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ADDRESS TO THE BOARDOFGOVERNORS

by

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I. INTRODUCTION

This is the thirteenth, and final, address that I will have the privilege of making in this forum.

The occasion, I believe, places on me a special responsibility, and hence what I have to say this morning will be particularly frank and candid, especially as it relates to the future role of the World Bank.

During the past 18 months the external environment affecting economic growth in the oil-importing developing countries—and thus their rate of social advance—has become substantially more difficult.

The new surge in oil prices, and the downturn in trade with the developed nations, have imposed on these countries huge and potentially unsustainable current account deficits. The result is that their critical development tasks, never easy in the past, are now seriously threatened.

Meanwhile, the industrialized nations continue to grapple with problems of inflation, unemployment, and recession. Governments are searching for politically feasible ways to reduce public expenditures. And though Official Development Assistance remains a miniscule and insignificant fraction of gross national product—and is, in fact, wholly inadequate to the urgent needs at hand—there is little legislative initiative to increase it.

Further, the global financial system as a whole, still trying to cope with past imbalances, must now find a way to recycle to appropriate recipients over $100 billion a year of additional surpluses being earned by the capital-surplus oil-exporting countries.

The cumulative effect of all of this is a climate of apprehension in which the temptation will be strong for both the developed and developing nations to react unwisely.

The developing countries will be tempted to postpone the internal policy changes required to adjust to the new external

conditions. And the developed nations will be tempted to turn to shortsighted protectionist and restrictive measures that in the end can only delay economic recovery for the rich and poor nations alike.

These temptations are very real. And they are very dangerous. They lead precisely in the wrong direction.

What we need are measures that lead in the right direction. They are available, but like almost everything else worthwhile in life they are going to demand courage and effort and vision.

I want to explore those measures with you this morning.

Specifically, I want to examine:

- The prospects for economic growth and social advance in the oil-importing developing countries throughout the 1980s;
- The actions the developing societies themselves, as well as the industrialized nations and the OPEC countries, can take to maximize that growth;
- The need to accelerate the attack on absolute poverty; and finally
- The role the World Bank itself ought to play in all of this in the decade ahead.

Let me begin with the current economic outlook.

II. ECONOMIC PROSPECTS FOR THE DEVELOPING COUNTRIES

Global economic prospects have seriously deteriorated since we met last year in Belgrade. 'the outlook now is that the oil-importing developing countries in the years immediately ahead are going to have a very difficult time. the Bank is currently projecting, for the decade of the 1980s, lower levels of economic growth in those countries than it did twelve months ago.

TABLE I — GROWTH OF GNP PER CAPITA, 1960-85

	1980		Average Annual Percentage Growth Rates		
	Population (millions)	GNP Per Capita 1980 dollars[a]	1960-70	1970-80	1980-85
OIL-IMPORTING DEVELOPING COUNTRIES					
Low-Income:					
Sub-Saharan Africa	141	239	1.6	0.2	–0.3
Asia	992	212	1.6	1.1	1.1
Sub-Total	1,133	216	1.6	0.9	1.0
Middle-Income	701	1,638	3.6	3.1	2.0
Total	1,834	751	3.1	2.7	1.8
OIL-EXPORTING DEVELOPING COUNTRIES	456	968	2.8	3.5	3.0
Industrialized Countries	671	9,684	3.9	2.4	2.5
Centrally Planned Economies[b]	1,386	1,720	—	3.8	3.3

The most probable outcome for at least the next five years is that the annual average per capita growth of the oil-importing developing countries — which was 3.1% in the 1960s, and 2.7% in the 1970s — will drop in 1980-85 to 1.8%.

More depressing still is the outlook for the 1.1 billion people who live in the poorest countries. Their already desperately low per capita income, less than $220 per annum, is likely to grow by no more than 1% a year — an average of only two or three dollars per individual. There would even be negative growth for the 141 million people in the low-income countries of sub-Saharan Africa.

There are two principal causes. The new surge in oil prices has more than doubled the cost of imported energy for the oil-importing developing countries. And the continuing recession in the industrialized nations, which comprise their most important markets, is severely limiting demand for their exports.

In 1973 the oil-import bill of these developing countries (in

[a]Preliminary estimates.
[b]Including China.

current dollars) was $7 billion. In 1980 it is likely to be $67 billion. The price of oil is not going to come down—on the contrary it is likely to continue to rise in real terms by perhaps 3% a year. The projection for 1985, therefore, is $124 billion, and by 1990—even assuming these countries more than double their own domestic energy production, and make a considerable effort at conservation—the bill is projected to be nearly $230 billion (see Table II).

TABLE II—PETROLEUM IMPORTS OF THE OIL-IMPORTING DEVELOPING COUNTRIES
(Billions of current US dollars)

	1973	1978	1980	1985	1990
Cost of Petroleum Imports					
Low-Income	1	2	6	13	23
Middle-Income	6	30	61	111	206
Total	7	32	67	124	229
MEMO ITEMS:					
Price per Barrel (c.i.f., U.S.$)					
Current Dollars	4.20	13.70	29.80	50.30	78.30
1980 Dollars	8.88	17.13	29.80	35.10	40.85
Volume of Net Imports (million barrels per day)	4.6	6.4	6.2	6.8	8.0
Volume of Domestic Production[a]	5.7	7.3	8.5	12.7	18.5

Meanwhile, as I indicated, the continuing sluggishness in the growth rate of the industrialized nations will pose additional problems for these developing countries. The expansion of their principal export markets will decline, and an already unfavorable situation could be seriously compounded by additional deflationary policies and a resort to greater protectionism in the developed world.

Reflecting the effect of these two factors, the current account deficits of the oil-importing countries have increased sharply.

[a]All forms of energy production translated into the equivalent of million barrels of oil per day.

In 1980 they are expected to constitute nearly 4% of their GNP (see Table III).

TABLE III—CURRENT ACCOUNT DEFICITS OF OIL-IMPORTING DEVELOPING COUNTRIES
(Billions of current US dollars)

	1973	1975	1978	1980
Current Account Deficits[a]				
Low-Income	2.3	5.4	5.7	10.0
Middle-Income	4.4	34.2	21.4	51.0
Total	6.7	39.6	27.1	61.0
Current Account Deficits as a Percentage of GNP				
Low-Income	2.2	3.8	2.7	3.6
Middle-Income	0.9	5.3	2.2	4.0
Total	1.1	5.1	2.3	3.9

III. A PROGRAM OF STRUCTURAL ADJUSTMENT

Persistent deficits of the magnitude reflected in Table III cannot be sustained indefinitely. In the short run the deficits can be, and are being, financed by additional external borrowing. But in the longer run this will not suffice since at the levels involved the mounting burden of debt service would soon become unsupportable.

The countries will, therefore, have to make those structural changes in their economies that can enable them to pay from their own resources for increasingly more expensive, but necessary, oil. This can only be done by expanding their exports, or by reducing their non-oil imports, or by some combination of the two.

Now, since there is no other way to do this, these internal adjustments will in fact take place sooner or later. And they will take place whether or not there is external financial assistance available to help get it done.

But the point is that it will make a very great deal of difference

[a]Excludes official transfers.

to these countries' economic and social advance—that is, to their development progress—whether these adjustments are made sooner rather than later, and with external financial assistance rather than without it.

For if the action in a given country is delayed, or if the external financial assistance available to it is inadequate, then the adjustment process will have to take place in an internal environment of low or negative growth, of little or no social advance, and of almost certain political disorder—a very heavy and unnecessary penalty for that society to have to pay.

But if, on the other hand, the required structural changes are initiated before a crisis situation develops, and scheduled over a reasonable period of time—say, five to eight years—and if during that adjustment period the country is assisted in maintaining a reasonable level of imports by an expansion of the external financial resources available to it, then the negative impact of the adjustment process on the country's economic growth and social advance will be substantially less.

This would permit growth rates in the developing countries to recover to more satisfactory levels in 1985-90, possibly exceeding even the rates achieved in the 1960s and early 1970s.

But such a reversal in fortunes will not be easy to achieve.

To begin with, there are significant differences between the present adjustment situation, and that of the 1974-78 period:

The real cost of oil actually declined from 1974 to 1978 by about 23%. Since 1978 it has risen sharply, and is now expected to continue to rise during the 1980s.

The commercial banks rapidly expanded their claims on oil-importing developing countries in the previous period: from $33 billion in 1974 to an estimated $133 billion in 1978. But now their capital to risk-asset ratios have worsened, and some feel overexposed in certain of these countries.

- Some of the middle-income developing countries, which borrowed extensively in the past, are regarded by the com-

mercial banks as being less creditworthy today than they were then. Increased spreads on new lending and a slower rate of growth in such lending are both likely.

- Considerable financing became available to cushion the impact of higher energy costs during the 1974-1978 period from bilateral aid programs and from international financial institutions. Neither source now seems likely to expand as rapidly in the future as it did in the past.

- The debt-servicing burden was considerably reduced in the 1970s by negative real interest rates, whereas the developing countries have recently been borrowing large amounts at positive real interest rates.

- Many developing countries have already carried out a major pruning of their import, investment, and consumption levels so that the scope for further retrenchment is now considerably less.

- The oil-exporting nations that are currently accumulating surpluses are likely to have them longer this time—thus prolonging the recycling task—since their imports are not expected to expand as quickly as they did in the previous period, nor are the workers' remittances from these countries likely to accelerate as fast.

- And finally, the possibility of a prolonged recession in the industrialized nations, particularly if it is accompanied by restrictive measures applied to trade or capital flows, will make the adjustment task of the developing countries that much harder this time.

It is well to remind ourselves of this comparison between the present and past. The sense of relief over the relatively successful adjustment in the earlier period should not be allowed to lead to a feeling of complacency now.

The truth is that even in the earlier period there was a considerable erosion of economic growth. Both new jobs and new income were simply lost in most of the developing countries. Their political and economic systems are already under serious

strain. And there are limits to how much more they can restrict their domestic consumption levels.

Further, this new adjustment problem is caused by a permanent change in the world economy, not by some temporary phenomenon which will later automatically reverse itself. Hence the longer the developing countries postpone adjustment policies, the more intractable their problems will become.

Many governments failed to recognize this in the 1970s. They looked instead to short-term finance as the answer to what they regarded as essentially a passing problem. But such finance merely borrowed time; it could not, and did not, substitute for basic adjustment policies.

Countries that recognized the long-term nature of the problem expanded their exports, reduced their imports through efficient domestic production, used borrowing to support investment and structural adjustment, and restored their growth momentum after a relatively brief decline. Those countries, on the other hand, that perceived it as a short-term problem did not use their external borrowing to carry out fundamental structural adjustments, and as a consequence merely accumulated more debt and a much greater problem for the future.

The point I want to stress here is the necessity of using external finance in support of structural adjustments, and not as a substitute for them. In the developing countries' interests, and in the interests of the world community as a whole, there is no other viable alternative.

Obviously it is desirable that these adjustment policies be implemented in a framework of vigorous development activity, rather than at depressed levels of investment and effort. What is needed is not just a new balance-of-payments equilibrium, but that this equilibrium be reached at the highest feasible level of economic growth. Indeed a key lesson of the 1970s is that success in adjustment should be measured not just by the reduction of current account deficits to present levels, but by the growth achieved during and following the adjustment period.

That is vital to these countries' future, and it is all the more

necessary if they are not to lose ground in the most fundamental struggle of all: the attack on absolute poverty in their societies.

Now let me turn to certain of the specific actions required if the prospective balance-of-payments deficits are to be reduced to a manageable level within a reasonable period of time, say during the next five or six years, while preserving as much growth momentum in the developing countries as is possible.

There will have to be major adjustments in both national and international policies, and a sustained, collective effort on the part of the world community, including:

- A sharp increase in the savings rate of the oil-importing low-income countries, and the reinvestment of over 25% of the increment in their CNP during the 1980-90 period;
- A significant rise in net resource flows to these countries, from $9 billion in 1980 to $19 billion in 1985, and $33 billion in 1990;
- A substantial increase in private capital flows to middle-income countries;
- A faster rate of growth in the exports of oil-importing developing countries during the Eighties than in the Seventies;
- A more than doubling of domestic energy production in these countries between 1980 and 1990, implying import substitution in the energy sector of over $280 billion a year by 1990; and
- Much greater efficiency in the domestic use of capital.

These are clearly a demanding set of actions and policy changes. What is essential is that the early years of this decade be used to establish the necessary framework of adjustment so that a vigorous economic recovery can take place in the later years.

Each country will, of course, have to design its own specific plan of action for this purpose. If exports are the dynamic sector in a given economy, the promising strategy would obviously be to stress further export expansion. If good possibilities exist for

import substitution — as they clearly do in domestic energy production — these ought to be pursued.

Let me comment briefly on this issue of domestic energy production in oil-importing developing countries.

Domestic Energy Production

It can make a very substantial contribution to the entire adjustment process.

To understand that, one need only reflect that even if their domestic energy production expands in the future at the rate of recent years (6.7% per annum), their oil-import bill in 1990 will be over $280 billion — a level that would be difficult to finance by any conceivable expansion of exports, or increase in external borrowing.

Although the sharp rise in the world price of oil has put considerable strain on the balance of payments of the developing countries, it has also changed the economies of domestic energy production dramatically.

At current and prospective oil prices, many oil-importing developing countries can now turn what were previously regarded as marginal energy reserves of oil, gas, coal, hydroelectric, and forest resources into commercial propositions. If they maximize energy production between now and the end of the decade, and pursue a vigorous program of energy conservation, we estimate that these countries could by then cut their annual oil-import bill by more than $50 billion.

But if they are to achieve this substantial saving they will have to adjust their domestic prices, incentives, and investment priorities so as to give much greater emphasis than at present to internal energy production. In all too many countries, governments have kept domestic prices of petroleum products artificially low compared to world prices, with the result that there has been little incentive for consumers to conserve, or for producers to invest.

What we propose is this: the oil-importing developing countries should establish efficient import substitution in energy as

one of their principal tasks for the 1980s. They should draw up concrete national energy plans, and formulate specific domestic investment programs. These, in turn, should be backed by newly mobilized domestic resources and by additional external assistance, including assistance from the World Bank which I will discuss in a moment.

External Financial Requirements of Low-Income Countries

As I indicated earlier, there is an urgent need for more external funds if the developing countries are to manage the adjustment process, including the expansion of domestic energy production, without avoidable and hence unnecessary penalties to their economic growth and social progress. tet me turn to that subject now, dealing first with the requirements of the low-income countries.

A major expansion in concessional flows to these countries is required in the 1980s to support their adjustment programs. What we have to remember is that they will benefit only marginally from world trade expansion, and will have limited access to international capital markets. Their financial requirements are likely to increase by $5 to $8 billion in 1980 over 1978 due chiefly to their declining terms of trade, to the sluggish growth in the OECD nations, and to the investments now required to adjust their economies to the changed international environment.

These are also the very countries that can least afford to cut back on their programs directed at reducing poverty. And yet they find themselves suddenly caught in a new and painful squeeze on their resources. They are clearly the priority case for a significant increase in concessional assistance.

But what are the prospects for this?

Total Official Development Assistance flows, including those from OPEC countries, did not increase in the 1977-79 period. In real terms they declined, and the outlook for the future is not bright.

Recent actions give cause for concern. The aid cuts an-

nounced by the British Government will cause their ODA to fall to .38% of GNP by 1985, from the .49% average for 1977-79. Aid bills continue to face difficulties in the U.S. Congress, suggesting that support from the largest donor is likely to remain the lowest, relative to GNP, of all major industrial nations. Germany and Japan have indicated their intention to continue to improve their aid flows, but most donors have not committed themselves to increasing the share of GNP allocated to concessional assistance.

What is even more disappointing, the portion of these ODA flows that were allocated to the low-income countries — which, of course, needed them most — was shockingly small in both absolute and relative terms. It amounted to less than one-half of the total (see Annex II). On a per capita basis, the low-income countries receive less concessional assistance than the middle- and high-income nations.

In view of the penalties the new global economic situation imposes on these poorest countries — a situation they themselves neither caused nor can do much to influence — the donors, both OECD and OPEC, ought to indicate clearly how much, if at all, they are prepared to help. The needs of the poorest countries are well known. It is not a time to temporize with the problem. It is a time to act.

The OECD nations should consider the following course of action:

- At the very minimum, each country should maintain its Official Development Assistance at the same percentage of its GNP as it did in 1978, and thus should increase the real level of its ODA as quickly as its GNP increases.

- Those countries which are well below the present OECD average of .34% — in particular, the United States and Japan — should consider increasing their real ODA flows faster than their GNP growth. The former Secretary of State of the United States called the U.S. performance "disgraceful" — and I agree with him.

- In view of the particularly difficult prospects the poorest

countries face in the 1980s, the OECD nations should increase the share that these countries will receive in their individual ODA allocations. As Annex II indicates, in 1978 these countries received less than one-half of the total ODA that DAC provided: in the case of Austria and New Zealand it was less than one-fifth; and for Australia, France, and the U.S. no more than one-third.

- The OECD nations in 1978 supported a retroactive adjustment of terms in respect to the past debt of poor and least-developed countries. However, only about $5 billion of past debts have so far been cancelled or rescheduled--out of a potential total of about $26 billion — and it is far from certain that this debt relief constituted additional assistance. Full cancellation or rescheduling would be equivalent to a substantial increase in concessional flows, particularly if it were extended to include all low-income countries.

A major responsibility rests as well on the capital-surplus oil-exporting nations.

Since 1973 the level of the ODA contributions of these countries — Saudi Arabia, Kuwait, Iraq, the United Arab Emirates, Libya, and Qatar — has been remarkable: they contributed 4.0% of their combined GNP during the 1974-79 period (see Table IV).

TABLE IV — ODA FLOWS FROM CAPITAL-SURPLUS OIL EXPORTERS TO DEVELOPING COUNTRIES[a]

	1973		1974		1975		1976		1977		1978		1979	
	$m.	% of GNP	$m.	% of GNP	$m.	% of GNP	$m.	% of GNP	$m.	% of GNP	$m.	% of GNP	$m.	% of GNP
Saudi Arabia	305	4.0	1,029	4.5	1,997	5.4	2,407	5.7	2,410	4.3	1,470	2.8	1,970	3.1
Kuwait	345	5.7	622	5.7	976	8.1	615	4.4	1,518	10.6	1,268	6.4	1,099	5.1
Iraq	11	.2	423	4.0	218	1.7	232	1.4	61	.3	172	.8	861	2.9
U.A.E.	289	16.0	511	7.6	1,046	14.1	1,060	11.0	1,177	10.2	690	5.6	207	1.6
Libya	215	3.3	147	1.2	261	2.3	94	.6	115	.7	169	.9	146	.6
Qatar	94	15.6	185	9.3	339	15.6	195	8.0	197	7.9	106	3.7	251	5.6
Total	1,259	4.5	2,917	4.5	4,837	5.8	4,603	4.6	5,478	4.5	3,875	3.0	4,534	2.9
Memo Item:														
Current a/c Surplus — in billion US$	7		43		31		36		34		20		56	

[a]Data for 1978 and 1979 are provisional.

The issue now is over future trends in their ODA. If the OPEC capital-surplus countries begin increasing their concessional assistance flows after the recent and hopefully temporary decline, this can make a major contribution to easing the adjustment problem of the poorest nations. Though they have a number of plans under active consideration, what the situation needs now are some firm decisions in order to meet the most urgent requirements of these low-income countries.

- In 1980 the current account surplus of the capital-surplus oil-exporting countries is expected to increase by about $100 billion over the levels of 1978. As already noted, they have provided 4.0% of their GNP in the form of ODA during 1974-79. The question is: can they continue to do so in the future, and can it be provided in the form of quick-disbursing assistance to a large number of the low-income countries in order to meet their immediate needs?

- Iraq, Venezuela, and Mexico have proposed that they compensate the poorest countries importing their oil for the recent oil-price increases by granting them long-term, low-interest loans. If this initiative is adopted by other oil exporters, it will have the immediate and beneficial impact of easing the balance-of-payments deficits of the poorest countries.

- The Long-Term Strategy Committee of OPEC has recently endorsed the proposal of Algeria and Venezuela to convert the OPEC Fund into a development agency with an authorized capital of $20 billion. If implemented soon, this initiative, too, could be of substantial help to the low-income developing countries.

The contribution of the Soviet Union, and the other industrialized countries with centrally planned economies, to Official Development Assistance is so small as to be scarcely measurable — only .04% of their GNP. Surely they, too, ought to do more.

External Financial Requirements of Middle-Income Countries

I want to turn now to the external financial requirements of

the middle-income oil-importing countries. As Table III indicates, between 1978 and 1980 these requirements will have more than doubled in absolute terms (frorn $21.4 billion to $51.0 billion) and nearly doubled relative to GNP (frorn 2.2% to 4.0%).

Commercial banks, of course, constituted by far the most dynamic element of capital flows to middle-income developing countries in the 1970s (see Table V).

TABLE V—BORROWINGS OF THE MIDDLE-INCOME DEVELOPING COUNTRIES FROM THE WORLD'S PRIVATE BANKING SYSTEM[a]
(US$ billions)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Claims of the Private Banks on LDCs—End Yr.[b]	30	37	44	53	72	92	110	151	204	251
Increase in Banks' Claims on LDCs[b]		7	7	9	19	20	18	41	53	47

The chief anxiety today is that the commercial banks may not be able to play a similar role in the 1980s. There are several reasons for this:

- As noted earlier, there is likely to be tough competition for funds between the developing countries on the one hand and the industrialized nations and centrally planned economies on the other;
- Two-thirds of the commercial banks' credits were concentrated in only 10 middle-income developing countries. These have now acquired sizable commercial debts, and some of the banks are concerned over their own portfolio limits; and
- There is an increasing tendency on the part of national regulatory agencies to restrict the activities of the commercial banks in developing countries.

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[a]Includes small amounts loaned to Low-Income countries which could not be separated out of total.

[b]1970-75 and 1979 World Bank estimates. For other years, BIS data.

This does not mean that the commercial flows to developing countries will not expand in the 1980s. They will. But the key question is this: will they expand enough to permit the adjustment process in these countries to take place at relatively high — rather than at unacceptably low — growth rates? In all probability they will in 1980, and perhaps even in 1981. But beyond 1981 they well may not. Already leading commercial bankers in both Western Europe and North America have expressed their doubts.

It is not too early, therefore, to discuss actions to supplement and facilitate the role of the commercial banks if these doubts materialize. This should be a major focus of the work of the Development Committee and of the Boards of the International Monetary Fund and the World Bank in the year to come.

If the task of recycling to the developing countries a portion of the surplus of the capital-surplus oil exporters is to be tackled efficiently and equitably in the 1980s, there is not the slightest doubt that the financial intermediation by the Bretton Woods institutions, as well as by other international institutions, should increase substantially above previously planned levels in order to supplement the role of the commercial banks.

Financial intermediation was, in fact, one of the main reasons for setting up these institutions: to stand ready to step in as last-resort intermediaries to help recycle funds from those countries that are in surplus to those countries that need them most, whether for short-term balance-of-payments support, or longer-term development needs.

The 1980s, then, call for a major reexamination of the function of the Bretton Woods institutions in the recycling of financial flows. And I will comment in a moment on a possible role for the World Bank in all of this.

Before turning to that, however, I want to reemphasize an underlying issue, which is in danger today of being obscured by the anxiety over the global adjustment problem. And that is the most fundamental development issue of all: the drive against absolute poverty.

IV. THE DRIVE AGAINST POVERTY

Over the past decade I have drawn attention repeatedly in this forum—sometimes at the risk of tedium—to the principal goals of development. They are: to accelerate economic growth, and to eradicate what I have termed absolute poverty.

Economic growth, of course, is obvious enough. And once one has been in contact with developing societies, so is absolute poverty: it is a condition of life so limited by malnutrition, illiteracy, disease, high infant mortality, and low life expectancy as to be beneath any rational definition of human decency.

The two goals are intrinsically related, though governments are often tempted to pursue one without adequate attention to the other. But from a development point of view that approach always fails in the end. The pursuit of growth without a reasonable concern for equity is ultimately socially destabilizing, and often violently so. And the pursuit of equity without a reasonable concern for growth merely tends to redistribute economic stagnation.

Neither pursuit, taken by itself, can lead to sustained, successful development.

When we met together here in 1972, I began a discussion of these issues with you. I pointed out that all too little of the benefits of economic growth was reaching the bottom 40% of the population in the developing world. For *800* million individuals, their countries were moving ahead in gross economic terms, but their own individual lives were standing still in human terms, locked in poverty.

As our analysis of growth and equity continued in these meetings in subsequent years, we outlined a number of specific actions designed to deal directly with that problem in the context of overall development planning. It was clear that any successful effort to combat poverty would have to do two basic things:

- Assist the poor to increase their productivity; and
- Assure their access to essential public services.

In our meeting in Nairobi in 1973, I proposed a major pro-

gram for the rural areas, where the vast majority of the absolute poor are concentrated. The strategy focuses on a target group of roughly 100 million subsistence farmers and their families, most of whom farm two hectares or less. It is directed towards raising their agricultural productivity, and thus their incomes, as well as providing them with more equitable access to the services they need.

Two years later, at our meeting in 1975, I outlined a comparable program for the urban areas. Though the circumstances of the some 200 million absolute poor in the cities differ from those in the countryside, the strategy is fundamentally the same: remove the barriers to their greater earning opportunities, broaden their access to basic public services, and help them more fully achieve their productive potential.

In each of the following years our discussion has pursued these issues further.

But now, as I have pointed out this morning, most of the developing countries are facing a new, an unanticipated, and what is certain to be—for at least the next several years—a very difficult situation.

Their rates of growth are going to be low. Their capital requirements are going to be high. And there are going to be severe pressures on their governments to adopt austere budget allocations for every activity that is not considered of immediate priority.

In these circumstances the temptation will be strong to push aside and postpone anti-poverty programs. The argument will be that poverty is a long-term problem, and that the current account deficits are a short-term emergency: that poverty can wait, but that deficits can't.

It is a very specious argument.

Mounting deficits cannot be indefinitely sustained, and, as we have seen, the necessary solution lies in structural adjustment. Efforts to get that basic adjustment in place must not, indeed, be delayed.

But absolute poverty in a society cannot be indefinitely sus-

tained either. To ignore it, to temporize with it, to downgrade its urgency under the convenient excuse that its solution is "long-term" — and that there are other immediate problems that preempt its priority — is dangerous self-deception.

To reduce and eliminate massive absolute poverty lies at the very core of development itself. It is critical to the survival of any decent society.

Development is clearly not simply economic progress measured in terms of gross national product. It is something much more basic. It is essentially human development; that is, the individual's realization of his or her own inherent potential.

Absolute poverty, on the other hand, is a set of penalizing circumstances that severely impair the individual's pursuit of that very potential. It is the direct denial of the benefits of development.

But it is more than just that. It is an open insult to the human dignity of us all: to the poor themselves, because simply as human beings they have deserved better; and to all of us in this room, for we have collectively had it in our power to do more to fight poverty, and we have failed to do so.

Now that both the developing countries and the developed nations are under the sting of hard times, are we going to do still less?

Let us be clear about one point. Sustaining the attack on poverty is not an economic luxury — something affordable when times are easy, and superfluous when times become troublesome.

It is precisely the opposite. It is a continuing social and moral responsibility, and an economic imperative — its need now is greater than ever. It is true that sluggish economic growth in both the developing and developed nations in the early years of the 1980s may mean that the privileged and affluent in most societies will have to accept slower rates of advance or even some selective reduction in their already favored standard of living. If they have to, they can absorb such inconveniences.

But for the 800 million absolute poor such a downward adjustment is a very different matter. For them downward does not mean inconvenience, but appalling deprivation. They have little margin for austerity. they lie at the very edge of survival already.

What we must remember is that absolute poverty is not a simple function of inadequate personal income. Though the poor have too little income, and desperately need more, their plight is not exclusively related to that.

Their deprivations go beyond income. And in many cases, even if their income were higher—which it must become—they could not by that fact alone free themselves from their difficulties.

The reason is that absolute poverty is a complicated web of circumstances, all of them punitive, that reinforce and strengthen one another.

And lest we become insensitive to the magnitude of those circumstances in the developing countries, it is worth reminding ourselves of their scope:

- 600 million of their adults—100 million more than in 1950—can neither read nor write, and only 4 out of every 10 of their children complete more than 3 years of primary school.
- Of every 10 children born into poverty, 2 die within a year; another dies before the age of 5; only 5 survive to the age of 40.
- Common childhood diseases—measles, diphtheria, whooping cough, and polio—which have either been eliminated or reduced to minor nuisances in the developed nations, are frequently fatal in the developing world. A case of measles is 200 times more likely to kill a child there than here.
- Though all four of those diseases can be prevented by a simple vaccination, fewer than 10% of the children born each year in the developing world are now being protected.
- Malnutrition afflicts hundreds of millions of individuals, re-

ducing their energy and motivation, undermining their performance in school and at work, reducing their resistance to illness, and often penalizing their physical and mental development.

- In the low-income developing countries, average life expectancy for their 1.3 billion people is 50 years. It is nearly 75 in the industrialized nations.

- In short, compared to those fortunate enough to live in the developed nations, individuals in the poorest countries have an infant mortality rate eight times higher; a life expectancy one-third lower; an adult literacy rate 60% less; a nutritional level, for one out of every two in the population, below minimum acceptable standards; and for millions of infants, less protein than is sufficient to permit optimum development of the brain.

Now, these impersonal rounded numbers are not simply statistics on some economist's computer. They represent individual human beings. Most tragic of all, so many of them are children. Of the total of two and a quarter billion people in the over 100 developing countries that the Bank has served, some 900 million are under the age of 15.

They are the chief hope of their society's future. And yet almost half of them suffer from debilitating disease likely to have long-lasting effects. Well over a third of them are undernourished. A third of primary school-age children are not in school.

All of this illustrates the tragic waste of poverty. If millions of a country's citizens are uneducated, malnourished, and ill, how can they possibly make a reasonable contribution to their nation's economic growth and social advance? The poverty they are immersed in, through no fault of their own, simply denies them that.

As I have pointed out before, it is the poverty itself that is the liability. Not the individuals who happen to be poor. They represent immense human potential.

It used to be said that lack of capital was the chief obstacle to economic growth. But we now know that capital formation explains less than one-third of the variation in growth rates among developing countries. Human resource development explains a great deal more.

Investment in the human potential of the poor, then, is not only morally right; it is very sound economics.

Certainly what is very unsound economics is to permit a culture of poverty to so develop within a nation that it begins to infect and erode the entire social and political fabric.

No government wants to perpetuate poverty. But not all governments, at a time of depressed economic growth, are persuaded that there is much that they can really do against so vast a problem.

But there is.

A number of avenues of attack deserve attention. Today I want to emphasize two that reflect our research of the past year. Both of these are concerned with human resource development. They are: the redesign of social programs to reduce their per capita cost while expanding their coverage; and the restructuring of the total set of social sector programs to establish priorities that take advantage of the linkages and complementarities between them, thereby reducing their overall cost. Unless essential services are both redesigned and reorganized to complement each other, governments will not be able to afford them on the scale required, particularly in periods of austerity.

Our studies confirm the synergistic effects on productivity of actions designed to meet basic needs in each of the five core areas: education, health care, clean water, nutrition, and shelter. Each has linkages to the others. Advance in one contributes to advance in the others, and all contribute to higher output.

Reducing, for example, the incidence of gastrointestinal disease and parasitic infection — through education, cleaner water, and health and sanitation programs — considerably increases the nutritional value to be gained from any given quantity of food.

This improvement in nutrition, in turn, can expand students' learning capacity, and hence the benefits that they will receive from education, including enhanced productivity and incomes.

Studies in many countries have demonstrated that small farmers with a primary education are more productive than those without it. They are quicker to adopt innovations, and are more receptive to the advice of extension agents.

Research has also confirmed the beneficial linkage between primary education and the reduction of infant mortality. Studies in Bangladesh, Kenya, and Colombia have shown that children are less likely to die the more educated their mothers are, even allowing for differences in income among families.

In Sri Lanka, widespread basic education has to a degree compensated for the poor quality of water because villagers have been taught to boil it in order to eliminate contamination. And health and nutrition everywhere in the developing world affects how well children do in school, how long they remain, or indeed whether they enroll at all.

Urban employment, particularly in the modern sector, is not only often dependent on the degree of education, but on health and nutrition as well. Workers who are easily fatigued and have low resistance to chronic illness are inefficient, and add substantially to the accident rate, absenteeism, and unnecessary medical expenditure. More serious still, to the extent that their mental capacity has been impaired by malnutrition in childhood, their ability to perform technical tasks is reduced. Dexterity, alertness, and initiative have been drained away.

And yet not only are essential public services often out of reach of the poor, but such facilities as are in place may be so inappropriately designed as to be virtually irrelevant to their needs: impressive four-lane highways, but too few market roads; elaborate curative-care urban hospitals, but too few preventive-care rural clinics; prestigious institutions of higher learning, but too few primary schools and village literacy programs.

Public services that are not designed modestly and at low

cost per unit will almost certainly end by serving the privileged few rather than the deprived many.

To reverse this trend, governments must be prepared to make tough and politically sensitive decisions, and to reallocate scarce resources into less elaborate—but more broadly based—delivery systems that can get the services to the poor, and the poor to the services.

The developing countries do not, of course, have the financial and administrative resources at hand today to eliminate rapidly all the inadequacies in education, health, and other public services that penalize the poor. They must—out of very real necessity—be selective in determining where to concentrate their efforts.

All the more reason, then, that they should analyze the most important linkages and complementarities between the various public services since utilizing them in combination can lead to substantial reduction in the cost of individual services, and hence in the total cost of the ongoing poverty program.

It has been estimated, for example, that in Egypt the full use of such complementarities among sectors, together with redesigned programs within sectors, would decrease by more than a third the resources required to reduce, and ultimately to eliminate, absolute poverty.

If choices have to be made—and they do—what are the most promising ones?

That will differ, of course, in various societies, but in the case of most developing countries two deserve particular attention. One is primary education, and most particularly for girls. And the other is primary health care.

Primary Education

School enrollments throughout the developing world still fall far below the objective of universal primary education for both boys and girls, and this picture is made even worse by dropout rates which are often over 50%.

Research makes it clear that economic returns on primary education for boys are high. This is not always recognized. But I want to emphasize today something much less recognized and understood. And that is the immensely beneficial impact on reducing poverty that results from educating girls.

In most developing societies women simply do not have equitable access to education. The number of illiterate females is growing faster than illiterate males. Nearly two-thirds of the world's illiterates are women, and virtually everywhere males are given preference both for general education and vocational training.

One reason for this is that the prevailing image of women distorts their full contribution to society. Women are esteemed —and are encouraged to esteem themselves—predominantly in their roles as mothers. Their economic contribution, though it is substantial in a number of developing societies, is almost always understated.

The fact is that in subsistence societies women generally do at least 50% of the work connected with agricultural production and processing, as well as take care of the children and the housekeeping.

Schooling clearly enhances a girl's prospects of finding employment outside the home. In a comparative study of 49 countries, the level of female education in each nation demonstrated a significant impact on the proportion of women earning wages or salaries.

Greater educational opportunity for women will also substantially reduce fertility. In Latin America, for example, studies indicate that in districts as diverse as Rio de Janeiro, rural Chile, and Buenos Aires, women who have completed primary school average about two children fewer than those who have not.

Of all the aspects of social development, the educational level appears most consistently associated with lower fertility. And it is significant that an increase in the education of women tends to lower fertility to a greater extent than a similar increase in the education of men. In societies in which rapid population growth

is draining away resources, expenditure on education and training for boys that is not matched by comparable expenditure for girls will very likely be diminished in the end by the girls' continued high fertility.

Women represent a seriously undervalued potential in the development process. And to prolong inequitable practices that relegate them exclusively to narrow traditional roles not only denies both them and society the benefits of that potential, but very seriously compounds the problem of reducing poverty.

Primary Health Care

In the health sector, as well, carefully designed and sharply focused efforts can contribute immensely to an overall anti-poverty program.

In most developing countries health expenditures have been heavily concentrated on supplying a small urban elite with expensive curative-care systems — highly skilled doctors and elaborate hospitals — that fail to reach 90% of the people. What are required are less sophisticated, less costly, but more effective preventive-care delivery systems that reach the mass of the population.

Even quite poor countries can succeed in this, provided sound policies are pursued. Some 25 years ago, for example, Sri Lanka decided to improve rural health facilities. As a result of its efforts in health care, along with those in education and in nutrition, there has been over the past two decades a decline in infant mortality to 47 per 1,000, an increase in life expectancy to 69 years, and an associated decline in the crude birth rate to 26.

But many other countries — countries with a much higher per capita national income than Sri Lanka — have spent as much or more on health, and by failing to stress simple, inexpensive, but effective primary care systems, have reaped much poorer results.

Turkey, for example, had a GNP per capita of $1,200 in 1978, compared to Sri Lanka's $190, but has concentrated on urban health, with conventional facilities, and today has an infant mor-

tality rate of 118 per 1,000, life expectancy of 61 years, and a crude birth rate of 32—all far short of Sri Lanka's accomplishments.

As part of their preventive-care programs, governments should make a special effort to reduce sharply current infant and child mortality rates. Average rates of infant mortality—deaths per 1,000 in the first year—are well above 140 in Africa, and roughly 120 in Asia and 60 in Latin America. In the developed countries they average only about 13.

Why are they so high in the developing world? Largely because of low nutritional standards, and poor hygiene, health practices and services. But infant and child mortality rates can be brought down relatively quickly with a combination of redesigned and reoriented health, education, and nutrition policies. And the return in lowered fertility, healthier children, and increased productivity is clearly worth the effort and costs.

The truth is that a basic learning package for both males and females—and particularly for females—and a carefully designed program of primary health care for both the countryside and the cities are investments that no developing country can afford to neglect.

The economic return will be huge. And the same is true of other investments in the immense untapped human potential of the absolute poor. Even in a period of austerity—indeed, especially in a period of austerity—those investments must be accelerated.

I want to turn now to the role the World Bank itself can play in the 1980s. And to establish the background against which this must be viewed, let me briefly summarize the principal points that emerged earlier in our discussion.

V. THE ROLE OF THE WORLD BANK IN THE 1980s

The current account deficits of the oil-importing developing countries have risen dramatically. The increase in these deficits is the mirror image of a portion of the rise in the surpluses of

the oil-exporting nations. A major objective of the world's intermediation effort to deal with these surpluses must be to assure that appropriate portions of them flow, directly or indirectly, back to these developing countries.

The assistance the developing societies will need in the 1980s — both to alleviate their burden of absolute poverty, and to facilitate the structural changes in their economies required by the changes in the external environment — is much larger than was projected before the events of the past 18 months.

The developing countries, already financing 90% of their own development efforts, will now have to mobilize substantial additional resources. But they cannot succeed in this enormous task by their own efforts alone. That is why all previously planned programs of international assistance, including that of the Bank, must be reexamined in order to determine how the most urgent needs of the developing world can be met.

It is in this perspective that the future level of World Bank lending, and the nature of its operating policies, should be reviewed. The Bank clearly cannot do everything. Nor should it try to. But neither can it be allowed to fail in its basic responsibility toward its developing member countries.

Let us examine for a moment the role the Bank has undertaken over the last decade.

During the past twelve years, the World Bank Group has expanded dramatically its level of financial assistance to the developing world (see Table VI).

TABLE VI—WORLD BANK CROUP: NEW FINANCIAL COMMITMENTS AND NET DISBURSEMENTS

(US$ billions)

	Annual Average Per Period					Working Plan[a]				
	FY64 -68	FY69 -73	FY74 -78	FY79	FY80	FY81	FY82	FY83	FY84	FY85
New Loans										
IBRD	.9	1.8	4.9	7.0	7.6	8.6	9.6	10.7	11.9	13.2
IDA	.3	.8	1.6	3.0	3.8	3.6	4.1	4.7	5.0	5.3
IFC	—	.1	.2	.4	.7	.6	.7	.8	.9	1.1
Total—Current $	1.2	2.7	6.7	10.4	12.1	12.8	14.4	16.2	17.8	19.6
-Constant FY80 $	5.0	6.8	9.5	11.2	12.1	11.9	12.6	13.3	13.8	14.3
Disbursements										
IBRD	.5	.9	2.2	3.6	4.4	5.2	6.3	7.4	8.3	9.2
IDA	.3	.3	1.1	1.2	1.4	1.8	2.2	2.7	3.5	4.1
IFC	—	.1	.2	.2	.3	.3	.5	.7	.8	.9
Total — Current $	.8	1.3	3.5	5.0	6.1	7.3	9.0	10.8	12.6	14.2
— Constant FY80 $	3.1	3.5	5.3	5.5	6.1	6.7	7.6	8.6	9.4	9.9

But our objective during these years was not principally the size of the Bank's operations. We did not simply want to do more. Rather, we wanted to do more of what would contribute most to our member countries' evolving development needs.

Thus, over the past decade there has been a major qualitative change in the Bank's lending, and in its development policies. That change arose out of the understanding that if the absolute poor had to wait for the benefits of overall economic growth to trickle down to them, their incomes and welfare would inch forward at an intolerably slow pace.

It became clear that developing countries needed to devise policies and investment programs to assist the poor in their societies to become more productive, and to assure an equitable distribution of basic services to them.

[a]The Working Plan is subject to annual review by the Executive Directors and is based on the assumption that necessary legislative action on the General Capital Increase and IDA VI replenishment will be completed according to schedule.

Throughout the 1970s the Bank made a determined effort to help its member countries to devise such policies, and to finance and implement such projects. It has devoted to this objective a high proportion of its intellectual resources, and a growing share of its expanded lending. In the FY64-68 period such loans, on average, amounted to only $60 million per year, and accounted for less than 5% of total lending. In FY80 they had grown to $3,565 million, and accounted for over 30% of total lending. In that year alone the Bank approved agricultural and rural development projects to raise the productivity, and thereby the incomes, of 29 million people, including 18 million of the world's poorest—and to increase food production by 6 million tons per annum.

Highways, electric power, and other traditional infrastructure and production investments remain, of course, vital to development. They are basic to strengthening the foundations of growth, and to expanding employment opportunities and enhancing the incomes of all members of society. While the Bank reduced the share of its lending to these sectors, it substantially increased its absolute volume. Bank lending for traditional infrastructure projects grew from an annual average of $700 million in 1964-68 to $4.4 billion in 1980; and for traditional production projects, from $350 million to $3.5 billion.

Only by raising its overall level of lending was the Bank able to meet its member countries' new development needs without neglecting their traditional requirements.

This clearly remains the path for the future. The Bank must be in a position to respond to new needs which have already appeared. And it will certainly be called upon again and again to help meet needs which we cannot yet foresee. It must be able to do so without disrupting other programs for which developing countries are counting upon its assistance.

Is the Bank in such a position now?

Last year I reported to you that we were making progress in laying a foundation for further expansion of the Bank Group's lending program in the 1980s. Let me summarize the steps

that have been taken over the past twelve months, and where we stand today.

The General Capital Increase in the Bank's authorized capital, from $45 billion to $85 billion, was approved by the Board of Governors in January 1980. Some countries, including the United States, will need legislative approval before they can subscribe to the additional shares.

Negotiations for a sixth replenishment of the International Development Association (IDA) were successfully concluded last December, and the basis for the replenishment was approved by the Governors in March 1980. The replenishment itself, however, is still not effective because a few countries, and in particular the United States, have not been able yet to complete the necessary legislation.

Other donor countries have agreed to make voluntary contributions to prevent an extended hiatus in IDA's lending program. But I want to emphasize the importance of early action by all governments to make the sixth replenishment effective, and the severe penalties for the poorest nations of the world that will result from prolonged delay and uncertainty.

Let us assume, however, that all the necessary legislative actions for the General Capital Increase and for the IDA VI replenishment will be completed soon.

Will the lending program summarized in Table VI, which the General Capital Increase and IDA VI are intended to support, be adequate for the role the Bank Group must play in the 1980s to assist its developing country members? Will it allow the Bank to meet these countries' needs in even the limited way that we hoped it would when the program was prepared?

The answer is clearly no.

The lending program for FY81-85 reflects the Bank's assessment of the future financial requirements of the developing countries as they appeared early in 1977, when the plan was prepared. In the light of that assessment we believed the planned level of lending would permit the Bank to increase its

new commitments each year by 5% in real terms, and that this projected growth would allow the Bank to make an adequate contribution to its member countries' priority development needs.

That assessment is no longer tenable. Four events have intervened in the meantime that invalidate its underlying assumptions.

A rampant and unexpected rate of inflation has reduced the real value of the commitments permitted by the General Capital Increase and the IDA VI agreements. In planning the program in 1977, the Bank had assumed a world inflation rate of 7.5% for FY79. It turned out to be 13.3%. And we now project inflation in future years will taper off more slowly than we had previously expected. As a result, the real value of the lending program planned for 1981-85 will fall 10.5% below what was projected. In today's dollars this represents a loss of over $5.6 billion.

Quite apart from this, our developing member countries' needs for Bank assistance have increased for three other reasons:

- First, as I have emphasized, the sharp rise in the oil price has raised the cost of their imports, while recession in the industrial countries has depressed their export prospects. They must react to these events by carrying out the far-reaching structural adjustments in their economies, discussed earlier, and yet do so without reducing their growth to totally unacceptable levels during the transition period.
- Second, as part of that process, in their own interest as well as that of the world community, they should step up substantially their investment in energy development.
- And third, the change in the representation of China has increased by 45% the number of people who now need, who now desire, and who are now entitled to have World Bank Croup lending.

Let me briefly discuss the effect on the Bank of each of these three points in turn.

First the financing required for the much larger than anticipated current account deficit:

Let me sum up the key points of the argument put forward earlier.

As compared to 1978, the oil-import bills of developing countries have increased by $35 billion. And even if the industrialized nations resist domestic protectionist pressures, as they must, their continuing problems of recession and slow growth have already reduced the export prospects of the developing world.

The problem is not that developing countries will be left with deficits they cannot finance. If deficits cannot be financed, they will disappear. But if they disappear because adequate financing cannot be found, this will seriously cripple their development programs.

If that were to happen, the rest of the world could not be cushioned from the deflationary pressures generated by such a collapse. Even the narrowest self-interest of the industrialized nations requires that these essential financing needs should be met.

Adequate financing of imports is not a substitute for structural adjustment to the new external circumstances. Rather, it is a prerequisite for such adjustment: it permits the developing countries to adapt sensibly their production, trade, investment, and savings patterns to new needs. Without adequate financing of their imports they will be forced to adopt "quick-fix" remedies—such as blanket controls on imports or arbitrary cutbacks in public investment programs—which are in no one's long-term interest.

Nor is the financing of structural adjustment a substitute for the financing of other development needs. The magnitude of the other investments required to make at least a minimally acceptable impact on absolute poverty has not diminished. The cost and urgency of raising the productivity of the world's poor and of providing them with equitable access to the essential public services they desperately need remain high.

Should not the Bank, then, shoulder part of the burden of financing its developing member countries' structural adjust-

ment? In doing so it would clearly not be substituting for the private-market mechanisms to recycle surpluses. On the contrary, it would be helping to underpin private flows, and by closely supporting the adjustment process it would improve the creditworthiness of the recipients.

Nor would the Bank be substituting for appropriate action by the IMF. Rather, it would be complementing such action by bringing its resources and its expertise to bear on the longer-term development aspects of structural adjustment.

To help meet these requirements, the Bank introduced structural adjustment lending several months ago, and is tentatively planning to commit $600-800 million for that purpose in the current fiscal year. In FY82 or '83, such lending might amount to $1,500 million, and in subsequent years to more.

At present, however, such structural adjustment loans have to be fitted into the previously planned lending program. But these new and unanticipated needs are clearly additional to the requirements identified in 1977, which the current lending program was designed to meet. The Bank needs, therefore, to expand the current program to respond to them. If it fails to do so, it simply will not be contributing to the solution of the world's intermediation problem.

Let me move now to the second point: the financing required for energy development.

Beyond their immediate impact on import costs, the higher energy prices present both long-term challenges and opportunities for the oil-importing developing countries.

Our studies indicate that at the new price levels there are highly profitable investment opportunities in these countries which are additional to current plans and which, taken together with vigorous conservation measures, would reduce oil imports by 3 million barrels of oil per day—150 million tons per year—by 1990. This would have obvious benefits for all producing and consuming nations. But the exploitation of these opportunities will require substantial investment over the next five years.

Total investment needs for energy development in oil-importing developing countries, in the period 1981-1985, will amount to about $185 billion in constant 1980 prices, as against $80 billion devoted to energy investment in these countries over the past five years. Most of these needs will be financed by their own savings, and by external sources other than the Bank.

The Bank, however, should help by expanding its previously planned energy development program, both in order to serve as a catalyst for other funds, particularly from private sources, and in order to finance those needs for which such funds are not likely to be available. To assist in this vital role, we now estimate that the Bank should lend an additional $12 billion above the $13 billion planned for energy development in the 1981-85 period.

Finally, let me turn to the matter of China.

The change in the representation of China in the Bank has increased by nearly a billion the number of people who now have a claim on the Bank's resources. That claim is no less compelling, and their needs are no less urgent than those of the Bank's other members. It will take time to translate these needs into specific Bank projects, but when that has been done it is clear that they will amount to several billion dollars per year.

If we had to accommodate these needs within the lending program planned earlier, we would have to reduce sharply our lending to other member countries. This would seriously disrupt their development programs, and this we must not do. An addition to the lending program is clearly required.

The inescapable conclusion of all these considerations is this: the Bank Croup must mobilize substantial additional resources if it is effectively to assist its developing member countries through the critical years of the 1980s. But it must do this in a manner that takes full account of the current budgetary constraints faced by the governments of the developed nations.

What we need to do now is to reach broad agreement on the following objective.

The Bank should:

- Increase its lending program in order to offset fully the higher-than-anticipated inflation levels;
- Finance structural adjustment, but not at the cost of reducing the development finance already planned for the oil-importing developing countries;
- Assist in financing an expanded energy development program, but not at the cost of cutting its assistance to other equally vital programs; and
- Respond to the development needs of China, but not at the cost of its other borrowers.

If we agree on this objective—and I believe we can—then our task is to find the means for financing the expansion in lending without imposing undue burdens on the budgets of our member governments.

Several approaches to that seemingly impossible task are worthy of consideration. Let me refer to them briefly.

It is through payments for capital subscriptions that the International Bank for Reconstruction and Development (IBRD) places demands on the budgets of our member governments. Those budgets are tight, and the equity capital that they finance is, therefore, a scarce resource. Loan funds, on the other hand, are available, and even abundant on the world's financial markets.

The issue facing the Bank today is whether we are making the best possible use of that very scarce resource, our equity capital, in order to mobilize those other more abundant funds. The question is: could we increase our borrowings in the private financial markets without imposing additional claims on scarce funds from governments?

Throughout its history, the World Bank has gradually improved the use it has made of its equity base.

Twenty years ago, for example, the Bank concluded that it had only barely begun to utilize the full financial power of that

base in support of its borrowing. At that time, in 1960, the Bank's callable capital of $17.3 billion — essentially member government guarantees of its borrowings — plus its paid-in capital and reserves of $2.5 billion, a total capital base of $19.8 billion, supported borrowing of only $2.1 billion and loans of $2.8 billion. To increase the efficiency with which its paid-in capital was being used, in 1960 the Bank doubled its subscribed capital without any increase in the amount of capital paid in. And yet even in 1970, when paid-in capital and reserves had risen to $3.9 billion, and callable capital amounted to $20.8 billion, borrowings totalled only $4.6 billion and loans $6.0 billion. We were an under-leveraged institution.

During the 1970s the Bank began to use its equity base to mobilize much larger amounts of borrowed funds for investment in its developing member countries. Borrowings and outstanding loans had increased to $30 billion and $27 billion respectively by the end of FY1980. Meanwhile, the Bank's paid-in capital and reserves rose to $7 billion — of which over half came from retained earnings — and callable capital rose to $36 billion. Moreover, the Governors, having reduced the amount of the paid-in portion of the 1960 capital subscription from 20% to 10%, have now reduced the paid-in portion of the new General Capital Increase from 10% to 7.5%.

When the General Capital Increase is completed, the Bank will have total subscribed capital of $85 billion. About $7.5 billion will then have been paid in. This will be augmented by reserves and retained earnings that amount to about $3.4 billion today, and are growing fast. This means that if it fully uses the authority provided by the General Capital Increase, the Bank's own paid-in equity and reserves will finance about 15% of outstanding loans. When callable capital is included, every single dollar of outstanding loans will be backed by a dollar of capital or reserves.

These ratios contrast with the standard practice of large commercial banks, whose capital to risk-asset ratios run to less than 6%. And yet none of these banks has the IBRD's repayment record; none of them relies on such long-term sources of funds; and none has such a strong liquidity position.

The World Bank, then, should continue to improve the efficiency with which it uses its immensely broad and uniquely guaranteed financial base. It must begin to use the demonstrated strength of its loan portfolio that reflects the prudent lending policies that it has followed for over thirty years. This is essential if it is to meet more fully the needs of the developing countries without imposing additional burdens on the budgets of other governments in a period when the domestic demands of many are particularly pressing.

The question is how can this best be done, while at the same time fully safeguarding the strength and integrity of the Bank's financial structure?

There are at least three actions that should be considered.

The relationship between the Bank's loans—and hence its outstanding debt—and its equity base could be changed.

The Articles of Agreement, drafted over 35 years ago in immensely different financial circumstances, provide that the Bank's total disbursed and outstanding loans cannot exceed its total subscribed capital and reserves.

The question the Brandt Commission, investment bankers, and other financial experts have been asking us in the Bank is this: in the circumstances of today, as contrasted with those of 1944, does it still make financial sense to limit any increase whatever in the Bank's lending authority to an equal increase in its capital?

The tentative answer appears to be that the 1 to 1 ratio, established at Bretton Woods in the closing months of World War II, is no longer really relevant to the Bank's financial condition or to the economic situation of its principal shareholders, and that the result now is an unnecessary underutilization of the Bank's capital base.

It is obvious that any action to change the ratio should not be construed as a substitute for the completion of the General Capital Increase. On the contrary, it should be viewed as a necessary additional step. The General Capital Increase was agreed to prior to the more recent events that have now sub-

stantially enlarged the financial requirements of our developing member countries. The change in the ratio would make it possible for the Bank to respond to these new requirements through a more effective use of the increase in its capital base which has already been authorized.

A second possibility would be the organization of a separately capitalized energy affiliate.

As I remarked earlier, the need and the potential for developing new energy resources present a major challenge, as well as a major opportunity, to the developing countries, and to the world community at large. To meet that challenge, and to exploit that opportunity, there is now an international consensus, reflected most notably in the decisions of the Venice Economic Summit and the meetings of the OPEC ministers, that measures must be taken to assist the developing countries in the development of their energy resources. More specifically, the World Bank has been asked to examine the possibility of setting up an energy affiliate to assist in this effort. Such an affiliate would serve both as a direct source of finance itself, and as a catalyst for other public and private funds.

The equity capital of such an institution could come from IBRD profits, and from contributions by member governments: not necessarily by all member governments, and not in the same proportion as their contribution to the Bank's capital. Such an equity base would be utilized to underpin borrowing and lending that could ultimately amount to a multiple of the scarce equity funds.

A third approach would be to raise the Bank's lending and borrowing authority again, as was done in 1960, by increasing subscribed stock, but without the necessity of additional paid-in capital.

Any one of these three actions, or a combination of them, would make it possible for the Bank to be more responsive to the urgent needs of its developing member countries which were not anticipated when the General Capital Increase was put forward. The variety of means available to equip the Bank to be more responsive should encourage those who, like myself,

believe that the current climate of budgetary constraint in the developed nations need not stand in the way of necessary action.

While these measures are being studied, because of the urgent need to expand the Bank's lending program for FY82-86, we should consider drawing forward a portion of the lending presently planned for later years to the nearer term. In this way we could increase IBRD loans over the next five critical years by a total of $10 billion.

Implementing these various proposals would allow the IBRD to expand its lending program. Yet that would not by itself help the Bank's poorest member countries, which require highly concessional financing of very long maturity. As I have indicated, the needs of these low-income countries have also greatly increased. And the IDA VI replenishment, while it is generous, will fall far short of meeting them.

Just as we need to find a way to exploit more fully IBRD's equity base, so we must also increase the leverage of scarce IDA resources. The creditworthiness of a number of countries which have in the past received IDA credits has now markedly improved. This is most notably the case for oil exporters such as Indonesia and Egypt. But others too have increased their ability to service debt on intermediate terms.

Some of these countries could shift in the future to IBRD loans only, or to a blend of IBRD and IDA loans less concessional than had been necessary earlier. This would permit an increase in IDA lending to those countries whose financial requirements have expanded but which are not yet creditworthy for IBRD loans.

It should go without saying that making additional IDA funds available to the poorest countries by shifting some countries from IDA to IBRD borrowing will be possible only if IBRD itself is enabled to meet these additional claims on its resources. And it should be unnecessary to add that a truly adequate response to the poorest countries' needs would require additional resources, raised perhaps by such new means as those suggested by the Brandt Commission.

In this discussion of the role of the Bank in the 1980s, I have focused on only one aspect of its work: its loans to developing countries, and the means of financing them. In the short run, this must have first claim on our attention. But in the longer run, as both Executive Directors and Ministers from developing countries have emphasized so often in recent months, it is the non-financial assistance of the Bank that is of even greater value than its financial support, indispensable as that is.

In the 1970s the Bank's policy advice and technical assistance were directed toward the twin goals of accelerating economic growth and reducing absolute poverty. These must continue to be our objectives in the 1980s. But the environment in which those goals will be pursued will be so different, and so difficult, as to require a major shift of emphasis within the Bank:

- Population growth, although decelerating, will place increasingly heavy burdens on the resources of most developing countries;
- Labor forces growing at explosive rates, reflecting past levels of population growth, will place a premium on job creation;
- Migration from the countryside will burden metropolitan areas grown larger than most in the developed world;
- Widespread malnutrition, if it is to be overcome, will require substantial increases in food production per hectare because opportunities for putting land under cultivation in the developing countries are sharply reduced; and
- External payments imbalances will require acceleration of industrialization and expansion of exports in the face of slower growth in world trade and rising tides of protectionism.

It is shocking to reflect that in spite of the progress of the past quarter century and the advances that are likely in the next two decades, it is probable that at the end of this century 600 million human beings in the developing countries will continue to live in absolute poverty.

Clearly there will be an immense intellectual and technical effort required from the Bank in the 1980s—in addition to its financial contribution—if it is effectively to assist the developing countries to address their fundamental social and economic problems.

Let me now summarize and conclude the central points I have made this morning.

VI. SUMMARY AND CONCLUSIONS

Global economic conditions over the past 18 months have become substantially more difficult, and the prospects for growth in the oil-importing developing countries during the decade of the 1980s now appear less promising.

The sharp new rise in oil prices has more than doubled these countries' cost of imported energy, and the continuing recession in the industrialized nations will seriously limit demand for their exports.

As a result, their current account deficits have increased rapidly, and now constitute on average 4% of their gross national product—and for many countries substantially more. Though they can continue to finance these deficits in the short term by additional external borrowing, in the longer term their mounting debt service would become unsupportable. the deficits must be reduced. What is needed are fundamental structural adjustments in their economies.

If these difficult changes are undertaken soon, and can be completed over the next five to eight years, growth rates in the oil-importing developing countries should recover to more satisfactory levels during the second half of the decade.

This, however, will require financial assistance in the interim, beyond what is now in prospect, if severe reductions in the level of their development activity are to be avoided. If this financial assistance is not available, or if the developing countries delay initiating the necessary structural changes, their development progress will be seriously compromised throughout the decade.

The current adjustment process is likely to be more difficult than the earlier one in the 1974-1978 period. One of the most important actions the oil-importing developing countries can take to moderate its damaging effects is to adopt efficient import substitution policies in energy.

At present and prospective oil prices, many of these countries can turn what were previously regarded as marginal energy reserves of oil, gas, coal, hydroelectric, and forest resources into profitable investments. This will require their mobilizing additional domestic and external finance, but would permit them by the end of the decade to reduce their annual oil-import bill—projected by then to amount to some $230 billion — by more than $50 billion.

The current global economic situation has imposed particularly severe penalties on the poorest developing countries. They desperately need additional Official Development Assistance to get through the adjustment period. But total ODA flows declined in real terms from 1977 through 1979, and that portion of the flows allocated to the poorest countries was shockingly small in both relative and absolute amounts.

Both the OECD nations, and the capital-surplus members of OPEC, should now consider what measures they can take to increase concessional assistance to the poorest nations who continue to be damaged by a global economic situation they neither caused, nor can do much to influence.

The middle-income developing countries will continue to depend on external capital flows from commercial banks throughout the decade, though it is questionable whether the volume will be sufficient from these sources to meet the additional requirements imposed by the new adjustment difficulties.

If the task of recycling to the developing countries a portion of the more than $100 billion a year of additional surpluses now being earned by the oil-exporting countries is to be tackled in the 1980s efficiently and equitably, there is no doubt that the financial intermediation of the World Bank, and other international institutions, should increase substantially above previously planned levels.

During the 1980s the Bank should:

- Increase its lending program in order to offset fully the higher-than-anticipated inflation levels;
- Finance structural adjustment, but not at the cost of reducing the development finance already planned for the oil-importing developing countries;
- Assist in financing the expanded energy development program called for at the Venice Economic Summit meeting, but not at the cost of cutting its assistance to other vital programs; and
- Respond to the development needs of China, but not at the cost of its other borrowers.

All of this can be done—and in a manner that takes full account of the current budgetary constraints faced by the governments of the developed nations — provided we make full use of the potential of the Bank's capital base, and facilitate the use of the large private resources available for sound investment opportunities.

The 1980s are likely to be a turbulent decade, preoccupied with a whole new range of financial difficulties.

But underlying the immediate financial concern, more fundamental problems persist.

The most fundamental of all is the persistence of widespread absolute poverty.

Development itself comprises a twofold task: to accelerate economic growth, and to eradicate absolute poverty.

These two goals are related, though governments are sometimes tempted to pursue one without adequate attention to the other. In the end, that approach fails from a development point of view. The pursuit of growth without a reasonable concern for equity is ultimately socially destabilizing. And the pursuit of equity without a reasonable concern for growth merely tends to redistribute the deprivation of economic stagnation.

In our meetings throughout the 1970s we have examined the

various requirements of these two goals. This morning I have stressed both the critical need and the economic good sense of developing those human resources who have been inequitably passed over by the modernization process.

None of us, of course, can pretend that our understanding of the complexities of the poverty problem is complete. We are all stilt learning. But I believe we can take a measure of satisfaction that many governments and institutions throughout the international development community, including this Bank, are beginning to think about poverty in a more thoughtful way than they did a decade ago. And they are beginning to ask themselves how they can reshape their own efforts to deal with it more effectively.

That should be encouraging to everyone in this room.

Due to your support, and that of the governments you represent, the World Bank over the past ten years has become by far the world's largest and most influential development institution.

That is important.

But what is far more important is what has transpired throughout the developing world in the millions of individual lives that this institution has touched.

What these countless millions of the poor need and want is what each of us needs and wants: the well-being of those they love; a better future for their children; an end to injustice; and a beginning of hope.

We do not see their faces, we do not know their names, we cannot count their number. But they are there. And their lives have been touched by us.

And ours by them.

ANNEX I

FLOW OF OFFICIAL DEVELOPMENT ASSISTANCE FROM DEVELOPMENT ASSISTANCE COMMITTEE MEMBERS TO DEVELOPING COUNTRIES AND MULTILATERAL INSTITUTIONS[a]

(Percent of Cross National Product)

	1965	1970	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Australia	.53	.59	.59	.41	.42	.54	.52	.51	.50	.50	.50	.51	.51
Austria	.11	.07	.17	.12	.24	.29	.19	.23	.25	.27	.28	.29	.30
Belgium	.60	.46	.59	.51	.46	.55	.56	.59	.60	.61	.63	.65	.67
Canada	.19	.41	.52	.39	.48	.52	.47	.46	.45	.45	.45	.44	.44
Denmark	.13	.38	.58	.56	.60	.75	.75	.67	.70	.70	.70	.70	.70
Finland[b]	.02	.06	.18	.17	.16	.17	.22	.22	.23	.24	.26	.27	.28
France	.76	.66	.62	.62	.60	.57	.59	.59	.59	.59	.60	.60	.60
Germany	.40	.32	.40	.36	.33	.37	.44	.44	.44	.44	.45	.46	.46
Italy	.10	.16	.11	.13	.10	.14	.09	.09	.10	.10	.11	.11	.11
Japan	.27	.23	.23	.20	.21	.23	.26	.27	.27	.28	.28	.29	.30
Netherlands	.36	.61	.75	.83	.86	.82	.93	.94	.94	.96	.97	.98	.99
New Zealand[c]		.23	.52	.41	.39	.34	.30	.30	.30	.30	.30	.30	.30
Norway	.16	.32	.66	.70	.83	.90	.93	.95	.96	.97	.98	.99	1.00
Sweden	.19	.38	.82	.82	.99	.90	.94	.95	.95	.95	.95	.95	.95
Switzerland	.09	.15	.19	.19	.19	.20	.21	.22	.25	.26	.26	.27	.28
United Kingdom	.47	.41	.39	.40	.46	.48	.52	.52	.49	.45	.42	.40	.38
United States[d]	.58	.32	.27	.26	.25	.27	.19	.18	.22	.22	.22	.22	.22
GRAND TOTAL													
ODA ($b-Nominal Prices)	6.5	7.0	13.8	13.8	15.7	20.0	22.3	24.6	28.7	32.1	35.7	39.7	44.1
ODA ($b-Constant 1980 Prices)	20.3	18.0	21.9	20.9	22.1	24.4	24.5	24.6	26.3	27.2	28.3	29.4	30.8
CNP ($t-Nominal Prices)	1.3	2.0	3.8	4.2	4.7	5.6	6.5	7.2	8.0	9.0	9.9	11.0	12.1
ODA as % of CNP	.49	.34	.36	.33	.33	.35	.34	.34	.36	.36	.36	.36	.36
Price Deflator[e]	.32	.39	.63	.66	.71	.82	.91	1.00	1.09	1.18	1.26	1.35	1.43

[a]Historical figures through 1979 are on note deposit basis as reported from OECD/DAC. Those for 1980-85 are based on OECD and World Bank estimates of growth of GNP, on information on budget appropriations for aid, and on aid policy statements by governments. They are projections, not predictions, of what will occur unless action not now planned takes place.

[b]Finland became a member of DAC in January1975.

[c]New Zealand became a member of DAC in 1973. ODA figures for New Zealand are not available for 1965.

[d]In 1949, at the beginning of the Marshall Plan, U.S. Official Development Assistance amounted to 2.79% of GNP.

[e]The deflator is the US$ GNP deflator which excludes the effects of changes in exchange rates.

DISTRIBUTION OF ODA FROM OECD COUNTRIES IN 1978 BY DEVELOPING COUNTRY INCOME GROUP

(Amounts in millions of dollars)

	To Low-Income Countries[a]			To Middle- and High-Income Countries[a]			Total ODA	
	Amt.	Percent of Total ODA	Percent of GNP	Amt.	Percent of Total ODA	Percent of GNP	Amt.	Percent of GNP
Australia	198	34	.18	390	66	.36	588	.54
Austria	31	19	.06	135	81	.23	166	.29
Belgium	384	72	.40	152	28	.15	536	.55
Canada	564	53	.28	496	47	.24	1,060	.52
Denmark	254	66	.50	129	34	.25	383	.75
Finland	30	56	.10	24	44	.07	54	.17
France	768	28	.16	1,937	72	.41	2,705	.57
Germany	1,171	50	.19	1,176	50	.19	2,347	.37
Italy	247	66	.09	128	34	.05	375	.14
Japan	1,136	51	.12	1,079	49	.11	2,215	.23
Netherlands	606	56	.46	468	44	.36	1,074	.82
New Zealand	7	13	.04	48	87	.30	55	.34
Norway	237	67	.60	118	33	.30	355	.90
Sweden	508	65	.59	275	35	.31	783	.90
Switzerland	91	53	.11	82	47	.09	173	.20
United Kingdom	897	62	.29	559	38	.19	1,456	.48
United States	2,078	37	.10	3,586	63	.15	5,664	.27
Total	9,207	46	.16	10,783	54	.18	19,990	.34

[a]1978 is the latest year for which available information permits distribution of ODA as between "Low-Income" and "Middle- and High-Income" countries. Low-Income countries have a total population of 1.3 billion with per capita incomes averaging $200 per year. The populations of Middle- and High-Income countries total 900 million with per capita incomes averaging $1,250 per year. The distribution includes bilateral ODA contributions and allocable shares of contributions to multilateral development assistance institutions.

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ADDRESS TO THE BOARD OF GOVERNORS

by

ROBERT S. McNAMARA

PRESIDENT, WORLD BANK

Washington, D.C.
September 30, 1980

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