarantee Agency

(MIGA). MIGA will fulfill a vital need for improving investment conditions worldwide through a more comprehensive coverage of noncommercial risks to foreign investors in developing countries and a broad range of promotional and technical assistance measures. MIGA responds both to developing country needs for increased foreign capital flows for development purposes and the concern of investors, from developed and developing countries alike, that their investments be protected against noncommercial risks.

The draft convention establishing MIGA, as drawn up by the Executive Directors, establishes it as a voluntary facility: each country may freely decide whether or not it wishes to join, and when it has joined it still retains control over the extent of MIGA's activities in its territories, as investments will be guaranteed only with the host country's approval. MIGA is also designed as a cooperative facility. Both financial responsibility and political oversight are shared by developed and developing countries. Countries joining MIGA will contribute to its capital in accordance with their relative economic strength as measured by their share allocations in the capital of the Bank. It is envisaged that the groups of developed and developing countries will eventually have equal voting power; during a three-year transition period special arrangements ensure the adequate participation of both groups in the decisionmaking process. Its cooperative structure is the best assurance that MIGA will indeed reduce political risk, and thus serve its developmental mandate while maintaining its financial viability.

We want to thank so many of you here today who have participated in the preparation of MIGA's draft convention. The result is a solid, prudent document, containing both the flexibility necessary for responsive management and the explicit recognition of member nations' sovereign rights. It is especially pleasing that in this, The World Bank's fortieth anniversary year, we are witnessing a growing welcome for this proposed new agency. We are hopeful that with your firm support MIGA will be launched before too long.

Let me now turn to our efforts on the stage of concessional flows—to IDA. The Report of the Task Force on Concessional Flows, which was submitted yesterday to the Development Committee, puts the issue in perspective: "the low-income countries still need concessional assistance and the poorest among them need more of it more than ever." But the levels of official development assistance going to developing countries have been falling since 1980 in real terms, and preliminary estimates are that it will register only a disappointing 2 percent annual increase in the years ahead.

We must be realistic and recognize that, unless official development assistance (ODA) to the poorest countries is increased, the pace of progress in these nations to implement adjustment programs, to sustain investments, and to alleviate poverty will be desperately slow. As the report concludes, no single alternative to increasing ODA or any combination of alternative measures will bridge the growing mismatch between ODA needs and supply.

IDA is the largest single source of international concessional flows. The exemplary record of IDA's achievements in the field is well known to all of you. IDA could be still more effective if it were strengthened. We trust that the donor nations will enter the next replenishment negotiations determined to equip IDA with the necessary resources and to do so in a timely fashion. IDA 7's resources will be exhausted by June 1987. In order to preserve continuity in IDA's operations the negotiations must conclude by December 1986.

It was the crisis in Sub-Saharan Africa, the inadequacy of IDA 7, and the low levels of ODA generally that compelled us to seek support for a Special African Facility. But the facility is a one-time, three-year operation. The problems which it was set up to address must be dealt with on a long-term basis by IDA. Donors need to consider this as they enter the next replenishment round. They need to consider, too, the scale of poverty that persists in much of Asia, and the very strong case that is so self-evident for greater flows of concessional resources to the poorer countries of that

region. China and India, in which more than 450 million of the world's absolute poor reside, need affordable external finance on a large and sustained basis to support their far-reaching efforts to realize their great potential. Several countries of the region, such as Bangladesh and Nepal, are heavily dependent on IDA too.

IDA is a crucial weapon in the global struggle to help defeat the forces of malnutrition and absolute poverty, and it must be strengthened.

Today we meet here in a nation that once was an IDA recipient and is now an IDA donor. IDA has proudly assisted the Republic of Korea, and the rapid progress of this nation is an inspiring illustration of what a development success story can really be. It can be, and indeed is being, replicated. But without adequate funds, IDA will be unable to help launch more of the poorest nations on their voyage of recovery and long-term development. That is unacceptable.

Permit me now to turn to the IBRD. The potential role that this institution can play in securing a stronger global economy is a formidable one. I have given you an overview of the lending strategies that we intend to pursue. Now we will turn to the IBRD's future level of operations and the question of adequate lending capacity. But in looking to the IBRD's future, it is important that we recognize clearly the creditworthiness and performance standards that the IBRD maintains.

The creditworthiness of borrowers must continue to be a major consideration in our lending. Our concern is, and has been, to see how The World Bank can actively support a country's development program so as to enhance its creditworthiness. And this must be assessed in a dynamic context. The question that needs to be asked is whether a country can be expected to service its debt to the IBRD. Where creditworthiness is weak, the focus is on how the Bank can most effectively participate in the formulation and in the financing of a creditworthiness-recovery program.

As we plan future IBRD lending levels, we also will remain most concerned about performance standards. Effective management of the economy and appropriate incentives at the sector and project level are essential steps toward economic efficiency and the enhancement of creditworthiness. If conditions are such that we cannot ensure the effective utilization of resources, then this can, and indeed must, constrain our lending levels. We see no long-term benefit to our members of any kind in lowering our standards simply to boost our lending volume.

Much work and ingenuity over the last five years has brought us to the point where the IBRD's financial base is stronger than ever. And the IBRD's robust health is essential to support our ambitious plans and to provide us with a sound base for an expansion in our lending commitments in the immediate period ahead.

We have reviewed on a country-by-country basis the future likely assistance that we can provide to our members with the lending strategies that I have outlined here. We see the clear need to expand our lending commitments, and we will be able to do so while still adhering to the rigorous standards we have maintained for so many years. It would be an error, however, to become wedded to precise figures at a time of such economic uncertainty and when the determination of your institutions to ensure the highest quality of lending should rightly have priority over quantity.

Yet the direction is clear. IBRD commitments this year are planned to be higher than in any previous fiscal year, and we expect our lending volume to grow in future years. The critical point is the need for shareholders' support both in terms of access to the capital markets in which the bulk of the Bank's resources are raised, and in terms of the level of capital needed to give the Bank the authority to lend on the scale required. The actions required by governments with respect to resources are thus not mainly the provision of budgetary funds; they mainly take the form of permission—both permission to borrow and permission to lend. We need to manage the future discussion of these

resource issues so as to ensure that resource constraints do not prevent the Bank from providing the scale of support which the borrowing countries need and which the Bank is otherwise well positioned to provide.

In view of our lending program over the next few years, there can be no question that we will need a substantial capital increase, although our lending plan for this year and the next need not be constrained as long as there is broad support on the part of our shareholders for a General Capital Increase that will support an expanded role for the Bank in the rest of this decade. An expanding lending program will be crucial for our middle-income borrowers, who will look to the IBRD increasingly in the absence of growth in other sources of finance. We must be able to assure them that adequate financial support from the Bank will be available in the years ahead as we urge them to undertake adjustment programs which will require several years to implement.

Discussions with our shareholders on the specific features of a capital increase will need to proceed in the months ahead so that we are ready with a specific capital increase request in time to avoid disruption of lending plans. Consultations with members must go forward in a spirit of common purpose that the IBRD will continue to have the lending capacity that it needs—a capacity to support the strategies I have outlined here; a capacity to respond, both as an agent and as a catalyst, to the changing needs of its borrower nations in a period of economic uncertainty; a capacity to play a still more prominent role in assisting nations to make the transition from crisis economic adjustment to sustained economic growth.

I cannot exaggerate how important your support is for us, both now and for our future lending strategies and resource needs. As the precise capital requirements of the IBRD emerge, I am confident that we will receive your strong and swift endorsement of our capital increase request.

Mr. Chairman, Governors and Ministers, Ladies and Gentlemen, when I made my first address to you as President of The World Bank and IFC in 1981 none of us could foresee how difficult and volatile the global economic situation would become over the following five years. At that time it was my intention to serve a single five-year term, and today I want to reaffirm that intention.

I have talked today about the major economic problems that the world confronts and the priority institutional issues before us—the need for a stronger and larger IDA, an enlarged role for the IFC, the establishment of MIGA, an expanded IBRD lending capacity, and the continued ability of our institutions to respond flexibly to the changing needs of our members. The temptation is great to participate in solving these problems as the President of your institutions. But the development process is a very long-term proposition, and I do not delude myself that if I stayed longer, the problems that I would bring before you two, three, or five years from now would be any less daunting or any less urgent than those that we face today. I have therefore decided that my original decision was sound and that this should be my last address to you, the Board of Governors, as your President.

The retrospective I have presented today shows that The World Bank and IFC are better prepared than ever to take up the challenges that lie ahead, and the perspective I have described defines these challenges. The global economic turbulence of the last five years has tested our capabilities and toughened our resolve. We have translated the fruits of our experience into strategies that are relevant, flexible, and sound. If we reach agreement on the expansion of IDA and IBRD resources, I have no doubt that when our successors attend the 1990 annual meetings they will, in addition to facing new challenges, be able to report major development progress.

Permit me to stress one last point.

The declining incomes in many developing countries, the years of austerity, the heavy burden of debt, and the need for pervasive

structural changes have created the impression that the development process offers no hope for the future. This is a fundamentally wrong conclusion to draw from our experiences of the last forty years and of the last five years.

Despite the setbacks and despite the many financial problems, there has been massive progress in the developing countries in recent decades. Economic growth has taken place; living standards have improved; infant death rates have fallen; life expectancy has increased; more children than ever before have been given educational opportunities; and employment has been provided to tens of millions who have entered the labor force. Development assistance has played a crucial role in these achievements.

Even the trials of the last five years have contributed to the future. Out of these experiences have evolved more realistic development strategies and incentive structures for the more efficient use of capital. In short, a sounder basis has been created for sustained and accelerated growth, and there is a new recognition that the future of peoples everywhere rests in their own hands.

But such accomplishments are not grounds for complacency because so much remains to be done. Hundreds of millions of people still live in absolute poverty. Almost three-quarters of a billion people face malnutrition. Population growth is well above sustainable levels in many countries. The recent, unprecedented drought in Africa has raised the specter of adverse long-term climatic changes and dramatically highlighted the immediate dangers of deforestation and desertification.

In too many countries still, the new pragmatism, the more realistic view of the relationship between the external environment and domestic capacities in an interdependent world, is mixed with yearnings for simpler solutions and for easy answers and with the natural desire to avoid hard choices.

So the task in the years ahead is not merely to ensure that growth

can be resumed—difficult though that will be; nor is it merely to secure this growth on a sound and sustainable basis—vital though that is. It is also to make certain that this growth will improve the quality of life of all peoples and will continue the effort to provide every individual with the opportunity for a long and productive life.

I am more than ever convinced that we—our member countries and the Bank—must ensure that growth in the developing countries is accompanied by programs to alleviate poverty and that a resumption of growth is accompanied by expanded investments in education and social services. We must redouble our efforts in the low-income countries—in Africa and in Asia—to end stagnation and allow the peoples of these countries to look to the future with hope. And we, as an international community, must undertake to reverse the depletion of our forests and the associated degradation of the land. Sustainable growth requires true development of human capital, the alleviation of poverty, and the maintenance of the environment. Improving the quality of life of all who dwell in the developing nations has more dimensions than ever before.

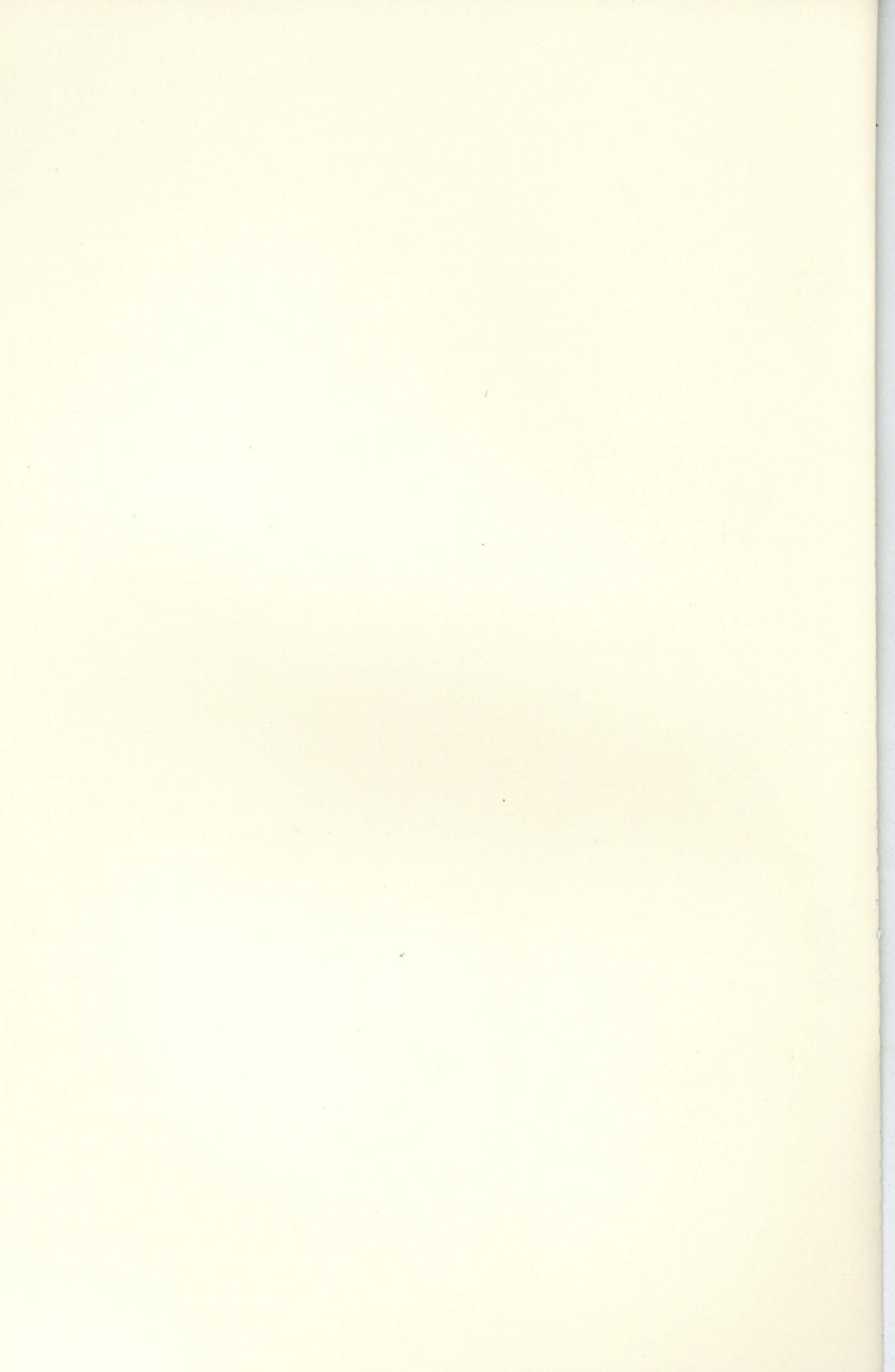
The World Bank Group has the capacity to deal with these complexities. With your support, these institutions can fulfill their potential as true partners in promoting economic and social progress in the developing world. With your support, too, we can help our members realize the vision to which all our efforts are dedicated—a more peaceful world and a world in which no mind will be stunted for lack of opportunity or lack of nourishment.

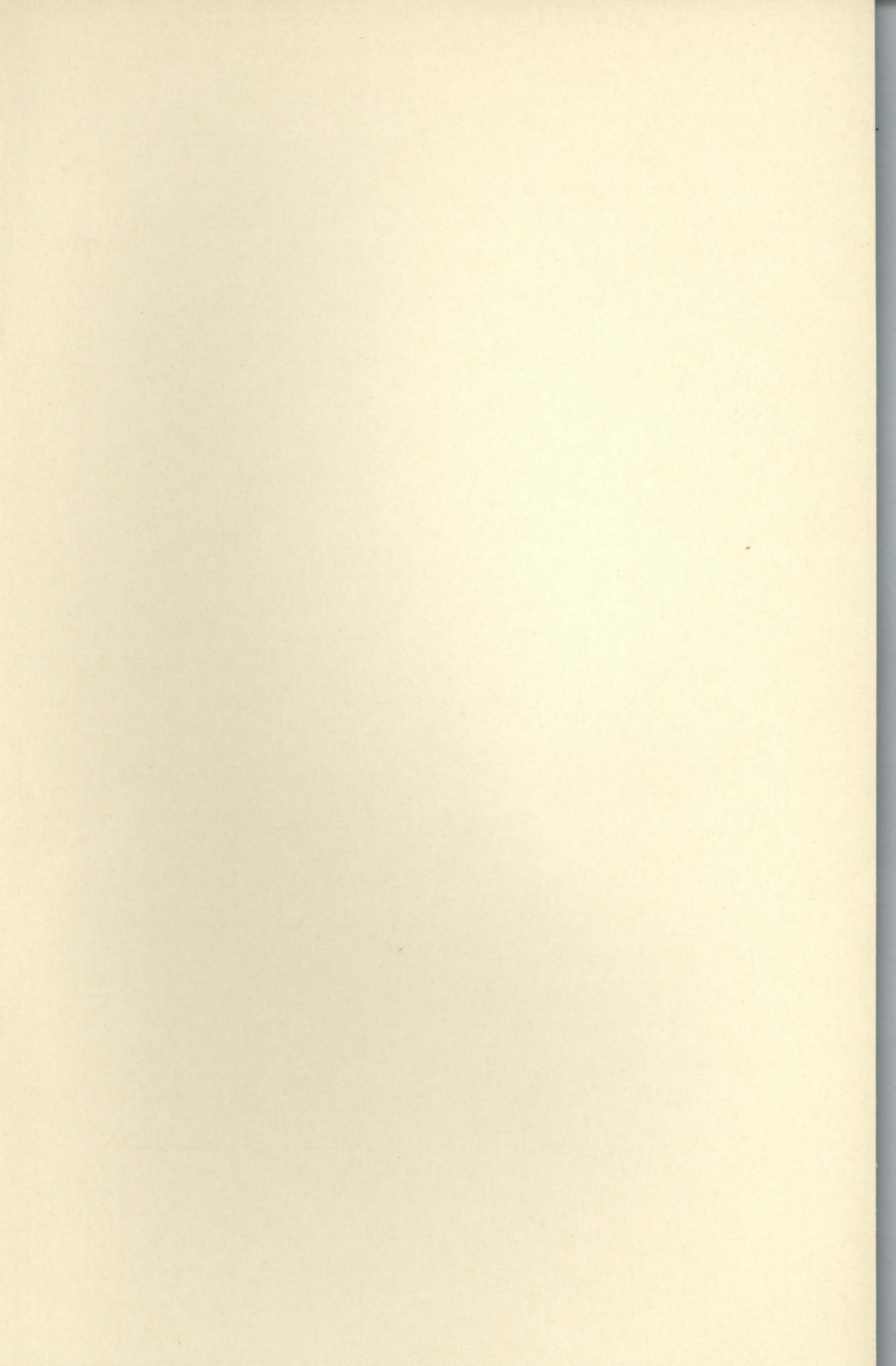
Mr. Chairman, Governors, Ladies and Gentlemen: I look back on the years since I joined these institutions with appreciation, despite the difficulties we have faced.

- Appreciation for having witnessed the courageous efforts of so many member countries in dealing effectively with the deepest recession in recent history and undertaking the far-reaching structural changes necessary for their recovery and sustained growth.

- Appreciation for having been associated with The World Bank and IFC, which have been able to assist those who were prepared to help themselves during the years of austerity and which are now ready and able to lead in a period of resumed growth.
- Appreciation for having been associated with you, the Governors, and with your colleagues, in our endeavor to safeguard the development achievements and to create a sound basis for future growth.
- And appreciation for your counsel, guidance, and support.









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