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P. P. KUCZYNSKI

Annual Meeting Speech  
October 1972 - April 15, 1973

The World Bank Group  
**Archives**



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Pedro-Pablo Kuczynski Subject Files: Annual Meetings Speech [McNamara] -  
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Poverty in the Less Developed Countries: An Overview

1. Major Dimensions

1. A year ago in Washington, I discussed with you some of the problems of the lowest income groups in the developing countries. While the evidence remains sketchy, it is clear that in many instances these income groups have not benefitted significantly from development during the past decades. It is also clear that the problems of poverty are highly complex and involve many elements of policy beyond economics. The complexity of the problems is only matched by our inability thus far to come to grips effectively with particular solutions upon which we can rely to substantially alleviate the dire poverty of the low income groups. The absence of a general approach, however, does not excuse the failure to undertake such programs as we can define which are designed specifically to improve the living conditions of the poor and to reduce unsustainable differences in incomes within countries.

2. Despite the complexity of the problem, certain features are clear:
- the gap between the rich and the poor nations is getting wider;
  - although there are differences between developing countries themselves in the financial and physical means at their disposal to attack the poverty problem, the situation of the lowest income groups - say the lowest 40 percent - has similar features whether they live in countries at the bottom or top ends of the developing world; and
  - a concerted attack requires not only finance but the will in the developing countries themselves to devote their best managerial and intellectual talents to this task.

Let me now turn to each of these points.

Relative International Poverty

3. The problem of relative poverty is basically a problem of income distribution. Internationally the gap between the rich and the poor countries continues to grow. If trends in income growth of the last twenty years continue, the average per capita GNP in the year 2,000 would be \$420 in the developing world as against \$9,300 in the industrialized countries. Today, the average income per person in the industrialized countries is 13 times greater than in the poorer countries; by the end of the century, that ratio could be as high as 22 times. Moreover, the resources which the industrialized countries make available in order to support development continue to lag well behind the targets established in the second development decade. I have previously reported that it is unlikely that the target transfer of 0.7 percent of GNP in official development assistance will be reached. Nothing that has occurred in the past year supports any change in that estimate. On the contrary, the actual ratio of official development assistance to GNP has remained almost constant in 1969-71 at 0.35 percent.

4. Although the total flows of assistance remain inadequate, the distribution of aid takes increasing cognizance of relative poverty of countries. The greater emphasis on the least developed and poorest countries is reflected increasingly in aid programs. This is also true in the allocation of IDA resources as I reported above. The share of IDA resources going to the UN list of least developed countries has doubled from 1961-68 to 1972-73, while the share of the relatively rich countries - per capita income over \$250 - has declined. Seventy-four percent of IDA commitments are to countries with per capita income of under \$120.

The Lowest Forty Percent

5. Of the 2 billion people who live in the developing world outside the Peoples Republic of China,<sup>1/</sup> at least 500 million live on an average annual per capita income of \$45, and another 250 million on \$75 annually. Thus, close to 800 million people - or 40 percent of the population of the developing world - live on \$55 annually or 15 U.S. cents a day. The bulk of this low-end poverty is concentrated in South Asia and in parts of Africa. The pervasiveness of poverty in India, for example, is such that the average income of the lowest 80 percent of the population is only \$80, and even for the second quintile from the top the average income is only \$120. The trend of population growth in the developing countries means that, unless there are dramatic changes in family planning and in agricultural technology, pervasive poverty will continue to be the fate of most of the population of those countries. Even with effective family planning programs which would reduce the ~~child~~ birth rate from 42 per 1,000 to 24 per 1,000 by the end of the century, - an ambitious target - the total population of the developing world will have risen to 4,500 million in the year 2,000 compared to 2,700 million at present.

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<sup>1/</sup> Note for Mr. McNamara: The section that follows can be recast to include Mainland China, if you wish. Mainland China population and GNP data are very vague, but estimates do exist.

6. Although the largest number of poor is concentrated in South Asia, all developing countries have a serious problem of low-end poverty. The bottom forty percent share a number of features independently of the average income level of the developing country they live in:

- They are largely in the rural areas. Since over-60 percent of the population of the developing world is in the countryside, poverty tends to be concentrated there. Invariably, urban incomes are higher, although the difference is generally less in the poorest countries. Recent research in the Bank indicates that in the last decade the average per capita urban income compared to that in rural areas was four times larger in Brazil, five times in Honduras, double in Tunisia and fifty percent higher in Pakistan. *A large proportion of the lower income groups in rural areas are landless.*

- They have shared little in the benefits of growth. Thus, in India, consumer surveys undertaken for 1960/61 and 1967/68 estimate that per capita consumption of the lowest 40 percent of income groups stayed constant in real terms at \$28 for rural areas. Even if the bottom 80 percent of income groups is taken, the rural average rose marginally from \$40 to \$41. In the case of Mexico, with a per capita income six times that of India, the situation was not much different: the income of the lowest 40 percent of the population rose in 1960 prices from \$94 in 1950 to \$112 in 1968, or by one dollar per year.

- They receive a very small proportion of public services. Public services are concentrated in the larger metropolitan areas. Thus, for example, Lima, which has 25 percent of the population of Peru, accounts for 44 percent of Ministry of Education outlays and 50 percent of those of the Ministry of Health, and for 90 percent of telephones. In Zaire, the capital city metropolitan area, with 7 percent of the total population has over half of the primary school teachers in the country. [More data being developed.]

7. Despite the similarities, it is obvious that the economies at a more advanced stage of development, with their higher per capita incomes, have a far greater proportion of the necessary resources for an attack on low-end poverty than the poorest countries. Moreover, the relatively high income countries also tend to be those with the higher growth rates. - Although the quality of the data remains poor, it is sufficient to show that the internal inequalities of income in these countries are very large. Of 11 countries in this group (from \$350 to \$1,000 in per capita income) for which some data is available:

- The bottom 20 percent of the population received only 5 percent of the income,
- The top 5 percent received 27 percent, and
- The top quintile has incomes which are eleven times that of the bottom quintile; in the case of the top 5 percent, the ratio is 23 times.

#### The Setting for Change

8. The financial resources which countries can command in order to begin a direct attack on poverty vary widely. But even before whatever resources are available can be put to use, far-reaching decisions are needed on the priority of the effort. Today, the bulk of professional and managerial talent in the developing world, and indeed in most countries, is directed to the areas of government and business in the modern industrial sector. The contact with the poor is left to the lower echelons or to charitable organizations with minimal funds. If the efforts in the industrial countries have something to teach us on the merits of a war on poverty, it is that such

efforts will fail unless the best available talent is involved in these programs, the active participation of the poor is sought, and unless appropriate incentives are established so that careers in rural areas can begin to compete with those in the cities. No rural development effort, no low-cost housing program, no literacy campaign can succeed if it is controlled from afar by functionaries who feel, or for whom the incentive structure makes them feel, that such activities are of secondary importance in the structure of power. No program can be viable if the most talented are drawn to the urban areas and to schools which prepare them in very large numbers, to join the ranks of the "educated unemployed", while the poor lack the technological and administrative skills to increase their productivity. A drastic shift in attitudes and incentives is thus essential for the success of any significant action program.

## II. A Program of Action

9. Although we do not have very precise data, it is rather easy to define the broad dimensions of poverty. The data that do exist bear out the frequent visual impressions and fragmentary analysis which show all too clearly the very large numbers of the unemployed, the undernourished, the ill-housed and the illiterates in every country. We can, and we must, improve our data and analytical understanding of the problem, we must learn more about the effects of various policies on the principal elements of poverty, and we must learn what the relationships are between accelerated growth and more equal distribution of benefits. But our ignorance should not stand in the way of action. While we do not know its exact dimensions, we do know the problem

is large - involving more than a billion people; while we do not know the precise remedies, we do have some inklings about what appropriate policies might be.

10. Because poverty is so closely interwoven with the social and political structure of each country, the responsibility for the alleviation of mass poverty is an indigenous responsibility which will require nothing less than a major intellectual revolution in the developing countries. It is not enough to collect some data and indices on the profiles of poverty. It is necessary to go beyond these statistics to see who the really poor are, what are the causes of their relative poverty, what is their bargaining position in the political and social life, and whether powerful forces within the system can be persuaded and motivated to change their condition of miserable existence. Unless the best intellectual and managerial resources of the system are devoted to this task, the task will never get done - best-laid plans will not get implemented, well-conceived legislations will become largely ineffective, new institutions will be created only to be discarded again. Let us be clear that what we are talking about is a fundamental change in these societies. The solutions are political, not technocratic.

11. Capital assistance is necessary, imported technology can help, but unless there is the necessary political will and national commitment to this objective, there will be no change. The problem must be perceived and dealt with in the developing countries. Indeed, it will be a great disservice on the part of the industrialized countries if they were to convince the developing world, or themselves, that policies for employment and distribution can be fashioned and delivered from abroad.

12. I have, therefore, no set solutions to offer. But let me explore with you, in a spirit of enquiry, some of the elements we may all have to consider in formulating an actionable program for mass poverty.

### Rural Poverty

13. The bulk of the poor live in rural areas - 1.6 billion out of a total population of 2.5 billion in the developing world. They all suffer certain common characteristics:

- The income of the rural inhabitants is significantly lower than in the urban areas. For instance, the difference between urban and rural incomes is 2:1 in Malaysia. In Guatemala, where the average per capita income is \$400, about half of the population has an average income of only \$75 and it is all living in the rural areas.
- The income in the rural areas has generally been growing at a much slower pace than the rest of the economy because of the low rates in agricultural growth. Per capita agricultural production in the developing world rose by only one percent during 1960-70 compared to a 26 percent rise in their average per capita income. Even in South Asia, with the dramatic increases in yields due to the Green Revolution, per capita agricultural incomes have barely risen since the mid-sixties.
- Agricultural holdings are generally small. At present, 700 million workers in the developing world - including Mainland China - farm about 600 million hectares of cropland, with each agricultural worker having on average slightly less than one hectare.

- The rural poor who have land are among the fortunate. In Latin America, less than 5 percent of the farms occupy more than 75 percent of the farmland. In Asia, where land-man ratios are extremely low, the distribution of ownership leaves the vast majority of the rural population either landless or with uneconomic size farms. In India, the ownership of 40 percent of the total cropland is held by only 8 percent of the land-owning farmers. About 46 million rural households (or over 200 million people) in India are landless today. In many countries, the tenants pay 50 to 60 percent of their gross product as rent, do not enjoy any security of tenure and constantly face eviction at the will of their landlords.
- The rural poor are generally underemployed or unemployed and receive a very inadequate share in the distribution of public services.

14. To reach the bulk of the rural poor, we must find some means of transforming subsistence agriculture, some way of reaching and motivating the small farmer. This is not only a social imperative but is fast becoming an economic imperative because of the widening food gap in most parts of the developing world.

#### The Growing Food Gap

15. If past trends in agricultural production continue, the gap between demand and supply of food and livestock products would widen, forcing the developing countries to spend \$43 billion on imports by 1985 compared to \$6 billion today. Obviously, food imports at this level will squeeze out development imports and greatly restrict the choices of the developing world.

16. Vastly increased production of foodgrains and livestock products is, therefore, a must. And much of this has to come from the present subsistence sectors and the existing small farms as the possibilities for any large scale colonization of additional arable land are both limited and costly.

17. The dominant pattern in most parts of the developing world is small-scale agriculture - particularly in the over populated regions of Asia - and it is likely to stay that way for a long time despite rapid industrialization. There are very limited possibilities for extending the present availability of cultivated land per agricultural worker. Moreover, any such extension would be concentrated mainly in Latin America and would be extremely costly. It is estimated that the developing world as a whole could bring a total of 1.15 billion hectares of cropland under cultivation of the increase of 550 million hectares, 400 million would be in Latin America (largely in South America, particularly in the Amazon basin), slightly over 100 million in Africa, and only 30 million in Asia. The average minimum capital cost to bring one additional hectare under controlled cultivation is estimated at \$1,000 so that the total cost of cultivating all potential arable land would be nearly \$600 billion. And it would still add only 0.7 hectares to the present availability of a little less than one hectare per agricultural worker.

#### Small Farmer

18. We must, therefore, accept the fact that the real challenge in the developing world is to increase agricultural productivity on the small farms. This is undoubtedly the most formidable task confronting development planners today and it would require an organizational and institutional revolution of unprecedented proportions.

19. It is sometimes argued that small farmers cannot become very productive because of their small holdings, limited savings, poor education and resistance to modern technology. This is simply not true. A recent study shows that output per hectare on the smallest farm size groups was 37 percent higher than that on the largest farm size groups in the case of India, 33 percent higher in Brazil, 67 percent in Taiwan and 92 percent in Guatemala. And it is output per hectare which is the relevant measure in land-scarce, labor-surplus economies, not output per worker.

20. The dominant factor behind low productivity is not the size of farms but the tenancy system and the absence of institutional support, particularly credit, for the small farmers. On average, an Indian farmer obtains \$4 in the form of institutional credit for every ton of wheat he produces compared to \$42 in Japan. A survey of West Bengal, published by the Government of India, touches specifically upon the pattern of response of a typical small-scale farmer. On the land they rent, they cultivate the high yielding variety because the landlord is in a position to obtain credit for his working capital needs. On their own land, however, they revert to the cultivation of the traditional varieties. Lack of organized support is prohibiting them from crossing the threshold of the Green Revolution.

21. Perhaps the greatest institutional obstacle hindering successful agricultural development is the prevailing agrarian structure in many countries. As pointed out earlier, the ownership of land is often concentrated in the hands of a small minority. Furthermore, these agrarian structures are frequently characterized by tenancy arrangements based on the worst forms of crop-sharing and insecurity of tenure. Without security in a minimum-size farm, there are no incentives for increased production and the way is

blocked to improving standards of living of millions of agricultural workers. This does not always mean land redistribution, though this may often be necessary, it may require land consolidation, new tenancy legislation and organized services for the small farmer.

22. Another essential step is to increase the resources which are saved in the rural areas and to channel them to investments which benefit the rural poor. Even if aggregate savings are high as a percent of GNP - and often they are not in the low income countries - the distribution of investible funds favors the modern industrial and agriculture sector. Efforts to help the poor take the perverse form of low interest rates for agricultural credit which means low rates on deposits and little rural savings. The inadequate supply of credit then becomes available to the rural rich and powerful while the rural poor have to rely heavily on the money lenders. There is no reason to suppose that the small farmers will not react rationally to adequate savings incentives by increased savings which will increase investible funds in rural areas.

23. The developing countries face the formidable task of devising new institutions which will work for the small farmer: which will provide him credit at reasonable terms for more fertilizer, new seeds and additional irrigation; which will offer him adequate incentives to produce and facilities for his marketing; which will give him a reasonable return on his saving and his investment; which will protect him against exploitation; which will extend to him an equitable share of public services - including education, health, water supply and roads - which are so far the privilege of only a few urban areas; which will overcome the handicap of his smallness by bringing him together in cooperative arrangements to pool his political and economic power; and, above all, which will motivate him to increase his productivity and to give back to him the rewards of his effort.

Measures to Increase Productivity

24. Increased productivity and better distribution have to be planned together. Particularly in those countries where the problem is that of absolute poverty, the income of the small farmer cannot be increased significantly without a major improvement in the productivity of the subsistence sector. In the last analysis, more production has to be obtained out of every one hectare of land that an agricultural worker cultivates on an average!

25. The problem is that a hectare is, economically, not a homogeneous unit. With very few exceptions, one hectare in developing countries produces an agricultural output estimated in 1960 to range from \$50 to \$150. In India, one hectare produces \$91 while in Japan it produces close to \$1,000. In a sample study of the agricultural output of 19 countries in 1960, the average output per hectare for the top four countries was estimated at \$660, compared with \$83 for the lowest four where the majority of the developing world population lives and \$160 for the other countries.

26. The global survey of agricultural yields published by the FAO, shows that for cereal production which occupies more than half of the total arable lands of Africa, Asia and South America, the variations are equally striking. In 1970, the cereal yields per hectare amounted to 6,720 kgm in Japan. But on average it amounted to only 1,270 kgm in Africa, 1,750 kgm in Asia and 2,060 kgm in South America.

27. Taking these magnitudes as indicators of the potential which can be tapped from existing lands, a target of doubling agricultural yields in developing countries by 1985, that is to reach an overall level of productivity per hectare equal, on average, to one-fifth of that achieved by Japan, should

hardly be considered unrealistic or unattainable. It would certainly require a tremendous effort. But in terms of economic growth, fulfilling such a target would amount to as much as a 50 percent increase in the combined national incomes of the developing countries. To achieve equivalent growth through industrialization, industrial output, which at present contributes some 15 percent of GDP on average, would have to increase by over 350 percent. Neither the absorptive capacity nor resource availability would make such an industrial target worth discussing.

28. To double agricultural yields by 1985 will require a massive and multifaceted effort which must include:

A. Credit

29. New varieties of wheat and rice recently introduced in Asian countries have greatly increased crop yields on irrigated lands provided that a combination of inputs (fertilizers and insecticides) are applied. The cost of these purchased inputs is around \$22 per hectare. It would be naive to advise developing countries to achieve a more wide-spread application of the Green Revolution formula unless funds are available to provide credit at reasonable terms for farmers to finance the purchase of these inputs. Today, the average farmer purchases less than \$6 worth of inputs per hectare. Of this insufficient amount, a very minor portion is provided for through institutional credit. At least a four-fold increase in the present volume of agricultural credit will be required by 1985. The global bill for that purpose would have to rise from about \$3 billion at present to \$12 billion by 1985. Not all of this needs to be additional. A reorientation of investment priorities is both feasible and necessary.

B. Fertilizer

30. Agricultural output per hectare is closely related to fertilizer application. Today, the developing countries of Asia, Africa and Latin America, with 46 percent of the world total land under cultivation, use only 15 percent of the world total consumption of commercial fertilizer. In 1970, the developing regions applied 8.7 million tons of fertilizers on a cropped area of 600 million hectares, an average of 14 kgm per hectare, compared with an average of over 70 kgm per hectare in the developed regions. It would require an annual rate of increase of about 12 percent in fertilizer application if the developing countries are to reach by 1985 the level of use in the developed countries today. In terms of quantity, this would mean that the global supply of fertilizers would have to increase by 35 million tons, a 60 percent expansion over present levels of fertilizer production. Efforts of similar magnitudes are required to expand the availability and use of other inputs and farm equipments.

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C. Extension

31. Because of the low literacy rates in rural areas, a sizable extension corps is needed to help the small farmer reap the benefits of the Green Revolution. In the developed countries today, the number of professional and technical workers in agriculture is around 5 percent of the agricultural labor force. In developing countries, the comparable percentage is an insignificant decimal. Realistically, the FAO World Indicative Plan aims for developing countries to achieve a ratio of 0.4 percent of the agricultural labor force by 1985 - less than one-tenth of that already achieved in developed countries. Even then, a major expansion of agricultural education programs would be necessary to provide additional trained agricultural personnel - some 100,000 senior workers and 500,000 field workers. The global bill for that purpose would be around \$ \_\_\_\_\_ billion annually, but much can be accomplished by reorienting the present output of the educational system. Simultaneously, basic education will need to be improved in rural areas to spread the adoption of better farming practices.

D. Infrastructure

32. Rural areas are not adequately served with feeder roads and other transport infrastructure and equipments. Rural electrification does not cover but a handful of villages in most developing countries; the standard of medical services is abominably low; piped water supply flows only to a few; education facilities do not exist in most villages, and where they do, the educational content is in most

cases irrelevant to the needs of modern agriculture and a catalyst for urban migration.

33. No exact figure of the cost of providing or improving all the necessary ingredients for a fuller human life and endeavour in the rural sectors of the developing regions of the world is possible but approximate orders of magnitude can be estimated. The FAO estimated the global capital costs needed for land improvement, farm equipments and machinery, livestock and building in the region of \$10 billion annually. For the expansion of land and water resources development, some \$8 billion are required per annum. A \$5 billion annual program for the establishment of social and economic infrastructures could have a visible impact. For improved seeds, fertilizers and crop protection, the annual working capital requirements would be around \$10 billion.

34. \$33 billion, while a large sum, is 1/3 less than the total cost of importing food by the developing regions in 1985, if performance of their agricultural sectors does not improve dramatically. Investment allocations for agricultural and rural development in national plans will have to increase substantially, from an average of some 10 percent of total resources to some 20 percent. Needless to say, these percentages vary widely for individual countries. But, for a global point of reference, overall annual investment in agriculture in developing countries, which was in the range of \$10-12 billion in the early 1970's, will have to increase substantially before the end of the decade. But not only must investments increase, they must be directed specifically to the smallholder and the poor. The aim is not only

increased output, but increased output equitably distributed.

### Urban Migration

35. If such an increase in agricultural yields is not achieved, there is likely to be a growing food deficit and, what is even more important, there may be a greater drift of population from rural areas to urban cities, creating major problems for urban infrastructure and leading to political and social unrest. It is presently estimated that of the 800 million increase in population during 1970-85, about 500 million will either be in, or migrate to, urban areas. But the estimate of urbanization could well be larger depending on what is happening in the countryside. Unless rural areas can provide an environment which is economically viable, an explosive problem may be created for many cities in the developing world.

36. The problem is aggravated by the tendency of the urban drift to be attracted to one major city. Of the total urban population of Argentina, 56 percent live in Buenos Aires; in Egypt 38 percent live in Cairo; in Sri Lanka 60 percent live in Colombo; in the Philippines and Thailand 45 percent live in Manila and Bangkok respectively; in the Sudan 34 percent live in Khartoum and 50 percent of the urban population of Kenya live in Nairobi. On the basis of a UN sample survey, already over 30 percent of the urban population of Africa and Asia live in slums and uncontrolled settlements; the ratio is even higher in most of Latin American countries.

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37. The economic cost of improving the present situation, of accommodating natural growth and of receiving the additional urban immigrants is almost prohibitive. Comparative information on costs of urban infrastructure is scarce. Available data indicate that the incremental capital cost per urban family is \$1,000 for water supply and sewage, \$500 for electricity, a minimum of \$1,000 for housing and \$450 per student place for primary schooling. Further investments would be required in transport infrastructure and equipment, health and other urban facilities. For the additional 500 million urban population expected between 1975 and 1985, the total bill is colossal.

#### The Bank Program

38. Although Bank Group lending for agriculture has tripled since 1968, this is not enough. It is our intention to earmark about \$5 billion in the next five years to support the agricultural and rural development programs of our member countries. Such an allocation would imply a 250 percent increase over our 1971 commitments for agriculture and would far exceed the current external assistance to agriculture from all sources which averaged \$630 million a year for the period 1966 through 1970. Moreover, we propose that a large portion of these funds should be directed to programs of integrated rural development which benefit the small farmer, both directly and indirectly. To help develop new approaches and to accelerate the preparation of these programs, we have established a unit in the Bank to provide expert assistance to member countries upon request.

Unemployment

39. Increasing agricultural productivity, with emphasis on the small farmer, will help to reduce the mass unemployment and underemployment. Poverty in many cases is nothing else than low productivity employment or total unemployment. But more immediate steps are also necessary since the number of the unemployed and underemployed is growing fast in the developing world. As a result of the post-war improvement in health standards, the labor force of developing countries is now increasing at an annual rate of 2.7 percent compared to 1.8 percent fifteen years ago - or by nearly 30 million every year. Neither the overall growth rates in production nor their sectoral composition nor the policies accompanying them have been such as to increase employment as fast as labor force.

40. Detailed country work by the International Labor Organization and by the Bank in Colombia, Iran, Kenya, Sri Lanka, and Trinidad and Tobago brings out some of the stark dimensions of the unemployment problem:

- In Kenya, open urban unemployment averages 12 percent and, if those who earn less than a subsistence income are included, urban unemployment and underemployment is more than 20 percent of the labor force.

- In Sri Lanka, about 15 percent of the national labor force is unemployed; as in other countries, unemployment is concentrated among the young, especially among the educated young. For example, of the Ceylonese youths aged 15 to 19 who have

successfully completed their mid-secondary diploma, 90 percent are seeking work; even among those with the same qualifications but aged 20 to 24, 60 percent are seeking work.

- In Colombia, it has been estimated that in the period 1970-85, with the application of a concerted agricultural development program, rural employment could increase by 1.8 percent annually; if total unemployment were to be cut down by half (still leaving 7 percent of the labor force unemployed in 1985), employment outside agriculture would have to increase annually by 7 percent or more than double the 3.2 percent rate achieved from 1964 to 1970.

41. Measures to increase employment must have top priority in any direct attack on poverty. For the small-scale farmer, hope lies in the intensive effort to increase his productivity discussed earlier. But even the most successful implementation of this effort will leave large numbers of households in the rural areas without land and many migrants in the urban areas without employment.

Thus, the effort to increase small-scale agricultural production must be supplemented by programs directly aimed at these people.

42. As in agriculture, the limited amount of capital stock available is not sufficient to extend gainful employment to the entire labor force at a high level of labor productivity. In addition, most of this capital is generally invested in a small modern sector, leaving a large part of the economy with only a meagre amount of capital.

43. One school of thought would advocate that the modern sector should be allowed to go ahead full blast, saving and investing and

accumulating capital, so that it can manage a high rate of growth and gradually absorb the traditional sector. The risk in such a strategy, however, is that it could lead to pronounced dualism and a widening of the disparities between the modern and traditional sectors for a long time to come. Moreover, the evidence to date suggests that growth of the modern sector will not have any major spillover into the development of the traditional sector even at a subsequent date. The alternative, of course, is to pull down the walls between modern and traditional sectors and to spread the limited amount of capital thinly all over the economy and to settle deliberately for low average productivity of labor so long as the total national product can be increased by mobilization of the entire labor force.

44. Such a complete reorientation of policy is difficult to conceive and probably even more difficult to manage. While we do not know enough to choose wisely between these alternatives, it is clear that a number of steps are feasible to increase the use of labor and thus provide more employment and income to the poor. These include:

- Revision of the educational system to produce people who will innovate with indigenous materials, adapt modern ideas to local conditions and address the immediate, practical needs of the country. For instance, India produces more than 20,000 engineers annually, many of whom are underemployed, but few have the motivation or the skill to tackle so basic a problem as food processing or preservation - even for private profit. Yet a very large percentage of foodstuffs are lost annually to pests and spoilage.

- Providing appropriate price signals to entrepreneurs.

Undoubtedly this is not a panacea but if capital is subsidized - as it is in many countries in many different ways - and labor is not, the choice is inevitable. Restoring the balance is essential. Beyond that the increased use of labor can be made attractive in many ways. For instance, better trained labor will reduce the preference for capital - a factor governments can affect.

- Greater reliance on indigenous technologies. This will require more extensive use of local skills and local consultants but, above all, it will require more investment in local science and technology institutions, and building a link between them and the producers. Indigenous technologies are more labor-intensive, but they will not flourish without support.

- Organization of rural and urban public works to construct low cost simple housing, small feeder roads to the market, small-scale irrigation and drainage facilities, and other similar programs of development requiring an extensive use of labor and relatively simple skills. There is no mystery about designing such programs. They have worked successfully at various times in various countries, though on a relatively limited scale. The real challenge is to extend these programs on a national scale. (Experience of selected countries with public work programs will be analyzed here.)

#### Public Services

45. As discussed earlier, the existing distribution of public services often favors the rich, the powerful and the privileged.

None on urban/rural split. p. 4

None on who gets public services p. 4

Check ratios p. 7

Industrial concentration in LDC's.

Rural share p. 8.

Effect of Green Revolution on employment p. 8.

Landless p. 9.

% of small farmers covered by credit p. 11, <sup>also p. 14</sup> 1

Data on security of tenure p. 11.

Infrastructure for poor p. 16-17

None on unemployment pp. 20-21

Experience on rural works p. 23

Cars & buses p. 24

How much is spent on education for poor p. 25 ?

- The poor generally live furthest from their jobs even though they have the worst transportation system (examples).
- Funds are readily available for highway construction to accommodate the burgeoning number of private cars but relatively little is spent on municipal mass transport. In a recent sample of \_\_\_\_ developing countries, the registration of private automobiles increased by \_\_\_\_ percent during 1960-70 while the corresponding increase in public buses was \_\_\_\_ percent.
- Other public utilities such as water, sewerage, and electricity, are invariably more plentiful in principal cities than in outlying areas and, within these cities, in the affluent rather than in the poor neighborhoods. In 1969/70 only half the houses in Accra and 32 percent in Dacca had water connections. In Kingston, Jamaica - a city with an average per capita income close to \$600 - only 60 percent of housing has piped-in sewerage service and only 70 percent units have in-house electricity. In most developing countries, those who must rely on private vendors for their water pay 10 to 20 times more than for piped water.
- It is taken for granted that each private dwelling in the affluent sections should have an adequate supply of pure drinking water, but it is a matter of much debate and extensive delay to provide even a dozen communal outlets of pure drinking water in every block in the slum areas.

- Educational expenditures often favor the urban upper income groups whose children have the means to attend the secondary and university level institutions. Budgetary expenditures for primary education, particularly in the poor areas, are more limited and adequate provisions for the poor to continue their studies are rare. (Some estimates.)

46. When the existing distribution of public services is as badly skewed as this, there is considerable potential for changing the conditions of the poor through a drastic redirection of public expenditures. In this case at least, the governments certainly have the means - if they have the necessary political will.

47. In particular, public services in rural areas must be increased. That is where the poor are - that is where the services are now lamentably deficient. It is a cruel anomaly to have a problem of the educated unemployed in the urban areas, while the rural poor thirst for the knowledge that is going to waste. Every country must examine whether it can afford to invest in higher education but fail to provide incentives to attract teachers to rural areas; to staff urban medical centers and to export its doctors, abroad but fail to send its doctors to the outlying areas; to build urban highways for the private automobile but not dig public wells for water in the villages. Resources are scarce in the developing countries, and their redistribution will not provide enough for everyone's needs but some redistribution is essential if the basis for a better future is to be created.

. . . . .

48. If poverty of the lowest income strata has to be attacked directly, we shall all have to think in terms of new and original institutional approaches to reach the poor. Programs and priorities for the very poor can only be devised in terms of their own basic human needs and aspirations. These must emerge from local leadership. Many of these programs will have to focus on community services, simple rural infrastructure, low cost housing, nutrition, education, health, and help for the small farmer and the small artisan. These programs require local raw materials and local initiative, they require indigenous technology and, above all, they require a commitment of the local community to undertake programs of self-help.

49. It may often not be possible to extend benefits of growth to the poor, particularly in the rural areas, without first creating appropriate institutions which can reach out to the poor and manage the programs designed for them. These institutions can take different forms depending on the political, social and cultural patterns in each country. They may be government-run or privately managed, they may be autonomous corporations with a good deal of private initiative, they may be managed by local leadership from all walks of life, but they have to be fashioned in the context of the needs of each country and must be socially responsive. We need intermediary institutions through which the national governments and donors abroad, including the World Bank Group, can channel much-needed resources to the poor without substituting their decisions and values for those of the local people.

50. What is important, of course, is not so much the setting up of any formal institutions but the commitment of the scarce managerial and intellectual resources of society to the task of mass poverty. Today, these resources are often pre-empted by urban bureaucracies and glamorous projects in industry and public utilities. If adequate institutional responses are to be fashioned for the urgent and complex task of alleviating mass poverty, then the developing countries will have to begin by a major redirection of their national effort.

DRAFT  
AMeguid:hk  
4/9/73

TO: Mr. Robert S. McNamara  
FROM: Hollis B. Chenery  
SUBJECT: Food Production and Agricultural Targets

1. This is in response to your memorandum of March 26, which expressed concern regarding those countries in which achieving adequate levels of food production will be a major problem in years to come. Your concern is justified both on a global level as well as in specific food-deficit countries.

Global Perspective

2. The major determinant of the intensity of the required effort in agricultural development in general and food production, in particular, is the continued rapid population growth. Even assuming a 2.5% annual growth rate, the population of the developing countries will increase by about 500 million during the 1970's. Additional demand for food would be also generated as a result of rising incomes. The provisional FAO indicative World Plan shows that population growth alone would require a 40% increase in food supplies between 1972 and 1985 without any improvement in the quality or quantity of individual diets. A further 20 percent increase in demand for food would result from income growth at the target rate of the Second Development Decade:

Projected Increase in the Demand For Food  
1972-1985

	Total Increase	(Percent)	
		Increase Due to Growth of Population	Income per Head
Far East	61	39	22
Near East & North West Africa	59	44	15
Africa (South of Sahara)	52	40	12
Latin America	54	47	7
All Developing Regions	58	41	17

Source: Extrapolated from FAO, Provisional Indicative World Plan for Agricultural Development, Rome 1969, Volume 1, P.15.

3. If past trends in agricultural production continue, the gap between demand and supply of food and livestock products, which if it had to be filled by imports from other parts of the world would by 1985 cost the developing countries some \$43 billion (at 1962 prices) compared to around \$3 billion in 1962. The major implication of these magnitudes is that because developing countries would be unable to support imports at that level, food imports would tend to rise at the expense of other intermediate and capital goods imports and would therefore adversely affect deficit countries' development prospects.

4. In order to avoid such a situation, production targets based on land availability and "realistic" yield increases, have been proposed by the FAO. These targets are summarized in the attached Table (1). The last column in that table indicates that the major thrust in Asia, Near East and North Africa will have to be in the form of higher productivity per acre rather than through expansion of land areas. In Latin America and Africa South of Sahara emphasis is on the expansion of cultivable land.

Deficit Countries

5. Asia is expected to remain the major food deficit area. Using cereal production as an indicator, a detailed assessment of the Indicative World Plan is given in Table (2). The IWP target growth rates of production

(computed in the mid 1960's) seem to be infeasible judging by actual achievements in<sup>a</sup>/number of countries. Target rates are too high for Ceylon (13%), for Malaysia (16%) and for most of the Near East countries (5% - 21%). In a number of countries where the target growth rate is not excessively higher than the actual, achievements could nevertheless be seriously hindered by physical and institutional constraints. Of more serious nature is the FAO assumption that 75 million hectares would be utilized for high yielding varieties of cereal in the Far East (around 4 times the current area) and 7.5 billion hectares in the Near East (about 10 times the present area). Moreover, the probability of weather-induced deficits have not been incorporated.

6. These estimates as well as additional relevant variables should, therefore, be brought up-to-date in the course of our economic reporting on the individual countries - particularly those who are major food-deficit countries. While economic and agricultural sector and project missions normally discuss the agricultural situation and Government plans in this sector as a regular activity, we will initiate discussion with the Regional Chief Economists on the possibility of devoting a section on the state of food surplus/deficit in individual countries with a view of presenting a global food budget on an annual basis. Progressively, such a budget would not only analyse macro data but would be supported by qualitative and quantitative assessments of the physical and institutional variables which determine the rate of progress of food production in individual countries.

TABLE 1 - AVERAGE PRODUCTION OF MAJOR FOOD CROPS IN 1961-63  
AND IWP OBJECTIVES FOR 1985

	Area		Percent of Total Area		Production		Annual	Percent of
	1961-63	1985	1961-63	1985	1961-63	1985	Growth of Production 1961-63 to 1985	Production Increase From Area to 1985
	Thousand Hectares		Percent		Thousand Metric Tons		Percent	
<b>FAR EAST</b>								
Cereals	124,540	143,298	69	65	132,935	304,069	3.7	17
Starchy Roots	1,763	3,104	1	2	15,464	37,442	3.9	64
Pulses (dry)	26,018	33,633	15	15	13,265	27,963	3.3	33
Groundnuts	6,962	12,753	4	6	5,125	19,611	6.0	45
Other Oil Crops	8,975	12,887	5	6	2,942	7,420	4.1	39
Vegetables	6,509	9,506	4	4	33,530	82,919	4.0	42
Fruits	2,937	5,274	2	2	17,093	46,676	4.5	58
Livestock & Products							3.3	
<b>AFRICA SOUTH OF SAHARA <sup>1/</sup></b>								
Cereals	35,111	53,980	63	61	25,122	50,902	3.1	60
Starchy Roots	7,784	12,020	14	14	44,782	80,300	2.6	73
Pulses (dry)	7,337	12,372	13	14	2,701	5,749	3.3	70
Groundnuts	4,414	6,984	8	8	3,454	7,122	3.2	62
Other Oil Crops	-	-	-	-	1,806	3,242	2.6	..
Vegetables	1,228	2,679	2	3	3,152	7,040	3.6	94
Fruits	-	-	-	-	10,455	17,314	2.2	..
Livestock & Products							3.9	
<b>LATIN AMERICA</b>								
Cereals	36,861	53,748	72	70	50,987	99,508	2.9	59
Starchy Roots	3,215	4,304	6	6	32,626	54,400	2.2	59
Pulses (dry)	5,775	8,018	11	11	3,382	6,860	3.1	45
Groundnuts	801	1,408	2	2	1,072	1,988	2.7	92
Other Oil Crops	1,019	2,552	2	3	2,655	7,534	4.6	89
Vegetables	858	1,518	2	2	7,413	16,867	3.6	69
Fruits	2,616	4,669	5	6	29,172	62,645	3.4	76
Livestock & Products							3.6	
<b>NEAR EAST AND NORTH AFRICA <sup>2/</sup></b>								
Cereals	27,450	31,613	82	76	24,714	49,000	3.0	20
Starchy Roots	152	232	-	-	1,486	2,939	3.0	63
Pulses (dry)	1,472	2,422	4	7	1,234	2,908	3.6	61
Groundnuts	1	8	-	-	-	12	-	..
Other Oil Crops	2,220	3,404	6	8	1,355	3,106	3.7	51
Vegetables	1,037	1,437	3	3	9,664	23,166	3.9	36
Fruits	1,761	2,402	5	6	7,807	17,973	3.7	38
Livestock & Products							3.1	

<sup>1/</sup> Total area refers to identified area.

<sup>2/</sup> Data for north Africa are relative to 1965.

Source: FAO, IWP.

TABLE (2) - FOOD BUYING FOR CEREALS - 1975  
FOR FAR EAST & NEAR EAST COUNTRIES

	Production 1968 <sup>1/</sup>	Domestic Utilization IWP Postulate 1975	Production Growth Rate		Deficit/Surplus in 1975 Assuming	
			Actual 1961-63 to 1967-69 (%)	Required 1968-75 to meet IWP Target (%)	1962/68 Growth Rate	IWP Target Growth Rates
	(Thousand Tons)					(Thousand Tons)
<u>FAR EAST</u>						
Ceylon	1,355	3,120	4.7	13.0	-1,250	-965
China (Taiwan)	3,297	4,290	3.6	3.7	-70	-560
India	102,246	132,110	2.9	3.6	-7,210	+1,419
Korea	7,331	11,180	2.2	6.3	-2,820	-1,634
Malaysia (West)	986	2,660	2.7	15.5	-1,470	-1,043
Pakistan (incl. Bangladesh)	27,067	36,180	3.9	4.3	-800	+2,426
Philippines	5,872	9,872	2.1	7.3	-2,930	-598
Thailand	11,888	10,700	4.5	4.5	+5,480	+4,717
Sub Total	<u>159,948</u>	<u>209,960</u>	<u>3.1</u>	<u>4.1</u>	<u>-11,070</u>	<u>+3,756</u>
<u>NEAR EAST</u>						
Afghanistan	3,775	5,132	0.9	5.3	-1,152	+234
Iran	6,600	8,561	3.5	3.7	+1,762	+511
Iraq	2,501	3,176	4.9	3.5	+318	+230
Jordan	177	564	2.2	18.0	-358	-378
Lebanon	75	561	-4.5	20.0	-486	-447
S. Yemen	48	197	4.4	20.0	-132	-135
Saudi Arabia	248	909	1.3	20.5	-639	-498
Sudan	1,755	2,880	0.6	7.3	-1,052	+124
Syria	1,512	2,049	-2.9	4.4	-537	+218
UAR (Egypt)	7,152	9,169	3.1	3.6	-315	+291
Yemen	742	1,384	-5.1	9.3	-642	-31
Sub Total	<u>24,645</u>	<u>34,582</u>	<u>2.7</u>	<u>5.0</u>	<u>-3,233</u>	<u>+119</u>
<u>Grand Total</u>	<u>184,593</u>	<u>244,542</u>	<u>3.1</u>	<u>4.1</u>	<u>-14,303</u>	<u>+3,875</u>

<sup>1/</sup> Average for the period 1967-69

Source: FAO, IWP.

please return to Dr. Hegrod

JUST HOW MISLEADING ARE  
OFFICIAL EXCHANGE RATE CONVERSIONS?

Comment on a paper by P.A. David  
(Economic Journal, September 1972, pp.979-90)

Bela Balassa\*

\*Professor of Political Economy, The Johns Hopkins University. This note was written in the framework of a consulting arrangement with the World Bank. The author is indebted to Charles Blitzer for helpful comments on an earlier draft and to Jonathan Levy for able research assistance.

December 12, 1972

Bela Balassa

I

It is curious how things get rediscovered in economics. A recent paper by P.A. David (1972) is a case in point. David takes to task the "perpetrators" of international cross-section models for their use of official exchange rates to convert national income data expressed in domestic currency into a common unit (in practice, the U.S. dollar); he notes the superiority of purchasing power parities as a conversion ratio; and <sup>he</sup> also shows the existence of systematic relationship between purchasing power parities and exchange rates. *He is wrong if he says that*

The inappropriateness of using exchange rates as a conversion ratio was first pointed out in my comment (1961) on H.B. Chenery's classic article (1960) [which] David also cites. I ~~farther~~ noted the existence of a systematic relationship between purchasing power parities and exchange rates and analysed the implications of this relationship for Chenery's results (For the sake of completeness, I may add that my conclusions were accepted by Chenery).

In a subsequent contribution, I provided a theoretical justification for the observed relationship between purchasing power parities and exchange rates using a simple trade model (1964). Briefly, with intercountry productivity differences being smaller in the service sector than in the sectors producing traded goods and the prices of traded goods <sup>being</sup> equalized internationally, the relative prices of nontraded goods (services) will be <sup>led to</sup> positively correlated with productivity levels in the individual countries. <sup>1/1</sup> Now, since service prices enter into purchasing power parities without directly affecting exchange rates, it is expected that the ratio of purchasing power parities to exchange rates (expressed as units

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1/ This conclusion applies also in the case when factor proportions are the same across industries; it is reinforced, however, if services are re-

*David, op. cit., p. 26.*

of national currency per the U.S. dollar) will rise with levels of productivity. Correspondingly, in using official exchange rates to convert national income data into U.S. dollars one underestimates real incomes in countries other than the United States, and the degree of understatement will be positively correlated with differences in levels of productivity.

Taking per capita incomes to represent productivity levels, I tested for the existence of this relationship among twelve developed countries for <sup>(1964)</sup> the year 1960, utilizing the same data sources as David <sup>1/</sup> (1964). In the following, I will compare my results to those obtained by David and show the existence of a systematic bias in his estimates. I will further indicate the pitfalls of applying the estimated relationship to countries that fall outside the range of observations and make recommendations for future research.

## II

My regression equation, re-estimated for comparability using gross national product rather than personal income and employing David's notation, is shown in (1). <sup>2/</sup> The equation provides direct estimates of the ratio of purchasing power

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<sup>1/</sup> However, my calculations do not include the Soviet Union. There is no justification for including Soviet data, in part because domestic and foreign trade prices differ in the Soviet Union and in part because the ruble exchange rate has been set artificially and plays no regulating role either in the domestic economy or in foreign trade that takes place in the framework of bilateral agreements -- A further difference is that my data include Sweden and refer to 1960 while David's pertain to 1950, 1955, and 1965.

<sup>2/</sup> Taking the U.S. dollar as the numeraire,  $\hat{r}_j$  denotes the official exchange rate,  $r_j$  the purchasing power parity,  $Y_j$  GNP per head in U.S. dollars calculated by converting data expressed in national currencies at the official exchange rate,  $Y_j$  GNP per head in terms of purchasing power parities, and  $Y_0$  GNP per head in the United States (1960). The estimates of the coefficients are

$$(1) \ r_i/\hat{r}_i = a+b\hat{Y}_i = 0.5731 + 0.000161\hat{Y}_i = 0.5731 + 0.4556(\hat{Y}_i/Y_0), \quad \bar{R}^2 = .918 \quad df=10$$

(0.0220) (0.000015) (0.0425)

parities to exchange rates ( $r_i/\hat{r}_i$ ) as a function of per capita income differentials, which is "the underlying structural relation we have been seeking" (David, 1972, p.986n), rather than deriving this in an indirect fashion as David has done. Thus, the evidence is at variance with David's statement (1972, p.983) that "casual inspection of these statistics is none too promising in disclosing a systematic association between ( $Y_i/Y_{US}$ ) and the "agio" measure ( $Y_i/\hat{Y}_i = \hat{r}_i/r_i$ )". <sup>1/</sup>

As will be shown below, the choice of the functional form hardly affects the estimated values, provided that the relevant terms are defined in the same way. This is not the case, however, since David employs purchasing power parities calculated with the consumption weights of the country concerned to convert national incomes expressed in domestic currency into U.S. dollars, <sup>2/</sup> whereas I employed for this purpose the geometrical average of purchasing power parities calculated by using U.S. and foreign weights in the binary comparisons. It is easy to see that David's use of foreign quantity weights introduces an upward bias in the estimates of foreign incomes.

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1/ While I have used  $\hat{Y}_i/Y_{US}$  rather than  $Y_i/Y_{US}$  as the independent variable, replacing the former by the latter does not appreciably affect the results. The alternative formulation provides a ~~slightly~~ lower coefficient of determination which is explained by the measurement error due to the use of purchasing power parities as conversion ratio in calculating the independent variable of the regression.

$$(1a) \ r_i/\hat{r}_i = 0.4918 + 0.5139 (Y_i/Y_0), \quad \bar{R}^2 = .864 \quad df = 10$$

(0.0380) (0.0611)

2/ David states that his real income comparisons have been made by valuing goods consumed in countries other than the United States (for short, foreign countries) in U.S. prices. Taking the United States as the basis in the comparisons, this amounts to using a Laspeyres-type quantity index that equals a value index of incomes expressed in the domestic prices of the two countries divided by a Paasche-type price index, i.e. one that uses foreign quantities as weights.

Assuming that indifference maps in the two countries are identical and linear homogeneous, Hicks' substitution theorem will lead to the conclusion that a country's consumption pattern will be "slanted" towards goods whose prices are relatively lower in that country. Correspondingly, the "true" purchasing power parity ratio will be overestimated by using U.S. quantity weights (Laspeyres-index) and underestimated by using foreign quantity weights (Paasche-index). While theoretically differences in tastes favoring higher-priced goods in each country could offset this substitution effect, there is no reason to assume that such would be the case, nor is it observed in the countries concerned. In fact, in 1960 the ratio of the two price indices has a mean of 1.33 and a median of 1.34.

The use of foreign quantity weights in calculating purchasing power parities will thus impart an upward bias to estimates of real incomes ( $Y_i$ ) in all countries other than the United States. A further source of upward bias is the observed inverse relationship between the ratio of purchasing power parities calculated by the use of the Laspeyres and the Paasche formulas and per capita incomes.<sup>1/</sup>

These considerations are borne out by the empirical results obtained in fitting David's estimating equation to my data.<sup>2/</sup> While the  $\beta$ -coefficient (the

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<sup>1/</sup> Excluding data for Japan, the estimated coefficient between the two variables (-0.23) is statistically significant at the 1 percent level. The level of significance is 5 percent if Japan is included; the ratio of the two indices is underestimated in the case of Japan because of the lack of observations in much of the service sector.

<sup>2/</sup> In equations (2) and (3), superscripts "P" and "F" refer to the use of Paasche and Fisher price indices as conversion ratio. The equations have been estimated in a constrained form by regressing  $(Y_0/Y_i - 1)$  on  $(Y_0/Y_i - 1)$  and a constant ( $\alpha$ ) to equal one minus the coefficient of the independent variable ( $\beta$ ).

regression coefficient for the independent variable) in the equation estimated utilizing as conversion ratios purchasing power parities calculated with foreign quantity weights (Paasche index) conforms to the "four-ninths rule" David has enunciated, <sup>1/</sup> this is replaced by the "five-ninths rule" if we employ instead purchasing power parities calculated as the geometric mean of estimates obtained by using U.S. and foreign weights (Fisher index). <sup>2/</sup> Reformulating David's statement, this will mean that "we are led to a simple rule of thumb: the "real" percentage gap between the per capita income of a given country and the United States is only (0.549) five-ninths of the percentage gap indicated by a

$$(2) \quad Y_0/Y_1^P = 0.552 + 0.448 (Y_0/Y_1)^{\wedge}, \quad \bar{R}^2 = 0.967, \quad df = 11$$

(0.025)

$$(3) \quad Y_0/Y_1^F = 0.453 + 0.547 (Y_0/Y_1)^{\wedge}, \quad \bar{R}^2 = 0.989, \quad df = 11$$

(0.017)

*Paasche*

<sup>1/</sup> Nor is there evidence of an "upward drift" of the  $\beta$ -coefficient as alleged by David (1972, p.985). The differences between the results obtained for 1950, 1955, and 1960 are not statistically significant at the 5 percent level and the higher  $\beta$ -coefficient obtained by David for 1965 is due to the inclusion of data for the Soviet Union and Canada. As noted above, there is no justification for including Soviet data. In turn, the ratio of the exchange rate to purchasing power parity David used for Canada is apparently in error; in 1965 the exchange rate was 1.07 Canadian per U.S. dollar and the purchasing power parity calculated at Canadian weights 0.97 (Daly and Walters, 1967, p.289), the ratio of the two being 1.10 against a ratio of 0.93 used by David (1972, p.989). Excluding the Soviet and the Canadian data, which do not figure in David's calculations for 1950 and 1955, the  $\beta$ -coefficient will be 0.41 which is not significantly different at the 5 percent level from the results obtained for the other three years.

<sup>2/</sup> Although its statistical properties are not known, the Fisher index is preferable to both the Laspeyres and the Paasche indices that are subject to upward and downward biases, respectively.

*Q. ref  
Hendy  
W. J. ...*

straight exchange rate conversion expressing all incomes in dollars" (David, 1972, p.985 -- Italics in the original). <sup>1/</sup>

The differences in the two sets of estimates of real incomes can be rather large; in 1960, real per capita incomes in Italy will be 35 percent of U.S. incomes if calculations are made using the Fisher index as against 47 percent using the Paasche index (at official exchange rates, the ratio is 25 percent). The differences will increase further if the "rule of thumb" is applied to make estimates for countries whose per capita incomes fall outside the limits of the sample.

### III

The last point leads to the question of the applicability of the observed relationship to countries with lower incomes. While at one point David seems to preclude this, <sup>2/</sup> his first major conclusion on the adjustment needed to compare real incomes in developing countries and in the United States (1972, p.987) is based on an extrapolation of the relationship obtained for developed countries to the developing nations. This involves extrapolation outside the range of observations: while incomes in the first group of countries are in the range of one-fourth to three-fourths of U.S. per capita incomes, in the second group per capita incomes average five percent of U.S. incomes and, in some important countries, such as India, Pakistan, and Indonesia, the ratio is

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<sup>1/</sup> It should be added that if we use the same price index in the calculations, the choice of the functional form will not appreciably affect the results. Thus, differences in the estimated values of both  $r_i/\hat{r}_i$  and  $Y_o/Y_i$  derived from the equations (1) and (3) in no case exceed two percent.

<sup>2/</sup> "The limitations of the available data preclude fruitful discussion of the question of the applicability of the Rule of Four Ninths to economies less developed than those represented in the present sample" (1972, p.985).

only 2 percent. <sup>1/</sup>

It is well-known that extrapolation outside the range of observations increases the standard error of the forecasts to a considerable extent. Using David's equation, the standard error of the forecast of the ratio of U.S. incomes to incomes per head in the country in question will be <sup>1.2</sup> 1.2 for the average developing country and <sup>7.9</sup> 7.9 for India as compared to estimated values of 9.4 and 22.6.

There is further the question if the underlying relationship is indeed linear. While a cluster of data can often be described by a variety of functional forms equally well, extrapolated figures may differ widely depending on the functional form used. This is so in the present case as the statistical fits obtained by using linear, log-linear, and semi-logarithmic forms are rather similar, <sup>2/</sup> yet extrapolated values of the ratio of U.S. incomes to incomes per head in the country in question will be, respectively, 9.4, 5.9, and

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<sup>2/</sup> The regression results obtained by David using a linear equation and those calculated using log-linear and semi-logarithmic forms are

$$(4) Y_0/Y_1 = 0.559 + 0.441(Y_0/\hat{Y}_1), \bar{R}^2 = 0.910, df = 29 \\ (0.013)$$

$$(4a) \log Y_0/Y_1 = 0.009 + 0.583 (\log Y_0/\hat{Y}_1), \bar{R}^2 = 0.906, df = 28 \\ (0.035)$$

$$(4b) Y_0/Y_1 = 0.839 + 1.029 (\log Y_0/\hat{Y}_1), \bar{R}^2 = 0.828, df = 28 \\ (0.087)$$

The sensitivity of the results to the choice of the functional form is further indicated by the fact that while the inverse log-function also gave a good statistical fit ( $\bar{R}^2 = 0.874$ ), the projected values of 70 for an average developing country and 44.400 for India are obviously nonsensical. *The inverse log equation is:  $\log Y_0/Y_1 = .215 Y_0/\hat{Y}_1 - .047$*   
 *$\bar{R}^2 = .874$   $df = 28$*

<sup>2/</sup> Data refer to 1968, the year David uses in his comparisons (1972, p. 957); they have been converted at official exchange rates (United Nations, 1971).

3.9 for the average developing country and 22.6, 10.0, and 4.9 for India. <sup>1/</sup>

IV

Last but not least, the question needs to be raised if it is at all meaningful to apply a relationship observed in developed countries to the developing countries. For various reasons, I would answer this question in the negative. First of all, while production, consumption, and trade patterns show considerable similarities among the developed countries, there are substantial differences between developed and developing countries in particular in the scope and the relative importance of nontraded goods. Differences in natural resource endowments, too, are relatively small among the developed countries but widen to a considerable extent if we include developing countries in the group. Now, as nontraded goods use relatively small amounts of natural resources, their relative prices will tend to rise with per capita endowments in these resources, thereby weakening the relationship between incomes per head converted at official exchange rates and at purchasing power parities (Clague-Tanzi, 1972).

And while, tariffs being relatively low, it can be assumed that the domestic prices of traded goods tend to be equalized among the developed countries,

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<sup>1/</sup> Replacing a linear by a log-linear or semi-logarithmic equation will also affect David's second major conclusion that "exchange rate conversions ... will magnify the appearance of any degree of convergence of the developing countries' per capita incomes towards the levels enjoyed in the countries that occupy the upper ranks of the international income distribution. This magnification may obscure the existence of relatively faster per capita income growth at the lowest end of the international ranking (1972, p.987 -- italics in the original). While these conclusions hold if a linear equational form is used, neither of them will apply in a log-linear relationship that involves proportional adjustments; furthermore, the degree of overstatement of the growth rate will be greater at the lower than at the higher income level if a semi-logarithmic form is employed. -- For completeness, let me add that the choice of functional forms does not affect David's third major conclusion as regards the underestimation of elasticities estimated from cross-section data converted at official exchange rate. This conclusion has been anticipated in Balassa, 1961, where the necessary effect is indicated graphically.

this will not be the case in developing countries where tariff averages often reach 100 percent. High tariffs, in turn, lower the exchange rate necessary to maintain balance-of-payments equilibrium, and thus raise the ratio of purchasing power parities to exchange rates.<sup>1/</sup>

Apart from tariffs, developing countries increasingly use export subsidies. The combination of the two is a substitute for devaluation in the sense that a particular level of domestic prices and balance-of-payments equilibrium can be attained with various combinations of tariffs, subsidies, and exchange rates. For example, if balance-of-payments equilibrium is reached under free trade at an exchange rate of 100, the same result can be obtained with a 100 percent tariff-subsidy scheme and an exchange rate of 50. Now, with domestic prices being the same in the two situations, the ratio of the purchasing power parity to the exchange rate will be twice as high in the second case than in the first. The results are modified if we also consider capital movements and nontraded goods without however affecting the thrust of the argument.

Finally, the calculations are based on the assumption of equilibrium in the balance of trade that was by-and-large the case in the developed countries during the period under consideration. However, in developing countries where about one-fourth of imports are financed by the inflow of foreign capital, the actual exchange rate will be lower than the rate which would ensure equilibrium in the balance of trade in the absence of a capital inflow. Correspondingly, the ratio of purchasing power parities to the equilibrium exchange rate will be overestimated, and the degree of overestimation will vary with the percentage difference between the actual and the equilibrium exchange rate. The magnitude

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<sup>1/</sup> Also, dispersion around the average introduces considerable error in the calculations. Nor are these conclusions affected if quotas are used in the place of tariffs; we now need to calculate the tariff equivalent of quotas.

of the possible error is indicated by the fact that the share of imports financed by the inflow of capital varies greatly among developing countries.<sup>1/</sup>

These conclusions are borne out by the results of Clague and Tanzi (1972) for nineteen Latin American countries which show a very weak relationship or no relationship at all between the ratio of purchasing power parities to exchange rates and per capita incomes, depending on whether incomes expressed in national currency have been converted at official exchange rates ( $\hat{Y}_i$ ) or at purchasing power parities ( $Y_i$ ).<sup>2/</sup> The statistical fit improves to a considerable extent if we replace per capita incomes by a variable representing the ratio of nonhuman to human capital in the regressions.<sup>3/</sup>

The work of Clague and Tanzi represents an important step in explaining differences between purchasing power parities and exchange rates in developing countries. They can be faulted, however, for interpreting the ratio of non-human to human capital as a proxy for natural resources per head since this ratio is also affected by intercountry differences in production functions and in physical capital per head. Also, for various reasons, the ratio of import duties to imports will not appropriately indicate the protective effects of tariffs. Firstly, import-weighted averages give high weights to low duties, low weights to high duties, and zero weight to prohibitive duties. Second, even using properly weighted

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1/ Data for the largest developing countries are: Brazil, 23 percent; India, 31 percent; Indonesia, 24 percent; and Pakistan, 43 percent (IBRD, 1971). They refer to the ratio of the net inflow of capital and changes in reserves to the value of imports of goods and services.

2/ The coefficient of determination is .24 in the first case and -.05 in the second; it rises to .38 and .02, respectively, if average import tariffs and export taxes are introduced as explanatory variables (Clague-Tanzi, 1972).

3/ The coefficient of determination is .70 in this case -- In the regressions, Clague and Tanzi used differences between actual incomes and income predicted as a function of human capital in the place of the ratio of nonhuman to human capital (1972, p.8).

tariff averages, one neglects the effects of quantitative restrictions that have been of importance in some of the Latin American countries. Thirdly, while consumers react to the nominal tariffs used in the calculations, for producers effective tariff protection is relevant.<sup>1/</sup>

Further progress in the explanation of the ratio of purchasing power parities to exchange rates would require introducing the natural resource variable directly in the regressions.<sup>2/</sup> It would also be desirable to provide improved measures of protection, to introduce variables reflecting the relative importance of indirect to direct taxes and of tourism,<sup>3/</sup> and to examine the extent to which the estimated relationships vary among country groups.<sup>4/</sup> Research along these lines would hopefully permit obtaining more reliable indicators of relative income levels that can in turn be used in international cross-section models.

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<sup>1/</sup> All three points are discussed in Balassa, 1965.

<sup>2/</sup> In a recent contribution by Keesing and Sherk (1971) population density has been successfully used as a proxy for natural resources per head.

<sup>3/</sup> A high ratio of indirect to direct taxes as well as a high proportion of tourism in export earnings will tend to raise the ratio of purchasing power parities to exchange rates (Balassa, 1964, p.596).

<sup>4/</sup> Thus, one should be wary of applying the relationship obtained for one developing area to another as Clague and Tanzi suggest in the case of Latin America (1972, p.13).

Purchasing Power Parities and Exchange Rates, 1960  
(National Currency per US Dollar)

Currency Unit	Official Exchange Rate (F)	Purchasing Power Parity				GNP Per Capita, US Dollar	
		At US Quantity Weights	At National Quantity Weights	Geometric Mean of Cols. 3 & 4 (r)	As a Percentage of the Exchange Rate (100r/F)	At Official Exchange Rate (Y)	At Purchasing Power Parity (Y)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
United States	Dollar	1.0	1.0	1.0	1.0	100	2830
Canada	Dollar	0.996	0.935 <sup>a</sup>	0.907 <sup>a</sup>	0.921	92.8	2163
Belgium	Franc	50.0	44.7	36.5	40.2	80.4	1248
France	Franc	4.90	4.47	3.23	3.80	77.4	1337
Germany	Mark	4.17	3.86	2.73	3.25	77.9	1301
Italy	Lira	620.6	574.0	330.0	435.0	70.1	703
Netherlands	Florin	3.77	2.96	2.13	2.51	66.6	980
United Kingdom	Pound	0.357	0.338	0.225	0.294	82.4	1378
Denmark	Krona	6.91	6.06	4.70	5.34	77.4	1300
Norway	Krona	7.14	6.81	4.84 <sup>b</sup>	5.74	80.4	1264
Sweden	Krona	5.18	5.29 <sup>b</sup>	4.11 <sup>b</sup>	4.66	90.0	1749
Japan	Yen	359.6	255.2 <sup>c</sup>	198.4 <sup>c</sup>	225.0	62.6	461

Source: Columns 1 - 6 Balassa, 1964, Table 1  
 Column 7 United Nations, 1970  
 Column 8 100(column 7):(column 6)

Notes: a) Derived from data in Daly and Walters, 1967.  
 b) Computed from column 5 on the assumption that the ratio of the Laspeyres (column 3) and Paasche (column 4) indices is the same as for Denmark.  
 c) Computed from data in "Analysis of Price Comparisons in Japan and the U.S.", Economic Bulletin, 1963.

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Notes on Annual Meeting Speech

I find the first part (pages 1-6) lacking in clarity. In particular it fails to make the distinction between absolute and relative poverty; which it ought to do right at the beginning. I suggest the following broad outline in the hope that it may be stated in fairly simple prose with the supporting statistical array somewhat downplayed:

1. What are we aiming at in our development programs for the next five or fifteen years?
2. It is not to narrow the gap between the industrialised and the non-industrialised, i.e. poor countries. This is not possible in the measurable future.
3. It is to use a mere 2% of the increment of the wealth of the industrialised nations to help the poorer nations to become richer, and so capable of having a more decent way of life. This is traditional Bank policy. What is new is that:
4. A large part of the increment which results from development in the non-industrialised countries should be mobilised in a direct attack on absolute poverty in those countries. This is primarily a domestic and political decision for the L.D.C., but the Bank can help.
5. Where is this absolute poverty, (i.e. the poorest people) to be found? In the rural areas. So it is in the rural areas that we must deal with poverty by direct action, and not by a trickle down from the wealth created in the modern sector in cities.
6. This effort to deal with absolute poverty must be a priority aim of the development effort, using the best people and methods available. It must not be secondary to the modernisation-industrialisation program.
7. Why is this a high priority? (i) moral-humanitarian reasons; the objective of development is the greatest good of the greatest number, and if a development plan only helps the people in the modern sector it is failing; (ii) reasons of prudence; the great need of the poorest countries is food, their greatest unused asset is labour in the rural, i.e. food growing areas.
8. How is this to be done? There follow the sections on rural development and employment policies etc.

20 - 1000

20 - 250

Note on pages 7-9

There is a danger that this theme will appear somewhat arrogant and godlike. The argument is admittedly for political action in spite of our Articles. How do we justify requiring that fledgling L.D.C. Governments should undertake socially equitable policies in income distribution, educational equality etc. when the free industrialised world has so far to go? (School busing on the one hand, and the admitted extreme global inequality demonstrated by the Cap).

Are we just recommending courses of action for others that we don't intend to follow ourselves "Do what I say, not what I do"?

Is this the Bank's neo-colonialism condemning the L.D.C.s permanently to be hewers of wood and drawers of water?

I think frank replies to this need to be said:

1. LDCs cannot progress along 19th Century lines of industrial development, certainly not immediately, if ever. In the immediate future their great interest is to ensure a relatively good life for their majority population - the farmers, on whom the whole state depends also for food.

2. Nothing in this prevents a growing industrial base, but that in itself is not enough.

3. The Bank is ready to help in both ways, but the decisions must be taken by the LDC.s themselves, who will provide most of the effort. The Bank is not forcing a certain course on a client, but pointing out choices to its members.

Page 14

There is need to show that the Green Revolution has had successes, and that the world food shortages are not a sign of its failure but of its limitations.

Page 23

Need to show how our advocacy of labour intensive industry fits in with our earlier recommendation of export oriented industry.

Mr. John L. Maddux, IPA

April 23, 1973

Pedro-Pablo Kuczynski, Division Chief, PPD

Additional Data for Annual Speech

1. Further to my memorandum to you of April 17, 1973, I am adding the following additional information:

2. Rural-urban split

i. In rural India, less than 10 percent of India's high school graduates and a negligible 6 percent of India's university graduates are employed in agriculture (where 70 percent of India's labor force is engaged). Even more disturbing is that with rising education levels, the brain drain from rural to urban centers is intensifying. A survey of Delhi University students showed that 22 percent came from rural areas (though only 3.8 percent from farming families), yet only 1.1 percent wished to return to agricultural work.<sup>1/</sup> The occupational breakdown of employed graduates makes it clear that very few had in fact returned to the villages - a generous estimate would be less than 10 percent. <sup>2/</sup>

ii. In 1963, Colombia was selected for a comprehensive health sector analysis conducted by the Government and international foundations. The survey showed that 20 percent of the population, mainly in rural areas are beyond the reach of even the most elementary medical assistance. Between 50 and 75 percent of all rural households occupy what are essentially slum dwellings with no water supply or sanitation. One-fourth of the population suffer from gastro-intestinal diseases. Among their children six out of ten suffered from serious malnutrition. <sup>3/</sup> Yet Colombia's public health expenditures in the mid sixties amounted to some \$100 million annually - less than double the average annual expenditures on highways which service the 225,000 cars, buses and trucks in a nation of 22 million (in 1970). <sup>4/</sup>

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<sup>1/</sup> A. M. Khusro, A Survey of Living and Working Conditions of Students of University of Delhi, Asia Publishing House, London 1967, pp. 31, 72 and 77.

<sup>2/</sup> V.K.R.V. Rao, University Education and Employment, Institute of Economic Growth, Delhi, pp. 10-11.

<sup>3/</sup> D. K. Zschock, "Health Planning in Latin America," Latin American Research Review, University of Texas, Vol. V, No. 3, 1970.

<sup>4/</sup> International Road Federation, "Highway Expenditures - Road and Motor Vehicle Statistics," Geneva 1973.

iii. In a survey of 11 African countries in 1965, 60 percent of national and expatriate doctors were located in the capital cities whose population is less than 10 percent of their countries' total population. Where health services are nominally available, the quality is of dubious value. In Malawi, a rural hospital assistant "examines" on average 150 patients in a morning. At present, over a third of all Sudanese doctors work in Khartoum where about 5 percent of the population lives. This phenomenon can also be clearly seen in Asia, Latin America, and the Middle East. As capital cities become relatively saturated, the tendency for medical personnel is not to move to rural areas but to migrate. Already some 35,000 medical graduates from schools in developing countries are working in the USA and the UK; the cost of educating them had been close to \$700 million, borne by the countries of their birth. Yet while there is one doctor for every 860 people in the UK, there is only one for every 5,000 in India and one for every 30,000 in Nigeria. 1/

3. Public v. private transportation. Regular surveys of transport statistics in a number of countries show that the registration of private automobiles increased almost twice as fast as the increase in public buses. Thus, during the second half of the 1960's, the increase in the number of automobiles in Chile was 43 percent against a 24 percent increase in the of buses. In Indonesia, the rates of increase were 27 percent and 11 percent respectively. In India, 33 percent against 21 percent and in Pakistan, the number of automobiles increased by 19 percent while the number of buses actually declined. 2/

4. Access to Credit. In Kenya, credit reaches less than 15 percent of the smallholders and less than a quarter of those with large enough farms to use credit effectively. 3/ In Thailand, only about 5 percent of the credit advanced in agriculture in 1963 came from institutional sources, and despite the five-fold increase in institutional credit between 1964 and 1970, its proportion to the total value of agricultural production remains insignificant - some 2.8 percent. 4/ In India, the share of institutional credit sources accounted for 3 percent of total credit in 1951 and increased to an impressive 25 percent ten years later. 5/ However, the expansion of credit observed in many developing countries

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1/ Oscar Gish, "Health Planning in Developing Countries," The Journal of Development Studies, London, Vol. 6, No. 4, May 1970, pp. 67-75.

2/ International Road Federation, op. cit. various tables.

3/ USDA, "Agricultural Credit in Kenya," 1973.

4/ U. Lele, "Role of Credit and Marketing Functions in Agricultural Development," p. 7.

5/ P. K. Mukherjee, "Institutional Framework of Agricultural Production in the ECAFE Region, UN Report of Fifth Interregional Seminar on Development Planning," 1969, p. 49.

April 23, 1973

is clearly not benefiting the smaller farmers. In India, farmers with up to two hectares representing 60 percent of owners and 80 percent of the land obtained less than 28 percent of the available institutional credit. 1/

5. Attached are tables on urban unemployment, rural v. urban incomes, and income distribution in agriculture and in the rest of the economy. Again, as with the statistical information I sent you last week, all this should be interpreted rather carefully, since often different sources conflict with one another. Also, the reliability of the data is often doubtful.

cc: Mr. Stern  
Mr. Haq  
Mr. Meguid

Attachments

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1/ Lele, op. cit., p. 9.

Importance et caractéristiques

Tableau 15. Taux de chômage urbain et rural (en pourcentage de la population active)

Pays	Années	Chômage urbain	Chômage rural
<i>Afrique</i>			
Algérie	1966	<del>26,8</del> 24,7	—
Burundi	1963 <sup>1</sup>	18,7 <sup>2</sup>	—
Cameroun	1964 <sup>1</sup>	4,6	3,4
»	1966	15,0 <sup>3</sup>	—
Côte-d'Ivoire <sup>1</sup>	1963	20,0	—
Ghana	1960	11,6	—
Maroc	1960	20,5	5,4
Nigéria	1963	12,6	—
Tanzanie	1965	7,0	3,9
Zaire (Rép. dém. du Congo)	1967	12,9 <sup>2</sup>	—
<i>Amérique</i>			
Antilles néerlandaises	1966	16,0 <sup>3</sup>	—
Argentine	1968	5,4 <sup>2</sup>	—
Bolivie	1966	13,2 <sup>3</sup>	—
Chili	1968	6,1	2,0
Colombie	1967 <sup>68</sup>	15,5 <sup>3</sup> 13,6	—
Costa Rica	1966-67	5,6 <sup>2</sup>	—
El Salvador	1961	6,6 <sup>2</sup>	—
Guatemala	1964	5,4 <sup>2</sup>	—
Guyane	1965	20,5 <sup>2</sup>	—
Honduras	1961	7,8 <sup>2</sup>	—
Jamaïque	1960	19,0 <sup>2</sup>	12,4 <sup>4</sup>
Panama	1960	15,5	3,6
»	1967 <sup>69</sup>	9,3 7,4	2,8 3,6
Pérou	1964	4,2 <sup>2</sup>	—
»	1969 <sup>70</sup>	5,2 <sup>2</sup> 2,9	2,5
Uruguay	1963	10,9	2,3
Venezuela	1961 <sup>68</sup>	17,6 14,0	4,3
»	1964	16,4 <sup>2</sup>	—
»	1968	6,5	3,1
Venezuela	1969	7,9	—
<i>Asie</i>			
Burma	1972	6,5	—
Ceylan	1959-60 69-70	14,3 8,5	10,0 7,2
Corée	1963-64 70	7,0 4,5	1,8
Inde <sup>5</sup>	1961-62	3,2	1,7 <sup>5</sup>
Indonésie	1961 71	8,5 4,9	— 1,8
Iran	1956	4,5	1,8
»	1966	5,5 4,6	1,8
Malaisie (occidentale)	1967-68	11,6 6,8	7,4 5,2
Philippines	1967-68	13,1 9,0	6,9 7,4
Singapour	1966	9,1	—
République arabe syrienne	1967	7,3	—
Thaïlande	1966 69	2,8 <sup>2</sup> 2,1	—

Voir notes p. suiv.

Annexes (20)

2

RELATIVE POSITION OF RURAL AND URBAN INCOMES

Countries*	Per Capita Income (\$)			Urban/ Rural Ratio <sup>2/</sup>	Regional Distribution of the Population in the Lowest 20% Income Group	
	National <sup>1/</sup>	Urban	Rural		Rural	Urban
Brazil	420	587	215	2.73	% 62	% 38
India	110	190	76	2.50 <sup>3/</sup>	--	--
Venezuela	980	1,288	515	2.50	73	27
Mexico	670	895	387	2.31	69	31
El Salvador	300	451	197	2.29	100	--
Costa Rica	560	725	394	1.84	76	24
Puerto Rico	1,650	1,774	1,044	1.70 <sup>4/</sup>	--	--
Argentina	1,160	1,179	1,026	1.15	22	78

\* Ranked in descending order of the urban/rural income ratio.

<sup>1/</sup> World Bank Atlas.

<sup>2/</sup> UN Economic Commission for Latin America, Income Distribution in Latin America, New York, 1971, p. 105.

<sup>3/</sup> V. Gandhi, Tax Burden on Indian Agriculture, Harvard Law School, 1966, p. 56.

<sup>4/</sup> R. Weisskoff, "Income Distribution and Economic Growth," Yale University Economic Growth Center, 1971, p. 319.

(-- ) Not available.

Table : Measures of Income Inequality in the Agricultural and Non-Agricultural Sectors

	Percent of Families (1)	Average Income Relative to Agriculture (2)	Gini a/ Coefficient (3)	Kuznets b/ Coefficient (4)	Coefficient of Variation (5)	Standard Deviation Of Logs Of Income (6)	Skewness (7)
1. Puerto Rico 1953							
a. Agriculture	31	100	0.323*	47.00*	1.015*	0.568*	0.106
b. All other	69	157	0.422	64.06	1.140	0.771	0.121
2. Puerto Rico 1963							
a. Agriculture	17	100	0.411*	61.60*	1.156	0.678*	0.275
b. All other	83	170	0.442	63.98	1.003*	0.855	-0.075
3. Argentina 1953							
a. Agriculture	21	100	0.499	76.82	1.805	0.746	0.585
b. All other	79	113	0.383*	55.70*	1.501*	0.576*	0.300
4. Argentina 1961							
a. Agriculture	16	100	0.489	74.40	2.086	0.716	0.554
b. All other	84	131	0.418*	60.20*	1.551*	0.622*	0.330
5. Mexico 1963							
a. Rural	44	100	0.475*	69.90*	1.290	0.808*	0.310
b. Urban	56	231	0.521	77.35	1.238*	0.976	1.144
6. U.S.A. 1957-59							
a. Farm	12	100	0.415	60.60	1.088	0.724	0.174
b. Non-farm	88	174	0.346*	48.20*	0.974*	0.641*	-0.009
7. U.S.A. 1960-62							
a. Farm	10	100	0.416	60.20	0.929	0.749	0.128
b. Non-farm	90	172	0.346*	49.00*	0.702*	0.685*	-0.118

Note: \* indicates the more equal sector.

a/ The Gini concentration ratio relates the cumulative ownership of land area to the land share that would be held by recipients under the conditions of "perfect equality" of land ownership. The ratio approaches zero as the distribution approaches perfect equality (i.e., one percent of the farmers own one percent of the land) and 1.00 as the concentration of land ownership increases.

b/ The Kuznets ratio is similar to the Gini ratio. It is calculated as the sum of absolute differences between shares of land and percentage share of ownership. Values for the Kuznets ratio vary from zero at perfect equality to 2.00 at maximum inequality.

Library source: Richard Weisskoff, Income Distribution and Economic Growth in Puerto Rico, Argentina and Mexico, New Haven, Connecticut: Yale University, Economic Growth Center, 1971, p. 319.

Table : Rural and Urban Incomes and the Relative Composition  
of the Income Structure of Selected Countries

Sector	Average Incomes (rural average = 100)	Percent of all Income Units	Percentage composition of different income groups				
			Lowest 20%	30% below the median	30% above the median	15% below the top 5%	Top 5%
<b>Venezuela <sup>a/</sup></b>							
Rural .....	100	40.8	72.9	48.6	28.7	16.3	12.2
Urban .....	250	59.2	27.1	51.4	71.3	83.7	87.8
Large cities ...	274	45.2	10.9	34.7	59.3	73.2	76.2
Small cities ...	176	14.0	16.2	16.7	12.0	10.5	11.6
<b>Mexico <sup>a/</sup></b>							
Rural .....	100	44.2	68.7	54.7	34.5	21.5	10.7
Urban .....	231	55.8	31.3	45.3	65.5	78.5	89.3
<b>Mexico</b>							
Agricultural .....	100	43.7	68.2	56.3	26.6	26.4	20.7
Non-Agricultural .	158	56.3	31.8	43.7	73.4	73.6	79.3
<b>Brazil</b>							
Agricultural .....	100	45.4	62.2	65.1	34.5	17.3	12.1
Non-Agricultural .	273	54.6	37.8	34.9	65.5	82.7	87.9
<b>Costa Rica</b>							
Agricultural .....	100	50.0	76.4	80.3	23.8	16.5	19.6
Non-Agricultural .	184	50.0	23.6	19.7	76.2	83.5	80.4
<b>El Salvador</b>							
Agricultural .....	100	60.2	100.0	87.9	30.4	23.3	18.8
Non-Agricultural .	229	39.8	-	12.1	69.6	76.7	81.2
<b>Argentina</b>							
Agricultural .....	100	14.8	21.9	20.0	6.9	12.2	14.9
Non-Agricultural .	115	85.2	78.1	80.0	93.1	87.8	85.1

<sup>a/</sup> The Venezuelan and Mexican classifications differ somewhat. In Mexico the urban category includes all cities with 2,500 or more inhabitants. In Venezuela the dividing line is 5,000 inhabitants. About 3.3 percent of the population in Venezuela resides in towns of from 2,500 to 5,000 inhabitants. Small cities in Venezuela are those with 5,000 to 25,000 inhabitants, and large cities those with 25,000 or more.

Library source: United Nations. Economic Commission for Latin America. Income Distribution in Latin America, New York, 1971, p. 105



47. In particular, public services in rural areas must be increased. That is where the poor are - that is where the services are now lamentably deficient. Environmental conditions are closely associated with the pattern of distribution of income and wealth. In most developing countries, the average per capita rural income is less than half that of the urban population and often, as in Brazil and India, is about one-third. Between 60 and 100% of the population in the lowest income group live in the rural areas of developing countries. The upper 20 percent of the population, mostly in urban areas receive between 50 and 60 percent of the national income. This uneven distribution is aggravated by a more iniquitous distribution of health, educational opportunities, social and economic services.

~~47a.~~ In rural India, less than 10 percent of India's high school graduates and a negligible 6 percent of India's university graduates are employed in agriculture (where 70% of India's labour force is engaged). Even more disturbing is that with rising education levels, the brain drain from rural to urban centers is intensifying. A survey of Delhi University students showed that 22 percent came from rural areas (though only 3.8% from farming families), yet only 1.1% wished to return to agricultural work.<sup>1/</sup> The occupational breakdown of employed graduates makes it clear that very few had in fact returned to the villages - a generous estimate would be less than 10%.<sup>2/</sup> It is a cruel anomaly to have a problem of the educated unemployed in the urban areas, while the rural poor thirst for the knowledge that is going to waste.

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1/ A. M. Khusro, A Survey of Living and Working Conditions of Students of University of Delhi, Asia Publishing House, London 1967, pp. 31, 72 and 77.

2/ V.K.R.V. Rao, University Education and Employment, Institute of Economic Growth, Delhi, pp. 10-11.

47b. In 1963, Colombia was selected for a comprehensive health sector analysis conducted by the Government and international foundations. The survey showed that 20% of the population, mainly in rural areas are beyond the reach of even the most elementary medical assistance. Between 50 and 75 percent of all rural households occupies what are essentially slum dwellings with no water supply or sanitation. One-fourth of the population suffer from gastro-intestinal diseases. Among their children six out of ten suffered from serious malnutrition.<sup>1/</sup> Yet Colombia's public health expenditures in the mid Sixties amounted to some \$100 m. annually - less than double the average annual expenditures on highways which service the 225,000 cars, buses and trucks in a nation of 20 million.<sup>2/</sup> These and related findings are not untypical of the developing regions of the world.

47c. In a survey of 11 African countries in 1965, 60 percent of national and expatriate doctors were located in the capital cities whose population is less than 10 percent of their countries total population. Where health services are nominally available, the quality is of dubious value. In Malawi, a rural hospital assistant "examines" on average 150 patients in a morning. At present, over a third of all Sudanese doctors work in Khartoum where about 5% of the population lives.

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<sup>1/</sup> D. K. Zschock "Health Planning in Latin America," Latin American Research Review, University of Texas, Vol. V, No. 3, 1970.

<sup>2/</sup> International Road Federation, "Highway Expenditures - Road and Motor Vehicle Statistics," Geneva 1973.

This phenomenon can also be clearly seen in Asia, Latin America, and the Middle East. As capital cities become relatively saturated, the tendency for medical personnel is not to move to rural areas but to migrate. Already some 35,000 medical graduates from schools in developing countries are working in the USA and the UK; the cost of educating them had been close to \$700 million borne by the countries of their birth. Yet while there is one doctor for every 860 people in the UK, there is only one for every 5,000 in India and one for every 30,000 in Nigeria.<sup>1/</sup>

47d. Other general facilities in the form of transportation, communications, storage, etc. are equally absent, and are effectively sabotaging progress in rural areas. A farmer with an ox-cart in which it will take a whole day to go 7 miles to market and back, and little or no ready money in his pocket is simply not capable of commercial farming in a modern sense unless supplies and services are brought virtually to his door. The choice is between help from his Government or from his more powerful neighbours - on their terms.

47e. Every country must examine ...

Paragraph 45, Second item in P. 24; replace the last four lines with:

Regular surveys of transport statistics in a number of countries show that the registration of private automobiles increased almost twice as fast as the increase in public buses. Thus, during the second half of the 1960's, the increase in the number automobiles in Chile was 43% against a 24% increase in the number of buses. In Indonesia, the rates

<sup>1/</sup> Oscar Gish, "Health Planning in Developing Countries,"  
The Journal of Development Studies, London, Vol. 6, No. 4,  
May 1970, pp. 67-75.

of increase were 27% and 11% respectively. In India, 33% against 21% and in Pakistan, the number of automobiles increased by 19% while the number of buses actually declined.<sup>1/</sup>

Paragraph 29, Line 5 from bottom; add:

.....

institutional credit. In Kenya, credit reaches less than 15% of the small holders and less than a quarter of those with large enough farms to use credit effectively.<sup>2/</sup> In Thailand, only about 5 percent of the credit advanced in agriculture in 1963 came from institutional sources, and despite the 5-fold increase in institutional credit between 1964 and 1970, its proportion to the total value of agricultural production remains insignificant - some 2.8%.<sup>3/</sup> In India, the share of institutional credit sources accounted for 3 percent of total credit in 1951 and increased to an impressive 25 percent ten years later.<sup>4/</sup> However, the expansion of credit observed in many developing countries is clearly not benefiting the smaller farmers. In India, farmers with up to two hectares representing 60 percent of owners and 80 percent of the land obtained less than 28 percent of the available institutional credit.<sup>5/</sup>

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1/ International Road Federation, op. cit. various tables.

2/ USDA, "Agricultural Credit in Kenya," 1973

3/ U. Lele "Role of credit and marketing functions in agricultural development" P. 7.

4/ P. K. Mukherjee "Institutional Framework of Agricultural Production in the ECAFE Region, UN Report of Fifth Interregional Seminar on Development Planning" 1969, P. 49.

5/ Lele, op. cit. P. 9.

29a. To improve the agricultural credit component of an effective rural development program, at least ...

Paragraph 44, add:

Despite the economic and social merits of rural works, Government are reluctant to appropriate sufficient funds for these programs. The administrative problems cannot be exaggerated, particularly the required degree of planning, decentralization and financial supervision. However, many countries have achieved successes in this regard and the lessons of experience could be beneficially exchanged. Examples of allocating counterpart aid funds (Morocco and Tunisia) of land armies (Mysore State in India and Mauritius), of organizational leadership (Comilla in Bangladesh) need to be closely assessed and adopted.

Mr. John L. Maddux, IPA

April 17, 1973

Pedro-Pablo Kuczynski, Division Chief, PPD

Annual Meeting Speech

1. As I told you this morning, we are developing much more information than we have in the first draft on subjects such as the urban-rural split, public expenditures of the poor, access to credit, the effect of the Green Revolution on employment, the experience in rural public works, etc. I hope to send these additional data to you later this week.
2. I attach the following:
  - (1) A set of tables on agriculture.
  - (2) A piece by Uma Lele of the Economics Department on rural poverty.
  - (3) Draft report by Keare of the Economics Department on the conclusions of his survey of four cities. (Ahmedabad, Seoul, Lima and Kingston).
  - (4) Tables on income distribution prepared by Mr. Tiemann, of the Development Research Center.
  - (5) A draft profile of poverty in Panama prepared by Mr. Arun Shourie, formerly of the Bank.
  - (6) A draft monograph of income distribution in Peru prepared by Professor Richard Webb of Princeton University.
  - (7) A report by the US Department of Agriculture on agriculture in the developing nations (belongs to Research Files).
  - (8) A draft on income inequalities in Rural India by Mr. Vaidyanathan of the Bank.
  - (9) A piece prepared last year for Mr. McNamara on growth and inequalities with special reference to India by Mr. Shourie.
  - (10) A draft report of the Peru urban and regional mission (2 volumes).
  - (11) Draft profile of poverty in Guatemala prepared under Bank auspices by Professor Webb of Princeton University.

April 17, 1973

- (12) My draft of the El Salvador economic report (pp. 1-9 are profile of poverty). I am sending you my own draft because I consider that the Region's yellow cover suppressed some of the important material.
- (13) Poverty in India by Dandekar and Rath.
- (14) Employment and income distribution in Uganda prepared by a team from the University of East Anglia.
- (15) Draft of the urban sector survey on Zaire (3 volumes).
- (16) Income distribution in Latin America, a study published by ECLA. (My own copy)
- (17) Report of the ILO mission to Kenya (library copy).
- (18) Tables on social indicators from the UN Report on the World Social Situation.

3. In addition to the above, the following, which are available within the Bank, are very useful.

- (1) Statistics on trends in developing countries, 1971 (Blue booklet prepared by Mr. Hayes' Department).
- (2) Economic Staff Working Paper No. 113 on agricultural employment in the LDC's by Professor Walter P. Falcon.
- (3) Bank Report No. 53-TR on employment in Trinidad and Tobago.
- (4) Board Paper No. R72-94 on the employment problem and Bank operations.
- (5) USAID Development Perspectives (1972 - a booklet of comparative world data).
- (6) ILO reports on employment in Colombia and Sri Lanka.
- (7) Yellow cover draft of Mexico basic economic report.

4. I would greatly appreciate your returning the items in para. 2 when you get through with them.

Attachments

cc: Mr. Stern  
Mr. Haq

## OFFICE MEMORANDUM

*Mr. Kuczynski*

TO: Mr. Robert S. McNamara

DATE: February 1, 1973

FROM: Hollis B. Chenery *ABC*SUBJECT: Draft Outline of the 1973 Annual Speech *File*

Following their discussion with you last month, Ernie and Mahbub have prepared the attached outline after a preliminary check as to what basic material could become available. It is still a rough sketch of the kind of themes which might be included in the Annual Speech but I am sending it to you in case you would like to see it at this stage and give us your reaction before you leave next week.

I have some doubts as to the wisdom of taking up these aspects of the income distribution theme again this year when we will have relatively little new material. A year later you could cover most of these ideas with much greater authority. Assuming that you want to stay in this general area, I think we could do somewhat more with the tradeoff between growth and distribution and tie it into a clearer statement of Bank objectives in its second five-year program.

Attachment

cc: Messrs. E. Stern (o/r)

*M. Haq*  
✓ P.P. Kuczynski  
Wm. Clark

MHaq/HBChenery:csm

DRAFT OUTLINE OF THE 1973 ANNUAL SPEECH

1. Introduction: Link up with the major themes in the 1972 Speech. Two aspects to mass poverty and income distribution - external and internal.
  
2. External:
  - (i) World income distribution. Accelerated growth in income disparities between the rich and the poor nations.
  - (ii) Need of the LDCs for more trade (draw on primary exporter paper) but growing barriers (examples). Compulsions for a more equitable sharing of benefits from exploitation of natural resources.
  - (iii) Trade not enough; aid also essential (refer to ODA estimates). International community has generally distributed aid in accordance with need with the exception of India (Mr. Chenery's article). But past, present and future levels of aid are inadequate and any major attack on poverty would require more resources (as well as new methodology).
  - (iv) Interdependence of world prosperity. Can the rich nations maintain their accelerated growth while a growing majority of mankind remains impoverished - analysis from economic, political and social angle.
  
3. Poverty Problems Within: Poverty has many faces. To move from description to policy, one must distinguish between the problems of urban and rural poverty.

- . Material on rural-urban income
- . Distribution of public services - rural/urban
- . Social aspects of rural and urban poverty
- . Migration

4. From Diagnosis to Policy Formulation: This section should link the diagnosis of the problem to the need for new policies by emphasizing that:

- . a direct attack on poverty must be mounted as the indirect filter-down effect of growth rates takes too long and is inadequate;
- . a comprehensive program for such a direct attack can be formulated by the developing countries themselves: the international world can only help those who demonstrate the will to change;
- . given the initiative in the LDCs, there are a few selected areas where the bilateral and multilateral donors, including the Bank Group, can play an increasingly active role so as to combine economic growth with greater distributive justice.

5. Reaching the Rural Poor:

- (i) Nature of rural poverty - numbers involved, magnitude of poverty.
- (ii) Integrated rural development programs - mistakes made, lessons learnt, successes achieved.

- (iii) Raising agricultural productivity of the small farmer (credit, extension, inputs). World land availability and use outlook - contrast between Asia and other LDCs. Critical role of land reforms - experience in selected countries.
- (iv) Role of publicly financed works in reducing rural unemployment.
- (v) The special problem of the landless.
- (vi) How to bring relevant education to the rural areas.

6. Urban Poverty:

- (i) Degradation of the cities - migration data; public services; why do people move.
- (ii) Absorptive capacity of the modern sector. Adaptive technology. Labor absorption in industry. Public works.
- (iii) Provision of low-cost housing can help both employment and distributive justice:

Estimates of total world requirements of housing.

Cost of providing adequate housing to the poor masses.

Role of public works programs in enlisting community self-help in building low-cost housing.

Site and service projects.

(iv) Spatial planning. New towns. Regional planning.  
Land use.

(v) Municipal reform. Local authority. Administrative  
improvement. Municipal tax base.

7. Bank Group Role: Some indication of the qualitative targets of Bank's  
next five year plan (74-78).

Limitations on policy answers from this subject.

for 2<sup>30</sup> mtg  
w/ Mr. Stern

## EDUCATION

File Annual Speech

### Nature of the Analysis

- General agreement on the importance of education for development despite the conflicting views about what the content of that education should be.
- Review the size of the educational requirement of LDCs and its cost. Review the debate about the need for radical change in the content. The financial wastage in present LDC educational systems (rural schools with incomplete cycles, very high ratio of repeaters, academic-oriented secondary and university education, etc.) and the social consequences of the wastage (frustrated expectations, emigration of skilled people, etc.). What is the appropriate level of educational expenditure at different country income levels?
- Analysis of the link between the employment problem and the inadequacy of educational systems, particularly in rural primary education and in urban vocational training.
- Education's role in long-term changes in income distribution.
- Criteria for an effective, development-oriented, educational system.
- The Bank Group's financing of education. Measures to support reform such as financing of rural primary education, incentives to redistribute educational services, support for regional technical universities.

### Advantages of the Theme

1. Education is a high priority item in Africa; 44% of Bank Group lending in education has gone to Africa.
2. Operational subject. Solid achievements; rapid growth expected.

### Disadvantages of the Theme

1. Too narrow, even though several other subjects (employment, distribution of public services) can be linked to it.
2. We are likely to have little to say on the conceptual side.

Too little to say about action.  
Emphasize rural development.

## EMPLOYMENT

### Nature of the Analysis

- The problem of unemployment is wide-spread and growing. Increasing documentation (if not precise data) is available from the ILO Missions - Colombia, Iran, Kenya, Ceylon, Philippines - and our own country employment work. (The report of the Bank employment mission to Trinidad and Tobago is in draft.)
- Employment is closely related to both the problems of income distribution and productivity.
- More emphasis on employment raises a number of controversial issues of policy and theory, including the trade-offs between labor and capital intensity, the trade-off between initial investment and maintenance and the potential relevance of intermediate technology. On the first two major research projects are well underway and work is also in progress on intermediate technologies.
- A discussion of employment would also link up with the problems of urban migration, rural poverty (a major study of African Rural Development will be completed), education and population growth.

### Advantages of the Theme

1. It represents continuity with the theme of mass poverty but provides a basis for more concrete program proposals.

2. It is timely to extract the lessons of the rather intensive studies of employment and translate them into policy conclusions.
3. Employment is an area where the Bank can play a fairly important and direct role both through its advisory function and its lending program.
4. Several specific proposals for Bank action might be possible, including our willingness for a major involvement in financing work programs, and assistance to indigenous technology institutes.

#### Disadvantages of the Theme

1. The speech will be in Africa, where concern with employment problem is still relatively small.
2. It might be seen by some as "overtaking" the ILO. (This, however, can easily be handled in the drafting of the speech.)
3. There might be too few action recommendations.

Sub - Theme, maybe.

## LEAST DEVELOPED COUNTRIES

### Nature of the Analysis

- Definition of the problem of least developed - manpower, capital, limited market, relative isolation. Why problem of least developed particularly intractable.
- Special problems of least developed in trade area (draw on Primary Exporter Study)
- Aid and capital flows to least developed.
- Status of special programs for least developed. Role of the Bank Group.

### Advantages of the Theme

1. It is a topical subject and has been commended to our attention by UNCTAD. The Speech could provide a timely opportunity to make our record better known to the world.
2. The UNCTAD list of least developed countries includes fairly small economies, mostly in Africa. The Chairman-designate for the next Annual Meeting raised the issue of Bank Group lending to small countries at the 1972 meeting.
3. The focus on least developed countries fits in with the theme of mass poverty taken up this year. It would also enable us to raise related themes - education, regional integration, rural development.

### Disadvantages of the Theme

1. It tends to bless the concept and list of the least developed countries, which does not contain some of the poorest countries in the world, e.g. Bangladesh.

2. The least developed constitute a small fraction of Bank membership. While their problems should not be ignored, neither should we become so preoccupied with them that we ignore the problems of the bulk of the poor.

Sub - theme, maybe.

## REGIONAL INTEGRATION

### Nature of the Analysis

- Economic integration as a need for the rational development of small economies, especially in Africa. A review of some of the problems of African development, underlining the costs for small economies of developing basic services and infrastructure which could be provided more rationally and cheaply through realistic schemes for regional integration.
- Examples of some of the advantages of integration. While integration is not a panacea, it can - if properly implemented - provide a useful stepping stone toward rational industrial development and permit the establishment of a common front in the negotiation of trade problems with the outside. The problems faced by developing countries in having access to markets in industrial countries for their non-traditional exports could be reviewed, perhaps in the context of the recommendations of UNCTAD III.
- The reasons for the failure of integration. The reasons why the integration schemes of developing countries have not achieved their objectives, especially the unwillingness of members to avoid duplication of industries and services. Statistics for Latin America and Africa on the number of national airlines, shipping lines, fertilizer factories, steel mills, universities, etc. and the excess costs which they represent.

- The Bank Group role. This section would include a review of our assistance to specific integration schemes (loans to the East African Common Services Organization, proposed loan to the Central American Bank for Economic Integration, Mekong, West Africa River Blindness, possible technical assistance to an Arab Development Fund (?), etc.) and of our more general assistance through the expansion of regional offices.

#### Advantages of the Theme

1. It is a topic of substantial interest in Africa and relates to the problems of the least developed.
2. It relates to a number of general issues such as dependence on primary exports and market access.
3. Substantial data is available.

#### Disadvantages of the Theme

1. The action program is bound to be weak. While the Bank can do more to assist regional schemes, the subject has important political aspects which have proven hard to deal with.
2. Outside a pledge to do more of the same, there is little new to be said on either the conceptual or program side.

Include natural resource exploitation.

(A good subject for a study wld. be how much real did Bank

gives - fairly  
into acct. r i,  
Hvaluation, etc)

PRINCIPAL PROBLEMS IN RELATIONS BETWEEN  
RICH AND POOR FOR THE DECADE

<sup>R</sup>  
Nature of the Analysis

- Concern with development has focused largely on the internal problems of LDCs. Because of the success of the growth of many countries in the 1960's, it is clear that there must be a broader framework, i.e., how to integrate LDCs into the world economy.
- Discussion of export performance; relation of trade to evolution of economy. Barriers to growth, trade in natural resources, ownership and management of these resources.
- Analysis of evolution of capital market - equity investment, supplier credits, growth of non-equity flows. (Distribution)
- The service of international economic infrastructure to LDCs (shipping, banking, insurance). Impediments to intra-LDC trade.
- Concern with development cannot be limited to aid flows. Aid flows remain vital for large number of countries, and fall well short of need. But for growing number of countries, capital can be obtained at commercial or near commercial terms. For both groups of countries it is time to define our views of what comes "after aid". What problems are there. How do we begin to plan for them.

- Role of the Bank. Obviously all countries and many agencies are concerned. Bank can assist in defining problems its members face as they move more broadly into the world economy; can provide technical assistance to its members in broadening their access to the non-equity capital market; its lending program can support regional integration, strengthen competitive position in trade, move primary exporters up the processing ladder and facilitate structural adjustments attendant on more open economies.

#### Advantages of the Theme

1. Looking at development through the aid telescope is increasingly outdated. The time is ripe to spell out that growth of LDCs means more participants in the world economy, more competition, more nations with a stake in monetary affairs, shipping, trade negotiations.
2. There are few others who have the kind of forum and vantage point which are the necessary basis for a global overview.
3. The areas of potential confrontation between LDC's and industrialized countries is growing - natural resources (OPEC replications), monetary reform (blocking of 72/73 SDR issuance), private foreign investment, trade negotiations, global pollution problems. Unless these are put in a framework of common objectives, they will continue to fester individually.

Disadvantages of the Theme

1. The subject is complex and we might not be able to encompass it.
2. Direct Bank action is limited.
3. The subject is political and may set off controversy, affecting IDA. However, this may well be more a function of how the topic is treated than of the subject itself.

## Distribution Aspects of Development

### Nature of the Analysis

- . Record of growth in past decade compared to expectations.  
Distribution of aid (HBCChenery material.) Link between aid flows and growth.
- . Criteria for aid allocation. Small countries; least developed; large countries; poverty; performance.
- . Role of the international aid coordinating mechanism in distribution. Relation of aid flows to capital movements and trade.
- . Link to internal distribution problems - distribution of income; assets public services. Role of government in distributing real income.
- . Employment and income. Measures to increase remunerative employment.
- . Specific examples of policy areas for action - housing, land reform, public works (work is in progress on all three). Examples of <sup>low</sup> government expenditure patterns exacerbate distribution.
- . Bank program.

### Advantages of the Theme

1. Direct follow-up on the 1972 Annual speech.
2. Topic continues to be of major concern and would provide an opportunity to spell out in more detail Bank actions in this areas.
3. The discussion would be timely, since it could be related to IDA replenishment and SDRs, if necessary.
4. The topic is broad enough to include comments on employment,

education and the integration of LDC's into the world economy.

Disadvantages of the Theme

1. ~~Dis~~pite its importance, it was the topic in 1972 and it might be useful to cover another issue this time.
2. Internal distribution problems are not as acute in Africa as elsewhere.
3. New prescriptions will be few; our knowledge of the problem will be better but only marginally

## OFFICE MEMORANDUM

*Rite Annual speech*

TO: Mr. Robert S. McNamara

DATE: December 19, 1972

FROM: Ernest Stern *ES.*SUBJECT: Themes for the 1973 Annual Speech

Attached are four possible themes for the 1973 Annual Speech. For each theme there is a brief outline and a short statement of the advantages and disadvantages.

The themes are not mutually exclusive (e.g., the education topic has a good deal to say on employment) but are intended to designate the main thrust. In each theme it is possible, and probably desirable, to make mention of the special problem of the least developed countries and the need to support regional integration movements. This is spelled out in the poverty and distribution topic but can also be incorporated easily in the others.

Please let me know when you are ready to discuss this further. The selection of a topic should be based not only on the importance of the topic but also on how much we are prepared to say about specific actions or policy changes.

## Attachments

cc: Messrs. W. Clark, Maddux, Haq, Kuczynski

EStern/lm

Comments of Mr. McNamara

- Distribution, poverty, & employment reinitiated. Very little of Bank lending has been directed at this.*
- Emphasize labor/capital mix, & results of our research.
  - Rural development: enable land x, efficiency with only, some output, How to improve productivity of lower 60% of farm lands. Extension.
  - Public works program. *We are very weak on education: how much of 6N?; how to allocate (this percentage)?*
  - Distribution of public services.
  - Emphasize distribution of education benefits.
  - Technical draft has to be ready to be consulted with outsiders.
- Outline to be ready Jan 22.*

*On agric. sector paper starts at wrong end, that of starting with land & how product. growth will be achieved.*

## EMPLOYMENT

### Nature of the Theme

- The problem of unemployment is widespread and growing. Increasing documentation (if not precise data) is available from the ILO Missions - Colombia, Iran, Kenya, Ceylon, Philippines - and our own country employment work. (The report of the Bank employment mission to Trinidad and Tobago is in draft.)
- Employment is closely related to both the problems of income distribution and productivity.
- More emphasis on employment raises a number of controversial issues of policy and theory, including the trade-offs between labor and capital intensity, the trade-off between initial investment and maintenance and the potential relevance of intermediate technology. On the first two major research projects are well underway and work is also in progress on intermediate technologies.
- A discussion of employment would also link up with the problems of urban migration, rural poverty (a major study of African Rural Development will be completed), education and population growth.

### Advantages of the Theme

1. It represents continuity with the theme of mass poverty but provides a basis for more concrete program proposals.
2. It is timely to extract the lessons of the rather intensive studies of employment and translate them into policy conclusions.
3. Employment is an area where the Bank can play a fairly important and direct role both through its advisory function and its lending program.
4. Several specific proposals for Bank action might be possible, including our willingness for a major involvement in financing work programs, and assistance to indigenous technology institutes.

### Disadvantages of the Theme

1. There might be too few new action recommendations since this subject has been touched on in several recent speeches.
2. The speech will be in Africa where concern with employment problems is still relatively small.

*Statistical annex on Y distrib., needed (eg. UNCTAD speech).*

## DISTRIBUTION AND POVERTY REVISITED

*Shows correlation of Y distrib. and education.*

### Nature of the Theme

#### A. Problems of Poverty

- Distribution of income, assets, public services. Role of government in distributing real income. New, specific information on sample countries. Examples of how government expenditure patterns exacerbate distribution.
- Employment and income. Measures to increase remunerative employment. Synthesis of lessons learned from ILO and Bank country work on employment.
- Education. Role of education in determining income. Level, content and distribution of education. Measures to increase relevance and efficiency.
- Least developed countries. Special nature of problem. Status of programs for least developed. Bank program in least developed (draw on exporter study). Need for regionalization and industrialization.
- Specific examples of policy areas for action - housing, land reform, public works (work is in progress on all three).

#### B. Distribution of Aid

- Record of growth in past decade compared to expectations. Distribution of aid (H.B. Chenery material). Patterns of aid and growth.
- Criteria for aid allocation. Small countries; least developed; large countries; poverty; performance.
- Beneficiaries of trade; distribution of capital flows; relation to aid flows.

### Advantages of the Theme

1. Direct follow-up on the 1972 Annual Speech.
2. Topic continues to be of major concern and provides opportunity to spell out in more detail Bank action program.
3. The discussion would be timely, since it could be related to IDA replenishment, if necessary.

Disadvantages of the Theme

1. Despite its importance, it was the topic in 1972 and it might be useful to cover another issue this time.
2. Internal distribution problems are not as acute in Africa as elsewhere.
3. New prescriptions will be few; our knowledge of the problem will be better but only marginally so.

## EDUCATION

### Nature of the Theme

- General agreement on the importance of education for development despite the conflicting views about what the content of that education should be. Rising demand for education; increasing frustration about ability to deliver relevant education to mass of people at acceptable cost.
- Review the size of the educational requirement of LDCs and its cost. Review the debate about the need for radical change in the content. The financial wastage in present LDC educational systems (e.g., very high ratio of repeaters, academic-oriented secondary and university education) and the social consequences of the wastage (e.g., frustrated expectations, emigration of skilled people). What is the appropriate level of educational expenditure at different country income levels?
- Analysis of the link between the employment problem and the inadequacy of educational systems, particularly in rural primary education and in urban vocational training.
- Education's role in long-term changes in income distribution.
- Criteria for an effective, development-oriented, educational system.
- The Bank Group's financing of education. Measures to support reform such as financing of rural primary education, incentives to redistribute educational services, support for regional technical universities. Measures to increase efficiency of the educational system.

### Advantages of the Theme

1. Education is a high priority item in Africa; 44% of Bank Group lending in education has gone to Africa.
2. Operational subject. Solid achievements; rapid growth expected.

### Disadvantages of the Theme

1. Although work is in progress, the subject is vast and we are likely to have little to say on the conceptual and policy side, and program suggestions will be few.
2. Too specific, even though several other subjects (employment, distribution of public services) can be linked to it.

PRINCIPAL PROBLEMS IN RELATIONS  
BETWEEN RICH AND POOR FOR THE DECADE

Nature of the Theme

- What is the future of the world economy. Concern with development has focused largely on the internal problems of LDCs. Because of the growth of many countries in the 1960s, the time is ripe to consider how to integrate LDCs into the world economy.
- Discussion of export performance; relation of trade to evolution of LDC economy. Implications for developed countries. Barriers to growth, trade in natural resources, ownership and management of these resources.
- Evolution of capital market - equity investment, supplier credits, growth of non-equity flows.
- The relation of the international economic infrastructure to LDCs - monetary system, shipping, banking, insurance. Impediments to intra-LDC trade.
- Concern with development cannot be limited to aid flows. Aid flows remain vital for large numbers of countries, and fall well short of need. But for growing numbers of countries, capital can be obtained at commercial or near commercial terms. For both groups of countries it is time to define our views of what comes "after aid". What problems are there? How does the world begin to plan for them?
- Role of the Bank. Obviously all countries and many agencies are concerned. The Bank can intermeditate between the rich and the poor countries; it can assist in defining areas of confrontation members face as they move more broadly into the world economy; it can provide technical assistance in broadening LDC access to the non-equity capital market; its lending program can support regional integration, strengthen competitive position in trade, move primary exporters up the processing ladder and facilitate structural adjustments attendant on more open economies.

Advantages of the Theme

1. Looking at development through the aid telescope is increasingly outdated. The time is ripe to spell out that growth of LDCs means more participants in the world economy, more competition, more nations with a stake in monetary affairs, shipping, trade negotiations.

2. There are few others who have the kind of forum and vantage point which are the necessary basis for a global overview.
3. The areas of potential confrontation between LDCs and industrialized countries is growing - natural resources (OPEC replications), monetary reform (blocking of 72/73 SDR issuance), private foreign investment, trade negotiations, global pollution problems. Unless these are put in a framework of common objectives, they will continue to fester individually.

Disadvantages of the Theme

1. The subject is complex and we might not be able to encompass it. 1974 might be a better time.
2. Direct Bank action is limited and the speech could end up as a litany of ills.
3. The subject is political and may set off controversy, affecting IDA. However, this may well be more a function of how the topic is treated than of the subject itself.

REGIONAL INTEGRATION

1. Economic integration as a need for the rational development of small economies, especially in Africa. This section might begin by a review of some of the problems of African development, underlining the costs for small economies of developing basic services and infrastructure which could be provided more rationally and cheaply through realistic schemes for regional integration.
2. Examples of some of the advantages of integration. The second section would underline that, while integration is not a panacea, it can - if properly implemented - provide a useful stepping stone toward rational industrial development and permit the establishment of a common front in the negotiation of trade problems with the outside. The problems faced by developing countries in having access to markets in industrial countries for their non-traditional exports could be reviewed, perhaps in the context of the recommendations of UNCTAD III.
3. The reasons for the failure of integration. This section should review frankly the reasons why the integration schemes of developing countries have not achieved their objectives, especially the unwillingness of members to avoid duplication of industries and services. Statistics ought to be provided for Latin America and Africa on the number of national airlines, shipping lines, fertilizer factories, steel mills, universities, etc. and the excess costs which they represent.
4. The Bank Group role. This section would include a review of our assistance to specific integration schemes (loans to the East African Common Services Organization, proposed loan to the Central American Bank for Economic

Integration, Mekong, West Africa River Blindness, possible technical assistance  
etc.)  
to an Arab Development Fund(?),/ and of our more general assistance through  
the expansion of regional offices. Clearly, the subject would not be a good  
main theme unless we are willing to say that we will provide much more aid  
to integration schemes and will place more emphasis in our country lending  
programs upon regional considerations.

#### EDUCATION

5. Its importance. This section should begin/stressing the general agreement  
by  
on the importance of education for development and highlighting the conflicting  
views about what the content of that education should be.
2. The problem. This section would review the size of the educational  
requirement of LDCs, the cost, and review the debate about the need for radical  
change in the content. This section would also emphasize the financial wastage  
in present LDC educational systems (rural schools with incomplete cycles,  
very high ratio of repeaters, academic-oriented secondary and university educa-  
tion, etc.) and the social consequences of the wastage (frustrated expectations,  
emigration of skilled people, etc.).
3. Education and Employment. There should be some analysis of the link  
between the employment problem and the inadequacy of educational systems,  
particularly in rural primary education and in urban vocational training.  
(Some reference might also be made to the wastage of resources on armaments  
in many LDCs.)
4. The Bank Group program. Again, as in the regional integration case,  
the subject is only worthwhile to the extent that we are in a position to  
announce new departures in our financing of education (such as financing of  
rural primary education, recurrent costs, regional technical universities, etc.)

DRAFT  
PPKuczynski/rso  
December 15, 1972

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*Mr. Kuczyński*OFFICE MEMORANDUM *RLE*

TO: Mr. Ernest Stern

DATE: December 11, 1972

FROM: M. Haq *mh*SUBJECT: Themes for the Annual Speech

After reflecting on the various themes for the Annual Speech that we discussed on Friday, my feeling is that we should make 'employment' as the central theme for a number of reasons:

(i) It would represent continuity with the theme of mass poverty taken up last year. ("Given the intimate link between poverty and massive unemployment, unemployment and underemployment must be attacked head-on." ... "Job creation must become a direct objective in itself.")

(ii) We should be able to distill some concrete data and insights from the current country work on employment.

(iii) The study on integrated rural development could yield some material for the Speech. In fact, the Annual Speech may be a good occasion to announce our willingness for a major involvement in the financing of rural works programs, carrying our declaration of intent of last year a step further ("It will be necessary to organize rural and urban public works .... The Bank will assist in financing such projects.")

(iv) Many other themes that we discussed (e.g. education, intermediate technology, rural poverty) can be linked up with the employment concern.

(v) This is a field in which the Bank can play a fairly important and direct role through its projects and programs (unlike the ILO which can merely talk about the problem). If employment is identified as the major theme for the Annual Speech, it may also help build up pressure to give some coherent focus to the piecemeal work on employment in the Bank.

(vi) The Speech will be delivered ahead of the U.N. World Conference on Population. It would be timely to talk about population and employment -- getting attention away from the Malthusian pessimism that population conferences always tend to produce.

Of course, the deciding factor would be whether we have enough worthwhile things to say about employment. This can be discussed with Hawkins, Yudelman and others concerned. My own impression is that we can say at least a few concrete things in this field -- and probably a lot more than we can say at this stage about a concrete program for income distribution or for elimination of mass poverty.

Another theme that appeals to me is a sober analysis of the emerging mood and compulsions in the Third World. But it is a politically charged issue and hardly appropriate in a year that we seek IDA replenishment. It may still be a good theme for 1975 in the context of a mid-year assessment of achievements and failures of the Second Development Decade.

cc: Mr. Kuczynski

MHaq/wh

Possible Main Themes for Mr. McNamara's  
Annual Meeting Speech in Nairobi

A. Education. If possible, the Meeting speech should be centered on something of special interest to Africa. The advantages of education as a central theme are:

- i. Clearly of special relevance to Africa.
- ii. 44% of Bank Group education lending has gone to Africa.
- iii. An operational subject: solid achievements behind us, and a 50% expansion in the five years ahead.
- iv. Not controversial with Part I countries, an important point at a time of IDA replenishment.

B. Regional Integration. Again, of special relevance to Africa, or at least to what Africans think of themselves. Advantages:

- i. The Bank has never said much on the subject (although others have).
- ii. Again, not controversial with Part I countries.

But there are drawbacks:

- i. Something of an old saw; smacks too much of God and Motherhood.
- ii. The Bank has not done much in this field, except in East Africa.

C. Policies toward growth, fuller employment and redistribution. Various sub-themes could be grouped together, as a prescriptive sequel to the 1972 speech. The various topics to be covered would be:

- i. The dearth of public savings and regressiveness of tax systems in most LDCs.
- ii. The overvaluation of currencies and distortions in trade and exchange systems in many LDCs and their effect on growth and employment.
- iii. Continued restrictions to LDC exports in most industrial countries.
- iv. The absence of specific policies towards fuller remunerative employment in LDCs (could draw on findings of various research projects).

Some disadvantages:

- i. The resulting prescriptions are not new; the subjects lack punch of a single theme.

- ii. The Bank extends little technical assistance in fiscal and employment areas, aside from recommendations in our economic reports.
- iii. Are we willing to change some of our policies faster towards employment goals? (e.g. by favoring local contractors, giving a preference to bidders who use more labor).

cc: Mr. Haq

## OFFICE MEMORANDUM

File *Mr Namera's*  
~~Research~~

TO: (See Below)

DATE: October 5, 1972

FROM: S. Reutlinger *S.R.**Speech*SUBJECT: Land Tenure Study

In the attached research proposal, Mr. Eckstein has outlined his present program of work on the land reform study. The emphasis will be on the interaction of land tenure structure with institutions serving agriculture and investment packages in the process of promoting rural development. Therefore the study should be of very direct interest to the Bank.

Mr. Eckstein has recently joined the Agriculture and Rural Development Division staff on a fixed term appointment for approximately one year. You probably will have occasion to meet with him sometime to exchange views on matters related to his work. We would, however, particularly welcome comments at this time in order that these could be accommodated in Mr. Eckstein's study. His extension is 2755.

Attachment

SReutlinger:coh

Distribution

Messrs. Chenery  
Stern  
Henderson  
Stevenson  
Churchill  
Hawkins  
Keare  
Price

Messrs. Evans  
Yudelman

Messrs. Avramovic  
Goffin  
Nelson  
Ross  
Kuczynski ✓  
Lerdau  
Hipskind  
Miller  
Sonley  
Pfeffermann

## RESEARCH PROPOSAL - LAND TENURE AND RURAL DEVELOPMENT STRATEGIES

### General Orientation

The general framework for this proposal is established by the Bank's Agricultural Sector Paper of June 1972:

- (a) "The challenge for agriculture is to combine an acceptable rate of growth of production with movement towards --- the goals of creation of employment opportunities and alleviation of poverty" (pp. 3,4).
- (b) "Governments should pursue land policies which help disperse the benefits of agricultural progress widely" (p. 35) through "land reforms aimed at securing a more equal distribution of land" (p. 30).

In this context, the basic question to be examined is: based on existing experience with a variety of land reform approaches in Latin America, how can land reforms assist in reaching simultaneously these primary development goals of raising output, achieving a more equitable distribution of income, and creating employment opportunities.

### Problems to be Analyzed

What has been the role that distributive land reforms have played in the economic development process, both directly within agriculture and indirectly in other sectors?

What are the complementarities and possible trade-offs between growth promoting and income distributing effects of various kinds of reforms? Is there a significant time lag?

How can land reform be turned into an effective tool for the redistribution of productive capacity, employment opportunities and hence income generating power?

To what extent can land reform induce technological innovations that will produce positive effects both in the production and in the distribution spheres?

What sort of reform policies can raise the productivity of labor without necessarily displacing workers?

What are the lessons of the role of reforms on economies of scale and what tenure models could achieve such scale economies within the basic objective of income redistribution?

Cooperative, collective or group farming is usually cited as a major solution to land tenure problems; where and under what conditions has it worked satisfactorily, and what lessons for future group farming schemes emerge?

"Integrated smallholder development" is another favorite prescription; how can land tenure changes be used as a basis or catalyst for such programs in technical, organizational, institutional, and financial terms?

The joint provision of an extension-credit-insurance-marketing "service package" is the economic basis for rural development -- how is this related to land tenure changes?

On the macro level, one of the main constraints to a massive increase in rural income through an output boost, is the low elasticity of demand for crops produced by poor farmers; under what conditions can land reform relax this constraint?

Proposed Research Method

Land reform was neither conceived nor carried out in a unique manner in different places and times. The analysis will be made in terms of a typology of the diverse reform policies and programs on which experience is available. The above-mentioned problems will hence be examined within the specific context of each reform type.

Clearly, each of the topics listed constitutes a title for a self-contained and **thorough** study by itself. It is not our intention to do all this, but rather to draw on existing evidence and experiences, going into depth only in those areas where existing data permit and the clarification of the whole picture justify it.

Nonetheless, it will be intended with regard to each of the major issues to **arrive** at meaningful and relevant conclusions, in three stages:

- (1) What has happened in practice? (Estimation of the real output, income and employment effects of diverse reform policies, and appraisal of the general and specific causes for this outcome in each case.)
- (2) What would be the feasible optimum conditions and organizational structure, at all operational levels? (Identification of promising reform designs, models of new tenure organizations and of supporting institutions.)
- (3) Appropriate strategy or policy conclusions and expectations bearing on the major development objectives.

The approach will be empirical and pragmatic without neglecting the theoretical and "forward looking" perspective.

Empirically, the experience gained in some Latin American countries in these matters will be thoroughly examined, as to why have some experiments

in tenure innovation failed, and what has contributed to the success of others. In the "forward-looking" realm, lessons will be drawn from this experience that are of practical relevance and use to rural development planning and implementation elsewhere.

Pragmatically, land tenure innovations, institutional arrangements, and rural development policies that offer promise of attaining the above-mentioned goals, will be assessed on all operational levels, but with special focus on the local level.

#### Scope of Study

It is proposed to concentrate on the Mexican experience, which is by and large the oldest, richest, and of largest scale in the region, drawing in relevant comparative material from Venezuela, Bolivia, Chile and Peru which have some very interesting experiences of more recent years.

Major emphasis will be put on the applicability of lessons for other countries and areas.

#### Contribution to Bank Research Objectives

It has been repeatedly stated, that the Bank has to address more attention to issues related to land reform. This the proposed study intends to accomplish.

It will increase the knowledge of the rural development process, as it is affected by and affects the alternative land reform policies, and will thereby establish factual basis for future Bank policy in this area.

It will also help in relating specific programs and projects designed to foster rural development, to the existing or projected land tenure setting, and facilitate the Bank's assistance for the preparation of investment projects in this area.

The proposed study ties in very organically with some of the other studies, presently being done in the Division, that dwell on the same issues mentioned above (components of rural development programs and projects, institutional and management aspects of agricultural development projects, farm mechanization in India and Pakistan, marketing problems in LDC, etc.), but without specific reference to the related tenure problems.

#### Plan of Work

1. Highly selective and critical examination and evaluation of reports and case studies (especially unpublished, original, grass-roots-level research material).
2. Statistical analysis of data collected in field surveys of Mexican CIDA Land Tenure Study, available here, together with comparable data whenever available from other sources and countries.
3. Brief field visits and survey of major relevant projects in some of the countries studied.
4. Interviews of and discussions with professional, technical, and administrative personnel involved in these projects.
5. Preparation of report and discussion with Bank staff.

#### Professional Staff

Dr. Shlomo Eckstein on a full-time basis (one year), and a Senior Consultant on a part-time basis (about three months during a 12-month period), with adequate research assistance.