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MANAGING COMMITTEE ERS/MC 85

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

—For MC Consideration Nov. 25/85
R E C O R D E-1227

ERS/MC85-13

DATE November 14, 1985

TO Managing Committee

FROM Anne O. Krueger aok

EXTENSION 33774

SUBJECT Report on Research

Attached is a draft of the report on research covering FY85 which has benefitted from comments from members of the Research Policy Council; the Research Projects Approval Committee; OPS, ERS, EIS and regional Department Directors. Part 1 of the report besides providing a summary of the financial and administrative aspects of Bank research, outlines the results of a recent review of the new research administration procedures introduced last year, the new initiatives undertaken by the Research Policy Council to disseminate the results of Bank research, and the results of the evaluation of a large backlog of completed research projects by the Research Projects Approval Committee. The current status of the comparative studies program initiated by the RPC in early 1984 is presented along with a summary description of the new starts in the research program in line with the research priorities laid down by the RPC in FY84. Finally, the last section provides some research results from recently completed projects as well as from some ongoing ones.

As presently scheduled, this report will be circulated to the Board on December 16 for discussion on January 16.

DL:lt

Report No.

FOURTH DRAFT

REPORT ON THE WORLD BANK
RESEARCH PROGRAM - PART I

November 14, 1985
Office of the Vice President,
Economics and Research Staff

LTR/AR85/11.14.85

REPORT ON THE WORLD BANK RESEARCH PROGRAM

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INTRODUCTION

Fiscal year 1985 represented a period of consolidation for the Bank's research program, during which the changes in the administration of research and the shifts in the research program in accordance with the new research priorities outlined in last year's report were implemented. The new research administration procedures introduced last year were reviewed by a committee set up by the Research Policy Council (RPC) at the end of FY85. Also, important new initiatives were undertaken by the RPC for the dissemination of research results, while the Research Projects Approval Committee (REPAC) completed its evaluation of a large backlog of completed research projects. Finally, in the comparative studies program two new studies were fully funded and research preparation for another approved in FY85. This report describes these developments.

The report has two parts. Part I provides a summary of the financial and administrative aspects of Bank research (Section I), outlines the objectives the Bank's research program seeks to serve, its current research priorities, a description of the current status of the comparative studies program which was initiated by the Research Policy Council in early 1984, as well as an overview of the new research starts approved during the year (Section II).

As noted in last year's report, the RPC was concerned about the evaluation of the output of research projects funded by the Research Support Budget (RSB). In FY85 REPAC conducted a major evaluation of the backlog of completed research projects. The results are highlighted in Section III whilst the detailed evaluation reports of the subject panels are presented in the annex to Part I.

Another major concern of the RPC over the past year was the improvement of the dissemination of Bank research outputs both within and outside the Bank. This led it to approve the establishment of three new research publications to disseminate Bank research. These developments are reported in Section IV.

In accordance with the Board's stated desire for this report to focus on the output and impact of the research program, Section V presents some research results of recently completed projects, as well as the preliminary findings of research work in progress in different parts of the Bank.

Finally, the narratives of research projects financed from the Research Support Budget which were ongoing in FY85 are presented in Part II of the report.

I. Finance, Size and Administration of the Research Program [1/]

Research in the World Bank is conducted mainly in ERS, OPS and EIS. In FY85, the World Bank devoted a total of $23.1 million to economic and social research, an increase in real terms of 2.6 percent over FY84. Although this increase is much smaller than that reported for the previous year (15 percent over FY83), the share of research in total Bank administrative expenses has remained constant at 3.5 percent (see Table 1). Research constitutes about one-fifth of the total analytical work undertaken in the Bank in support of its lending activities. The two other major components of the Bank's analytical work are country economic and sector work, and policy analysis. As it is often difficult to differentiate between these three forms of analytical activity, the above distinctions are mainly of budgetary use.

Of this total expenditure on research $4.8 million was funded by a central Research Support Budget (RSB). This budget, administered by VPERS, allows researchers in all parts of the Bank to compete for funds to finance consultants, research assistance, computing and travel in connection with research projects which have been centrally approved. The rest represents the cost of staff time spent by Bank researchers on both RSB-funded research projects ($8.1 million) and on studies initiated by Bank departments ($10.1 million). Taking the RSB and stafftime expenditures together, centrally

1/ The Bank's research program comprises research projects which are centrally approved and funded through the Research Support Budget and other studies initiated and supported by departments through the allocation of stafftime. It explicitly excludes research financed under loans and credits and research of a technical nature, such as that funded by Bank participation in the Consultative Group on International Agricultural Research (CGIAR).

Table 1: RELATIONSHIP OF RESEARCH TO OTHER BANK ANALYTICAL WORK AND ADMINISTRATIVE BUDGET
(Current US $ million; percent of Bank analytical work)

	FY80		FY81		FY82 a/		FY83 a/		FY84 a/		FY85 a/	
	$	%	$	%	$	%	$	%	$	%	$	%
Research	11.4	20.4	15.8	20.5	16.6	16.0	17.8	16.0	21.7	19.2	23.1	20.5
Economic and Sector Work	34.7	62.2	48.5	62.8	63.5	61.4	69.5	62.3	72.4	64.0	71.2	63.3
Policy Work b/	9.7	17.4	12.9	16.7	23.4	22.6	24.2	21.7	19.1	16.9	18.2	16.2
Total Analytical Work	55.8	100.0	77.2	100.0	103.5	100.0	111.5	100.0	113.2	100.0	112.5	100.0
Memo Item: Research as a % of Bank Administrative Expenses	3.4		3.6		3.3		3.2		3.5		3.5	
Memo Item: Research Expenditure in constant 1985 dollars	17.6		19.8		19.3		19.5		22.5		23.1	

Notes: Source: PBD. Details may not add due to rounding.
a/ Revised.
b/ Includes ERS, OPS and EIS policy work only.

approved projects account for 56 percent of total research expenditures, compared to 44 percent for departmentally-funded studies and research preparation. These proportions have remained the same as in FY84 (Table 2).

Table 3 provides the breakdown of Bank research by departments, distinguishing between centrally approved projects, research preparation and departmental studies. In FY85, ERS, the main research complex, was responsible for 48.1 percent of Bank research, while OPS/EIS and the Regional Offices were responsible for 44.9 percent and 6.9 percent respectively. This reflects no significant change from FY84. Table 4 shows the distribution of resources devoted to research in FY85 by subject category rather than by organizational unit.

The RSB is the main instrument for coordinating research throughout the Bank, and for influencing its direction and quality. As reported last year, the RPC has sought to make Bank research more policy-oriented, cost-effective and quicker yielding in its results. Reflecting these new directions the new research projects approved from the RSB by the Research Projects Approval Committee (REPAC) during FY85 have tended to be of smaller size than in the past. Consequently, they are typically also of shorter duration so that for them the interval between the inception of a research idea, execution of the research project and the dissemination and application of research results will be shortened. Equally important, projects have become more focused on policy-oriented research.

Most of the large research projects approved in FY85 formed part of the special program of comparative studies (described in Section II) which are approved directly by the RPC, and these accounted for 29 percent of RSB expenditures in FY85.

Table 2: RESOURCES [a/] DEVOTED TO RESEARCH BY COMPONENT, FY78-85
(percent of total research resources)
Current US$ million

	FY78		FY79		FY80		FY81		FY82 b/		FY83 b/		FY84 b/		FY85 b/	
	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	%
Centrally Approved Research c/	5.7	60.6	7.3	70.9	7.8	68.4	8.7	55.1	8.5	51.2	10.3	57.9	12.2	56.2	13.0	56.3
of which																
-Research Support Budget	(2.2)		(2.9)		(2.7)		(2.6)		(2.6)		(3.3)		(3.7)		(4.8)	
-Staff Costs	(3.5)		(4.4)		(5.1)		(6.0)		(5.9)		(7.0)		(8.6)		(8.1)	
Departmentally Funded Research Studies d/ (staff time costs)	3.8	40.4	3.0	29.1	3.6	31.6	7.1	44.9	8.1	48.8	7.5	42.1	9.5	43.8	10.1	43.7
TOTAL RESEARCH	9.4	100.0	10.3	100.0	11.4	100.0	15.8	100.0	16.6	100.0	17.8	100.0	21.7	100.0	23.1	100.0

Note: Percentages do not add, due to rounding.
a/ Includes all administrative costs.
b/ Revised.
c/ Includes the full costs of all research activities which were reviewed and approved by the Research Projects Approval Committee, and the comparative studies program which is reviewed by the Research Policy Council.
d/ Research activities conducted using departmental resources only and not subject to review and approval by the Research Projects Approval Committee. These studies were carried out by the departments listed in Table 3.

TABLE 3: RESOURCES DEVOTED TO RESEARCH, BY DEPARTMENT a/, FY85
(CURRENT US$ 000; STAFF YEARS)

	Centrally Approved Projects				Research Preparation		Departmental Studies		Total Research			
	Research Support Budget Expenditure	Staff		Total Costs	Staff		Staff		Staff		Total Research	
		Time b/	Costs c/		Time b/	Costs c/	Time b/	Costs c/	Time b/	Costs c/	Costs d/	%
Operations Policy Staff												
Agriculture and Rural Development	392.8	1.4	297.8	690.6	2.5	541.5	2.2	483.8	6.1	1323.1	1715.9	7.4
Country Policy	1250.6	3.4	738.0	1988.6	1.7	377.2	2.0	427.5	7.1	1542.7	2793.3	12.1
Education and Training	273.9	.6	126.2	400.1	2.2	483.5	.4	83.0	3.2	692.7	966.6	4.2
Population Health and Nutrition	21.5	.2	46.4	67.9	.1	25.0	2.3	493.6	2.6	565.0	586.5	2.5
Transportation	146.0	3.1	675.4	821.4	.0	.0	4.0	863.3	7.1	1538.7	1684.7	7.3
Water Supply and Urban Development	209.1	2.0	423.2	632.3	.6	127.2	.2	49.5	2.8	599.9	809.0	3.5
Projects Policy	72.5	.0	7.4	79.9	.0	.0	.7	157.4	.8	164.8	237.3	1.0
Economic Development Institute	.0	.0	.0	.0	.0	.0	1.0	219.5	1.0	219.5	219.5	1.0
Office of the Vice President - OPS	80.6	.0	5.8	86.4	.0	.0	.2	45.8	.2	51.7	132.3	.6
Total	2447.0	10.7	2320.1	4767.1	7.2	1554.5	13.0	2823.4	30.9	6698.1	9145.1	39.6
Energy and Industry Staff												
Energy	.0	.0	.0	.0	.0	.0	1.6	342.8	1.6	342.8	342.8	1.5
Industry	70.7	1.3	280.2	350.9	.0	.0	2.5	526.0	3.9	806.1	876.8	3.8
Total	70.7	1.3	280.2	350.9	.0	.0	4.2	868.8	5.5	1148.9	1219.6	5.3
Economics Research Staff												
Development Research	1482.5	20.1	4457.9	5940.4	7.2	1606.3	6.7	1479.4	34.0	7543.6	9026.1	39.1
Economic Analysis and Projections e/	60.3	1.1	253.9	314.2	.6	128.1	2.5	557.0	4.2	939.0	999.3	4.3
Office of the Vice President - ERS	366.3	1.7	378.9	745.2	.4	86.2	1.1	246.5	3.2	711.7	1078.0	4.7
Total	1909.1	22.9	5090.7	6999.8	8.2	1820.6	10.3	2283.0	41.4	9194.3	11103.4	48.1
Regions	411.1	2.0	426.1	837.2	.0	4.5	3.6	760.6	5.6	1191.2	1602.3	6.9
Other f/	.0	.0	1.4	1.4	.0	.0	.0	2.1	.1	3.5	3.5	.0
Total	4837.9	37.0	8118.4	12956.3	15.4	3379.6	31.1	6737.9	83.5	18235.9	23073.8	100.0

NOTE: Details may not add due to rounding.

a/ Include all administrative costs.

b/ Data on staff time are taken from the Bank's time reporting system. They include regular professional, departmental consultant, and Y.P. staff years only.

c/ Cost factors used are all-inclusive average unit costs by vice-presidency.

d/ Includes research support budget expenditure and total staff time costs.

e/ Excludes routine work on commodity analysis and projections.

f/ Young Professionals Program, and research done under collaborative arrangements with UN organizations.

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TABLE 4: RESOURCES DEVOTED TO RESEARCH, BY SUBJECT CATEGORY, 1985
(CURRENT US$ '000; STAFF YEARS)

	Centrally Approved Projects				Research Preparation/ Departmental Studies		Total Research			
	Research Support Budget Expenditure	Staff Time b/	Staff Costs c/	Total Costs	Staff Time b/	Staff Costs c/	Staff Time b/	Staff Costs c/	Total Research Costs d/	Total Research %
I. Development Policy and Planning										
1.A. Income Distribution	156.7	2.4	531.1	687.8	2.3	500.1	4.6	1031.2	1187.9	5.1
1.B. Planning Growth, Ctry. Econ. Analysis	611.8	3.8	839.7	1451.5	9.5	2077.7	13.3	2917.5	3529.3	15.3
Subtotal	768.5	6.2	1370.8	2139.3	11.7	2577.9	17.9	3948.7	4717.2	20.4
II. International Trade and Finance	1449.6	8.5	1871.3	3320.9	2.5	543.3	11.0	2414.7	3864.3	16.7
III. Agriculture and Rural Development	1112.0	8.0	1751.8	2863.8	5.1	1117.1	13.1	2869.0	3981.0	17.3
IV. Industry	191.3	3.4	729.7	921.0	1.7	359.1	5.1	1088.8	1280.1	5.5
V. Transportation, Water and Telecommunication	97.5	2.9	639.3	736.8	4.0	861.6	6.9	1501.0	1598.5	6.9
VI. Energy	136/0	1.1	243.7	379.7	1.6	334.5	2.7	578.2	714.2	3.1
VII. Urban and Regional Development	281.1	3.2	698.4	979.5	.8	171.7	4.0	870.1	1151.2	5.0
VIII. Population and Human Resources										
VIII.A. Education	377.7	2.4	528.2	905.9	2.3	497.7	4.7	1025.9	1403.6	6.1
VIII.B. Labor and Employment	3.0	.1	23.9	26.9	1.9	421.8	2.0	445.7	448.7	1.9
VIII.C. Population and Health	185.4	1.0	212.2	397.6	3.1	667.5	4.1	879.7	1065.1	4.6
Subtotal	566.1	3.5	764.2	1330.3	7.3	1587.1	10.8	2351.3	2917.4	12.6
IX. Other	235.8	.2	49.2	285.0	11.7	2565.1	12.0	2614.3	2850.1	12.4
Total	4837.9	37.0	8118.5	12956.4	46.5	10117.5	83.5	18236.0	23073.9	100.0

See footnotes in Table 3.

LTR/AR85-IT/10.24.85

Three important developments took place in the administration of research during FY85 concerning regional coordination of research, the evaluation of completed research projects, and in the dissemination of research results. First, to facilitate better communication and coordination between the Regional offices and the research staff responsible for the comparative studies, the Comparative Studies Coordination Committee, consisting of the six Regional Chief Economists and the Research Administrator, was established. Second, REPAC undertook to evaluate the backlog of completed research projects, with REPAC members acting as chairmen of six subject panels under which the research projects were organized. They were assisted by internal, external and OED reviewers who submitted evaluation reports on individual projects which were used by the chairmen in preparing both reports on individual projects and subject panel reports. Third, following the decision by the RPC to publish two new journals, The World Bank Economic Review and The World Bank Research Observer, and to restyle the Research News, editors and managing editors were appointed to launch these publications, along with editorial boards charged with the responsibility of selecting or commissioning articles for inclusion in the journals. The development of an infrastructure in the Research Administrator's Office to support the production of the three research publications has also progressed satisfactorily. These will be taken up in the subsequent sections in greater detail.

Review of the Reorganization of Research Management

Following the reorganization of research administration outlined in last year's Annual Report, the main bodies overseeing the allocation, monitoring and evaluation of funds spent from the RSB are: (i) the five-member vice-presidential Research Policy Council (RPC) which has overall responsibility for guiding and coordinating research; (ii) a Bank Research Advisory Group (BRAG) consisting of eighteen senior staff from all parts of the Bank which advises the Council on Bankwide research issues; and (iii) The Research Projects Approval Committee (REPAC) consisting of nine senior staff members, which assesses the technical quality of research proposals submitted for funding from the RSB, and evaluates completed projects. (REPAC's rules and procedures are given in Appendix 2). Supervising managers in the research producing departments are responsible for ensuring the institutional relevance of research proposals and their conformity to the research priorities set by the RPC.

A three-member committee was appointed in FY85 by the Research Policy Council to review these changes in research administration. The Committee reviewed the relevant files and documents in the Research Administrator's Office covering the period February 1984 (when REPAC was formed) to July 1985 and interviewed a large number of Bank staff covering all parts of the Bank and a wide spectrum of its hierarchy. It reported in October 1985. In the following paragraphs we first summarize its findings on the distribution of research projects; its assessment of the REPAC review process and its recommendations which were accepted by the RPC. Next we outline its recommendations (and the actions taken by the RPC) on the size and functions of REPAC, on BRAG and on changing some adverse perceptions of the new system.

(1) The Distribution of Research Projects

Over the period under review, REPAC, as a full committee, met eleven times mostly to discuss proposals requesting more than $125,000. In addition to these meetings, according to the current rules, subcommittees of REPAC met several times for projects requesting less than $125,000. During this period, REPAC reviewed 94 projects, 11 of which were in Category A (more than $125,000), 9 in Category B ($50,000-$125,000) and 74 in Category C (less than $50,000). The average turnaround time for the review of these projects was 10 weeks for Category A; 5.6 weeks for Category B; and 2.3 weeks for Category C.

As originally intended, the new rules and procedures implemented by the Research Policy Council have shifted the incentives provided to research sponsors away from submitting large research proposals towards smaller ones. Of all the projects submitted to REPAC, 79 percent were for projects of less than $50,000, whereas the other two categories combined accounted for 21 percent. 1/ Furthermore, there appears to be a strong regional involvement in requesting research funds. Thirty-two requests were received from the regions; the distribution was as follows: four were received from East Asia; seven from South Asia; three from East and South Africa; six from West Africa; six from EMENA; and six from LAC. ERS submitted 36 requests and OPS 45 during the period covered by this review. 2/

Over this same time period, REPAC approved 68 percent of the research proposals submitted. Because some proposals are approved at less than full funding while others are totally rejected, REPAC has approved 42 percent of the dollar amounts requested; total requests for research funds amounted to

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1/ Since seven of the eleven requests for more than $125,000 were submitted either for REPAC's initial February 1984 meeting or were unfinished business of the old Research Committee, the tilt towards smaller proposals under the new procedures may be even stronger than the data indicates.

2/ The total number of funding requests (113) exceeds the total number actually submitted (94) because a request may be sponsored by more than one organizational unit, in which case the request is ascribed to each of the participating departments.

$9.048 million while $3.793 million were approved. Considering only research proposals actually approved by REPAC, the dollar amounts approved as a percentage of the amounts requested were: 58.4 percent for projects in Category A; 61.4 percent for projects in Category B; and 90.7 percent for projects in Category C. For all approved proposals, 62.8 percent of the dollar amounts requested were approved by REPAC. This can be interpreted to mean that, on average, a research proposal has a 68 percent chance of approval, though at less than full funding. The approval rate by department and size category of the projects is shown in Table 5.

(2) The Reviewing Process

As required by current RPC rules all proposals submitted to REPAC have been refereed by at least two individuals. All proposals requesting funds over $50,000 have had internal and external referees. The Committee found the internal (Bank staff) and external referees chosen were of high quality and well matched to individual proposals. The anonymity of the referees contributed significantly to the quality of reviews. This arms-length approach to evaluation has effectively eliminated "interpersonal strategic considerations" (seen as a major problem of the old system by the OPD review committee as outlined in last year's Annual Report) and provided more honest evaluations. The Committee found a clear consensus among researchers and reviewers that this refereeing process and system of speedy decisionmaking are fair and effective and superior to the old system. The Committee, therefore, recommended and the RPC accepted that the current process of evaluation be largely maintained and the anonymity of internal and external referees be preserved.

Table 5 REPAC Approval Rate

	ERS			OPS	Regions	Bankwide Total
	DRD	EPD	Total			
Category A (more than $125,000)						
% proposals approved	75	0	60	67	33	57
%$ amount approved	41	0	37	60	15	38
Category B ($50,000-$125,000)						
% proposals approved	80	-	80	67	33	64
%$ amount approved	46	-	46	43	12	36
Category C (less than $50,000)						
% proposals approved	69	78	73	79	58	71
%$ amount approved	52	63	55	62	41	53
TOTAL A + B + C						
% projects approved	72	70	72	76	53	68
%$ amount approved	44	40	43	57	22	42

Note: A "-" indicates no proposals were received by REPAC in that category.
A "O" indicates that none (of those received) was approved.

Proposals requesting funds under $50,000 which, under the existing rules, do not require referees, have increasingly been sent to internal and external referees and in the last few months this has become the norm. The Committee suggested that this practice should be formalized as the benefits to researchers of the detailed comments from referees' outweigh any costs of the associated delays in the review process. The RPC accepted its recommendations that:

(i) for all projects under $50,000, at least two referees' reviews be obtained (if possible, one should be external) and a decision be made within two weeks;

(ii) requests for research preparation funds should continue to be decided by the Research Administrator; for research preparation requests that exceed $30,000, he should solicit the views of at least two other REPAC members.

(3) The Size, Composition And Function of REPAC

REPAC currently consists of nine members: three from ERS, two from OPS, one from EIS, and three from the Regions. The frequent meetings of REPAC, the large number of proposals to be evaluated, and the importance of a fast turnaround time impose a fairly heavy work load on individual members.

To ease the workload, to generate and maintain support for research in the operations complex (particularly in the regions), and to ensure stronger interaction between researchers and the regions, the Committee recommended and the RPC approved:

(i) an expansion of REPAC by two members with operational experience selected from the regions;

(ii) the RPC replace about 25 percent of the members of REPAC every two or three years.

The Committee also noted that there was some misunderstanding of REPAC's technical functions in reviewing proposals. It suggested and the RPC accepted that:

(iii) as part of its technical functions REPAC should also take account of the proposal's broad conformity with the research priorities laid down by the RPC.

(4) The Bank Research Advisory Group (BRAG)

During the period under review by the Committee, BRAG met only twice. The Committee found that its terms of reference are not clear to its members and as a body it lacks clear focus and direction. In many ways, the Committee believed that whatever the original motivation for instituting BRAG, continuation, in its current mode, was counterproductive. The RPC accepted the Committee's recommendations that BRAG be replaced by the Comparative Studies Coordination Committee which would be expanded and renamed the "Research Coordination Committee" (RCC); it would coordinate relationships between the regions and research producing departments on all research projects. Furthermore, the RPC accepted the Review Committee's recommendation that in order to obtain Bank-wide views on specific research related issues, 'ad hoc' committees will be set up, as the need arises.

(5) Perceptions

Finally the Review Committee noted two areas where there was a need to redress some jaundiced perceptions of the new research procedures.

The first concerned the transparency of the new system. The Committee noted that transparency was defined differently by different individuals. Even though information on the new procedures, the new research priorities and the content of the program is disseminated via Operational Manual statements, annual reports and various memoranda, there was a strong criticism by both researchers and other Bank staff that they are poorly informed about REPAC and RPC procedures. The Committee did not subscribe to the view that all individuals in the Bank must be fully informed about all aspects of research and its management. The RPC concurred. However, in an attempt to change these perceptions, but without adding to the already large flow of paper in the Bank, the RPC accepted the Committee's recommendation:

> to use both the new Research News and the new Research Coordination Committee as the major instruments for disseminating such information.

Secondly, the Committee reported that there was a lack of information and corresponding misperceptions about the procedures for the inclusion and appraisal of particular studies in the special comparative studies program.

It was noted that the current procedures for the comparative studies recognize the inherent risks and the large investments required in their design; they attempt to minimize these risks by specifying the topic, requiring a pre-project proposal brief -- designed to outline the major issues/questions and their relevance to policy and the Bank -- and setting up a Review Board (made up of external and internal referees) for each study, which evaluates both the pre-project proposal brief and the final research proposal itself and subsequently monitors the progress of the study until its completion. Nevertheless, to overcome the misperceptions about these procedures, the Committee suggested and the RPC accepted that:

REPAC would examine the Review Board's recommendations on subsequent comparative studies and its judgment would be submitted to the RPC, which would still take the final decision on the approval of the study.

The above measures taken by the RPC should allay these perceptions about the transparency of the system.

II. The Research Program: Objectives, Priorities and New Developments

Research Objectives

The Bank's research program continues to be guided by the broad objectives stated in last year's Report on the World Bank Research Program: to support all aspects of the Bank's operations; to broaden understanding of the development process; to improve the Bank's capacity to provide advice to member countries; and to assist in developing indigenous research capacity in member countries. These objectives underline the twin functions that research performs in the Bank, both supporting Bank operations as an intermediate input - increasingly important as the role of the Bank as a policy advisor to developing countries expands - and as one of the important final outputs of the Bank, in keeping the Bank in the forefront of thinking on the economics of developing countries, and sharing research results with the development community.

In translating these broad objectives into more specific research program priorities, last year's Report noted the changed perception of the development process which has led to new research directions by the RPC. This essentially reflects the evolution of knowledge about the development process from the interaction of research results and experience. Unlike the natural sciences, there are no real scientific revolutions in economics, but as Professor Sir John Hicks has noted most revolutions in economic thought are more in the nature of a "change of attention." Economic theories underpinning beliefs about the workings of an economy, which at particular times are fairly appropriate, are subsequently rejected in the light of changing circumstances. Whereas in the natural sciences 'the facts' to be explained are in a sense immutable, in economics 'the facts' are thrown up by a constantly changing world: "a theory which illumines the right things at one time may illumine the wrong things at another. This may happen because of changes in the world (the things neglected may have gained in importance relatively to the things considered) or because of changes in ourselves (the things in which we are interested may have changed)." 1/

Perceptions of development have changed in recent years, in part because the world has changed, in part because earlier research answered some important questions and led to policies that reduced the magnitude of the problems that then seemed central, and in part because of the burgeoning of empirical research which has contributed so greatly to our knowledge about the economics of developing countries.

In an important sense, the change can be summed up as an increased recognition of the importance of markets and incentives - and of the limits of government intervention and central planning.

But, having said this, it must be emphasized that the current reappraisal of the role that governments should play in development does not entail any commitment to laissez faire and research must be directed as much to understanding how governments act and can be effective as to understanding the functioning of markets. One of the most important functions of government is to establish and maintain the countries' 'infrastructural' and 'social overhead capital,' such as roads, communications, ports, primary education, primary health services, etc., much of which have some features of a public

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1/ J.R. Hicks: 'The Scope and Status of Welfare Economics,' Oxford Economic Papers, Nov. 1975, p. 320.

good. In addition and not to be underestimated are the classical governmental functions of providing the public goods of law and order and a sound money, as well as an economic environment where individual thrift, productivity and enterprise are cherished and not thwarted.

The successful economies in the Third World which have recognized the importance of markets and incentives are not laissez faire economies. Their success is in large part due to the importance attached by their governments to providing these essential public goods required for development. Even though these governments have not fully succeeded in avoiding policy induced distortions in their economies, compared with the less successful developing countries they have concentrated the state's energies and resources relatively more on doing those things which only governments can do, and less on those areas of economic life which are by and large best left to private agents.

Once it is recognized that individuals respond to incentives, and that "market failure" is the result of inappropriate incentives rather than of nonresponsiveness, development economics becomes an "applied applied field," in which the tools and insights of labor economics, agricultural economics, public finance, and so on are addressed to the special questions and policy issues that arise in the context of development.

The modern view of development focuses on both resource accumulation and improving the efficiency of resource use. This latter concern concentrates on improving markets -- by institutional methods such as developing the capital market, by governmental provision of public goods such as agricultural research and extension services, and by removing government-imposed impediments to economic efficiency such as import licensing, currency overvaluation and other regulations that drive a wedge between private and economic profitability.

This is not to downgrade the importance of resource accumulation. All observers recognize that countries with low per capita incomes have little physical and human capital per head, and that increasing capital is essential to growth. However, given the earlier emphasis on resource accumulation and the fact that many developing countries have dramatically increased savings rates without raising their growth rates, analysis of the efficiency issues has understandably come to the fore in recent years.

Research Priorities

In view of these changing perceptions of the development process, last year's Annual Report reported a new set of research priorities approved by the RPC, which are listed in Appendix 1. They imply a shift in the research program toward greater emphasis on research oriented to making policy and less efforts to understand what would happen in an optimizing society where all regulations could be exogenously imposed and costlessly enforced; it is away from big modeling enterprises for planning and forecasting and toward studies of how individuals, institutions, and governments behave in different economic environments.

In summary, five broad areas have emerged as the most important ones for supporting the Bank's operations and for keeping the Bank at the forefront of the economics of developing countries.

- The costs and benefits of government intervention. As knowledge has increased, a central question is what governments can achieve, and how governments behave. In a sense, the effort is to understand the functioning of governments, in both a positive and normative sense, in much the same way as so much sophisticated analysis has gone into analyzing the functioning of markets.

- The interplay of incentives and institutions. How do various institutional arrangements affect the workings of various policy measures? How do these same measures impinge on private and public agents?

- The interaction between DCs and LDCs in the world economy. Especially in light of the experience of the successful developing countries with outward oriented strategies, improved understanding of the interactions between developed and developing countries becomes increasingly urgent. Studies in this area seek to understand the linkages between DCs and LDCs and the impact of policy measures on them. This line of research also analyzes what global trends mean for developing countries and their policy choices.

- The way short-term policies affect long-term development. Focus here is on the link between policies geared at short-term macroeconomic balance and those aimed at long-term growth with emphasis on complementarities and trade-offs between shortrun and longrun objectives.

- The role of economic planning. Given that the physical planning models of the 1950s and 1960s no longer seem the central element of policy concern, a question arises as to the appropriate role of planning for development. As already indicated, the emerging view of government gives it a strong positive role in areas of both infrastructural development and institutional improvements. The research effort generally will shift from comprehensive planning models for economies or sectors to studies of institutional planning and development, and an analysis of how effective planning of public sector investment programs, expenditures, and receipts can best be undertaken in ways conducive to development. A major question is the ways in which rules may be modified and institutions developed or changed so as to be supportive of better functioning of markets and more effective government intervention, where appropriate.

In several of these areas, a major question of concern for the Bank is the effectiveness of aid in the development process. One particular focus of research cutting across all five lines of inquiry, relates to the lessons that may be learned from past foreign assistance to improve its effectiveness in the future.

The Comparative Studies Program

Some, though by no means all, of the priority questions are ones which, at the present time, existing theory cannot answer. Much of the needed research is inductive and positive in nature: how has trade liberalization proceeded? What has happened when countries have attempted to control agricultural prices? And so on. Once policies are put in place, what pressures arise to alter them over time? And how are they actually implemented? The fact that different developing countries have addressed similar policy concerns in different ways provides a number of 'experiments' from which a great deal can be learned.

While an analytical framework is essential for addressing these questions, they are at heart empirical. And, because policies are implemented over time for purposes of empirical analysis, a major problem of addressing these questions on a country-by-country basis is that focus is on evolution over time, and analysts are often confronted with difficulty in sorting out those events which arose from the policies under analysis from those phenomena which had origins in other, simultaneous or contemporaneous, events.

Moreover, the underlying questions are ones about the lessons to be learned from different policy stances, and efforts at answering them can probably best be undertaken by comparisons of alternative experiences. Since, within each country, experience is limited, a more fruitful line of research would be one in which the same basic questions were addressed, within a common framework, for a number of countries across a number of natural experiments.

To this end, part of the Bank's resources for research are being devoted to a "Program of Comparative Studies." In this program, for a few key policy issues, an effort is made to develop a common analytical framework for the study of a particular policy question, and then to have researchers - usually from the individual countries - work in parallel, comparing research results within a common framework. Once these individual country studies are completed, the project organizers undertake an analysis of those systematic patterns that appear to emerge from different countries' experience.

Comparative studies are by their nature large-scale, and need a high degree of coordination. The comparative advantage of the World Bank in research must lie in such studies - as a multilateral agency, its opportunity to develop comparative insights into the development process is probably unparalleled.

Last year's Annual Report noted that the Research Policy Council had initiated a program of large multicountry comparative studies of important policy-related issues. There are four characteristics of the studies launched so far. First, they are empirical studies of such issues as the way changing policies affect development, and how policies change.

Second, they usually cover ten or more countries. All research is constrained by budgets, so there is always a tradeoff between the number of countries studied and the depth of each study. At one extreme are cross-country statistical studies that look at almost all countries but use little information on each of them. At the other extreme are country studies that use much historical information and are comprehensive. The new comparative studies fall between the extremes, using a sample large enough to enable valid contrasts and looking at countries in enough depth to perserve the analysis and perception of case studies.

Third, they have a common research plan which sets out each study's objectives and methods. An analytical framework specifies the underlying theory that guides what information will be collected and how it will be analyzed in the individual studies - thus providing guidance to teams doing the country studies and ensuring that a body of information is comparable across all countries in each study. A collection of case studies will be published to present findings of interest and value from each country. And a summary book will draw the main lessons, identifying patterns common to all the countries, contrasting differences in approach and outcome, and thus contributing most to a better understanding of development.

Fourth, the individual country studies normally involve collaboration with researchers in developing countries and thus permit fruitful interaction between these researchers and the Bank. Researchers meet periodically during the course of the research and thereby can consult with researchers with common interests. This provides a valuable experience for researchers whose work is otherwise limited to a much more limited range of evidence, and simultaneously adds to the credibility of the findings and, if that credibility increases the impact of the findings on policy formulation, this will further increase the benefits of the research.

Likely to be large and expensive, the comparative studies are of a kind that could not be done at universities and related research institutes. They thus coincide with the Bank's advantage in research and will reinforce, and be reinforced by, the Bank's activities in policy dialogue with its member countries. Launched in February 1984 with the approval by the RPC of the first study on "The Timing and Sequencing of a Trade Liberalization Policy", it now includes two additional studies both approved for full funding in the second half of FY85. One is on "Agricultural Pricing Policies" and the other is on "Poverty, Equity and Growth". Funds to prepare a full proposal for a fourth study on "Macroeconomic Adjustment and Long Run Growth" have also been approved by the RPC in FY85.

Each of these studies covers about eighteen to twenty countries selected from different regions of the world (see Table 6). Since the program involves such a large number of countries, a Comparative Studies Coordination Committee, consisting of the six Chief Economists and the Research Administrator, was established at the end of FY85 to provide a formal mechanism for a) ensuring regional consultation and coordination; b) providing information on the progress of the individual comparative studies to the regions; c) facilitating the participation of the regions in the periodic conferences which will be held to monitor and review the progress of each comparative study; and d) disseminating the results of the comparative studies to the regions as they become available. Following the review of research management the functions of the Committee and its membership will be enlarged. It will become the "Research Coordination Committee" (see Section I, Review of Research Management) which will provide a channel of communication between researchers, the region and the research administration, on <u>all</u> research projects.

Table 6

Country Coverage of the Comparative Studies Approved by the RPC

Regions	The Timing and Sequencing of Trade Liberalization	Agricultural Pricing	Poverty, Equity and Growth
Latin America and Caribbean	Argentina Brazil Chile Colombia Peru Uruguay	Argentina Brazil Chile Colombia Dominican Republic	Brazil Colombia Costa Rica Haiti (tentative) Jamaica Mexico Peru Uruguay
East and South Asia	Indonesia Korea Pakistan Philippines Singapore Sri Lanka	Korea Malaysia Pakistan Philippines Sri Lanka Thailand	(territory of Hong Kong) Indonesia (tentative) Malaysia (tentative) Singapore Sri Lanka Thailand
Europe, Middle East and North Africa	Greece Israel Portugal Spain Turkey Yugoslavia	Egypt Morocco Turkey Portugal	Egypt Malta (tentative) Turkey (tentative)
Sub-Saharan Africa		Ghana Ivory Coast Madagascar Sudan Zambia	Ghana Madagascar (tentative) Malawi Mauritius Nigeria

While the research on the two recently approved studies on "Agricultural Pricing" and "Poverty, Equity and Growth" has only just begun, the study on "Trade Liberalization" is now at a relatively advanced stage and appears thus far to have made progress according to schedule. The following sections summarize the current status of this project and some of its preliminary results, and present the outlines the other three studies currently included in the comparative studies program.

(i) The Timing and Sequencing of a Trade Liberalization Policy

This project addresses various issues of transition associated with trade liberalization such as the appropriate circumstances for the introduction of a trade liberalization policy; the merits of a one-stage *versus* a gradual, multistage liberalization; the length of the liberalization process and the appropriate speed of implementation; the role of tariffs and export promotion in this process; the relationship of trade policy and other measures; the costs of adjustments; and the specific policy package to ensure the sustainability of the trade liberalization policy. The objective is to draw lessons from the experiences of countries that have attempted to undertake a liberalization of their trade regime so as to understand the problems of adjustment and transition following a move from a tightly restricted towards a more open trade regime. The study covers trade liberalization episodes in eighteen countries and consists of four phases. The first three phases are now completed. They provide the background material from which complete country manuscripts will be prepared. Phase IV will synthesize the eighteen country studies and will be completed in late 1987.

The preliminary results for the study suggest some common attributes of most successful, significant trade liberalization attempts -- that is, trade liberalization policies that have been sustained for a considerable length of time. On a priori grounds, three factors could be expected to lead to a partial or complete reversal of trade liberalization: a balance-of-payments crisis; a worsening employment situation; and inimical effects on income distribution. A balance-of-payments crisis could lead to the restriction of imports to conserve foreign exchange. Unemployment, particularly in the sectors from which protection is removed, could lead to resistance in removing protection from other import-competing activities. Large changes in income distribution, resulting from the decline of profits and other specific factor rewards in the liberalized sectors, could create resentment and reinforce objections to liberalization. Of these three potential factors hindering a sustained liberalization, the analysis of concrete liberalization episodes in the country studies suggests that the reversals of liberalization attempts have most often coincided with balance-of-payments crises. Unemployment has only been an obstacle to liberalization in a small number of cases -- primarily in Mediterranean countries. Income distribution considerations, in general, and the decline of factor rewards in the liberalized sectors in particular, have not hindered trade liberalization. However, balance of payments difficulties following trade liberalization attempts may be the final outcome of other policies - such as fiscal policies, expansive monetary policy, running down of foreign exchange reserves, and inflexible foreign exchange regimes - which may have been used to mitigate the adverse effects, perceived or real, of trade liberalization on factor rewards. Hence, the links between trade liberalization policies and macroeconomic management will be a primary focus of the next phase of the study.

(ii) Agricultural Pricing Policy

The second study on the "Agricultural Pricing Policy" was approved by the RPC in March 1985. It seeks to answer a number of questions relating to agricultural pricing policies within a common framework for some twenty countries from all World Bank regions. It is expected to be completed by June 1988. The questions to be examined are: (1) What has been the impact of government price interventions on agriculture's relative prices? (2) What has been their effect on output, consumption, trade, the budget, resource transfers, and on income distribution? (3) Are there some internal dynamic forces that lead to some predictable rules about the evolution of policy interventions? More specifically, how do the effects of the policies relate to the stated objectives of the interventions? And what explains the difference, if any, between them?

This study will focus both on the short-term and on the long-term impact of these interventions. This will be done by: (a) examining the impact on relative prices within agriculture as well as between agriculture and the rest of the economy over time; (b) examining the effect of macroeconomic and non-agricultural trade policies. In particular, the impact of exchange rate policies and Dutch disease type phenomena (food aid, foreign aid, workers remittances, etc.) will be examined; and (c) by making use in each country study of existing data, studies, models and parameter estimations both from World Bank and other sources.

Answers to those questions should be of interest to policymakers and helpful to the Bank regions in their advisory role. The comparative analysis to be done at a later stage should allow policymakers and advisors to assess policy options in a comparative perspective and base their decisions on evidence about the success or failure of these policies in a number of countries.

(iii) Poverty, Equity and Growth

The third comparative study on "Poverty, Equity and Growth", approved in May 1985 and to be completed by December 1988, is concerned with the following policy-related questions: What is the role of initial conditions (physical and human resource endowments, trade orientation, agricultural systems and socioeconomic institutions) in explaining the divergent poverty, equity and growth outcomes in the countries to be studied? Can these outcomes be related to particular policies, for instance, trade and industrial policies, fiscal and monetary policies, labor market interventions, pricing policies, social policies (such as education), direct redistribution policies such as land reform? If so how? If not why not? Were the 'failures' of policy due to bad design, to mutually contradictory policies or to a failure to deal with the countervailing actions of powerful pressure groups? Will policies which reduce poverty also improve equity, or is there a tradeoff? What are the circumstances in which particular policy packages (including reforms of current policies) are likely to lead to better poverty alleviation and growth outcomes?

The comparative framework is useful in answering these questions as it allows an assessment of the relative importance and interactions of the three basic underlying factors which can be expected to explain the observed outcomes: (a) initial conditions (economic structure and resource base);

(b) institutions (forms of economic organizations); and (c) public policy interventions (including those which were or could have been undertaken).

In answering these questions the preliminary results from the other comparative studies which are phased to start before this one, on trade liberalization and agricultural pricing, will be extremely valuable. The outputs will consist of individual country monographs and a synthesis volume which will provide the comparative analysis.

(iv) Macroeconomic Adjustment and Long Run Growth

The fourth comparative study on "Macroeconomic Adjustment and Long Run Growth", for which research preparation was approved this year by the RPC, deals with the central issue of macroeconomic management during periods of crises. It is concerned with three main questions: 1) why some countries have succumbed to crisis and others not; 2) how best to get out of a crisis, and return to a viable growth path; and 3) what are the relationships between short and medium-term macroeconomic management in general, and long run development. To enhance its policy relevance, the study will place emphasis on the economics of government decisionmaking. Based on a comparative approach, and embracing a large number of countries in all continents, the study will attempt to throw light on the problems that governments face in devising policies that are most conducive to long run growth in an often rapidly changing economic environment.

Other New Research Projects

The new research projects approved this year by the Research Projects Approval Committee cover a wide range of topics which generally conform to the priority guidelines established last year by the Research Policy Council and summarized in last year's Annual Report. These are reproduced in Appendix 1.

A number of these new research starts are concerned with the costs and benefits of government interventions: for instance, a study will examine the effectiveness of state intervention in the promotion of the traded goods sector in Japan in order to derive the policy implications for developing countries (Ref. No. 673-66); another will study the effects of government regulation of product quality in international and domestic trade as applied in a number of developing countries (Ref. No. 673-59); the issues of subsidy and cost recovery in the context of support programs for agriculture are the focus of another project with a case study of rubber replanting programs in Thailand (Ref. No. 673-44); at a more macro level a study will explore the effects of fiscal deficits in developing countries as compared to those in industrialized countries (Ref. No. 672-62), while another will attempt to analyze the distributional effects of government policies in Egypt (Ref. No. 673-55).

A second group of new projects, more sector-specific, are concerned with behavioral and institutional issues: in the study of the role of risk in Sahelian agriculture for instance, farmer technology and farmers' production behavior will be investigated to help improve the knowledge of the factors influencing farmers' decisions, knowledge that is crucial in the design of farm and food policies (Ref. No. 673-67); the relative costs of various types of secondary education in Shanghai will be the subject of a collaborative research project between the Bank and Fudan University as part of a larger effort to address questions that are important for policies towards technical and vocational education in China (Ref. No. 673-69); a third study will develop a methodology for evaluating the demographic and health impacts of urban upgrading projects in low-income neighborhoods (Ref. No. 673-45).

Third, among the projects concerned with the international economic environment, one will examine the role of foreign aid and other capital flows on investment and growth (Ref. No. 673-49); another the relationships between performance indicators and monitorable policy instruments to help in the design of medium-term action programs in the context of debt rescheduling (Ref. No. 673-70).

In addition to the projects funded centrally from the Research Support Budget there is a body of new research studies financed by departmental resources. Taking both together there has been a marked increase in new research activities dealing with the global issues of trade, debt, development assistance and macroeconomic adjustment. Sector-specific research is also geared more directly towards the issues faced by the Bank in its operational and policy advisory work. Evidence from all the new starts in the research program, including the comparative studies, suggests that the process of reorientation in line with the priorities established last year by the Research Policy Council and approved by the Board is well underway.

An Agenda of Research Priorities for Sub-Saharan Africa

REPAC took an important initiative last year to develop an agenda of research priorities for Sub-Saharan Africa, as part of the World Bank's effort to promote a better understanding of the process of economic development in that region of the world and the factors underlying its present deteriorating economic situation. The agenda seeks to identify some research questions which merit the development of high quality proposals by the world-wide research community. These research priorities were developed during two meetings: The first, in Easton, Maryland, sought to elicit the views of Bank researchers and regional staff about the main research priorities. The second meeting held at the beginning of this year in Bellagio, Italy, brought together African policymakers, academics and World Bank staff. The Report [1/] covers four main areas of inquiry. The first two--trade policy and macroeconomic adjustment, and public economics and resource mobilization--are concerned directly with the major determinants of the economic environment which govern economic performance. The two others address longer-term development issues concerning agricultural development and population and human resources. We highlight some of these issues in the following paragraphs.

A large body of research, both theoretical and applied, is already available on the appropriate economic environment for promoting economic development. Much of this is of direct relevance for policy formulation and implementation in Africa. Furthermore, The Bank's comparative studies program will provide a vehicle for synthesizing and disseminating this stock of knowledge on important policy-related issues. In addition, however, there are areas where applied research specific to Africa to corroborate the findings from other regions in the developing world may be useful. Examples of these cited in the Agenda are: the effects of non-tariff barriers on African exports; and an *ex post* evaluation of infant industry protection in some sub-Saharan African economies.

Much of the traditional economics of policymaking is based on some implicit institutional premises, namely that governments' have the knowledge, foresight and administrative capacity to undertake various complex

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1/A copy of the report is available on request from the Research Administrator's Office, Economics and Research.

interventions in the economy. It is also assumed that the intended effects of these interventions can be achieved, as the private agents whose behavior governments seek to alter can be expected to react passively -- without undertaking any countervailing actions to undermine the intent of public policies. The experience of the last three decades has shown that these assumptions may be invalid.

Particularly in sub-Saharan Africa where institutions and administrative structures are weak, it will be important to assess the feasibility of particular government interventions and the likely divergence of their actual from intended outcomes when strategic interactions between public and private agents are of importance. Various issues of macroeconomic adjustment in sub-Saharan Africa could be fruitfully studied within this perspective. For example, defining macroeconomic crises as an excess of aggregate domestic expenditure above present and expected future levels of output, how do these crises typically arise? And how are they dealt with? What are their effects on growth?

A related area concerns the removal of various policy induced distortions in many sub-Saharan (and other) economies. An investigation of the dynamic sequence and interactions of different, often uncoordinated and some times unintended policy interventions in the past, which have resulted in the existing distorted system of incentives, may be required to understand the reverse process of liberalizing such undesirably repressed economies. Possible research topics are: studies of agricultural pricing policies, and the winners and losers of policy change; the fiscal effects of trade reform; the political economy of government expenditure policy and the observed tendency towards structural fiscal deficits; the reform (including privatization) of public enterprises.

Whilst the above provides some areas for research which are relevant for policy reforms to improve the existing economic environment, there are a number of longer term issues concerned with the relative supplies of productive resources - including human skills - and the appropriate institutional and legal framework required for their efficient utilization. Past research on Africa (some under World Bank aegis) has shown that compared with other developing regions, factor markets (for land, labor and capital) in sub-Saharan Africa are attenuated, leading to inefficient factor use. The largely institutional causes of these inefficiences and appropriate remedies (some of which may emerge spontaneously with the increasing pressure of population on land) could be usefully studied. Furthermore, given the dramatic increase in the rate of growth of population in Africa, there are a number of fertility and health-related issues which could be usefully researched. These include studies of the demand for fertility control which could be useful in designing appropriate family planning programs and studies of the financing of health care. Finally, given the enormous need to upgrade the growing stock of human resources in Africa, various studies analysing the outcomes of past educational policies on appropriate human resource development and their reform could also be usefully undertaken.

Developing Indigenous Research Capacity

One of the important features of the comparative studies program is that it involves the collaboration of a great number of researchers and institutions from Part II countries. Each study under the program covers some eighteen to twenty developing countries from all regions of the world. For each country to be analyzed, efforts are made to associate local researchers and institutions in the conduct of the research, and regional conferences are organized periodically to bring them together to share their views and findings and to interact with each other. In the two studies currently underway on "The Timing and Sequencing of a Trade Liberalization Policy" and on "Agricultural Pricing Policy", the total numbers of local researchers and institutions involved are respectively forty-four and forty-two. Further collaborative arrangements are being made in the context of the third study on "Poverty, Equity and Growth".

Besides the comparative studies program other research projects have also used a large proportion of consultants from Part II countries. Data available for FY83 showed that the percentage of consultant days from Part II countries used on RSB funded projects was 50 percent, which can be compared with a figure of 28 percent for the percentage of Part II consultant days in the total consultant days used by the Bank.

III. Evaluation of Completed Research Projects

One of the major concerns of the RPC after it was set up in 1983 was the large backlog of completed projects resulting from the past research program which had not yet been evaluated. Under its direction, a major exercise was carried out in FY85 by REPAC to clear this backlog. As of July 31, 1984 the number of such projects had risen to 93, representing both the backlog from previous years and the 'problem projects' that were closed by REPAC in FY84. The latter consisted of projects which had extended well beyond their authorised duration, some having been ongoing for over ten years or had overspent their budget. Because of the large number of projects requiring evaluation, the Research Policy Council decided that of this backlog only those projects utilizing more than $100,000 each from the Research Support Budget would be subject to evaluation. This reduced the number of research projects to be evaluated by REPAC to 38. The combined total authorizations from the RSB for these 38 projects were $7.4 million, compared to $10.2 million for the whole backlog. Thus the completed evaluations cover over 70 percent of the funds spent from the RSB. Projects to be evaluated were classified under six sectoral panels, each under the chairmanship of one or two REPAC members.

An independent evaluation was made of each project by an internal and an external reviewer. The internal reviewers were specifically asked to focus on the usefulness and relevance of the research projects to Bank policies and operations, whereas the external reviewers would focus on their technical quality. The issue of regional support to, and participation in, the projects would also be examined. A set of guidelines for the evaluation of completed research projects was provided to the reviewers (see Appendix 6). OED was also asked to participate in the evaluation by appointing a representative to each panel. However, because of the large number and diversity of projects, it decided to participate on a selective basis, particularly where its experience in operational evaluation would be most relevant. In the event, because of staff shortages, OED's participation was limited to a review of some of the projects under the agriculture and education/population/health panels. The project sponsors were asked to provide written comments on the evaluation reports of the individual reviewers.

Based on the reviewers' reports, and the researcher's reactions to them, the panel chairmen put together evaluation reports for individual research projects, as well as overview reports summarizing the main findings and conclusions at the sectoral level, with a view of conveying some idea of the extent to which the research program in the Bank over the past 5-6 years has been effective. These sectoral reports are given in the Annex to this Part.

In reviewing these evaluations, it should be remembered that all the projects evaluated formed part of an older research program. To the extent the new research directions enunciated by the RPC last year reflected the need to restructure the research program towards more policy-oriented and operational research, criticisms of those older research projects on those grounds have already been taken into account in determining the current and future directions of Bank research.

Moreover, four other points need to be borne in mind. First, research by its very nature is risky. What may appear ex ante to be a highly promising line of research may ex post turn out to be a blind alley. In such cases it is best to cut one's losses. Second, in some cases the stated objectives of a research project at its inception may not appear to be as important as new ones which emerge in the course of conducting the research. In such cases it is important to change the focus of the research which should not then be judged in terms of its original objectives. Third, the research conducted may be technically sound but the questions it addresses may no longer be of much policy interest; this would be a failure of setting the right questions for research and not in its execution. Finally, as many of the research projects in the past were of long duration - both planned and unplanned - (see Table 7) the policy relevance of their results could be expected to be attenuated by time. Examples of all four cases can be found in the evaluations of individual projects. However, the new policy of allowing a maximum of 3 years for the duration of a research project, and its close monitoring during its life time, the explicit shift in incentives to smaller and less data intensive projects, and the attempt to promote research of policy relevance should hopefully reduce these problems in the current research program.

By contrast, the fully successful research project in applied social science would be one which tested and changed beliefs and actions (behavior) - both public and private - based on premises about how the world could, should or does work. An example of this is the work on the functioning of labor markets in developing countries which has shown that labor markets generally function well, and that the pessimistic view based on a rigid institutional view of labor markets and the development process that the benefits of growth would not be shared by the poor is not supported by the empirical evidence.

Table 7: Average Duration 1/ of Completed Research Projects
Evaluated by REPAC

Subject Category	Number of Projects	Duration Maximum	Minimum	Average
A. Agriculture	8	8 yrs. 6 mos.	2 yrs. 4 mos.	5 yrs.
B. Planning/Growth/Country Economic Analysis	4	8 yrs. 2 mos.	2 yrs. 2 mos.	4 yrs. 5 mos.
C. Income Distribution/Labor/Employment	6	11 yrs. 2 mos.	3 yrs. 1 mo.	8 yrs.
D. International Trade and Finance/Industry/Energy	11	9 yrs.	3 yrs.	6 yrs. 1 mo.
E. Urbanization and Regional Development	3	8 yrs. 6 mos.	4 yrs. 5 mos.	6 yrs. 9 mos.
F. Education/Population/Health	6	6 yrs. 7 mos.	4 yrs. 4 mos.	5 yrs. 10 mos.
All Projects	38	11 yrs. 2 mos.	2 yrs. 2 mo.	6 yrs.

1/ Duration is defined as the period between the date of approval of the research project and the date of filing of the mandatory completion report on that project.

Another project -- the City Study -- shows that cities whether in the developed or the developing world exhibit strong regularities in their pattern of development; supports the hypothesis that conclusions and policies based on fundamental behavioral findings are largely transferable; and, finally, upholds the significant operational conclusion regarding the important role of markets in the allocation of resources in urban areas. By implication the City Study suggests that urban operational strategies need not treat each city as a special case; further, that efficient city management will require appropriate economic policies and not physical planning.

Other projects judged to be successful mostly used state-of-the-art methodologies, applying them competently to development issues which previously had not been researched to the same extent or with the same rigor. Examples of such projects include the analysis of export incentives (especially as regards the importance of access to tax-free inputs and credits) and the assessment of the role of small-scale enterprises in industrial development and employment generation. The latter found that: First, overall incentives play a central role in ensuring efficient (and appropriately labor-intensive) industrialization. Second, special interventions in favor of small-scale enterprises need to be treated with considerable caution, and cannot be justified on the basis of higher labor intensity or efficiency of small-scale enterprises because they are neither more labor intensive or more efficient than larger enterprises. Third, especially designed interventions in support of small-scale enterprises (or of traditional types of manufacturing techniques) do lead to resource misallocation without offsetting distributional benefits. Since interventions in support of small-scale and medium-scale enterprise development are still important in many developing countries, the project's findings are relevant to the Bank's policy dialogue in these countries.

There are numerous instances in which the project results have been incorporated in the Bank's operational work. Even some projects which were thought to have shortcomings in their research design, have been helpful to Bank staff in providing information on and some implications of a specific phenomenon. An example of this is the project on Labor Migration and Manpower in the Middle East and North Africa where the data collected helped EMENA staff appreciate the implications of massive migration even though the country model that was developed--with its neglect of wages and prices--was flawed. Others, such as that on the evaluation of data on income distribution, failed to meet their initial, ambitious objectives but have nevertheless been important for the Bank's learning process and have led to a better statistical understanding of the problem.

Bank research has made many important contributions to Bank operations and a better understanding of development problems and policies. There are, however, a number of lessons to be drawn from this major evaluation which should improve future research projects.

The most serious problem which has been identified in the evaluation and which requires urgent attention concerns the dissemination of research results. Time and again the reviewers pointed to interesting and potentially useful research findings which have remained in unfinished form as working or discussion papers and have consequently been of limited use to the rest of the Bank, policymakers and the academic community. This is in part due to insufficient incentives for Bank staff to convert research outputs into published products for wider dissemination. Related to this is the reviewers' recommendation that for large studies, involving research results for a number of country studies contained in separate papers, a synthesis paper or published summary should be produced to assure tangible and readily accessible outputs of the research program.

A contributing factor is that a number of the large and long duration studies ran into problems of staff turnover during the lifetime of the project. This led to delays in the completion of projects and difficulties in the appropriate dissemination of research findings.

Furthermore, whilst some projects successfully disseminated their findings to the academic community through the publications of books and articles in professional journals, they were not effectively disseminated within the Bank. The results from other projects, on the other hand, were incorporated into the Bank's operational work without being disseminated to a wider audience. All in all, the reviewers found that there has been a serious underinvestment in the dissemination of research results.

Secondly, the evaluation panels recommend a more forceful effort in the management of research. The importance of the timeliness of producing research results requires greater emphasis. Many of the projects evaluated took much longer than originally anticipated which reduced the usefulness of their findings when they became available. Problems of turnover of staff are more likely to occur when projects suffer time overruns. Following the recent reorganization of research administration procedures, many of these defects of research management should be overcome.

Other recommendations for increasing the effectiveness of the research program concern the design of research projects. It would be desirable to ensure that policy related research projects are designed with policy-relevant questions in mind at the proposal stage so that the projects do not end up without any policy-relevant conclusions.

Finally, in some projects the researchers had underestimated the difficulties of collecting primary data so that they could put in little time and effort in their analysis. In general, data collection can be a very costly exercise, even for secondary data. However, it may also be the only way to explore certain issues. Nevertheless, the cost-effectiveness of research based on large primary data gathering exercises needs to be constantly kept in mind. Imaginative use of existing data bases is likely to yield higher and quicker returns in many areas of policy-relevant research. In the new directions for research provided by the RPC and being implemented by the REPAC in approving research projects, emphasis is shifting from long-duration research projects based on large-scale primary data gathering towards shorter term, smaller, policy focused studies which rely primarily on readily available secondary data. These should help in overcoming some of the defects of the past research program highlighted by these evaluations.

IV. Dissemination Initiatives

The problem of dissemination of Bank research highlighted by the evaluation of completed research projects in the last section, has also been a major concern of the RPC. During FY85, it undertook a number of initiatives to promote a more effective dissemination of the findings of Bank research projects following a review by BRAG and discussions by REPAC.

Bank research serves a varied audience. The resulting output should be of use not only to an academic audience but also to Bank staff who may no longer be researchers, to policymakers in developing countries as well as to a larger lay public which is concerned and interested in ongoing debates on development. Accordingly the dissemination of Bank research needs to be tailored to these different audiences.

Three concerns were expressed regarding past efforts at dissemination. The first was the highly fragmented nature of the nonbook-length output of the research program, which reduces its visibility to important constituencies such as the Board, and top Bank management. The second concerns the lack of any systematic dissemination of research output relevant to answering the broad questions about the development process and development policy that are of interest to a much more general audience than just Bank or outside professionals, at whom much of the existing dissemination efforts seem to be aimed. Finally, the internal mechanisms for providing non-research Bank staff with discriminating access to recent research findings relating to their work seem to be weak. Indeed it was felt that probably the biggest lacuna in current dissemination was in serving the internal consumers of Bank research.

A new policy-related in-house journal was proposed to provide coherence and visibility to the Bank's nonbook-length professional research output and to disseminate it outside the Bank. The existing forms of publication of this research output in the form of Staff Working Papers (SWP) and Reprints were considered inadequate for a number of reasons. The SWP's are meant to represent intermediate and unpolished outputs of research projects. They are unrefereed and of variable quality, and yet, they are increasingly being looked upon as the final output of Bank research. The Reprint series issues the research output published in outside refereed journals. But given the publication lag in most journals the results of Bank research take a long time to be disseminated. Also these publication delays are a discentive to researchers in polishing their intermediate outputs, which they prefer to leave as SWP's.

To deal with the resulting fragmentation, lack of quality control and absence of a discriminating guide to readers of a large and varied research output, the Research Policy Countil has approved the establishment of a three-tier structure of publications designed to serve a number of different audiences.

Research News, a newsletter, is to appear four times a year. Strictly speaking it will not be a new publication, but rather a successor of the old Research News containing considerable changes in substance and presentation. With a circulation of 17,000, it will be journalistic in style and format. In keeping with its origins, Research News combines descriptions of newly approved research projects, summary abstracts of completed research, and highlights from recent selected Bank publications. In addition it now provides two new services: first, to foster better communications with producers of research, it regularly updates initiatives taken by the Bank's research administration; second, in order to bring new research findings to the attention of the widest possible audience, each issue contains four to five "Research Briefs," short, nontechnical reports highlighting the policy and program implications of recent Bank sponsored research. The first issue of the new Research News appeared in the summer of 1985.

The World Bank Research Observer is a new publication of the World Bank. To be issued twice a year, it aims to help policymakers and nonspecialists concerned with the problems of developing countries keep abreast of the growing body of relevant research. Articles in the Observer will be written primarily for the generalist reader with some knowledge of economics. But it is also hoped that they will be a useful source of information for specialists about research in fields other than their own and provide an introduction to topics at the forefront of today's development debates to students of economics.

The first article in each issue of the Observer will provide a summary of the results of a recently completed project--or series of related projects--sponsored under the World Bank research program. There will be three or four other articles reviewing a particular policy-relevant area of research. These reviews will carry extensive bibliographies to allow the interested reader to pursue the subject further.

The World Bank Economic Review is a refereed professional economics journal of high standard aiming for worldwide readership among development professionals in government departments, private business, financial institutions, international agencies, universities and development research institutions. The Review will publish articles by Bank staff and consultants and is intended to serve as the principal professional outlet for the dissemination of the flow of Bank-sponsored research, policy analyses and other studies in economic development. Articles published in the Review will emphasize policy relevance, both implications and applications, as distinct from issues of primarily theoretical and methodological interest. They are expected to be written so as to be clearly understandable to readers with a knowledge of fundamental principles of economic theory and modern economic analysis but who may not be familiar with advanced mathematical or econometric techniques and who may not have ready access to a wide selection of current periodical literature. Before an article is accepted for publication it will be reviewed by at least one internal and two external reviewers. Special issues of the Review may be put together from symposia on specific topics. Authors will be individually responsible for views expressed in contributed articles which are not to be taken as statements of Bank policy.

The Review is still in the preparatory stages. A call for submission of articles for the first issues has been circulated and a panel of external reviewers has been put together. The Review will be published four times a year, with the first issue expected some time in 1986. Public announcement of the journal will be made when the first issue is ready for the press and articles to be included in the next several issues have been selected. Subscription rates for both the Review and the Observer will be kept at a level that will not be completely out of reach of readers in developing countries. The Publications Department will assume responsibility for the production, promotion and distribution of these journals.

All three publications are managed by the Research Administrator's Office, Economics and Research. $140,000 from the RSB have been allocated to this dissemination effort. The editorial board members for these publications are drawn from all parts of the Bank and are listed in Appendix 5.

Whilst these initiatives provide new mechanisms for disseminating the results of World Bank research, their ultimate success will depend upon the quality and policy relevance of the research output produced by the research program.

The Bank's wide-ranging research portfolio will continue to be updated in the Abstracts of Current Studies which is published annually.

In addition to the above publications, research funds have also been used to sponsor a variety of conferences and seminars, as well as a monthly seminar series on the Frontiers of Economics which is designed to keep Bank staff abreast of the latest developments and directions in economic research. Each month a distinguished economist is invited to discuss his current research, his views of the unresolved issues and their significance, and, as appropriate, applications to the Bank's operations. The series has brought distinguished economists to the Bank who do not normally address Bank audiences. The presentations are nontechnical and facilitate understanding and appreciation of the literature and controversies in all fields of economics. Seven seminars have already been held and judging from the attendance the series appears to have been very successful. A list of the seminars is appended in Appendix 7.

V. The Research Program in Perspective

Last year's Annual Report described the Bank research program in terms of three major themes or set of questions it seeks to address. These are all relevant for policy formulation as well as for understanding the development process:

(a) current and long-standing debates on development;

(b) generic and behavioral issues concerning the behavior of both individuals and governments; and

(c) more narrowly focused operational issues like those concerning the evaluation or monitoring of Bank projects.

This section highlights some of the results of recently completed research or the preliminary findings of work in progress within this framework. 1/

A. Current and Long-Standing Development Debates

Given the increased importance of international economic interdependence, global economic issues concerning debt, trade and aid have formed a major part of ongoing debates on development. Studies concerned with these are first reviewed in this section, followed by other areas concerning adjustment policies, education and agricultural policies.

1/ The convenient categorization of individual research projects into these different themes is only illustrative as many projects straddle several themes. Research projects which are centrally funded are identified by a reference number. The others are departmental studies.

Debt

One of the most important current debates concerns the debt crisis. A symposium on "International Debt and the Developing Countries" financed by REPAC identified the misjudgments on the part of both borrowers and lenders which led to the debt problem and recommended cooperative solutions for its resolution, as these entailed lower costs and larger benefits for both borrowers and lenders than any of the confrontational or unilateral solutions sometimes proposed.

To help countries avoid future crises, another project on "The Assessment of Country Foreign Borrowing Strategies" (Ref. No. 673-01) has developed an analytical framework to identify a suitable trend rate of foreign borrowing given expectations of the domestic and external economic environment and to show the appropriate modifications to smooth the intertemporal path of consumption in the event of an external shock.

Other debt-related issues have also been analyzed in a number of smaller studies. One examines the trends in reserve accumulation by selected debtor countries over the period 1973-84. It concludes that the quality of economic management has been more important than the level of a country's reserves in influencing perceptions of creditworthiness. Also a major study of the external debt position of Sub-Saharan African countries is exploring possible options for reconciling future debt servicing with improved growth prospects.

Trade

The recent spread of trade restrictions affecting the export prospects of developing countries is documented in a project on "Non-Tariff Barriers" (NTBs) (Ref. No. 673-40). Based on UNCTAD data it found that in

1981, using a wide definition of NTBs, more than one-fourth of the merchandise imports of industrial countries faced such trade barriers. Since 1981 an additional $13 billion of industrial country imports have come under NTBs -- an additional 1.5 percent of their merchandise imports. Taking the industrial countries as a group, one-half of their textile imports, one-third of their imports of agricultural products, iron and steel, and vehicles were subject to government regulation by non-tariff measures. Nearly half the non-tariff barriers took the form of quantitative restrictions, either unilaterally imposed or negotiated as "voluntary restraints." The other half consisted of various forms of monitoring -- such as governmental screening of import volumes and prices which signal an implicit threat to exporters that, if volumes are exceeded or the import prices fall below an established domestic price, more direct action would be taken. These industrial country NTBs covered a larger share of their imports from developing countries than of their imports from each other and were concentrated on product categories with a large weight in developing country exports -- textiles, agricultural products, fuels.

With this spread of NTBs, developing countries need to consider the best way of allocating their export quotas, so that these are met at minimum domestic resource cost. According to the results of a study analyzing several non-price mechanisms used to allocate export quotas in Sri Lanka, Hong Kong and Korea, if production for exports by individual firms were to fulfill the minimum cost condition and public policy for the allocation and use of export quotas were consistent with the achievement of that purpose, then quotas assigned to different firms will differ according to the firms' production costs [i.e. the higher marginal cost of production, the lower the quotas]. A well-organized secondary market for export quotas, absence of rigid physical allocation, and, the public auction of quotas to raise revenue and minimize rent-seeking activities are the desirable policies to be adopted.

Aid

Of the ongoing research projects concerned with aid effectiveness, the project on "Managing Agricultural Development in Africa" or "MADIA" (Ref. No. 673-04) involves a study of the major donors' aid to African agriculture over the 1970-84 period. Preliminary results of the study of World Bank agricultural programs in six African countries, found a number of discrepancies between the Bank's sectoral analysis and the content of its subsequent lending program, as for instance in Malawi where despite their identification in sector work, inadequate attention was devoted to incentives to smallholder agriculture in Bank projects. This has jeopardized their success. Similarly the high concentration on industrial investments by the Bank in Tanzania and the neglect of resource allocational issues at the macroeconomic level has had harmful effects on agriculture.

Preliminary results from another project recently funded by REPAC, "Multicountry Analysis of Development and Aid" (Ref. No. 673-49), indicates that the marginal propensity of recipient countries to invest nonrelief aid flows is significantly greater than that of domestic income and hence past fears of an adverse relationship between foreign aid inflows and domestic investment and growth in host countries may be unfounded.

Adjustment Policies

An important area of current concern in designing conditionality for policy-based lending, is the identification of good performance indicators. A study on "Adjustment Policies in Developing Countries 1979-83" seeking to derive such indicators from an analysis of the policy response of a group of thirty developing countries to the external shocks of the 1979-82 period, found much of the intercountry differences in domestic adjustment to external shocks was explained by exchange rates and energy price policy and to a lesser extent by monetary and interest rate policy.

Another study surveyed policy issues arising in overall economic liberalization attempts and showed that the major determinants of success are realistic fiscal and exchange rate policies and careful sequencing of financial and trade reform measures. The analytical work strongly indicates that a financial sector liberalization preceding trade reform will lead to serious misallocation of resources, potential balance-of-payments problems, and real exchange rate effects that will hamper any subsequent attempt to liberalize commodity trade. Empirical evidence based on the Chilean experience strongly supported those theoretical results.

Related to this, a major empirical project on "Liberalization and Stabilization in the Southern Cone" (Ref. No. 672-85) studied the liberalization cum stabilization packages introduced by Chile, Uruguay, and Argentina in the mid-1970s. It found that the first phase of reforms consisting of anti-inflationary policies based on "orthodox" stabilization policies was successful, especially in Uruguay and Chile--with both exports and productivity growing. But in the second phase when the exchange rate was used as an anti-inflationary tool and foreign capital flows accelerated with the opening up of the capital account of the balance of payments, there was a large real exchange rate appreciation and a boom-bust cycle, which ended with each country having accumulated staggering volumes of external debt.

The most obvious lessons are that using the exchange rate as an anti-inflationary tool leads to major macroeconomic disturbances which undermine stabilization, and that a properly designed reform package should coordinate the opening of the current and capital accounts. Further, it was found that during a process of trade liberalization, exporters are particularly vulnerable to movements in the real exchange rate. Finally, in Chile and Argentina the phenomenal opportunities for financial speculation provided by the possibilities for arbitrage between domestic and foreign interest rates under the tablita [1/] led firms to assume risky financial structures, thereby setting the stage for widespread banking crises when the tablita ended. These patterns of financial behavior were abetted by easy access to foreign credit and by the implicit or explicit provision of commercial bank deposit insurance. These outcomes suggest that closer supervision of financial activity is advisable when financial systems that have been highly regulated for a long time are liberalized.

Focusing on adjustment problems of the oil-exporting countries, another study of the impact of windfall gains and economic management in these countries (Ref. No. 672-49) shows their performance did not match their promise because of their suboptimal use of profits from the oil price rise--both in terms of its public versus private absorption and intertemporal allocation between capital formation at home and foreign assets. They provide a cautionary tale on the use of windfall gains, which can be readily dissipated through inappropriate policies.

1/ Official pre-announcement of future values of the exchange rate.

Education

A long-standing debate in education policy concerns the relative priority to be given to physical versus human capital formation for promoting economic growth. A comparative analysis of the economic profitability of investment in education in sixty countries has shown that: as judged by their social rates of return there is underinvestment at all levels of education, especially in Africa. As the social rate of return to primary schooling is higher than for secondary and higher education, it should have priority in investment. However, in many countries a subtantial fraction of the educational subsidy goes to higher education. Thus, a better allocation of resources would result if some cost recovery is implemented in higher education and the resulting resources were to be allocated to expand primary education. This policy would also be equitable, as universities are mainly attended by children from richer families. Past fears that educational expansion would lead to unemployed graduates or drastically lower social rates of return are unfounded, as time-series evidence shows a small decline in the returns to education with a rise in the rate of investment.

Agricultural Growth and Distribution

Debates among economists about the distributional impact of the Green Revolution in Asia, or more broadly of agricultural growth, have by-and-large concentrated on the question of how the gains are distributed across farm size groups and between landowners and workers. Typical topics have included differential adoption behaviour, differential access to factors of production or credit, and the direct impact of technical change on labor demand. A recently completed research project on "Markets and Policy Determinants of Rural Income" (Ref. No. 672-39) in India, has extended this work by examining the general equilibrium effects of various policies. It yielded the following results. It found that during the early Green Revolution period (between 1965-66 and 1970-71), real rural per capita income in India rose by about eight percent. These early productivity gains were retained by the agricultural sector because of the Indian policy of reducing food imports pari passu with the rise in domestic production. But when near self-sufficiency was reached and foreign trade in grains virtually eliminated, all the extra domestic output was absorbed domestically, with the internal terms of trade moving substantially against agriculture. This transferred the benefits of the productivity gains to consumers.

The study also found that major improvements in the incomes of the rural poor must eventually come mainly from demographic changes and growth in nonagricultural employment. The other avenue for substantially affecting their incomes -- direct income and land transfers -- increases food demand and under closed economy conditions leads to rising food prices, thereby eroding the gains to the rural poor to roughly 90 percent of the initial nominal transfer. More important than this erosion of benefits, however, is the effect these price changes have on shifting the burden of the tax required to finance the income or asset tranfers. Where the rural rich are the source of taxes (or land) to finance the income (or land) transfer, the rise in food prices and therefore in farm profits drastically reduces the real incidence of the tax on them and shifts it to the urban groups. In the case of more broad-based taxes such as an excise tax, the rural rich can even end up as net gainers from the income distribution because the increase in farm profits exceeds their tax burden. It should be noted that these conclusions would not hold in a free trade situation where food prices remained at a constant level. This emphasizes the crucial importance of trade policy on the real outcome of government policies.

B. Generic and Behavioral Issues

An important part of the research program is devoted to the analysis of behavioral and generic issues which are relevant to the understanding of development processes such as living standards and income distribution, technological development, agricultural development, labor markets, urbanization, education and demography. Better understanding of these processes and the development of analytical tools to help analyze relevant issues are essential in guiding Bank lending and the formulation of appropriate development policies in the various sectors.

Poverty and Distribution

The Living Standards Measurement Study (LSMS) is concerned with the measurement of living standards and the development of analytical tools for understanding sources of differences in living standards among households. The objective is to develop a system that will provide policymakers in the Bank and in member countries with more accurate and timely information on the distributional effects of their decisions. The first phase of LSMS, now nearing completion, reviewed existing theory and methodologies to identify what data were necessary to meet LSMS's objectives. In its second phase, LSMS's first field trials have been launched in FY85; one in the Ivory Coast in conjunction with the research project on "The Distribution of Welfare in the Ivory Coast" (Ref. No. 673-22) and the second in Peru in the context of the research project on "Education and Informal Sector Employment" (Ref. No. 673-26).

Another project on the "Evolution of Living Standards in Sri Lanka" found that a superficial reading of the data (and especially a crude comparison of unadjusted figures for 1969/70 and 1980/81) suggested that there was an apparent large fall in food consumption and living standards between the endpoints of the decade of the 1970s; a more careful examination, however, shows that: (a) the crude comparison masks a steep fall followed by a strong recovery; (b) adjusted data for the endpoint years show a reduced deterioration in living standards; and (c) by the early 1980s, food consumption and living standards had risen in a permanent long-term sense to levels approximately matching the artificial peak observed for 1969/70. The study also points out that Sri Lanka could not have avoided the reforms that it has undertaken, given the high cost of earlier policies combined with the external shocks experienced in the 1970s. The reforms were also accompanied by increased domestic rice production and a decline in the level of imports.

Technology

Firms' behavior in response to government policies in the area of technological development has been investigated in the context of the research project on "Acquisition of Technological Capability" (Ref. No. 672-48). Results, based on a comparison of four semi-industrial countries (Mexico, Brazil, India and Korea) which have adopted widely different strategies in relation to their technological development suggest that public efforts to promote or control technological development have most often been counterproductive. They also indicate that the openness of the economy provides incentive to firms to master imported technology in a cost minimizing and quality enhancing manner. Autarchic technology policies impose extremely high costs, whilst autarchic trade policies discourage socially appropriate use of imported technology.

A completed study on "Agricultural Innovations in India" (Ref. No. 672-14) investigated the importance of the small/large farmer dichotomy in explaining farm productivity differences in developing countries. One of the major conclusions of this research was that the popular view which has underpinned the case for land reform that small farms are more efficient (with a higher land productivity) is exaggerated, as most of the observed differences in land productivity were explained by land quality differences. As a by-product, a theoretical model incorporating the costs of labor supervision was developed to explain why small farms may, ceteris paribus, have a higher average quality of land. Also, it was shown that farm size did not influence the adoption of fertilizers. Finally, a methodology was developed to measure land quality and the results show that the distribution of land, adjusted for soil quality, is much more equal than the "raw" land distribution in India.

Another project, the "Agricultural Mechanization and the Evolution of Farming Systems in Sub-Saharan Africa" (Ref. No. 673-16), concluded that: a) The transition from handhoes to animal-drawn plows is only profitable at higher intensities of farming; b) population growth and market access are the main determinants of agricultural intensification; c) in most circumstances, it is economically infeasible to bypass the animal traction stage and move directly to tractors.

Industrial Policy

The research project on "Productivity Change in Infant Industry" (Ref. No. 672-86) has accumulated a body of evidence on the nature and sources of long-term changes in production costs, with a focus on infant industries. The project has measured changes in production costs over time in terms of total factor productivity changes at the sectoral, subsectoral, and firm level, in both Egypt and Thailand. A clear pattern emerges at the sectoral and subsectoral levels, between exposure to competition, high productivity performance, and improvements in international competitiveness, with productivity change often offsetting major deteriorations in the terms of trade. This aggregate pattern is supported by evidence at the firm level.

Factor Markets

Research on the structure and functioning of the "Nigerian Labor Markets" and their interaction with developments in the macro-economy, particularly oil income flows and the resulting changes in the real exchange rate, is part of an effort to develop an appropriate agricultural strategy for Nigeria. The issue is whether, in what sense and to what extent, Nigeria is a "high wage economy." The research shows that Nigeria's "high wages" were caused primarily by the overvalued exchange rate and that real wages--at least in agriculture--did not rise noticeably during the oil boom, although there almost certainly was an expansion in employment, particularly in the public sector. Since the end of the oil boom in 1981, real wages have, of course, been falling, and so has public sector and other formal employment.

Another study on "Labor Migration among the Poor: The West African Case" examines the role that international migration plays in West African society and economy, emphasizing its socioeconomic effect and the extent to which international worker migration contributes to economic development.

Urbanization

In the urban sector, a research project on "Housing Demand and Finance" (Ref. No. 672-46) found: (i) Housing demand varies in a predictable way in developing countries, with low-income households generally spending higher fractions of income for shelter than high-income households, and with all income groups spending higher fractions of income for shelter as the level of economic development increases; (ii) The lowest income households, those with little or no assets of any kind, "finance" housing by progressive development, i.e. by upgrading very low quality units as funds become available; (iii) Theoretical work on tenure security suggests that some punitive government actions designed to reduce squatting may actually increase it. Additional work suggests that increasing security of tenure represents a net efficiency gain to society, not just a transfer to participants; (iv) An investigation of the experience of Cairo with rent control has shown a vacancy rate of almost 6 percent and a high rate of new construction despite enforced controls on monthly rents paid. In that market "key money" and other side payments are shown to largely equilibrate the market: when they are included, average rental prices are almost identical to the average of estimates of the long run competitive price. However, these averages mask large welfare gains and losses to individual tenants.

Another research project on "Industrial Location Policies" (Ref. No. 672-91) evaluates the effectiveness and relative inefficiencies of alternative policies intended to influence the location patterns of manufacturing employment in Seoul (Korea). It found: (i) that a surprisingly small portion of firms (16 percent) moved in response to government policy actions such as incentive schemes and relocation orders in spite of the effective policy implementation records in Korea; (ii) small new firms and firms which required extra land for expansion tended to locate their operations just outside the restricted area where they could still gain access to Seoul's markets and services. This is consistent with previous findings that small firms spend their early years near the city center with easy access to essential services and firms do not move long distance when they move.

Transportation

An ongoing study of the "Determinants of Demand for Personal Travel" (Ref. No. 673-05) relies in its first phase on the analysis of household expenditure surveys to provide: (i) a model to forecast the demand for travel in rural and urban areas with a given socioeconomic and demographic composition of households and to measure the welfare effects of changes in the cost or the provision of travel facilities (whether infrastructure or services); (ii) a survey instrument applicable in developing countries that will cover people who currently travel as well as those who do not. A result of immediate interest is the share of travel in expenditures of poor households: even the poorest groups spend on travel and the proportion is sometimes unexpectedly high. While this research has some relevance to the question about the development effects of new transport facilities in hitherto unprovided areas (such as new penetration roads), much more empirical work is needed to throw light on that long-standing issue of special importance to Africa and to sparsely settled regions.

Population

During FY85, work on determinants of fertility and consequences of rapid population growth has continued, with increased emphasis on policy implications and with a special focus on Africa. One research effort explored the relationship between population and agriculture in Africa, the objective being to suggest ways in which agricultural sector development considerations can be integrated into population policy decisions and vice-versa. Another showed that the current levels of fertility in sub-Saharan Africa, resulting from a pattern of early and universal marriage and limited contraceptive use, would be even higher but for pervasive and prolonged breast-feeding. Similarly a recently completed research project in Bangladesh (RPO 672-70) found that age at marriage and the duration of breast-feeding rather than educational levels or landholdings, accounted for fertility differences across households.

C. Specific Operational Issues

In this category are grouped those research projects which are concerned with more narrowly focused operational needs, for instance in the evaluation and monitoring of Bank projects.

Farm Extension and Mechanization

A recently completed research project (Ref. No. 672-29) evaluated the impact of the Training and Visit Extension System on knowledge and adoption of improved farming practices, on input use, and on farm productivity. The key findings from the farm survey and its statistical analysis were: a) The area where T&V extension was introduced has a 6-7 percent gain in the productivity of wheat but no significant effects for rice compared to the area with traditional extension. The incremental investment in T&V extension yields a rate of return of more than 15 percent. Most of the extension-induced gains in wheat yield derive from farmer's improved access to timely and research-based advice concerning their specific production problems. The study area was very advanced even before the introduction of T&V extension, and no significant gain was identified in the use of high yielding varieties or fertilizers. b) There was no significant evidence that the productivity of smaller farmers increased less than that of larger farmers.

Transportation

A large and extended research project on "Highway Design and Maintenance Standards" (Ref. No. 672-27) completed this year, was in engineering economics, which sought answers to question about the effects of road conditions on the cost of using roads, and of the effects of traffic on road condition, which together are an essential basis for road policy and taxation.

The study found that often it is economical to build stronger roads than conventionally accepted and that the process of road deterioration is highly non-linear so that deferring infrastructural maintenance beyond a point leads rather suddenly to steep increases in the costs of both vehicle operating and road repair.

As for the study on "Pricing and Taxing of Transport Fuels" (Ref. No. 672-83), it sought to answer two sets of questions, by way of analysis and empirical application to Tunisia: how to assess charges for the use of roads, and what to base those charges on (e.g., fuel or annual license fees); and what is the impact of changes in fuel prices (or taxes) on the price level and on real income distribution. Preliminary results in the latter enquiry indicate that the impact on both inflation and distribution of increasing fuel taxes can be readily offset, at no loss to the revenue, by compensatory adjustments to other major taxes.

Education

One major question facing educational policymakers in developing countries is whether the secondary school curriculum should be "diversified" to include prevocational subjects. In fact nearly all Bank lending for secondary schools has included diversification of the curriculum with the hope that it will aid the transition of the graduates to the world of work. A major research project (Ref. No. 672-45) studied diversified curricula in Colombia and Tanzania. The main rationale for diversifying the curriculum (i.e., to improve the employment possibilities of the graduates) has not been supported by the data, as diversified curricula are difficult to implement and expensive. Nor does specialized training increase graduates' earnings; nor do vocational students end up in jobs that are better matched to their training than other students. Where, say, 20 percent or less of the eligible age group is in school, access to secondary schooling and upward mobility could perhaps be expanded by the least costly means--more conventional schools.

Health and Nutrition

The initiation of direct project lending for health has led to two principal areas of concentration of research: resource allocation within the sector, and resource mobilization (how should health services be paid for). A completed project in Mali assessed the demand for health, education and water services in poor rural areas, assessed the willingness to pay for new services and estimated the elasticities of demand for existing services with respect to fees, distance and service quality. The results showed less than the required willingness to pay for community health worker activities except in the largest villages, but adequate willingness to pay for well maintenance in all but the smallest villages. Another study of health service finance in developing countries found that there is considerable scope for users bearing a larger share of health care costs particularly for non-referral curative care.

Research on nutrition has shifted toward identifying the impact of nutrition and health interventions through nutrition projects and components as well as the nutritional effects of agriculture and rural development policies and projects. A research project conducted in Kenya confirmed the results of previous studies that anemia limits worker productivity and parasitic infestation hampers child development. Another study on the "Benefit and Cost Analysis of Nutritional Interventions for Anemia Prevention" considered the effects of policies of medicinal supplementation and food fortification. The benefit-cost ratios of such interventions to reduce anemia appear to be large. A state-of-the-art review of nutrition education found that nutrition education can effectively promote the adoption of many low-cost or cost-free practices to improve the nutritional status of family members, particularly of children.

ANNEX 1.

SUMMARIES OF EVALUATIONS OF COMPLETED RESEARCH PROJECTS

This annex summarizes the results of a major exercise carried out this year by REPAC to evaluate a number of research projects which had been completed but not evaluated. Because of the backlog of projects requiring evaluation, the Research Policy Council decided to evaluate only those projects costing more than $100,000 each. These 38 projects were classified under six sectoral panels, each under the chairmanship of one or two REPAC members, and were evaluated independently by an internal reviewer and also an external reviewer. These have been summarized into sectoral reports which are presented here.

I. EVALUATION OF COMPLETED RESEARCH PROJECTS

No.	Title	Approval Date	Completion Date	Duration
A. AGRICULTURE				
671-17	Analytics of Change in Rural Communities	07/30/74	01/28/83	8 yrs. 6 mo.
671-34	Management and Organization of Irrigation Projects	07/07/75	09/02/81	6 yrs. 2 mo.
671-42	Country Case Studies of Agricultural Prices and Subsidies	06/25/76	10/18/78	2 yrs. 4 mo.
671-45	Programming and Designing Investment in the Indus Basin	09/27/76	06/15/84	7 yrs. 9 mo.
671-57	Distribution of Income through the Extended Family System	07/05/77	07/31/84	7 yrs. 1 mo.
671-88	Adoption of Farm Technology in Northern Nigeria	03/28/79	08/07/81	2 yrs. 4 mo.
672-11	Agricultural Sector Analysis Framework Study	02/01/80	05/13/83	3 yrs. 3 mo.
672-67	Conditions for Sustained Farm Mechanization	11/25/81	06/30/84	2 yrs. 7 mo.
B. PLANNING/GROWTH/COUNTRY ECONOMIC ANALYSIS				
671-27	Social Accounts and Development Models (SAM)	06/03/75	07/19/84	8 yrs. 2 mo.
671-87	International Real Product Estimates	11/05/80	01/11/83	2 yrs. 2 mo.
672-25A	Development of a SAM Basis for Planning and Modeling in Egypt	11/05/80	08/07/84	3 yrs. 9 mo.
672-26A	Multi-Sector and Macro Economic Models of Structural Adjustment for Yugoslavia	01/06//81	06/30/84	3 yrs. 6 mo.

No.	Title	Approval Date	Completion Date	Duration
C. INCOME DISTRIBUTION/LABOR/EMPLOYMENT				
670-45	Labor Force Participation -- Income and Unemployment	10/19/71	01/05/83	11 yrs. 2 mo.
670-83	Evaluation of Latin American Data on Income Distribution	08/02/73	01/20/83	9 yrs. 6 mo.
671-06	Employment Models and Projections	06/25/74	08/07/84	10 yrs. 1 mo.
671-08	Evaluation of Asian Data on Income Distribution	06/21/74	11/30/82	8 yurs. 5 mo.
671-63	Labor Migration and Manpower in the Middle East and North Africa	01/04/84	02/23/81	3 yrs. 1 mo.
671-84	Wage and Employment Trends and Structures	12/27/78	07/31/84	5 yrs. 7 mo.
D. INTERNATIONAL TRADE AND FINANCE/INDUSTRY/ENERGY				
671-09	Natural Resources and Planning - Issues in Trade and Investment	06/25/74	01/31/83	8 yrs. 7 mo.
671-28	Linkage of Commodity and Country Models	06/03/75	01/21/83	7 yrs. 7 mo.
671-32	A Comparative Study of the Sources of Industrial Growth and Structural Change	06/02/75	06/30/84	9 yrs.
671-79	Sources of Growth and Productivity Change: A Comparative Analysis	06/13/78	06/30/84	6 yrs.
671-35	Export Incentives in Developing Countries	07/07/75	07/31/84	9 yrs.
671-59	Small-Scale Enterprise Development	10/31/77	06/30/84	6 yrs. 8 mo.
671-77	Appropriate Industrial Technology	06/13/78	02/01/84	5 yrs. 7 mo.
671-85	The Industrial Incentive System In Morocco	03/28/79	08/12/83	3 yrs. 4 mo.

No.	Title	Approval Date	Completion Date	Duration
671-86	Standards of Rural Electrification	03/28/79	04/10/84	5 yrs.
671-92	Industrial Statistics	07/09/79	11/09/82	3 yrs. 4 mo.
672-41	Changes in Comparative Advantage in Manufactured Goods	06/26/81	06/30/84	3 yrs.
E. URBANIZATION AND REGIONAL DEVELOPMENT				
671-20	Urban Traffic Restraint -- Singapore	08/07/74	01/25/83	8 yrs. 6 mo.
671-47	Strategic Planning to Accommodate Rapid Growth in LDC Cities	02/08/77	06/30/84	7 yrs. 4 mo.
672-13	National Spatial Policies: Brazil and Korea	02/04/80	07/24/84	4 yrs. 5 mo.
F. EDUCATION/POPULATION/HEALTH				
671-38	Narangwal Population and Nutrition	02/18/76	06/30/82	6 yrs. 4 mo.
671-60	Textbook Availability and Educational Quality	10/31/77	06/06/84	6 yrs. 7 mo.
671-61	Socio-Economic Aspects of Fertility Behavior in Rural Botswana	10/31/77	02/26/82	4 yrs. 4 mo.
671-70	Case Studies of Determinants of Recent Fertility Decline in Sri Lanka and South India	12/31/77	06/01/84	6 yrs. 5 mo.
671-74	Economics of Schistosomiasis Control Activities	02/23/78	06/30/84	6 yrs. 4 mo.
672-01	A Comparative Study of Labor Market Consequences of Educational Expansion	07/12/79	06/30/84	4 yrs. 11 mo.

EVALUATION PANEL ON AGRICULTURE

The research program on agriculture focused on two major areas: (a) methodologies to assess the benefits and distributive effects of large expansion of irrigation systems as well as issues regarding the management of these systems; and (b) methodologies to evaluate alternative development policies applied to agriculture, in particular, the effects of alternative pricing policies.

The quality of the different research projects varied considerably. Some of them were quite innovative, although quite costly for a case-by-case replication. Others were less successful in the sense that the methodology was not clearly spelled out before the collection of data. Several interesting country case studies were developed in order to evaluate alternative agricultural development strategies. Nevertheless, these efforts would have had a substantial additional payoff had they been summarized in a synthesis piece comparing different methodologies and country case studies.

Future research in this area could be improved substantially by:

(a) more careful specification of initial conditions, and examination of their implications as well as choice of assumptions and methodologies selected in the studies for generalizability of research results;

(b) improving the translation of those research results which have obvious generalizability to other conditions in terms of policy and operational significance; and

(c) increased emphasis on effective dissemination of research results by the publication of synthetic pieces of easy access to policymakers. Accessibility of research findings to Bank staff and especially the policymakers in developing countries have received relatively little emphasis.

Incentives to the staff doing research have not been explicitly geared to rewarding those who successfully complete and publish results and participate in the active dissemination of those results. Participation of research staff in dissemination to some extent is crucial in ensuring the continued policy and operational relevance of their research.

Some REPAC resources should be allocated urgently to the distilling and dissemination of those completed studies, where such investment would have a high payoff.

EVALUATION PANEL ON PLANNING/GROWTH/COUNTRY ECONOMIC ANALYSIS

The four projects in the above group, have the common features of (i) attempting to provide improved quantification of economic performance and/or policy choices, and (for the two planning model related projects) (ii) general purpose models for policy analysis. The project on International Real Product Estimates (671-87) is in a class by itself. It was complementary with the larger Kravis et al ICP study supported by the Bank. Its most notable finding was that because of various offsetting effects real output indicators are insensitive to the assumptions made in the ICP about the productivity of services.

The main achievement of the two projects (671-27 and 672-25A) to develop and apply SAMs was in demonstrating the usefulness of SAMs as an accounting framework which allows checks to be made upon the quality and consistency of macroeconomic data in a country. The project 671-27 was less successful in its laudable objective of incorporating income distributional aspects into SAMs. The modeling attempts associated with these SAMs were however, not particularly useful for policy purposes because of the underlying weaknesses of the data base and the inability of the modeling framework used to take account of various dynamic and institutional aspects relevant for policy analysis. By contrast, the application of a CGE model in Yugoslavia (672-25A) was highly successful in part because of its relevance to the institutional framework in which it was applied. However, the attempt to convert it into a model to answer macroeconomic questions was unsuccessful. The technical quality of most of the output produced by the projects was fairly good.

The general lessons to be learned from all four projects are that first, standard tools in the economic kit such as SAMs and CGEs can, in particular cases, and in the hands of good economists be usefully applied. Second, the desire to produce an all-purpose general planning model which can be routinely used like an engineering model is misplaced. Third, whilst it was useful for the Bank to have experimented with developing SAMs and CGEs as policy models, the returns from this experiment in terms of the general usefulness and relevance of the models developed (except in the exceptional case of Yugoslavia) was not very high.

EVALUATION PANEL ON INCOME DISTRIBUTION, LABOR EMPLOYMENT*

One general impression emerging from these six projects is that of dispersion and heterogeneity not only between projects but also within many of the projects. Individual researchers, after having submitted to time-consuming reviews at the proposal stage, were then left largely to their own devices with very little supervision. As a result, not only have most of the projects taken years longer than had been intended, but the design and content of projects was allowed to diverge from the original objectives without evidence of attempts on the part of the Bank to correct the situation. Slippage, indeed, was so bad in some cases that the principal researchers left the services of the Bank or abandoned the project altogether before completion. A better link between achievement and financial rewards might have helped avoid this serious problem. Partly as a result of this, the output of the projects most often lacks a synthesis or even a published summary. Output usually consists of a series of papers, articles, sometimes not even published, which are of little or no use to the rest of the Bank, to policymakers or to the academic community. Little effort seems to have been made by Bank management to ensure that projects would end with a compact tangible and readily accessible product.

Another recurrent theme is the underestimation by the research managers of the enormous difficulties (and costs) involved in collecting primary data suitable for many of the analyses approved by the research committee. The need to collect and organize data in some cases absorbed the bulk of the approved budgets and consequently led to a curtailment of the analytical parts of the research. As few of the projects were designed with a policy-relevant question in mind at the proposal stage, few ended up with policy-relevant conclusions. Two of the projects had to do with income distribution data reviews (RPO 670-83 and 671-08). Perhaps the most important positive legacy of the other projects is that several of them tested the widely-accepted paradigm that market imperfections in developing countries are so overwhelming that the workings of the labor market do not deserve empirical examination. Some of the projects in this sample played a major role in examining country situations in a historical perspective and with the help of very careful surveys (or careful analyses of existing surveys). The unanimous conclusion 1/ is that markets do indeed matter; that they function remarkably well in the course of development; and that pessimism based on a rigid "institutional" view of the development process is simply not backed up by

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* A sample of six projects is far too small to permit valid generalizations, particularly given the very broad area covered by the panel on distribution, labor and employment in developing countries. Consequently, the analysis should be taken as tentative.

1/ The project on labor migration and manpower in the Middle East and North Africa (RPO 671-63) does not, however, fall into this category, since it consists of a model which does not recognize the workings of the labor market.

empirical evidence. This has played an important part in turning around the thinking of many Bank economists (indeed, "mainstream" Bank thinking is now consistent with the outcome of these research projects) and also economists outside the Bank.

EVALUATION PANEL ON INTERNATIONAL TRADE AND FINANCE/INDUSTRY/ENERGY

Research in this category included eleven projects whose objectives were 1) to provide the analytic tools and data to analyze global supply and demand conditions of selected commodities; 2) to analyze the pattern of, and changes in, comparative advantage in the production and trade of manufactured goods; 3) to examine the sources of industrialization and growth; 3) to analyze the role of incentives in promoting exports, employment generation and industrial development; 4) to develop a methodology for analyzing the sources of productivity differences among firms; and 5) to develop a methodology for the preparation and evaluation of designs and standards for rural electrification projects.

In most cases, the objectives of the projects were met, and the strategies developed to address the problems proved adequate for the task. The research has mostly used state-of-the-art methodologies, applying them competently to development issues which previously had not been researched to the same extent or with the same rigor. For the projects under review, there are only a few examples where new methodology development or significant adaptation took place. In general, the projects have provided valuable insights into important elements of the development process and policies. Examples are the modeling of worldwide commodity markets (especially for aluminum and copper), the analysis of export incentives (especially as regards the importance of access to tax-free inputs and credit), and the assessment of the role of small-scale enterprises in industrial development and employment generation.

The findings of the latter project suggest that overall incentives play a central role in ensuring efficient (and appropriately labor-intensive) industrialization; that special interventions in favor of small-scale enterprises need to be treated with considerable caution and cannot easily be justified on the basis of higher labor intensity or efficiency of small-scale enterprises; and that specially designed interventions in support of small-scale enterprises (or of traditional types of manufacturing techniques) can lead to resource misallocation without offsetting distributional benefits. Similarly, a project on changes in comparative advantages in manufactured goods, employing the simple but effective statistical approaches developed in the earlier studies of the principal author was found to be interesting and original in its attempt to test the new theories of international trade under monopolistic competition. There has been much less empirical work in this field than on the Heckscher-Ohlin theory, and the research reported in this group of papers on intra-industry specialization is both important in itself and likely to stimulate further work by others. The attempt to distinguish between the impact of product differentiation and economies of scale on the pattern of intra-industry trade, for example, is particularly interesting and important.

However, this evaluation panel found that the use of comprehensive models to analyze complex policy issues has not proven to be very successful, although it has yielded valuable insights. Examples are the two multicountry comparative studies on industrialization and growth. Although the projects carried forward significantly the methodologies on input-output and CGE modeling to analyze the sources of growth, and to some extent the implications of different strategies and policies of industrialization, they were less successful in analyzing policies and incorporating policy instruments in modeling in an explicit and quantitative form. As with a number of other projects, the researchers had also underestimated the difficulties of data collection, forcing postponement of subsequent phases of the research.

The evaluations also indicate that large research projects can easily go into divergent directions, unless carefully and closely managed by a homogeneous team of Bank staff and consultants working with a clear common methodology and without interruption. In fact, the pervasive delays, lack of summary documentation of project findings, and poor record on dissemination which has characterized some of the projects can readily be traced to excessive discontinuities in the staffing of research projects.

The issue of the need for improved project design also arises with respect to the project on global supply and demand conditions of selected commodities where despite underlying high quality econometric work, innovative frameworks for specific models, and some excellent reports, the project was vaguely formulated in that it encompassed subjects that were not interrelated in a mutually supportive fashion, making it difficult to pull together overall findings.

A number of projects point to important lessons for the improvement of future research. They emphasize the need for closer collaboration initiated early between researchers and the regional staff both to allow more flexibility in research design and to insure operational relevance. Although the project on appropriate industrial technology made an important contribution to analysis of technology choice and determinants of productivity in developing countries, operational staff were not involved in the research and the methodology involved has been used very little in Bank projects.

Dissemination and the results of these projects should have been given higher priority, including feedback into the Bank's operational and policy work, which should be carefully designed and monitored. In all the projects reviewed, there was a serious underinvestment in dissemination of this kind. In most cases, researchers have a built-in bias and incentives to write for an academic audience completely ignoring the needs of Bank economists. Research managers must alter these incentives.

EVALUATION PANEL ON URBANIZATION AND REGIONAL DEVELOPMENT

The three projects dealt with under this subheading really addressed three distinct issues (i) traffic patterns and policies; (ii) urban growth and the economics of urban growth; and (iii) regional policy. While quite distinct in terms of subject matter, two major themes do emerge from the review of the findings and evaluation of these projects.

The first theme relates to the validity of basic economic laws or regularities. For example the Bogota "City Study" suggests that cities whether in the developed or the developing world exhibit strong regularities in their pattern of development, supports the hypothesis that conclusions and policies based on fundamental behavioral findings are largely transferable and upholds the very significant operational conclusion that markets play an important role in the allocation of resources in urban areas. By implication the "City Study" suggests that urban operational strategies need not treat each city as a special case; further that efficient city management will require appropriate economic policy and not just physical planning. Similarly, the findings of the research project on national spatial policies emphasize the importance of analyzing the industrial location decisionmaking process with the basic tools of microeconomic analysis. The researchers conclude that the best spatial policy consists of good sectoral policies and good sectoral policies emphasize economic efficiency.

The second and related theme is that macroeconomic and trade policies, while not targeted to spatial or urban objectives, in fact have very important influence on urban and spatial development.

Incentives policies not normally considered to be spatial in their impact (such as trade, exchange rate, fiscal, and credit policies) are found to have a strong spatial impact. They favor larger, more diversified centers and penalize secondary centers specializing in more traditional lines of production. A major finding is that reforms of these non-explicit spatial policies, which are seen as undesirable on non-spatial efficiency grounds, would also improve market signals and lead to more efficient location decisions favoring efficient decentralization of economic activity. The thrust of the findings is distinctively in favor of reducing or eliminating price and policy distortions, however well-intentioned, and allowing market forces to play a greater role in guiding industrial location decisions.

EVALUATION PANEL ON EDUCATION/POPULATION/HEALTH

Although all dealt with human resource issues broadly defined, the six projects evaluated under this subheading ranged widely in terms of subject matter, objectives, and methodologies. One concerned the production of education in developing countries; two explored aspects of fertility decline; one tested models of service delivery in the area of health and family planning; one analyzed the interplay between formal education and labor markets; and one looked at costs of alternative approaches for controlling a major parasitic disease. Such diversity makes the reporting of general findings from these efforts difficult but several themes do emerge with important implications for the design and management of future Bank research.

First, and perhaps most important, the less closely a project is linked to operational activities, especially project design, the more demanding are requirements for (1) good management, and (2) effective dissemination. Although virtually all projects in this area were viewed by reviewers as potentially important to Bank operations those that scored highest with the Bank's nonresearch staff were, not surprisingly, those whose results led directly and unambiguously to project design recommendations. The best example of such a project is the work on "Textbook Availability and Educational Quality."

Projects that considered broader issues such as determinants of fertility or the functioning of labor markets faired less well in terms of their actual or perceived effect on Bank operations. To some extent this is to be expected: the more "basic" is the research, the less directly applicable to project or program design it is likely to be. However, there is also a clear sense in several reviews that shortfalls in dissemination contributed to a lack of direct applicability. Reviewers for virtually every broadly focused project bemoaned the lack of a true "final product" that synthesized findings and emphasized general lessons.

Second, a number of projects in this group invested heavily in the collection of primary data. These data resources were considered to be of great potential value to the Bank and the human resource research community more generally, but their actual value has often fallen short of this potential. Two reasons for this shortfall stand out. First, data were usually closely held by the originating researchers for a considerable period of time, limiting the scope for a "competition of ideas" with regard to analysis of alternative hypotheses. Second, even had access been unlimited poor data documentation, at least as represented in published works, would have put researchers not directly connected with the original project at a serious disadvantage. Since primary data collection is often a costly undertaking the Bank may want to consider a more systematic approach to issues of both data documentation and access.

Finally, large projects with vaguely defined objectives tended over the course of time to stray well beyond the confines of even those general constraints. This widening of the scope of analysis came in one or two instances at the cost of the project's primary objective. While research is inherently an uncertain process researchers should make more effort to fulfill the specific objective that originally motivated their efforts or provide a clear statement of why they did not do so.

Overall one is left with a sense that the projects in this group asked interesting and important questions but, with, perhaps, two exceptions, were less than completely successful in either answering those questions or "selling" their findings to prospective consumers within the Bank. One solution would be to require of each project a "policy summary" of no more than twenty pages highlighting major findings and their implications for Bank policy or project designs.

APPENDIX 1

RESEARCH PRIORITIES

There are five broad areas which the RPC recommended and the Board approved in 1984, as important fields for research which would both support Bank operations as intermediate inputs as well as provide important final outputs to keep the Bank in the forefront of thinking on the economics of developing countries. It is recommended that research be encouraged in these priority areas: 1/

(1) Costs and Benefits of Government Intervention: Policy-Induced Distortions and Economic Incentives - This area includes an extension of studies of the incentive system in trade and agriculture to other types of distortions of relative prices and economic incentives. It would also include studies of incentives *within* various types of organizations - including private firms, public firms and public agencies, as well as more comparative studies on the size, causes and consequences of policy-induced distortions in product and factor markets. In addition, it includes studies of instances where government intervention was on balance helpful on grounds of efficiency and equity. Related to this is the important question of the appropriate timing and sequencing of policy reforms.

1/ Other relevant areas, of course, would not be excluded.

(2) Interrelationships Between Institutions and Incentives - In this area, research would take account of the way institutional arrangements affect the impact of various policy measures. It would also cover studies of the behavioral determinants of the actions impinging on economic outcomes of both private and public agents; studies of alternative institutional arrangements for the regulation of firms and markets such as alternative contract forms, systems of property rights and job security legislation; the systems, rules and practices of the management of public firms and public agencies; the organization of the distribution of public services, including their financing by taxes, fees or rationing; the control of the budgetary system and reform of tax systems; the political economy of decisionmaking on economic policy; alternative public policy mechanisms to impact upon the major determinants of fertility and mortality; and the general application of 'household economics' to questions concerning human resource development.

(3) The International Economic Environment - Studies in this area would, for example, chart and analyze emerging trends in trade and capital flows in the global economy; consequences and policy options for developing countries of developments in international trade and financial markets; global and country specific aspects of developing country indebtedness; prospects and problems of government and private capital flows to developing countries; the role of foreign aid in development.

(4) The Relationship of Stabilization Measures to Long-Term Economic Development - Research in this area would be designed to understand the relationship of short-term macroeconomic policy measures to longer term economic development. These studies would, for instance, analyze the real effects of past stabilization policies on long-term growth, including the determinants and interrelationships of the key macroeconomic relative prices - real exchange, wage and interest rates - over the medium and long-term course of development; and the appropriate sequencing of policy reforms which serve to correct distortions in both microeconomic as well as macroeconomic relative prices.

(5) Economic Planning - The research effort should shift from the past emphasis on comprehensive planning models and project and sectoral planning techniques, towards studies of 'institutional planning' or 'institutional development' which concerns attempts to improve the mechanisms and institutional aspects of both markets and the public sector, by modification of existing rules and institutions and the creation of new ones.

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Operational Manual Statement

The World Bank

RESEARCH PROJECTS APPROVAL COMMITTEE (REPAC)

I. INTRODUCTION

1. The purpose of this Statement is to set out the rules and procedures governing the appraisal of research proposals by the Research Projects Approval Committee (REPAC). The main objectives of this system are the following:

(a) to place responsibility with line managers for the substance and operational relevance of research proposals, and for seeing that proposals conform to the research priorities to be laid down by the Research Policy Council (RPC);

(b) to ensure the technical quality of research proposals; and

(c) to expedite the research project approval process.

II. POLICY

2. REPAC has been established by RPC to evaluate and recommend individual research projects for funding from the External Research Budget (ERB).[1]

III. RESPONSIBILITY

3. It is the responsibility of line managers to consult widely in the Bank to help ensure the institutional relevance of research proposals and that they conform to the research priorities laid down by RPC.

Regional Support and Contribution

4. Studies involving specific countries or regions should be coordinated by the sponsoring department(s) with the appropriate regional program or projects departments and chief economists. When regional support of the proposed research project is cited as a major justification, the regional department(s) concerned will be expected to make a contribution in the form of funds and/or staff time to the research project.

Conflict of Interest

5. Members of an ad hoc subcommittee appointed by the Chairman to review a proposal normally should not be from the same department(s) as the proposal's sponsor(s) (or from the same vice-presidential unit(s) if members are chief economists). Also members of REPAC with a substantive interest in a particular proposal will not participate in the discussion and decision making on that proposal.

External Collaborators

6. To ensure that Bank-sponsored research is of the highest quality, REPAC will encourage the use of the best available external collaborators in designing and executing research proposals. Primary responsibility for proposing such collaboration will rest with submitting departments. Howevever, REPAC will be ready to help departments identify high quality external collaborators both as an input into the development of a proposal and as a resource for executing an approved proposal. Departments may suggest research topics to REPAC on which outside collaboration would be useful. If REPAC concurs with these topics, it will in consultation with the departments send these topics to a number of research institutes around the world to obtain completed research proposals to be funded from ERB. REPAC in consultation with the concerned departments would review them and advise on the best external collaborator for the particular topic. Such proposals would be subject to the normal review procedures of REPAC. When important topics within the RPC guidelines have not come up as departmental proposals, REPAC may from time to time seek to interest departments in sponsoring proposals and help them to identify external collaborators who could develop and conduct the proposed project.

[1]See Organizational Manual Statement 3.50.

Operational Manual Statement

IV. PROCEDURES

Review and Decision Procedures

7. Any request for ERB funding, regardless of its nature, is subject to common procedures, as outlined below. All requests for ERB funding should be submitted to the Secretary of REPAC in twenty copies. The Secretary will immediately circulate them to all REPAC members.

(a) *For requests below $50,000*: The Chairman will decide on these requests, after consulting members of REPAC. These requests are expected to be dealt with very expeditiously.

(b) *For requests between $50,000 and $125,000*: The Chairman will review these requests in consultation with an ad hoc subcommittee of REPAC and at least one external reviewer. Other internal reviewers may also be used. The Chairman makes recommendations on these requests to the Vice President, Economics and Research Staff (VPERS), who decides on projects recommended for funding. VPERS can ask the Chairman and subcommittee members of REPAC to reconsider their decision on research projects they have recommended for rejection, but the final decision of REPAC on proposals that are rejected will not be overruled. The process is not normally expected to take more than one month.

(c) *For requests above $125,000*: For each proposal in this category, the Chairman of REPAC appoints an ad hoc subcommittee of REPAC members to review the proposal. The proposal is subject to at least two high quality external reviews and, if considered necessary, to internal review by other Bank staff with relevant expertise. External reviewers will be chosen from a roster of external referees maintained by REPAC. The roster will attempt to cover as wide a body of external reviewers as possible from around the world. The subcommittee reports on the proposal to the full committee, which reviews it and makes a recommendation to VPERS, who decides on projects recommended for funding. For research projects rejected by REPAC, VPERS could ask REPAC to reconsider its decision, but REPAC's final recommendations on research proposals that are rejected will not be overruled. The review and decision procedures should take about two months for projects above $125,000.

A decision memorandum will be sent to project sponsors outlining the basis for the decision made and giving a synopsis of external referee comments when such have been elicited.

Meeting Intervals and Quorum

8. REPAC will meet at least once a month. To transact business, REPAC must have a quorum of at least five members present at its meetings. The Chairman can appoint a member of REPAC to act as Chairman of REPAC in his absence.

Submission Deadline

9. Submit proposals above $125,000 by the last day of each month to enable the reviewing process to be organized at the beginning of the monthly meeting of REPAC. Other proposals may be submitted at any time to the Secretary of REPAC.

Resubmission of Proposals

10. When REPAC decides against funding a proposal, it will include in the decision memorandum a recommendation on whether the proposal may be resubmitted. A recommendation in favor of resubmission will, in principle, mean that the revised proposal will be reviewed by the same external referees.

Research Preparation

11. REPAC will fund preparatory work on project proposals in cases where this is judged to be necessary. Such funds will not constitute a guarantee of favorable consideration of the research proposal that follows. When a research proposal is not submitted following the use of preparatory funds, a report on the use of these funds will be required from the sponsor.

Operational Manual Statement

The World Bank

Supplementaries

12. REPAC will not normally consider requests for supplementary funding of research work previously authorized in an ongoing research project. Exceptional circumstances will need to be established for such funding. Requests for supplementaries to finance research work *additional* to that in the original proposal will be subject to the same review and decision processes as the new research proposals.

Duration of Research Projects

13. Normally REPAC will not consider research projects which are planned to extend beyond three years. Any exceptions will be reported to RPC.

Projects Extending Beyond Authorized Duration

14. REPAC will request Controller's to close the account of any project which is six months behind the authorized completion date (as shown in the original proposal), unless its sponsors obtain a time extension from REPAC on the basis of a proper justification. For ongoing projects a grandfather clause will apply, i.e., their books will be closed one year after the authorized completion date as shown in the original proposal.

APPENDIX 3

RESEARCH POLICY COUNCIL MEMBERS

RPC

Anne O. Krueger	Vice President, Economics and Research (Chairperson)
David Knox	Vice President, Latin America and the Caribbean Regional Office
Jose Botafogo Goncalves	Vice President, External Relations
Shahid Husain	Vice President, Operations Policy
Joseph Wood	Vice President, Financial Policy, Planning and Budgeting
Deepak Lal	Research Administrator, Economics and Research, Ex-officio Secretary.

APPENDIX 4

RESEARCH PROJECTS APPROVAL COMMITTEE MEMBERS

REPAC

D. Lal	Research Administrator, Vice President's Office, Economics and Research (Chairman)
A. Choksi	Chief, Trade and Adjustment Policy Division, Country Policy Department
K. Dervis	Chief, Industrial Strategy and Policy Division Industry Department
D. de Tray	Chief, Living Standards Unit, Development Research Department
U.J. Lele	Chief, Development Strategy Division, Development Research Department
F.S. O'Brien	Chief Economist, West Africa Regional Office
G.P. Pfeffermann	Chief Economist, Latin American and Caribbean Regional Office
M. Selowsky	Economic Adviser, Office of the Vice President, Operations Policy
G. Tidrick	Senior Economist, East Asia and Pacific Regional Office

* Mr. J. Linn, Senior Economist, Country Programs Department, East Asia and Pacific Regional Office, replaced Mr. G. Tidrick in June 1985.

APPENDIX 5

Editorial Board of the Research News

Editor:	Bruce Ross-Larson (Consultant)
Editorial Board Members:	Dennis de Tray, Chairman (DRDLS) Vinod Dubey (CPDDR) Michael Finger (DRDIE) Peter Muncie (PUBDR) Stephen O'Brien (WANVP)
Managing Editor:	Oey Astra Meesook (VPERS)

APPENDIX 5

Editorial Board of The World Bank Research Observer

LTR/AR85/11.14.85

APPENDIX 5

Editorial Board of The World Bank Economic Review

External Members:	Professor Assar Lindbeck, Institute for International Economics, Stockholm
	Professor T. N. Srinivasan, Yale University
	Professor Joseph Stiglitz, Princeton University
Internal Members:	Deepak Lal, Research Administrator, *ex officio* Mark Leiserson, Managing Editor, *ex officio* Sarath Rajapatirana Anandarup Ray Marcelo Selowsky

LTR/AR85/11.14.85

APPENDIX 6

GUIDELINES FOR EVALUATION OF COMPLETED RESEARCH PROJECTS

The principal objectives of evaluation as applied to completed Bank research projects are illustrated below. These are in the form of questions for discussion at evaluation panel meetings. These questions, taken together, are an attempt to determine how effectively the research project has met its goals and how useful the project has been in improving knowledge of development issues. While not intended as exhaustive, questions are grouped into headings which are suggested as an organizing format for the report on the panel's findings.

The evaluation reports that we receive are not uniform in character; this makes it difficult to compare the relative quality of different research projects. In the interest of uniformity, it is strongly urged that the format presented below be followed as closely as possible. However, as noted above, the questions are not intended to be exhaustive. Therefore, if necessary, evaluators should not hesitate to broaden the scope of the evaluation.

A. Objectives, Strategy, and Results

1. What general questions did the study seek to answer? What answers did it find? How significant are these answers for a) Development policy in general? b) Bank operations?
2. To what extent did the study fulfill its objectives?
3. Were the objectives of the study clearly formulated? Did they change as the study was undertaken?
4. Who are the intended beneficiaries? (Bank staff; planning authorities and decision makers in developing countries; other researchers).
5. Has the project assisted in developing research or other analytical capacity in the countries under study?
6. Were efforts made to coordinate work with other studies underway in the Bank or outside, to enhance the comparability of results or avoid duplication?

B. Design

1. Does the research improve in specific ways upon a well-established methodology, or is the analytical framework relatively innovative?
2. Were the theoretical approaches and the methodology employed in the study appropriate to its stated purposes? Were difficulties encountered in applying the methodology? If so, how were they overcome?
3. How reliable were the data? Does their reliability depend on the design and coverage of sample surveys conducted as part of the project? If so, were such surveys properly designed and

carried out, and their results adequately incorporated in the research?

C. Organization

1. Did the research tasks follow a logical sequence? Were there opportunities to review progress at intermediate stages?
2. How effective were the consultants or consulting firms employed? How open were the channels of communication between Bank staff and consultants?
3. Was the extent of Bank staff involvement in design, implementation, and supervision adequate to meet the study's objectives?
4. What was the nature and extent of awareness, support, or participation among:
   -- Bank operating departments, including regional departments?
   -- Local research institutes?
   -- Government agencies?

D. Dissemination

1. Are the research outputs written and presented in a manner which makes them accessible to the intended audience(s)?
2. By what means have findings been communicated to the intended beneficiaries?

E. Cost

1. How does the overall cost and efficiency of the study compare with initial estimates? Did it take longer than expected? Were there significant cost overruns?
2. What appreciation, however broad, can be given of cost-effectiveness?

F. Summary

What lessons for the conduct of future research projects are suggested from the above?

APPENDIX 7

Seminar Series on the "Frontiers of Economics"

Speakers have discussed a broad range of economic analysis and research.

The first ten seminars are:

Alex Leijonhufvud	"Whatever Happened to Keynesian Economics?"
Edward Leamer	"Let's Take the Con Out of Econometrics: Sensitivity Analysis for Economic Data"
Mancur Olson	"The Decline of Nations: Afterthoughts"
Robert Lucas	"On the Mechanics of Economic Development"
Avinash Dixit	"Current Developments in Trade Theory: A Selective Survey"
Thomas Sargent	"Where Do the Econometric Battles on Rational Expectations Now Stand?"
James Buchanan	"The Public Choice Perspective"
Robert Barro	"New Developments in the Theory of Rules Versus Discretion"
Sherwin Rosen	"Implicit Contracts"
Gary Becker	"Population and Economic Development"

REPORT ON THE WORLD BANK RESEARCH PROGRAM

PART II

Table Of Contents

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

ERS/MC85-12

DATE: October 3, 1985

TO: Managing Committee

FROM: Anne O. Krueger, VPERS aok

SUBJECT: **International Compilers' Working Group on External Debt Statistics**

1. The various agencies concerned with debt statistics met early last year and decided that a degree of ongoing collaboration would be desirable. They called themselves the International Compilers' Working Group. The purpose of the group is to improve the quality of published statistics on international debt by providing an informal mechanism of liaison and cooperation between the major compilers. Members are the International Monetary Fund, the Bank for International Settlements, the Organization for Economic Cooperation and Development, the Berne Union, and the Bank, represented by its External Debt Division. Two full meetings have so far been held -- each a 3-day program covering a wide range of data issues -- and several new collaborative efforts have been initiated between members.

2. The activity of the Working Group is a tangible response by the international institutions to a specific problem highlighted by the debt crisis, that is, the need to improve the timeliness and reliability of information on international lending. The Fund has kept its Executive Board informed of the Working Group's progress. It seems appropriate to follow a similar course with regard to our own Board members, in view of the Bank's central responsibility for debt statistics of developing countries.

3. Attached please find a summary of work to date, together with minutes of the most recent meeting of the Working Group. I would propose to send these documents to the Board members. You will note from the minutes that the Working Group agreed upon a significant expansion of its activity at the last meeting, through the creation of a small technical subgroup to accelerate progress in harmonizing practices and standards between member institutions. As noted on page 3 of the minutes (paragraph 8), this will involve some additional commitment of resources by members.

Attachments

Record Removal Notice

File Title	Barcode No.
Managing Committee Official Files: Issues Papers - Economic Research Staff (ERS) - Issues papers 85-01	1775416

Document Date	Document Type
October 3, 1985	Memorandum

Correspondents / Participants
To: Executive Directors
From: Anne O. Krueger, VPERS

Subject / Title
International Compilers' Working Group on External Debt Statistics

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	May 23, 2017

International Compilers' Working Group on External Debt Statistics

Meeting Held June 12-14, 1985

1. Representatives of the International Monetary Fund (Fund), the World Bank, the Bank for International Settlements (BIS), the Organization for Economic Cooperation and Development (OECD), and the Berne Union convened for a second meeting of the International Compilers' Working Group on External Debt Statistics (the Working Group). Participants reviewed the major achievements of participating organizations, in the field of external debt statistics, since the first meeting in March 1984; examined the preliminary steps that had been taken toward the construction of a general statistical framework, within which the external debt data compiled by participating organizations could be explained and the processes of collation and reconciliation could continue; discussed a number of methodological and technical issues of data compilation that were of concern to participating organizations; agreed a set of institutional procedures for further enhancing collaboration between the organizations and the desirability of referring specific items to a small technical subgroup; and formulated a program of work that would form the core of the continued collaboration that was deemed necessary.

2. Collaboration between participating organizations had been much intensified since the previous meeting of the Working Group. The Fund and the World Bank had cooperated on the exchange of information on external debt between the two organizations and, within the context of wider Fund/World Bank collaboration, had taken steps to ensure that there was no duplication of effort between the two organizations in the work on external debt; preliminary work on the reconciliation of each organization's data on the long-term external liabilities of countries' banking systems had been effected. The Fund was now receiving regularly, from the OECD, creditor-source data on external trade-related credits and the Fund and the World Bank had supplied information to aid the production of the OECD's soon to be published Annual Survey of the External Debt of Developing Countries. The OECD and the World Bank had made progress in the reconciliation of data on long-term external debt at a global level and had undertaken a comprehensive, loan-by-loan, comparison of data for six countries, which had produced useful results of general application. The Fund and the BIS had cooperated in the expansion of the reporting area of countries providing a geographic analysis of banks' external claims and liabilities and in the development for publication of improved international banking statistics, and the BIS was supplying data on the currency composition of banks' external positions to the Fund to aid the Fund in producing estimates of exchange rate adjusted international banking flows. The BIS and the OECD had maintained close collaboration in the continued joint publication of Statistics on External Indebtedness: Bank and Trade-Related Nonbank External Claims on Individual Borrowing Countries and Territories and had improved the coverage and quality of the data.

3. In addition, participating organizations had made significant progress in their own areas of comparative advantage. The BIS had moved its

semiannual analysis of The Maturity Distribution of International Bank Lending to a fully consolidated basis by nationality of reporting banks and had developed a new set of statistics of the Nationality Structure of the International Banking Market and the Role of Interbank Operations. In addition, it had collected detailed information from its reporting banking systems on the treatment, within the banking statistics, of overdue payments, debt restructurings, and the banks' role as borrowers and investors in the securities markets. The OECD had greatly expanded the coverage of the forthcoming Annual Survey of the External Debt of Developing Countries, attempting to provide a comprehensive record of the outstanding debt of each of the countries included. The World Bank reported significant progress in the implementation of the Revised External Debt System and had completed preliminary work on the collation of data on countries' short-term debt and on the improvement of data on long-term private nonguaranteed debt. The Fund had issued the Methodology for the Fund's International Banking Statistics as a guide to the expanded international banking statistics published first in the March 1985 issue of International Financial Statistics (IFC) and had continued its work on the synthesis of external debt statistics for individual countries. In addition, a preliminary study of industrial countries' external debt had been undertaken and preliminary work done towards the construction of a framework for the presentation of external debt data from multiple sources.

4. Participants recognized that the period since the first meeting of the Working Group had been one of significant development and expansion of data bases on external debt. Nevertheless, this reflected, to some degree, unilateral and bilateral progress by participating organizations. The Working Group considered that the point had now been reached where high priority should be given to collaboration in the harmonizing of reporting and accounting practices and definitions, while avoiding unnecessary duplication of effort. In this context, it was acknowledged that an urgent priority was the further development of a detailed statistical framework within which the external debt data of participating organizations could be explained and the processes of collation and reconciliation continued. It was agreed that organizations would collaborate in the development of such a framework.

5. With the development of a framework came a responsibility on the part of the organizations to provide analysts and other users of the data bases with more information on the conceptual and methodological underpinning and the content of, and the overlaps and divergences among, those data bases. Participants agreed, therefore, that it would be desirable to produce a joint publication, sponsored by the organizations. It was envisaged that such a publication might be issued in two parts. The first would offer a description of the compilation methodology and output of the external debt statistics systems of each of the participating organizations and would describe, in terms of the overlaps and divergences among the systems, how the elements of each system might best be used by analysts in the assessment of country indebtedness. The publication would include a glossary of terminologies used in the organizations. Consideration would be given to the appointment of an individual to offer editorial suggestions and a first draft of an introductory chapter. The second part, to be issued subsequently, would describe the framework for external debt statistics as eventually developed by the organizations individually.

6. The imminent publication, by the OECD, of new and expanded data on the external debt of individual countries gave additional impetus to the need for the completion of joint work on a framework and an explanatory publication. It was expected by participants that the publication of the OECD's data would act as an inducement to many debtor countries to improve the quality of external debt data that they supplied to participating organizations and might allay the reluctance of some national authorities to permit the publication of their external debt data.

7. Some progress was made, in the course of discussions, in resolving issues related to the precise definition of gross external debt, concepts of net external debt, and the accounting and reporting procedures for the generation and liquidation of overdue payments and for debt reorganization. It was recognized, however, that remaining differences would need to be addressed at a more technical level and that a series of detailed recommendations would need to be formulated for the consideration of the Working Group.

8. Participants considered that more resources would need to be committed to the collaborative effort, in order to accomplish the desired ends, than had hitherto been committed by participating organizations. Accordingly, participants proposed that, where necessary, steps be taken, within individual organizations, to seek from managements formal recognition of the ongoing work of the Working Group; it was envisaged that this work would include making recommendations to organizations on methodological issues relating to the statistical treatment of external debt. It was considered that the Working Group would meet no more than once a year.

9. Participants considered that a number of the objectives could best be achieved through the establishment of a technical subgroup which would be given the mandate to formulate specific recommendations to the Working Group in the following areas of concern:

a. the further development of the framework for external debt statistics;

b. the definition of gross external debt and the concept of net external debt;

c. accounting/reporting procedures for the generation and liquidation of overdue payments; and

d. accounting/reporting procedures for debt reorganization.

The technical subgroup might also, if it were deemed appropriate, give initial consideration to drafts of the proposed joint publication. It was considered that the technical subgroup might meet more frequently than the Working Group.

10. It was agreed that the Fund would continue to provide a permanent secretariat for the Working Group. It was also agreed that the chairmanship of the Working Group would revolve; the OECD would host the next meeting of the Working Group.

11. Participating organizations would continue to expand their bilateral collaboration. Specifically, the OECD would seek to obtain, and would then share with the World Bank, information, not currently collected, on officially guaranteed private export credits with a maturity of less than five years. The Fund would seek to develop the maturity analysis, by original maturity, of the external positions of the banking systems of countries as reported for the regular money and banking statistics in cooperation with national authorities, and would collaborate with the World Bank in furthering the reconciliation with World Bank data of its data on the external liabilities of countries' banking systems. The Fund would consider ways in which the accepted balance of payments presentation could be elaborated to distinguish new lending to countries from imputed flows on account of debt reorganization. Building on the work already undertaken by the Fund, organizations would cooperate in the development of a comprehensive data base on the external debt of industrial countries. They would also continue their efforts to improve upon the quality of available data on short-term debt.

12. Each participating organization outlined the main features of its own work program for the period ahead. The World Bank would continue to develop and refine its data bases on the short-term debt and the long-term private nonguaranteed debt of developing countries. The Berne Union would take measures to bring its quarterly return of commitments in forty countries into conformity with the semiannual reports made by creditor countries to the OECD. The BIS would be seeking to consolidate the work of the past year, to bring one further major offshore banking center, hitherto only partly covered, into its quarterly reporting system, and to focus on the timeliness of reporting; additionally, it would seek to produce a guide to all BIS statistics and to determine a regular form of publication for its new data base on the nationality structure of international banking. The OECD would be holding a workshop for reporting export credit guarantee agencies around October 1985 and might, as a result, amend reporting procedures slightly; other than that, it was envisaged that the OECD would produce its Annual Survey of the External Debt of Developing Countries, its semiannual Statistics on External Indebtedness: Bank and Trade-Related Nonbank External Claims on Individual Borrowing Countries and Territories, published jointly with the BIS, and an annual presentation of key subaggregates of external debt, for countries included in the joint publication, on a regular cycle. The Fund would be seeking further to expand the number of countries participating in the international banking statistics project by providing geographic analyses of banks' external positions and to refine the bank/nonbank breakdown of deposit banks' external positions and the deposit bank/ nondeposit bank breakdown of monetary authorities' external positions; additionally, work was in hand to develop data of international banking flows to and from individual countries, using data on the currency composition of BIS-reporting banks' external positions with individual countries provided by the BIS. The Fund would also be seeking to integrate international banking statistics and other major sources of information into a scheme of Fund statistics on external debt, and would be focusing more intensively on the production of syntheses of external debt statistics for a range of individual countries.

Participants in the Meeting of the International Compilers' Working Group on External Debt Statistics at Fund Headquarters June 12-14, 1985

Name	Organization	Title
Mr. F. P. Jeanjean	Berne Union	Chief Economist Export Development Corporation of Canada
Dr. Helmut Mayer	B.I.S.	Assistant Manager Monetary & Economic Department
Dr. Bernhard Timm	B.I.S.	Head of Section Monetary & Economic Department
Mr. Bevan B. Stein	O.E.C.D.	Head Reporting Systems Division
Mrs. Jane Saint-Sernin	O.E.C.D.	Reporting Systems Division
Mr. Nicholas Hope	World Bank	Chief External Debt Division
Mr. Charles Larkum	World Bank	Economist External Debt Division
Mr. Manuel Trucco	World Bank	Debt Specialist External Debt Division
Mr. John B. McLenaghan	Fund	Assistant Director Bureau of Statistics
Mr. Peter L. Joyce	Fund	Acting Division Chief International Banking and External Debt Division Bureau of Statistics
Mr. Gumersindo Oliveros	Fund	Economist External Finance Division Exchange and Trade Relations Department
Secretariat:		Bureau of Statistics
Mr. Hans Flinch Mr. John Thornton		

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

ERS/MC85-11

DATE: September 4, 1985

TO: Managing Committee

FROM: Anne O. Krueger *aok*

EXTENSION: 33774

SUBJECT: Chargeback for FY86 - FIS/MC85-41 Word Processing Maintenance

I will be travelling on September 9 and shall not be able to participate in discussion of the above paper. However, I would like to voice my dissatisfaction with the proposed base budget distribution for word processing maintenance for ERS.

The base budget of $49,000 (Attachment 1) proposed for distribution to ERS is totally inadequate. Using IRMD's proposed rates of $125 per keyboard per month and taking into account the number of keyboards installed, it is estimated that ERS' total FY85 base would be $109,500. This would leave a balance of $60,500 to be found within the ERS budget, rather than the incremental demand of $42,500 (Attachment 2) projected in this paper. We understood that the amount that would be distributed to cover maintenance costs in FY86 would have covered all such costs. No provision has been made in the ERS FY86 budget submission for this purpose. Thus the proposed distribution will require that ERS come up with an extra $60,500.

I believe the base budget for word processing maintenance should be reviewed and a more realistic figure proposed for base budget distribution for ERS.

cc: Mr. R. Southworth

P-1866

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

ERS/MC85-10

DATE August 20, 1985

TO Managing Committee

FROM Anne O. Krueger *aok*

EXTENSION 69001

SUBJECT Outline for the World Development Report, 1986

I shall appreciate your comments on the attached WDR Outline, which is scheduled to go to the Board for discussion on September 24. Unless you request it, I am not planning a Managing Committee meeting.

Attachment

cc: Messrs. Michalopoulos
Ray

P-1866

ERS/MC85-10

OUTLINE

WORLD DEVELOPMENT REPORT

PART I: THE HESITANT RECOVERY AND PROSPECTS FOR SUSTAINED GROWTH

PART II: TRADE AND PRICING POLICIES IN WORLD AGRICULTURE

JFW9001-Outline-8/20/85

Sample Table of Contents

Chapter 1: Introduction

This chapter will provide a broad overview of the issues treated in the Report and summarize the principal conclusions and recommendations.

Economic Outlook

We shall review the trends in OECD policies to explain the characteristics of the current recovery and to indicate the types of policies most likely to establish the conditions for sustained growth of the world economy. We shall emphasize fiscal, monetary, exchange rate and trade policies affecting stability and growth. The consequences for developing countries of alternative sets of OECD policies will be presented, in terms of capital flows, debt, trade and growth. The implications of trade liberalization or increased protectionism will be highlighted. The policy options faced by the developing countries and the progress made by the major debtors in reforming their economies will be discussed.

The fragile basis of the world recovery will be emphasized as well as the difficulties faced by agriculturally dependent economies in adjusting to adverse external events. The importance of restoring the liberal trading system for manufactures and for establishing such a system for agricultural products will be brought out.

Trade and Pricing Policy Issues in Agriculture

The world system of production and trade in agriculture has permitted an expansion of worldwide food output but has also led to large food surpluses in industrial countries and both chronic and transitory food deficits for large segments of the population in developing countries. Tariff and nontariff barriers against exports of agricultural products have adversely affected many developing countries, especially those without mineral resources or strong manufacturing sectors In addition, the prices in world agricultural markets continue to be highly unstable. The instability of prices has encouraged autarkic domestic policies, which in the aggregate increase rather than decrease instability. With the prevalence of state trading, use of bilateral trade arrangements and the creation of special trade preferences, the world trading system in agriculture has developed significant inefficiencies.

This trading system reflects the combined effects of trade and domestic policies in both developed and developing countries. Generally speaking, industrial countries tend to use explicit or implicit barriers to agricultural imports and "subsidies" on agricultural exports whereas developing countries often "tax" their agricultural exports. The degree of their import protection varies but import "subsidies" are not as infrequent as one would expect. The combined effects of national and international policies reduce world real incomes and inhibit economic growth along the lines of comparative advantage in both industrial and developing countries.

The existing world system will be described and the main types of international initiatives that have been proposed or taken to offset some of the deficiencies of the system discussed. The gains that industrial and developing countries can expect from trade liberalization will be brought out.

We shall then outline the considerable scope for improving policies in developing countries even if the external environment in agriculture is unchanged. Developing countries have tended to adopt inward looking development strategies and macroeconomic policies which discourage agricultural production and increase the risks of food shortfalls. Exchange rates are often overvalued, agricultural exports are often taxed excessively, internal price stabilization schemes are often excessively costly, and input and credit subsidies are frequently inefficient (and occasionally significant causes of macroeconomic instability).

Developing countries need better management of the exchange rate and greater linkages between domestic and border prices to complement other aspects of agricultural policies. Better, and in many cases larger, public expenditure programs for irrigation, crop research, extension, and marketing infrastructure are needed along with improvements in incentive policies.

The last chapter of Part II will bring out the main directions in which the policies in developing countries can be improved and the large stake which all countries have in initiating global liberalization of agricultural trade policies under the auspices of the GATT.

PART I: THE HESITANT RECOVERY AND PROSPECTS FOR SUSTAINED GROWTH

This part of the Report will discuss the types of economic policies in both OECD countries and in developing countries that are required to provide a stable basis for sustained growth of the world economy. Four key elements will be emphasized: growth-augmenting policies in the OECD, liberalization of trade, policies in the developing countries, and the promotion of public and private capital flows to developing countries.

Chapter 2. Secular trends and the current recovery

In many respects the past ten to fifteen years have been unique in the history of the Western economies since the end of World War II. The coexistence of high inflation and unemployment, the oil price increases, slower growth, and the serious debt problems are the most obvious manifestations of the changes in the world economy during this period. Many features which were once thought to be transitory cyclical factors (suh as unemployment and inflation) are now clearly more like secular phenomena. While considerable progress has been made since the late 1970s in reducing inflation from about 10-15 percent to about 5 percent, the latter is still high by historical standards. Also, even allowing for cyclical effects, there has been little evidence of a decline in the ratio of government spending to GNP. Another feature of the current recovery is the continued existence of very high levels of unemployment in many OECD countries--a factor that bears strongly on the prospects for trade liberalization.

This chapter will discuss the trends in OECD policies. It will explain the interactions of monetary, fiscal, exchange rate, and trade policies in order to clarify the policy conditions for sustained growth. Recent trends in protection and in growth-inducing incentive policies in general will be reviewed, emphasizing the inter-relationships between fiscal deficits and trade deficits.

Chapter 3: Policies for Sustained Growth

This chapter will focus on the policy basis for sustained growth in the world economy. By way of illustrating the main messages, it will develop possible scenarios for the world economy for the next ten year with particular emphasis on the medium term 1986-91. The macroeconomic policy trends in the OECD discussed in the previous chapter will provide the basis for constructing alternative scenarios for the world economy and for exploring their implications for the developing countries. Sensitivity tests will be designed to highlight implications of:

- trade liberalization or increased protection,
- alternative growth paths of financial flows, with emphasis on the continued adjustment problems being faced by developing countries,
- alternative assumptions about future real oil prices.

The chapter will begin with a fairly aggregative discussion of the implications for developing countries of the policies that the OECD countries can pursue in terms of domestic and trade policies. The differential impact of the external environment on different groups of developing countries (e.g. oil importers and exporters, major debtors, countries that are highly dependent on agricultural exports) will be brought out.

The policies that the developing countries can adopt to move toward sustainable growth will also be discussed. Both the longer-run policy requirements for growth and the shorter-run requirements for domestic stability will be highlighted, drawing upon the recent experiences of the major debtors. The need for external capital--whether private or public--will be discussed, with indications of the scope for coordinated international and national policy options.

PART II: TRADE AND PRICING POLICIES IN WORLD AGRICULTURE

Chapter 4: Trends in World Agriculture

This chapter will present an overview of world production, consumption, and trade in agriculture and discuss the various concerns with food provision and agricultural trade that have become so prominent since the early 1970s. Production trends will be examined at global and regional levels, distinguishing between food and nonfood products. The factors underlying the growth of productivity in agriculture will be described and the improvements in yields related to changes in varieties, the increased use of fertilizers and pesticides, irrigation, and improved harvesting and transportation. The importance of appropriate technologies will be stressed, bringing out the link between technology and incentives.

Broad trends in the patterns of food consumption will be discussed briefly before attention is focused on basic foods. Basic requirements and standards will be defined and the point made that the increment necessary to bring everybody up to the minimum standard is usually only a small proportion of total consumption in most countries. Measures of deprivation will be discussed and vulnerable countries (and populations within countries) identified. Chronic and transitory food shortages will be distinguished. The causes of risks in food availability will be described, separating the roles of food crop failures, cash-crop failures, falling exports and rising prices of imported food. Famine, the most extreme risk, will be shown to be due primarily to failures of distribution--both physically and in a broader economic sense. It will be stressed that, provided it is exploited effectively, international trade and, where required, aid can significantly help alleviate malnutrition. The role of food imports and food aid will be discussed in this context, but it will be argued that aid is neither sufficient in the short run nor appropriate as a solution in the long run. The long-run solution to improving nutritional well-being involves fundamentally general economic growth and institutional development that permits increasing access of the poor to food supplies.

The majority of developing countries rely on agriculture as their principal source of foreign exchange. The growth rates of agricultural and other exports will be examined, distinguishing between at least three periods --pre-1972, 1973-78, 1979-present. The changes in the share of agriculture in total trade will be shown, and their implications discussed.

In addition to the relatively slow growth of agricultural exports, the developing countries' share in trade has steadily eroded for many commodities. There are two separate issues. First, developing countries' exports--especially those of tropical low-income countries--are heavily concentrated in slow growing markets, For beverages and raw materials the problem here is not so much barriers to trade as the low income and price elasticities of demand, the reductions in raw material requirements in using industries, and the expansion in the use of synthetic substitutes. The second issue is developing countries' falling share in particular markets due to expanded outputs in and exports from industrial countries. The role of developing and industrial country policies in explaining these trends will be analyzed.

The terms of trade between primary goods and manufactures is a favorite issue among development economists. The Malthusian and Prebisch-Singer hypotheses will be presented and discussed. Country specific terms of trade will be presented along with an explanation of their relationship to the commodity specific data. The relationship of different terms of trade indicators to national welfare will be discussed, with specific examples.

Turning to the issue of stability, standard measures of price instability will be reported for various commodities and contrasted with similar measures for other goods and asset prices. It will be shown that average trade prices (unit values) fluctuate less than commodity spot prices (because of nonmarket transactions, long-term contracts, etc.), and that, in terms of nondollar-related currencies, exchange rate changes account for a significant portion of total fluctuations. Finally, the importance of revenue stability relative to price stability will be analyzed.

Chapter 5. Agriculture Policies in Industrial Countries

This chapter will describe and analyze the industrial country policies that influence the markets for developing countries' agriculture. It will assess the economic consequences of these policies and indicate how changes in them would benefit the developing countries, the industrial countries, and the world economy.

Developing countries' agriculture is affected by industrial countries' trade interventions and by their domestic policies, both of which affect world commodity supply and prices, These policies include: import or export taxes and quotas, which cause border distortions between domestic and international prices; domestic subsidies or taxes, which influence supplies and demands on world markets; and various transitory policy shocks which disturb world markets. Examples of the last are the Soviet Union's decision to maintain domestic cereal consumption by means of massive grain purchases in 1972 and 1975 and the U.S. decision to reduce its grain stocks and increase commodity prices by idling some 20 percent of its cropland in 1983.

OECD countries' intervention in commodity markets has primarily been aimed at supporting the incomes of producers, but a subsidiary purpose has been to stabilize farm incomes and domestic food price fluctuations. Various policies have been explored for accomplishing these objectives within the constraints of domestic budgetary costs and consumers' aversion to food price increases. In the industrialized centrally planned countries the thrust of agricultural policy has been quite different. These countries' tendencies toward the implicit taxation of agricultural commodities and subsidization of food prices for consumers, more nearly reflects the pattern of developing countries. For both groups, the period since 1970 has seen a fuller integration of the national agricultural sector into the world market, and for industrial countries this has been supplemented by a tendency toward fuller integration between farm and nonfarm sectors. These developments have made it both more difficult and more costly to support farm incomes and factor returns at levels different from those in the nonfarm sector.

The main instruments considered will be as follows, with explicit examples and descriptions drawn from all the main industrial countries.

- Import restrictions--tariff and nontariff barriers;
- Producer price guarantees through governmental payments;
- Export subsidies, including food aid for surplus disposal;
- Production and acreage controls;

- o Market price support and stockpiling policies (noting the inconsistency of most intervention prices with stable stock levels);
- o Input subsidies;
- o Farm income insurance schemes; and
- o State trading and purchasing agencies.

After presenting the policies individually, this section will show how the instruments combine to define the overall policy stance toward certain commodities. The gains and losses within the industrial countries resulting from these policies will be quantified both in aggregate and, more importantly, for different groups such as farmers, consumers, and processing industries.

Several approaches will be used to assess the effects of industrial countries' policies on developing countries: qualitative analysis, simple models of particular sectors or small groups of countries, and broader multi-country and multi-commodity models. We will consider the effects of policies both in individual industrial countries (or groups of industrial countries) and in OECD as a whole. In each case the consequences for world prices, trade flows and price stability will be estimated and the potential welfare gains and losses for producers and consumers in the developing countries assessed.

Chapter 6. International Initiatives on Agricultural Trade

Throughout the twentieth century, but with increasing intensity after 1945, various international initiatives for promoting greater stability in agricultural products have been explored. This chapter will deal with two types of attempts designed to cope with instability: international commodity agreements and compensatory finance schemes. It will also discuss special trade preferences for developing countries--which have been aimed more at the level of developing countries' earnings than their stability, and have been cast more widely than just the agricultural sector.

The UNCTAD IV Integrated Programme for Commodities (IPC) will be discussed in terms of the history of individual ICAs for agricultural commodities. First, the various objectives of ICAs will be noted--more stable prices and earnings, "fairer" prices for developing countries and improved market access for primary commodity exporters--and the potential conflicts noted. Next the instruments available for achieving these aims will be considered and the difficulties of using them noted: stock-piles, exports and production control, subsidized credit for stocks (private or public). Examples will be drawn from sugar, wheat, rubber, coffee, and cocoa. Their effects on the trends and variances of prices and earnings, on the level of non-ICA stocks and on the incentives for efficient private markets will be assessed.

Another response to unstable agricultural export revenues is compensatory financing, by which countries borrow in times of shortfall and repay in times of surplus. By this means unstable export earnings need not translate into unstable purchasing power. Shortfalls in local (nontraded) food production or rises in imported food prices can similarly be uncoupled from food consumption shortfalls by financial flows, at least in the absence of global food shortages. At its simplest, compensatory borrowing is a more efficient approach to instability than commodity buffer stocks simply because money is cheaper to store than goods.

We will discuss two international compensatory finance facilities.

(a) The IMF's Compensatory Finance Facility (CFF). Its evolution since 1963 will be described and its current position outlined. The distinction between export compensation and import price compensation will be made. The extent of the CFF borrowing will be shown.

(b) The EEC's Stabex: This facility is limited to the EEC's purchases from her associated (ACP) states and is restricted to cover earnings from only a small sub-set of their exports (about 20 percent). Its funding is small, but its conditions fairly generous. These details will be presented and an assessment made of Stabex's contribution to purchasing power stability and income transfers.

On trade preferences, the chapter will discuss schemes for giving developing countries preferential access to their markets. Such preferences have influenced trade patterns, and are sometimes advocated as a means of stimulating and stabilizing developing countries' foreign exchange earnings. We will cover the General System of Preferences (GSP), which is open to all developing countries, as well as more restricted policies such as the EEC's Lome Agreement with the African, Caribbean, and Pacific (ACP) states, and the United States' Caribbean Basin Initiative (CBI),

Chapter 7: Economy-wide Policies and Agriculture in Developing Countries

The efficiency and growth of the world economy in the long run will require not only liberal manufacturing trade but also the introduction of a liberal and competitive trading environment for agriculture. However, it is important to examine the options of developing countries even within the current environment. Have developing countries attained the potential that the current trading system offers or have they exacerbated the difficulties by adopting domestic policies which magnify, rather than reduce, the inefficiencies of the system? This is the basic question that will be discussed in this and the following chapters.

This chapter will review the diversity of agricultural output and trade performance in developing countries during the last two or three decades and bring out the fact that many countries facing similar external markets have performed quite differently. Notwithstanding the significance of the external environment and differences in resource endowments, the chapter will bring out the importance of internal policies in explaining differences in agricultural performance. The framework of internal policies that impact on the agricultural sector in developing countries will be reviewed. The debate on the appropriate role of agriculture in the development process has ranged over a wide area. The most popular view may be explained in terms of the "development through protected industrialization" strategy many elements of which have been widely adopted in developing countries in the past three decades. It will be noted that a core set of policies followed in the developing countries with varying degrees of intensity imply a strong bias against the agricultural sector.

This core set of policies consists of inefficient import substitution in the non-agricultural sectors, underpricing of agriculture, cheap capital through controlled interest rates, overvaluation of exchange rates and inadequate allocation of public expenditure in agriculture. The magnitude of these policies will be quantified across a number of developing countries. The stated rationale for these policies and the concepts on which they are based will be examined.

The trade-offs, both budgetary and in terms of efficiency which policy-makers often face in pursuing these policies will be brought out. In particular the long-run implications of these policies will be emphasised, and will be related to the stated objectives of these policies. Have these development strategies met their stated objectives or have they adversely affected both agricultural and non-agricultural growth as well as equity?

Macro-policies pursued for various reasons can produce very significant impacts on the agricultural sector. A key variable through which the impact of macro-policies is transmitted to the agricultural sector is the real exchange rate, which is a crucial determinent of the agricultural (internal) terms of trade. Overvaluation of the real exchange rate has been common in the last decade and its impact on agricultural output and exports will be analysed for a number of developing countries.

The costs of policies which result in strong disincentives to agriculture will be noted. The increasing re-alignment of development policy toward greater emphasis on agriculture and on appropriate incentive policies to farmers will be documented. At the same time the role of the public sector in providing public goods in the form of research and extension, irrigation and other infrastructure, and health and education facilities will be re-emphasised. The complementarity and interdependence between appropriate pricing policies and public expenditure policies in a balanced agricultural strategy will be highlighted.

Chapter 8: Agricultural Pricing Policies in Developing Countries

This chapter will review the main highlights of the types of pricing policies most commonly observed in less developed countries. The major issue of whether to tax outputs and subsidize inputs or to lower both taxes and subsidies will be discussed. Among the questions to be addressed are:

-- What are efficient and equitable ways of generating tax revenues from the agricultural sector?

-- What should the domestic policy response be to the imposition of a non-tariff barrier in a protected foreign market?

-- How are distributional, efficiency, and budgetary constraints to be reconciled in designing food price policies for assisting low income households?

-- What is the appropriate design for pricing and subsidy policies to respond to the problems of information and credit constrained farmers with limited or no access to insurance markets.

This chapter will suggest that there is considerable scope for improving the efficiency of incentive regimes. Many examples exist where neither efficiency nor equity are being served. Given the importance of the agricultural sector to poverty, employment, and trade, the presumption--if any can be suggested at the general level--may well be that the standard paradigm of urban food subsidies plus producer taxation plus production subsidies is both inefficient and regressive.

In view of the low incomes of large shares of populations in less developed countries, the maintenance of low and stable food prices is often an important objective. This concern is of fundamental importance to all aspects of public agricultural policies, including producer pricing policies, commodity price stabilization schemes and public expenditure policies. The experience with food policies will be reviewed to identify the directions of change that are worth considering in designing reform packages.

There are many issues to be addressed. Are the consumption subsidy programs effective in reaching and/or discriminating in favor of the targeted low income groups? In practice, one frequently observes a strong urban bias with little discriminatory power. Budgetary constraints and problems in the distribution chain may lead to shortages and parallel markets with higher prices. Low-income groups often lose out in the rationing process. The value of the subsidies are greatly reduced by the time and efforts required to gain access to the rationed commodities. Policies that reduce prices of important agricultural products may also have an impact on nominal wage rates. Gains in real income for low-skilled workers may be limited or reversed by these wage effects.

The level of fiscal costs involved in food price policies can be very high, involving significant sacrifices in other national objectives. The financing of food subsidy schemes often involve explicit or implicit taxation of low-income groups--especially in countries where the agricultural sector is a large tax base. Food subsidies, when unavoidable--need to be designed very carefully to ensure fiscal viability and positive net benefits to society. A broad sketch of the main design issues will be presented. We shall also discuss the subsidies to sales of raw material inputs and other policies to promote agro-processing industries.

Regarding producer price policies, few developing countries rely on direct taxes. Tax systems are usually based on indirect taxes levied via export taxes or captured via marketing boards. Frequently, these output taxes coexist with input subsidies that are instituted partly to moderate the effects of the output taxes. These tax systems reflect a perceived high administrative cost and political difficulties with direct tax systems. They also indicate a poor understanding of the efficiency losses per unit of net government revenue generated, a cost that is often extremely high at the margin.

The output-tax input-subsidy package may, under certain conditions, closely approximate a land tax system. These conditions, requiring uniformity of output taxes and input subsidies across activities and a uniformity of input subsidies across inputs other than land, are seldom even approximated. The result is often a highly distorting tax system biased against the traded goods sector and with significant resources shifted in subsidies to domestic consumers or users of agricultural products as input.

In discussing these issues we shall also consider the special cases in which a developing country's share in the world market for a commodity is large enough to affect world prices. More generally, we shall discuss how developing countries can deal with quantity restraints on its exports or with artificially low prices at which its imports may be available.

Some of the economic issues raised by input subsidy and public sector support programs will also be examined. Input subsidies and subsidized public sector support programs for various crop development activities are often used to encourage the introduction of new technologies, inputs, or crop varieties in a smallholder sector characterized by information problems, credit constraints, and aversion to risk that can not easily be insured against.

There is often a credit subsidy as well so that the actual prices paid by farmers reflect two types of subsidies: the subsidy on inputs relative to their opportunity costs, and the subsidy given through the credit system for their purchase.

Finally, we will review the experience with price stabilization schemes in developing countries. The quest for price stability is a major factor in domestic pricing policies in the LDCs. Given wide fluctuations in world market prices for traded goods and a lack of faith that private sector speculative operations can adequately stabilize nontraded good prices, the public sector has frequently assumed a responsibility for maintaining price stability. Different methods of price stabilization will be discussed. The role of private market activities, including the development of futures and options for promoting stability, will be analyzed. Lastly, the case for limiting interventions to prices outside a price 'band' that can be automatically and periodically adjusted to changing market conditions will be discussed.

CHAPTER 9: Reform OF Trade and Pricing Policies

This concluding chapter will summarize the major points of Part II and pull together its basic themes. The first section will discuss national priorities and the second the need for coordinated reforms of trade and domestic policies on a global basis.

We shall outline the key elements of promising agricultural policy strategies available to developing countries, taking the external environment as given. These elements would include greater inter-sectoral neutrality in national tax and incentive regimes, better management of real exchange rates, greater moderation (as well as changes in design) in consumer subsidies and in input subsidies for producers, decreases in and rationalization of farm output taxes, and a reduction in the administrative role of the public sector in the area of pricing and trade. At the same time, we shall acknowledge that reforming incentive policies is often a very difficult process, for both political and technical reasons. Reforms are often introduced in a piece-meal and gradual manner. When a gradual process is followed, the appropriate "second-best" measures may well differ substantially from the measures that are relevant over the longer run. We shall try to illustrate this by drawing on lessons from policy reforms in selected countries. We shall also comment on the role of the World Bank in promoting pricing and trade policy reforms through the new types of lending instruments that it had introduced over the past several years.

We shall summarize the long-term advantages of global liberalization of agricultural trade, showing trade to be far more promising as a means of improving the global economy than such measures as trade preferences and international commodity agreements. Both developed and developing countries are likely to gain substantially from the increases in world real income and greater stability in commodity prices that global liberalization should give rise to.

Trade liberalization is inseparable from reforms of domestic policies in both industrialized and developing countries. With respect to the developing countries, this reinforces the desirability of the national policies outlined. With respect to the industrialized countries, they would also reap substantial internal benefits even apart from their gains due to increased trade. Both groups of countries therefore have a stake in initiating the process under the auspices of GATT.

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

ERS/MC85-09

For MC Consideration
R E C O R D

May 21/85
E-1227

DATE May 20, 1985

TO Managing Committee

FROM Anne O. Krueger aok

EXTENSION 69001

SUBJECT World Development Report 1985

During the Board discussion of the draft WDR 1985, a number of Executive Directors thought that the discussion of the Role of the Bank in Chapter 10 could be strengthened by reference to the communique of the Development Committee. The U.S. Executive Director, on the other hand, indicated that there should be no reference to the general capital increase.

Attached is the redrafted text of Chapter 10 on the Role of the Bank. I would appreciate your comments at the Managing Committee meeting on Tuesday, May 21, since the Report has to go to the printers this week.

Attachment

Role of the Bank

The role of the Bank as a provider of finance and other services must be seen in the context of the increased importance of international finance in economic development. The Bank is playing an increasingly active role in assisting developing countries with needed policy reforms. It has been flexible in adapting its operations and instruments to the changing needs of its member countries. It complements and--to the extent possible--exercises a constructive influence on capital flows from other sources. ~~In order to carry out these functions, the Bank's own financing must be on a scale that is meaningful both to borrowing countries and to other sources of finance.~~

The Bank is the major channel by which developing countries access the international bond market and other fixed rate markets. This function is critical particularly for countries that rely mainly on commercial capital and are most sensitive to the impact of fluctuations in the world economy. Bank lending is an important component in the acceptable balance between official and private sources, between short- and long-term maturities, and between fixed and variable rate instruments.

Although the worldwide recession has meant temporary slowdowns in many investment projects in developing countries and reductions in private and public investment, resumed growth will involve increased ability to use external resources productively. The resumption of growth of private capital flows will be more likely if private investors have confidence in the policies and programs of the recipient countries. Here, the Bank plays a dual role. In its own lending, the Bank has a unique perspective from which to analyze a country's prospects and needed policy reforms and to provide this analysis to policymakers. In its cofinancing efforts, the Bank provides instruments to increase the assurance of investors in projects and countries' development prospects. ~~In order to cary out these functions, the Bank's ability to increase its own lending is crucial.~~

The Development Committee at its twenty-sixth meeting in April 1985 discussed the role of the Bank in the light of the uncertainties in commercial flows to the developing countries and the changing world economic situation. Bearing in mind the need to maintain lending standards and prudent financial policies, the Committee called for an expansion in the Bank's lending program in order for it to respond more effectively to the needs of its borrowing members and to stimulate the flow of capital from other sources.

Low-income countries that must depend on concessional capital have experienced relative stagnation in new commitments in recent years. Attention has focused on sub-Saharan Africa where the prospect for a dramatic decrease in concessional flows has been highlighted as an overriding obstacle to achieving sustainable development. This underscores the need for a substantial increase in IDA resources in the medium term to meet the needs of this region and to provide uninterrupted support to IDA borrowers in Asia.

However, in its proposals to respond to the potential decline in funds for sub-Saharan Africa, the Bank has stressed that improvements in the volume of aid must go hand in hand with improvements in aid effectiveness and has suggested that new forms of aid coordination should go beyond the traditional use of cofinancing instruments with official aid agencies to emphasize targeted support by lenders for reform efforts by borrowers. The potential Bank contribution to achieving these dual objectives through enhanced aid coordination has received strong support from the aid community. In exercising this function, the Bank is prepared to assist borrowing governments in strengthening existing mechanisms for investment review to help ensure that proposed projects are consistent with explicit development priorities and with the capacity to effectively implement and operate projects.

The Bank also has a long history of collaboration with export credit agencies and commercial banks. Various cofinancing instruments have been developed and will continue to evolve in the future as the demand increases for resources from the Bank and other sources of finance. The Bank could, through its assessments of investment programs and individual projects, support the efforts of both export credit agencies and commercial banks to improve the quality of lending, thereby increasing the development benefits of such flows while strengthening the portfolios of the lending institutions. Beyond specific cofinancing arrangements, the Bank's role in regularly reviewing country policies and performance against the medium-term growth objectives should provide a basis for encouraging the flow of new lending into high-priority sectors and investments.

To ensure that the resumption of growth is sustainable, the continuing adjustment efforts must be based on a stable economy and a sound medium-term policy framework. This requires that the Bank's relations with the International Monetary Fund enable both institutions to provide consistent, effective support to their members. This objective is critical in resolving stabilization problems and in supporting the transition to sustainable growth in major middle-income debtor countries whose economies have recently begun to recover. This implies the need for a coherent approach to policy issues and coordinated efforts to mobilize support for policy reform.

Finally, foreign direct investment is an important aspect of the Bank's catalytic role and its function in international capital flows. In the past, the Bank Group has sought to encourage private investment both directly, through the activities of the IFC and certain specific Bank projects--and indirectly, through financing investments in physical and human infrastructure and by helping governments revise their foreign investment codes. Much of the work the Bank does in support of structural adjustment is also directly related to the prospects for private investment. An important new initiative is the proposed Multilateral Investment Guarantee Agency (MIGA), which would provide various forms of investment guarantees, including multinationally financed investments, and reinsure guarantees written by national insurance agencies.

For MC Consideration April 8/85
RECORD E-1227

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

ERS/MC85-08

DATE March 25, 1985

TO Managing Committee

FROM Anne O. Krueger AOK

EXTENSION 69001

SUBJECT Draft WDR 1985

Attached is a draft of WDR 1985 which is scheduled for review at the Managing Committee on April 8, 1985.

The draft has benefited from extensive comments by staff from the Regions, Finance, Legal, IFC, OPS, and External Relations. We have also received comments from the IMF--they agree with the general thrust of the Report and have made a number of specific suggestions.

A Foreword is being prepared which will include the same disclaimer as in the English version of last year's Report. It is as follows: "As its predecessors, this year's World Development Report is a study by the staff of the World Bank, and the judgments in it do not necessarily reflect the view of our Board of Directors or the governments they represent."

Attachment

WORLD DEVELOPMENT REPORT 1985

International Finance and Economic Development

Chapter 1

Chapter 1 Overview

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Chapter 1 Overview

1.1 The economic turbulence of the past few years has partially subsided. The recovery of industrial economies in 1983-84, policy adjustments by many developing countries, and flexibility by commercial banks in dealing with debt-servicing difficulties, have all helped to calm the atmosphere of crisis. This does not mean, however, that the world economy has regained its momentum of the 1960s, or that development is again making rapid progress. Growth has slowed in most developing countries that experienced debt-servicing difficulties, and in many of those that did not. Average real incomes in most of Africa are no higher than they were in 1970; in much of Latin America, they are back to the levels of the mid-1970s. Dozens of countries have lost a decade or more of development.

1.2 The experience of the past few years has raised many questions about the role of international capital in economic development. Only a few years ago, there was general agreement that the more advanced developing countries could and should borrow more commercial capital from abroad. That consensus has been broken. Some people believe that the case-by-case approach to addressing debt difficulties is creating a sustainable balance of growth and debt servicing that will in time encourage more lending, including bank lending. Others think that new approaches are needed if developing countries are to service their debt and resume economic growth. As with so many changes in conventional wisdom, both new and old arguments are often stylized and exaggerated. It is important not to lose sight of the fundamentals of international finance.

1.3 Capital has long flowed from richer to poorer countries. It has done so because it is relatively scarcer in economies that are at earlier stages of development, and the expected rates of return tend to be correspondingly higher. What is at issue is the nature of capital flows, their terms, and their uses. These questions were relevant in the nineteenth century, and remain so today.

1.4 This Report offers a broad and long-term perspective on the role of international capital in economic development. It emphasizes that international flows of capital can promote global economic efficiency, and can allow deficit countries to strike the right balance between reducing their deficits and financing them. However, the availability of international capital also involves risks: first, that it may delay the policy reforms required for adjustment; and second, that countries may borrow too much if they misjudge the way that external economic conditions are going to evolve.

1.5 Both benefits and costs can be illustrated by recent experience. On the benefits side, most developing countries have made substantial economic progress over the past twenty years. Their GDP growth averaged 6.0 percent a year in 1960-80. The life expectancy of their people rose from an average of forty-two years in 1960 to fifty-nine years in 1982, while infant mortality was halved and the primary-school enrollment rate rose from 50 to 94 percent. These advances principally reflected developing countries' own efforts. But there is considerable evidence that capital flows, often accompanied by technical "know-how", have played a part.

1.6 Foreign capital has also helped individual countries to cushion shocks--either internal (like a harvest failure) or external, such as big changes in commodity prices or recessions in industrial economies. External finance can act as a shock absorber, allowing countries to adjust their spending gradually and reallocate their resources for a new environment. In the 1970s many developing countries were able, in the first instance, to pay for more expensive oil by borrowing more. Those countries that accompanied borrowing with policy reforms restored rapid growth and avoided debt-servicing difficulties. Other countries used borrowing to avoid the policy actions required for adjustment. Many of them ran into debt-servicing problems and needed to take even more drastic and costly adjustments later.

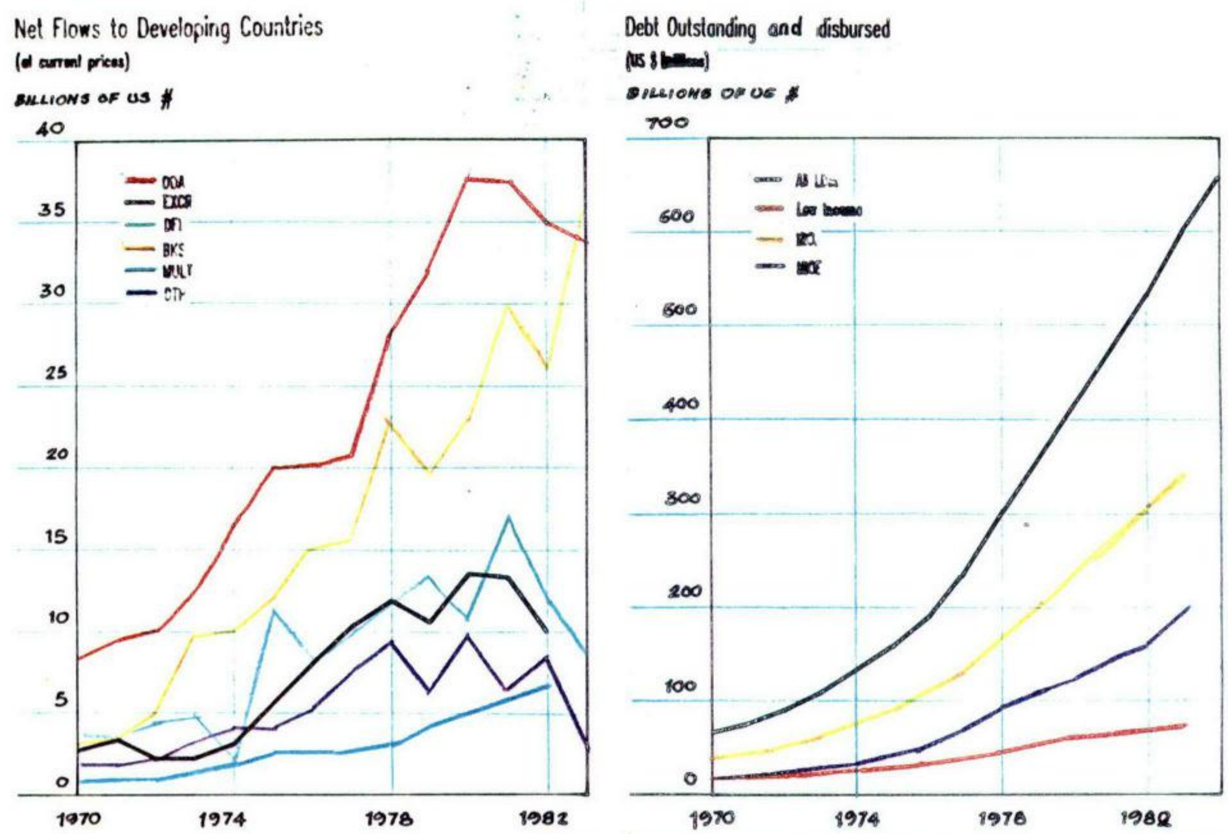
1.7 This contrast emphasizes that foreign borrowing is not a painless or riskless alternative to adjustment. The accumulation of debt makes a country more susceptible to international financial fluctuations, as the swing from negative real interest rates to unprecedentedly high positive rates has made all too plain. The need for rapid adjustment was increased. Borrowers and lenders often fail to take full account of the institutional, social, and political rigidities that restrict a country's capacity to adjust.

The historical context

1.8 The ten years 1973-82 saw a big increase in the foreign finance going to developing countries. As a result, both the gross and net debt of developing countries increased sharply. Between 1970 and 1984 the outstanding medium- and long-term debt of developing countries expanded almost tenfold, to $686 billion (see Figure 1.1), despite the decline in capital flows since 1981. The most striking feature of this growth was the surge in lending by commercial banks. Their share of total new flows to developing countries increased from 15.0 percent in 1970 to 36.0 percent in 1984.

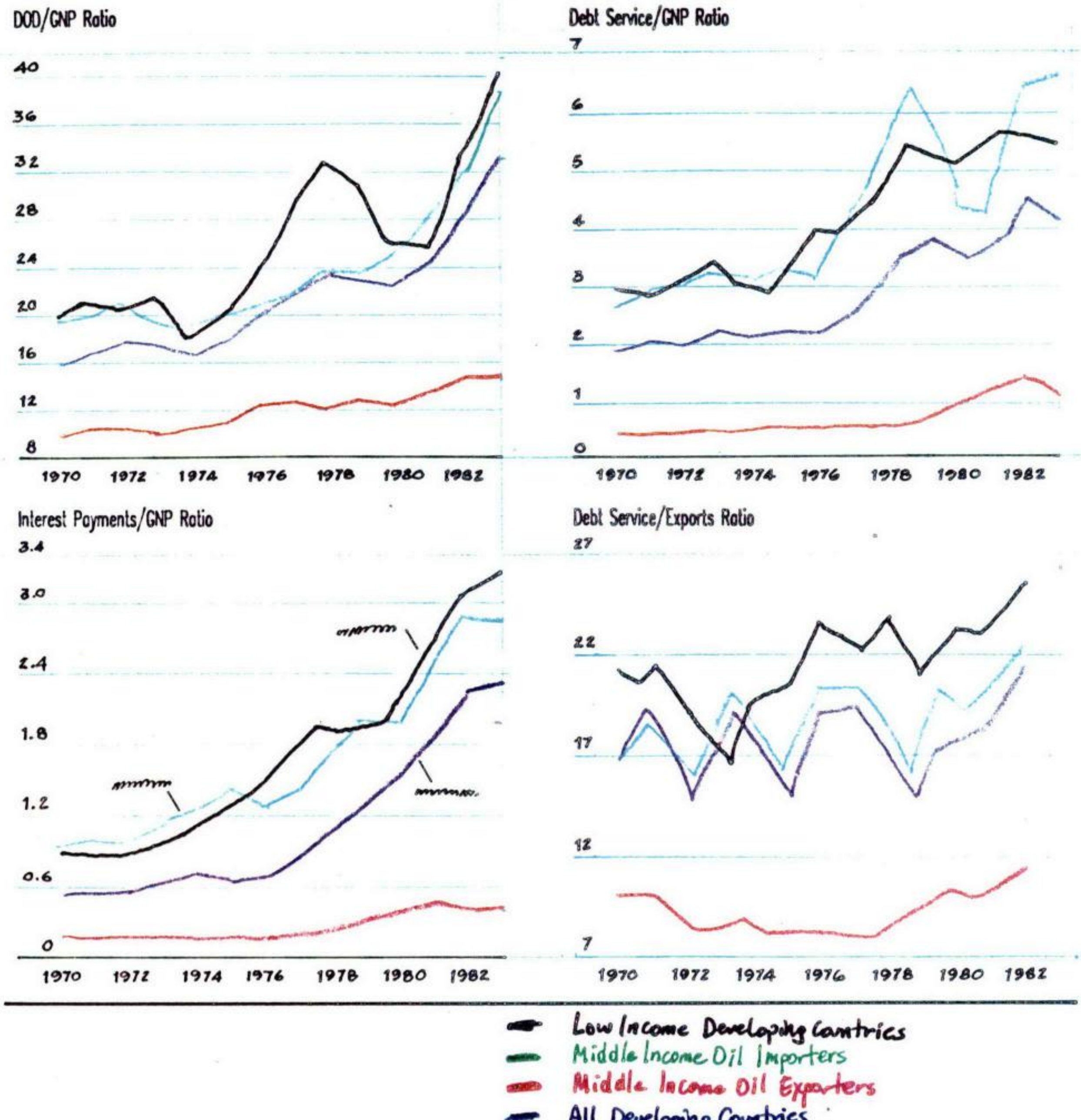
1.9 On every measure, the debt-servicing abilities of developing countries deteriorated, particularly after 1974, as their debt increased (see Figure 1.2). The ratio of debt to GNP more than doubled from 14.0 percent

Figure 1.1 Net capital flows and debt outstanding and disbursed



SOURCE: World Bank data.

Figure 1.2 Trends in selected debt indicators



SOURCE: World Bank data.

in 1970 to almost 34.0 percent in 1984. The ratio of debt service to exports rose from 15 percent in 1970 to a peak of 20.5 percent in 1982 declining to 19.6 percent in 1984. Interest payments on debt increased from 0.5 percent of GNP in 1970 to 2.8 percent of GNP in 1984, and accounted for more than half of all debt-service payments in that year. These averages conceal wide regional and country differences.

1.10 Dramatic though the recent growth of foreign borrowing has been, it is not unprecedented. As Chapter 2 makes clear:

o The volume of international capital flows has often been larger in relative terms than in the 1970s. Between 1870 and 1913, Great Britain invested an average of 5 percent of its GNP abroad, rising to almost 10 percent just before World War I. For France and Germany, the figure was 2 to 3 percent of GNP. By contrast, recent capital exports have been less than 2 percent of the industrial countries' GNP. As a proportion of the recipient country's GNP, capital inflows were also often larger. For Canada, for example, they averaged 7.5 percent of its GNP between 1870 and 1910, and accounted for 30 to 50 percent of its domestic investment. During the investment booms in Argentina and Australia, foreign capital was roughly half of all gross domestic investment. By contrast, net capital inflows to all developing countries averaged 2 to 3 percent of their GNP between 1960 and 1973, while financing 10 to 12 percent of their gross investment; since then, net capital inflows have been between 3 and 6 percent of their GNP and financed 10 to 20 percent of their gross investment.

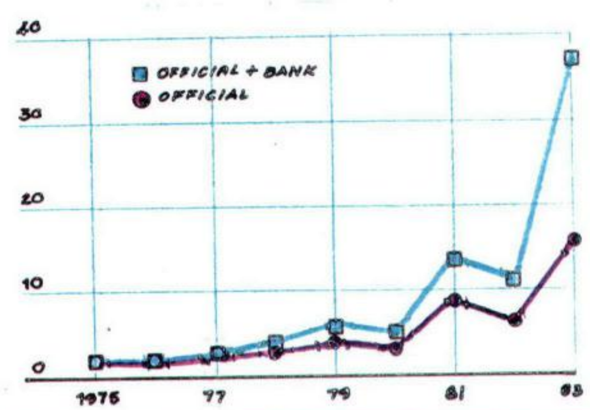
1.11 o The structure of financial flows to developing countries has changed several times. In the years before World War I, private bond markets were the main source of capital. In the 1930s, following the Great Depression and widespread defaults by borrowers in both industrial and developing countries, commercial lending to developing countries virtually stopped. It was replaced after World War II by an expansion of official flows, mainly on concessional terms; the largest part was bilateral aid but some was channelled through the new multilateral agencies such as the World Bank and later the International Development Association (IDA). Along with private direct investment and suppliers' credits, official finance provided the bulk of external capital for developing countries until the late 1960s, when commercial banks started to emerge in a dominant role.

1.12 o Debt-servicing difficulties have been common, and usually caused by a combination of poor domestic policies and a deteriorating world environment. The fifty years before World War I saw several debt repudiations, including the Peruvian and Turkish crises in the 1870s and the Argentinian and Brazilian crises of the 1880s and 1890s. Defaults, however, were not confined to developing countries; some borrowers in the United States, for example, defaulted on their debts in these years. In the 1930s defaults were widespread, starting with Germany in 1932. Argentina was the only country in Latin America to service its debt on the terms contracted during these years. Except in the 1930s, countries were able to resume borrowing (albeit on more expensive terms) once they had reformed their policies.

1.13 By historical standards, debt-servicing difficulties in the 1960s and 1970s do not seem unduly serious. In 1955-70, seven developing countries (Argentina, Brazil, Chile, Ghana, Indonesia, Peru, and Turkey) were involved in seventeen debt reschedulings. There were also some debt reschedulings for low-income countries, including India, but these were designed to provide additional finance when official lenders could not increase new lending. In the 1970s, despite the sharp fall in their terms of trade in 1973-74, only four developing countries a year rescheduled their debts.

1.14 It is only in the 1980s that debt problems have multiplied. The number of reschedulings rose to thirteen in 1981 and to thirty-one (involving twenty-one countries) in 1983 (see Figure 1.3) and a similar number in 1984. Countries have restructured their repayment schedules, sometimes for several years at a time, in the context of agreed programs of policy reforms. However, low-income countries, particularly in Africa, have yet to benefit from the kind of multi-year rescheduling that some major debtors have negotiated.

Figure 1.3 Multilateral debt reschedulings



SOURCE: World Bank data.

1.15 The similarities with the past should not obscure some differences as well. Developing countries have become more vulnerable to debt-servicing difficulties, for three related reasons. First, loans have far outstripped equity finance. Second, the proportion of debt at floating interest rates has risen dramatically, so borrowers are hit directly when interest rates rise. Third, maturities have shortened considerably in large part because of the declining share of official flows and debt--and by even more than Table 1.1 suggests, if account is taken of the way that higher inflation and interest rates have front-loaded repayments.

Table 1.1 Composition and terms of capital flows to developing countries in selected periods

	1960-65	1975-80	1980-83
Direct foreign investment as proportion of total capital flows	23.0	15.0	9.0
Percent of new debt at floating interest rates	--	27.5	36.1
Average maturity of total debt	18.0	15.0	14.0

Source: World Bank.

1.16 Another major and disturbing difference today is that many of the countries with debt-servicing difficulties are in the low-income group. This is partly because their aid receipts have been erratic. The dollar value of net official development assistance (ODA) receipts by all developing countries increased one-and-a-half times between 1970 and 1975; stagnated between 1975 and 1977; almost doubled between 1977 and 1980; and has declined since then. In real terms, the pattern is similar, but the fluctuations are less marked. This pattern is explained by variations in bilateral ODA, particularly flows from OPEC countries, since multilateral ODA increased steadily between 1973 and 1980 and has only declined slightly since then. Many low- and lower-middle-income countries borrowed commercially and accumulated large amounts of debt. In earlier periods, the poorest countries had obtained virtually all their foreign capital in the form of direct investment for export-earning activities, or official flows on concessional terms.

1.17 The historical perspective reveals certain broad lessons about debt-servicing problems. The financial links between industrial and developing countries depend on three variables: (a) the policies of industrial countries; (b) the policies of developing countries; and (c) the financial mechanisms through which capital flows to developing countries. No analysis of international finance is complete unless it includes all of these variables. In doing so, it reveals a much wider range of country experience and why some countries have borrowed and encountered debt servicing difficulties, while others have not.

Policies of industrial countries

1.18 As Chapter 3 makes clear, the fiscal, monetary, and trade policies of industrial countries largely determine the external climate for developing countries. The connection is not simply that rapid growth in the industrial world "pulls up" the growth of developing economies, though it helps to do so. Nor is it just that prolonged recession and increased protectionism in the industrial countries cause difficulties for developing countries. Increasingly, the links are financial, through changes in the availability of finance and movements in interest rates and exchange rates.

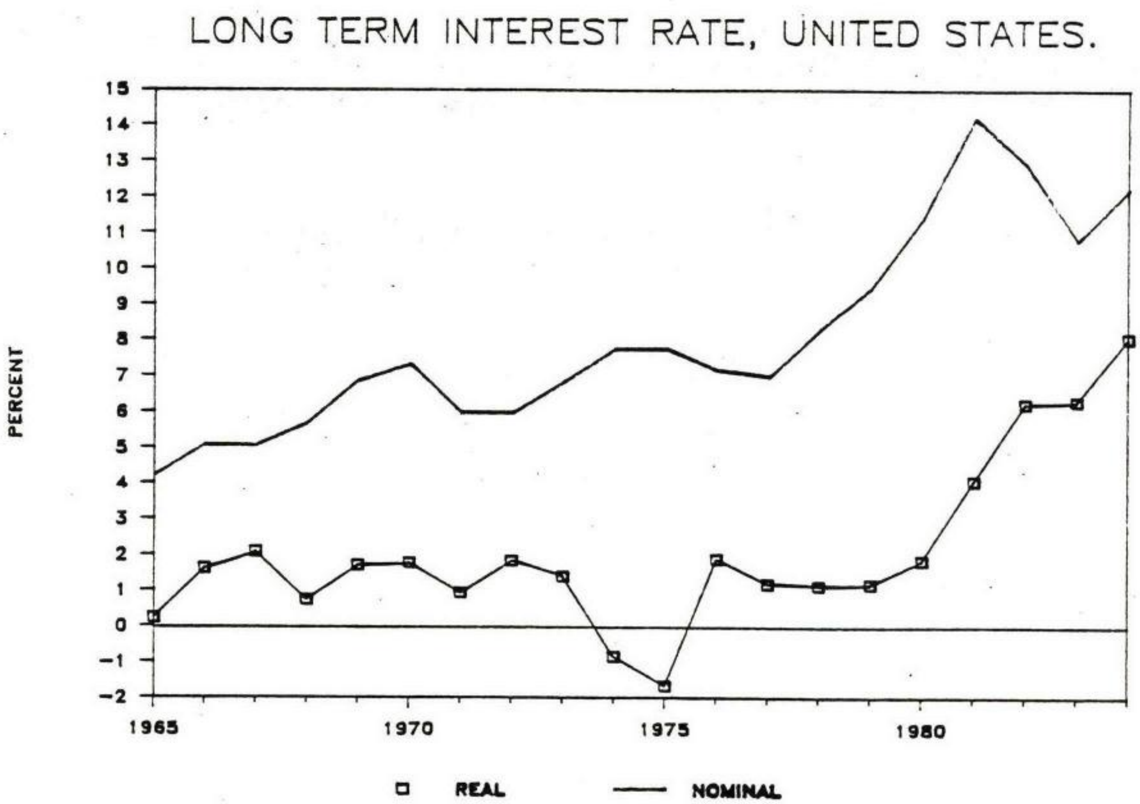
1.19 This became clear in 1979-80, for example, when United States monetary policy switched from interest-rate targeting to targeting of monetary aggregates. Interest rates became more volatile. Latin America, with a higher proportion of floating-rate debt, was more affected by this change than either East Asia or Africa. This entailed abrupt increases in debt service payments. Developing countries find it difficult to make sudden and large changes in repayments. The strains felt by many developing countries were increased in the early 1980s by the recession in the industrial countries. It reduced export volumes and weakened commodity prices at a time when real interest rates were rising (see Figure 1.4 and Chapter 3, Figure 3.6). Unsurprisingly, the combination made it hard for many countries to service their debts.

1.20 The recovery in the industrial countries has helped to ease some of the liquidity pressures on developing countries. World trade grew by about 8.5 percent in 1984 and world output increased by 4.2 percent. Developing countries' grew by 4.1 percent and the volume of their exports increased by an estimated 8.9 percent, compared with less than 4 percent a year in 1981 and 1982. Real interest rates have softened a little but remain at historically high levels. However, the world recovery in 1983-84 did not lead to the normal cyclical rise in commodity prices in dollar terms. This was in part due to the U.S. dollar's further appreciation, as well as to technological and other factors affecting the demand for commodities. So net primary commodity exporters (including Brazil) benefited less than countries like Korea which are net commodity importers. In addition, all developing countries continue to be threatened by protectionist measures in the industrial economies.

1.21 For the future, the effects that industrial countries have on developing countries will depend primarily on what happens in two areas of policy: first, real interest rates, which are explored in detail in

Chapter 3. The analysis there concludes that large budget deficits in industrial countries remain an obstacle to lower interest rates. As a proportion of national income, budget deficits of general government rose substantially between 1979 and 1984 in all major industrial countries except Germany and Japan. In 1984 the combined deficits of industrial economies,

Figure 1.4 Interest rates



adjusted for inflation, were 2.3 percent of their national income. The United States deficit has grown much the fastest over the past five years. Without a credible fiscal retrenchment in the United States, real interest rates cannot be expected to come down for more than a short period. Avoiding a recessionary impact of such a policy change will require careful coordination with monetary policy in the United States, and with monetary and fiscal policies in other major industrial countries.

1.22 The second issue of vital concern to developing countries is protection. To service their foreign debts, the biggest debtors will need to run large trade surpluses in the next few years. Yet many import restrictions--on steel, sugar and beef, for example--have been directed primarily against major debtors including Argentina, Brazil, Korea, and Mexico. Others, such as the Multi Fibre Arrangement (MFA), affect a broader range of countries. The harder the big debtors find it to service their debt, the greater the strains on the world's banking system.

1.23 When developing countries cannot earn the foreign exchange to expand their imports, exporters in the industrial countries are also damaged. To take one example, United States exports of manufactures to major debtors fell by 40 percent between 1980-81 and 1983-84. Such harm is widespread, since industrial economies run a surplus on trade in manufactured goods with developing countries. And protectionism acts as a brake on the adjustment and growth that the industrial countries themselves so badly need.

1.24 Over the longer term, protectionist barriers in the industrial world can have a profound effect on development strategy. They suggest to governments in developing countries that a strategy based on export growth is highly risky, and thus encourage a return to the inward-looking policies of earlier years. There is abundant evidence that such policies are bad for growth and employment in the developing countries, and also reduce the scope for industrial countries to promote productivity improvements in their own economies.

Policies of developing countries

1.25 The past dozen years have underlined, as discussed in Chapter 4, the crucial role of domestic policies in determining the performance of developing countries. This applies particularly to the use they make of foreign finance. Foreign finance can promote growth through higher investment and technology transfers. It can allow countries to adjust gradually to new circumstances in the world economy. But it can also be misused, so that countries end up with more debt but no corresponding increase in their ability to service it.

1.26 In the 1970s, it was right for countries to borrow when real interest rates were low or negative--but only if they followed appropriate policies and invested in economically justified projects. It was wrong to assume that low interest rates would continue, and it is always expensive to reverse investment decisions. These mistakes are quickly exposed when world conditions deteriorate, as they did in the early 1980s.

1.27 Developing countries suffered in 1979-84 from a combination of more expensive oil, historically high real interest rates, prolonged recession in industrial economies, and more trade barriers. Despite this, as many as 100 countries have continued to service their foreign debt without interruption. Some have experienced only small shocks, including countries that are oil exporters or have benefited from workers' remittances (for example, certain Asian and Middle Eastern countries). Some had borrowed only a little or mainly on concessional terms in the 1970s (for example, China, Colombia, and India). And some borrowed to facilitate economic policy reforms (for example, Indonesia, Korea, and Tunisia).

1.28 Countries which ran into debt-servicing difficulties, however were not necessarily those that had suffered the biggest shocks. They were countries which had borrowed and failed to adjust or had not tackled the new problems with sufficient urgency. First, the low-income countries of Africa, whose development is a long-term process constrained by weak institutional structures, a shortage of skills and often (as in the past ten years) natural disasters as well. They have traditionally used concessional capital from abroad to finance the bulk of their investment. In the 1970s they were faced with higher import bills. Many countries that had commodity booms were able to borrow on commercial terms when interest rates were low. They used this foreign finance partly for consumption, and also for investment in large public projects many of which contributed little to economic growth. Capital inflows enabled some countries to postpone policy reforms. Debt-servicing difficulties could have been expected, and did occur. The net result has been a further setback to their economic development.

1.29 The second group of countries with debt difficulties includes many countries in Latin America and some major debtors. The reasons for their financing problems are more complex. But three common features are: (a) fiscal and monetary policies that were too expansionary to achieve a sustainable external balance; (b) overvalued exchange rates that prevented exports from competing on world markets and encouraged capital flight; and (c) increased domestic savings efforts but increased investment by even more. Some countries, such as Chile and Uruguay, attempted comprehensive economic reforms, but parts of their policy package were defective and the timing of measures taken was inappropriate. Other countries borrowed heavily and undertook some policy changes (for example, Brazil, Philippines, and Ivory

Coast). But they underestimated the length and depth of the recession and the large rise in interest rates in the early 1980s. Many of these countries are now in the process of reforming their policies, with results that are thus far encouraging.

1.30 The diverse experiences of developing countries emphasize certain basic lessons for policy. One can be summarized as the need for flexibility. A characteristic of foreign finance is that it requires both borrowers and lenders to take account of uncertainty. The best way of doing so is to be able to respond flexibly to changes in the external environment. Adjustment to external changes is good economic management with urgency. Countries as varied as India, Indonesia, Korea, and Turkey have adapted their economic policies quickly to changed circumstances. The most critical changes in the short-term are the ability to reduce fiscal deficits and adjust real exchange rates and real interest rates. When for political or other reasons countries cannot adjust their policies quickly, they should be conservative in resorting to foreign borrowing.

1.31 A second lesson is that the policies required to make best use of external finance are essentially the same as those that make best use of domestic resources. A country must earn a return on its investments which is higher than the cost of resources used. However, in the case of foreign finance, a country also has to generate enough foreign exchange to cover interest payments, plus remittances of dividends and profits. This depends on three groups of policies:

- Key economic prices must be aligned with opportunity costs. These encourage activities in which the country has a comparative advantage and increase the flexibility of productive structures. When oil prices rose in

1973-74, many countries--including both oil importers and oil exporters--delayed raising their domestic energy prices, so increasing pressures on their balance of payments; many other countries avoided these pressures by raising energy prices earlier. Further, investment decisions are influenced by the appropriateness of pricing structures, including interest rates. Governments need to evaluate carefully their own investment programs, and to create a framework of incentives to ensure that private investors allocate resources in the most efficient way. Countries such as Brazil, Ecuador, Ivory Coast, Nigeria, Peru, and Turkey combined negative real interest rates with over-ambitious or inefficient investment programs. By contrast, Colombia and Malaysia had more appropriate interest rate levels and investment incentives.

o Exchange rates and trade policies also play a major role. In the 1970s and early 1980s many countries--notably Argentina, Chile, Mexico, Nigeria, Turkey, Uruguay, and the Philippines--allowed their exchange rates to become overvalued and their trade policies to become distorted. This biased production toward the domestic market, stimulated imports, and provoked capital flight. Comprehensive trade and price reforms by Turkey following difficulties it experienced in 1980, produced good results. Countries which are protectionist in their trade policies, stimulate the kind of private direct investment which exploits the protection it was given against foreign competition.

o Efforts to raise domestic savings should be strengthened despite the availability of external capital. The correct role of foreign finance is to supplement domestic savings; it must not substitute for them. The danger of poor savings performance was well understood by many governments. In fact, many developing countries managed a creditable performance on savings in the

1970s, with two-thirds of a sample of forty-four developing countries increasing their domestic savings ratios. They included such diverse economies as Cameroon, India, Korea, Malaysia, Malawi, and Tunisia. In other cases, including Argentina, Morocco, Nigeria, and Portugal, inadequate domestic savings efforts contributed to over-borrowing. Improvements in savings performance require measures by both public and private sectors. In the public sector, tax measures, realistic pricing of public goods and services, and cuts in spending are required to reduce deficits and increase public saving. If higher public spending is financed by borrowing more from abroad rather than by increasing fiscal revenues, cumulative strains are put on budgets (since governments have to pay debt interest) and the balance of payments. Mexico's experience in 1981-82, when the budget deficit more than doubled as a proportion of GNP to meet increased public consumption and was financed partly by external capital, sowed the seeds for its debt crisis in 1982. As for private savings, domestic interest rates which are kept low curtail savings, contribute to capital flight, lead to credit rationing, and increase the pressures for borrowing abroad. Government policies of adjusting exchange rates by less than the rate of inflation and of subsidizing foreign borrowing artificially lower the domestic currency cost of borrowing, thereby inducing capital inflows as was the case in Argentina, Chile, and Uruguay.

Managing foreign borrowing and debt

1.32 Policies determining the level of domestic savings and investment also determine the need for foreign borrowing, so the management of capital flows should be an integral part of macroeconomic management. Certain aspects of debt management deserve special attention, and these are discussed in Chapter 5.

1.33 The first issue is whether and how governments should regulate foreign borrowing and lending by the private and public enterprise sectors. The answer depends fundamentally on a government's macroeconomic and incentive policies; in general, less government intervention is needed the more that prices, interest rates, and exchange rates reflect opportunity costs. Although some governments have constructed elaborate controls over capital inflows and outflows, experience strongly suggests that these are no substitute for sound macroeconomic policies. On the other hand, some procedures for regulating capital movements--prior approval for borrowing, minimum maturity or deposit requirements, or withholding taxes--have sometimes proved a helpful complement to fiscal, monetary, and trade policies.

1.34 The second broad area of concern is the composition of capital flows and debt. This involves decisions about: (a) the terms of foreign borrowing --interest, maturity, and cash-flow profiles; (b) the currencies in which liabilities are denominated; (c) the balance between fixed- and floating-rate instruments; (d) ways of sharing risk between lenders and borrowers (including the balance between debt and equity); and (e) the level and composition of a country's reserves. It is not possible to formulate precise rules for external debt management that will apply to all countries. The experience of the past few years, however, argues for prudence by developing countries in deciding on both the volume of foreign borrowing and its composition, and in maintaining enough reserves to give a country time to adjust to domestic or international pressures without unduly jeopardizing its economic growth. If the capacity to borrow abroad is not stretched to its limits, it will provide a cushion in times of particular need.

1.35 Many countries fail to manage capital flows effectively because of inadequate data, lack of technical expertise about financing options, and an institutional set up which does not integrate debt management with macroeconomic decisionmaking. In all these areas, institutional development is an important priority.

Financial mechanisms

1.36 Developing countries account for only a small proportion of international flows of capital, so their influence on the international financial system is limited. The system itself evolves in response to three main factors. First, the external environment. For example, changes in regulations, financial innovations, and high and vòlatile inflation in the 1970s led investors to lend on floating-rate rather than fixed-rate terms. Second, the demand for the services of financial markets and institutions, which is affected importantly by global payments imbalances. For example, OPEC countries in the 1970s and early 1980s initially preferred to keep their surpluses in highly liquid form, so commercial bank deposits and lending increased. More recently, the large current-account deficits run by the United States, which have their counterpart in surpluses in Japan and other industrial countries, have led to a much larger role for international asset markets. Third, the preferences of financial institutions. For example, in the 1970s commercial banks chose to lend abroad to satisfy their own portfolio and profitability objectives (see Chapter 8).

1.37 In the short term, developing countries have to make the most of the opportunities presented by the international financial system. From a longer-term point of view the key policy questions are: How can the stability of external capital flows be enhanced and lending by banks be restored? And what arrangements can be made for the future financing of external deficits, including enough concessional assistance to meet the needs of low income countries?

1.38 The answer lies in five areas:

- Longer maturities. Developing countries can borrow long-term, though seldom directly from the market; they rely almost exclusively on the intermediation of the World Bank and regional development banks. These institutions will remain the primary sources of longer-maturity capital for developing countries in the next few years. They need to have the capability to provide more financing to developing countries, since the prospects for expansion of private financing are not good. Financial innovation to expand the range of maturities available to developing countries would help them to manage their debt and reduce refinancing risks.

- Hedging. The nature of the financing instruments used in the 1970s meant that developing countries assumed the risks of adverse developments in the world economy. One of the central functions of a financial system--effective risk sharing--was not efficiently served. Instruments for hedging risks already exist in many financial markets: it would be desirable to make greater use of them in lending to developing countries.

- Commercial risk-sharing. While conventional bank loans do not involve sharing of commercial risks, equity financing does (see Chapter 9). The introduction of equity-based instruments in lending to developing countries is another area where progress could be made.

o Secondary markets. As most commercial lending to developing countries in the 1970s was done by banks, it tended to increase risks by concentrating assets in a single group of creditors. The expansion of secondary markets for some types of developing countries' liabilities could widen the range of lenders, and so enhance the stability of lending. Such a development, although desirable, must be a phased process. In the long run, secondary markets could also provide an extra indicator of country creditworthiness, making it easier for lenders to diversify their risks.

o Aid volume and effectiveness. Low-income countries need a considerable quantity of aid, more than is available at present. They also need to use aid efficiently (see Chapter 7). Donors can improve their own efficiency by focusing their aid primarily on development objectives and by coordinating their efforts within programs agreed with the recipient.

Prospects and options

1.39 How much and what kind of foreign finance will developing countries need in the years ahead? That question can be answered only by analyzing the global outlook for growth, trade, interest rates, and so on. Traditionally, World Development Reports present alternative scenarios for ten years ahead. These, it needs emphasizing, are not predictions; their outcome depends on the policies adopted in industrial and developing countries. Nor do they allow for exogenous shocks to the world economy. Last year's Report contained scenarios to 1995. The discussion in this year's Report, in Chapter 10, is in the context of last year's scenarios, but pays greater attention to the next five years.

1.40 The next five years are a period of transition. During that time, about 70 percent of the debt of the developing countries will need to be rolled-over or amortized. The constructive and collaborative actions taken by debtors, creditors, and international agencies in recent years need to be continued. They need in particular to be extended to countries--several middle-income exporters of primary commodities and many low-income African countries--where debt servicing difficulties and development problems are intertwined. Consideration needs to be given to the extent to which multi-year debt restructurings for official credits and other arrangements might be considered on a case-by-case basis as part of the overall financing package supporting stabilization and adjustment, particularly in low-income sub-Saharan African countries committed to strong adjustment efforts. Beyond that, much will depend on whether or not industrial and developing countries successfully pursue policies for structural adjustment.

1.41 Over the past few years, many developing countries have made progress in dealing with their financial difficulties. The economic situation, however, continues to remain fragile in many countries. GDP growth in 1980-85 is currently estimated at slightly more than one-half that of 1973-80. Exports have grown at close to 6 percent a year, but the pressure of continued high interest payments has meant that imports could grow at only a little more than 1 percent a year. Substantial trade surpluses run by many developing countries have been used to meet greatly increased interest payments. The high level of real interest rates is thus one of the critical variables whose course will influence outcomes in the next five years. Developing countries need to keep the rate of growth of export earnings above the rate of interest if the principal debt ratios are to return to more sustainable levels. This will depend on their own policies, but also on the rate of growth of industrial economies and whether or not protectionist measures are rolled back.

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1.42 Two simulations have been prepared for the period 1985-90, and are discussed in detail in Chapter 10. Both simulations assume that developing countries continue with their present course of policies, which in many cases (as for example in some low-ioncome Asian economies) imply substantial policy reforms and adjustment efforts. As for industrial economies, the difference between the simulations is that the Low one assumes limited progress in policies for adjustment, while the High one embodies policy changes which result in some progress in adjustment. The Low simulation makes three key assumptions: no progress in reducing budgetary deficits and in improving the monetary-fiscal balance so that real interest rates remain high; a failure to tackle labor-market rigidities such that unemployment stays high and real labor costs continue to increase; and a substantial increase in protection. By contrast, the High simulation assumes reduced fiscal deficits compared with the Low simulation thus permitting improvements in the monetary-fiscal balance and resulting in a lowering of real interest rates; reductions in labor market rigidities such that unemployment declines and increase in real labor costs slows down; and the increasing success in adjustment results in a steady decline in protection.

1.43 For developing countries, the implications of these assumptions are far-reaching. In the High simulation their output grows at a healthy 5.5 percent a year (or 3.7 percent a year per capita), and there is a major improvement in all the major debt indicators. The Low simulation produces a different, and more problematic outcome. Slower growth at 4.1 percent a year (or 2.3 percent a year per capita). A combination of high real interest rates and protection makes debt-servicing considerably more difficult. The main debt indicators deteriorate, and "involuntary" lending continues to be required.

1.44 The challenge for the next five years is to ensure that the world reaches the High case. How it could do so will be implicit in many of the chapters in this Report, and made explicit in Chapter 10. It is quite clear that foreign capital will play a significant part in meeting the challenge of faster growth; it is also possible that its legacy from the past ten years will act to slow down growth, unless creditors, debtors, and the international community continue to ease the pressures of debt.

1.45 In dealing with all these issues, the Report starts with an historical perspective on the role of international finance in economic development (Chapter 2). It then assesses the policies of industrial economies from the perspective of developing countries (Chapter 3). The importance of developing countries' policies in deriving benefits from foreign capital is taken up in Chapter 4; and issues in managing capital flows are covered in Chapter 5. The Report then discusses the main mechanisms through which foreign capital flows to developing countries. Chapter 6 gives an overview of the international financial system and its relations with developing countries. Chapter 7 examines issues in official development finance. Chapter 8 outlines the evolving relationship between the developing countries and international capital markets; and Chapter 9 examines the possibilities for a bigger role for direct and portfolio investment in developing countries. The Report ends by looking at prospects for the future, and the policies needed to promote faster growth.

Chapter 2

Chapter 2 An Historical Perspective

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Chapter 2 An Historical Perspective

2.1 The history of international finance is full of examples of its productive contribution to economic development. It has also produced occasional financial crises and, more frequently, debt-servicing difficulties for a variety of countries. This chapter starts by examining the role of international capital since the late nineteenth century. The object is to highlight lessons that help to analyze the experience of the 1970s and 1980s, rather than to provide a detailed discussion of history. The chapter then pays closer attention to the postwar period, and particularly to the past two decades.

The pre-1945 period

2.2 The years before 1945 can be conveniently divided into two parts, 1870-1914 and the interwar period, each of which had its own distinctive features.

2.3 1870-1914. This period was dominated by the London financial market as a source of capital for other countries. Europe's industrial revolution produced a strong demand for food and raw materials, which could be satisfied only by investment in many other parts of the world. Expansion of railroads and other infrastructure was externally financed, and foreign investors repaid later from the resulting export earnings. Some of the countries where these investments were made--like the United States, Canada, Australia and Argentina--were able to buy imports of manufactures from the more industrialized countries in Europe. Then, as now, this growing economic interdependence was facilitated by international finance.

2.4 What was unique about the years 1870-1914 was the scale of international finance. Over the period as a whole, Great Britain invested 5 percent of its GNP abroad, reaching a peak of 10 percent just before World War I. Its net receipts of investment income from abroad were in the range of 5 to 8 percent of GNP, implying that new foreign investment did not keep up fully with inflows of interest and dividends. As a proportion of British savings, capital outflows ranged between 25 and 40 percent. France and Germany also invested heavily abroad, though not as much as Britain. By the late nineteenth century, French and German gross capital exports were averaging 2 to 3 percent of GNP.

2.5 The nature of the capital flows varied considerably in 1870-1914. The largest single group included the market-oriented investments, largely undertaken by Britain, in the resource-rich countries of North America, Latin America and Oceania. In 1914, these accounted for 70 percent of Britain's total foreign investments and more than half of all gross foreign assets. A second group, accounting for a quarter of all foreign investment, involved investments in Russia and other Eastern European countries and in Scandinavia; France and Germany were the principal investors. A third group covered the politically motivated investments in China, Egypt, India, Turkey, and some African colonies. These three groups received capital at different times, so new regions were incorporated into the world economy only gradually: the United States in the 1830s, 1850s and 1870s; Australia and Argentina in the mid- and late-1870s; Canada and Brazil in 1900-13.

2.6 For the large debtors in the nineteenth century, capital inflows had only a small weight in their economies. For most decades, capital inflows to the United States were around 1 percent of its GNP, and never exceeded 6 percent of its domestic investment. For the smaller debtors, however, capital inflows as a proportion of GNP were higher than for many developing countries today. Capital inflows to Canada averaged 7.5 percent of its GNP, accounting for between 30 percent and 50 percent of annual investment from 1870 to 1910. Ratios were similar in Australia and the Scandinavian countries. The most striking case was that of Argentina, where capital inflows annually ranged between 12 and 15 percent of GNP, and financed about 40 percent of its total investment during the first two decades of the twentieth century. By contrast, net capital inflows to all developing countries averaged 2-3 percent of GDP between 1960 and 1973. Since 1973 they have not exceeded 6 percent of GDP, and have financed between 12 and 20 percent of gross investment.

2.7 Differences do not stop with geography and the relative volume of external finance. In the years 1870-1914:

- Almost all lending came from private sources, in the form of stock and bond issues.
- Lending terms were long: maturities of up to ninety-nine years were common.
- Nearly two-thirds of foreign capital went to finance investment in railroads and utilities.
- A large proportion of the flows went to relatively high-income countries; North America, Latin America and Australia received more than half of the total. The international capital market in the nineteenth century did not, and was not designed to, provide poorer countries with access to capital. For example, even India--though favored in British capital markets--received very little investment. Capital was drawn to investments that yielded higher returns than were available in the domestic economy. Thus it operated selectively, to the advantage of high-income borrowers; although there were politically motivated investments, they were often marginal in economic terms.

2.8 These differences compared with the recent past were also accompanied by some close parallels: periodic debt-servicing difficulties, and an early version of what is now known as conditionality. Lenders and borrowers operated against a backdrop of large cyclical swings in international economic activity compounded by rebellions and wars. Sometimes borrowers failed to make their payments. They fell into two broad categories. First, countries such as Argentina and Brazil where foreign capital was important in integrating their economies into an expanding world economy. Their problems were cyclical, and related to abrupt declines in foreign-exchange earnings. Foreign loans were used, along with domestic policy changes, to alleviate liquidity crises until exports recovered. In some cases, foreign creditors got involved in domestic-policy issues. In the Brazilian crisis of the 1890s, for example, the government pledged all its customs receipts and agreed to a moratorium on new (internal and external) debt issues.

2.9 The second kind of debt crisis was the result of stagnant domestic revenues and expanding fiscal deficits. Countries in this group included Egypt, Peru, and Turkey in the 1870s, and Greece in the 1890s. Capital inflows could not continuously finance deficits and became increasingly expensive. Before defaulting, countries' export growth slowed down considerably. In these cases, creditors intervened not merely at the moment of default but sometimes much sooner. In the Turkish crisis, for example, a foreign loan (the first in a series) was issued in London with the encouragement of the British government. A condition of the loan was that commissioners should be sent to oversee the expenditure of the proceeds.

2.10 Notwithstanding all these difficulties, the record up to 1914 shows that investment abroad was profitable for investors in Great Briain and continental Europe. It earned returns which have been calculated to be between 1.6 and 3.9 percentage points higher than returns on domestic investment. Within that average, the most profitable investments were in railroads in the United States. Although they were untypically lucrative, they helped to foster a general climate in favor of foreign investment. Another influence working in the same direction was that loans were used to purchase British exports, so financial and real flows went together. When borrowers got into difficulty, they found that the London capital market was not an unyielding taskmaster.

2.11 The interwar period. Between the two world wars, the pattern of international investment shifted dramatically. The United States emerged not merely as a net creditor country, but as the main source of new capital flows. In certain respects, it played a role similar to Britain's earlier one. It financed many long-term bond issues: of the 1,700 foreign dollar issues offered in the United States in the 1920s, almost half had average maturities of twenty years. Some 4 percent had average maturities of forty years, and 1 percent of more than forty years. At least forty-three governments borrowed during the 1920s, and none defaulted. During the peak period of floatations, from 1924 to 1928, the interest-rate differential in favor of new foreign issues was between 1.7 and 1.9 percentage points. The United States also financed a large amount of direct investment, mainly in Canada and Latin America. Its direct investment rose by almost $4 billion during the 1920s, two-thirds of it going to western hemisphere countries.

2.12 However, the 1920s were different from earlier decades in several vital respects. First, the volume of government lending and borrowing was far greater. At least forty-three governments borrowed during the 1920s, and they accounted for nearly half of the foreign dollar issues in the United States. No less important, World War I had left a legacy of official debt. The United

States was owed almost all the inter-Ally debts, totalling more than $16 billion. In addition, the Allies had heavy reparation claims against Germany.

2.13 The second difference was that foreign capital was no longer part of an integrated system of population and trade changes. By the mid-1920s, commodity prices were falling. Some countries borrowed to finance a growing stockpile of unsold commodities; one example was Brazil in the 1920s, to finance coffee stocks. From the mid-1920s on, there was an increase of 75 percent in commodity stocks, financed indirectly by foreign capital.

2.14 The third difference with the pre-World War I period was the trade policy followed by the major global creditor. British free trade had served to guarantee debtors a market for their products. The United States was more protectionist. Following the recession of 1920-21, it raised tariffs back to where they had been before some liberalization in 1913. If debtors could not generate export surpluses, they needed capital inflows to service past debts. The process inevitably produced ever increasing debt.

2.15 The Great Depression of 1929-32 turned a potential threat into a disaster. Between 1929 and 1932, output in industrial countries fell 17 percent and the volume of world trade by more than a quarter. The international monetary system disintegrated. There was no lender of last resort to provide liquidity, a function which the United Kingdom had previously undertaken. And the liberal trading system of the pre-war years virtually disappeared. Most countries raised tariffs, and applied quotas and exchange controls. Lack of finance contributed to the decline of international trade, and vice versa.

2.16 Several industrial countries defaulted on their war debts and reparation. Germany, facing declining production, exports and prices, first obtained a one-year moratorium in 1931, and then defaulted on all its external debts in 1932. Developing countries were also failing to service their debt. Bolivia defaulted on its dollar obligations in 1931, and was soon followed by most other Latin American countries. By the end of 1933, Argentina was the only Latin American country which maintained full servicing on its external debts. Effectively, access by developing countries to commercial markets ceased until the 1960s.

2.17 Although the deterioration in the general economic climate was the proximate cause of defaults in the interwar period, it was not the only one. Other contributions came from excessive borrowing, particularly between 1925 and 1929; poor risk assessment on the part of lenders; panic; and an abrupt cessation of lending just before a default. In general, the financial penalties for defaulting were rather small in the 1930s. Defaulting governments had established a precedent, and the number of private defaulters was too large for sanctions to be enforced. However, the cost in domestic adjustment could be severe. Between 1929 and 1938, the maximum peak-to-trough declines in output for major Latin American countries ranged from 7 percent for Brazil to 26 percent for Peru.

2.18 Some historical lessons. Three broad lessons emerge from the experience of international finance between 1870 and 1939.

o Finance seeks out profit: in general, the highest returns were from investments which directly or indirectly exploited natural resources. Technological change--such as the expansion of railroads in the nineteenth century--was also a major absorber of capital, and international capital in particular. Repayments were more likely when investments led to increased exports (as was generally the case before 1914) than when the ability to export was constrained by protectionist measures in capital-exporting countries (as was the case in the interwar period). Political risk was minimized by investing in colonies or in countries which were integrated with capital exporters through trade and finance.

o The volume and composition of finance changes to reflect shifts in the world economy. Before World War I, private capital markets were dominant; in the interwar period, public borrowing and lending assumed a much larger role. Financial innovation is also influential: for example, the nineteenth century saw the establishment of mutual funds, which separated ownership from the management of portfolios and spread risk more widely.

o Reschedulings and defaults were the result of inadequate policy responses by borrowers to declining terms of trade. Defaults were typically settled in negotiations with bondholder committees on terms that seldom preserved more than a small fraction of the original capital value. Negotiators explicitly assessed the borrowers' ability to undertake policy reforms; this "capacity to repay" formed the basis for determining how much debt should be forgiven. In most cases, existing debt was consolidated and extended with a significant reduction in principal and interest due; interest arrears were often waived entirely. External intervention, including military force, was common where lending had been determined by political factors. Where countries ran into liquidity difficulties, they were able to borrow more if they revised their policies and while they waited for their export earnings to recover.

The post-1945 period

2.19 1945-72. The Bretton Woods Conference (see Box 2.1) in July 1944 outlined the postwar international economic system and led to the creation of the International Monetary Fund (IMF) and the International Bank for

Reconstruction and Development (The World Bank). The United States continued as the major creditor country, and its dollar became the main reserve currency. In 1947 it announced the Economic Recovery Program (or Marshall Plan), designed for the reconstruction of the war-ravaged countries of Europe. Between 1948 and 1951, the Program provided over $11 billion to western Europe, with a further $2.6 billion between 1951 and mid-1953. The aid took the form of grants of commodities. It helped Europe to make a dramatic recovery: the countries participating in the Economic Recovery Program increased their industrial production by 39 percent between 1948 and 1952.

2.20 The ending of Marshall Aid did not produce a big swing in the United States balance of payments. On the contrary, America's foreign investment expanded as a result of incentives to United States banks and corporations to invest abroad, plus a big devaluation of European currencies against the dollar in 1949, and America's large military presence in Europe. The overall United States balance of payments moved into deficit in 1950 and stayed there for many years. During the 1950s, this aroused little concern. It was a commonly held view that there was a "dollar shortage" and that such deficits were appropriate for the leading international creditor. The United States also increased its loans and grants to developing countries, and private direct investment increased sharply in Latin America.

2.21 Europe's balance of payments improved considerably in 1958, boosting its foreign reserves. At the end of that year, most European governments declared their currencies convertible (Japan did the same only in 1964). Capital markets in Europe and the United States started to integrate, with private capital flows becoming responsive to movements in interest rates. In the late 1950s, European banks, notably in London and Switzerland, began to deal in dollars. This marked the inception of what came to be known as Eurocurrency markets (described in Chapter 6, Box 6.2). The decade had begun with official capital flows contributing to economic growth and trade expansion; it ended with a growing volume of private capital flowing between industrial economies.

2.22 The postwar years also saw the progressive decolonization of the developing countries. The United States and later other industrial countries began their formal programs of foreign aid. In the early 1950s, the World Bank shifted its focus from reconstruction to development, though it continued lending to industrial countries, including Japan, during the 1950s and 1960s. In 1956, the International Finance Corporation (IFC) was created to assist the private sector in developing countries through loans and equity investments. In 1960, governments formed the International Development Association (IDA) to provide a multilateral source of concessional finance for low-income countries. These years also saw the establishment of several regional development banks, including the Inter-American Development Bank (1959), the African Development Bank (1964) and the Asian Development Bank (1966).

2.23 For most of the 1960s, the world economy enjoyed a period of largely untroubled progress. Industrial economies grew by an average of 5 percent a year, with little year-to-year variability in growth rates. World trade grew even faster, at an average of 8.4 percent a year. Inflation rates in industrial economies as a group varied between 2 percent and 5 percent a year, though individual countries had bouts of more rapid price increases. Nominal interest rates adjusted for inflation (that is, real interest rates) were usually in the 2 to 3 percent range.

2.24 Developing countries benefited from these international conditions. As a group, their output increased by over 5 percent a year. Some developing countries grew much faster than others, accentuating the differences in average incomes. Current-account deficits were financed chiefly by official flows (loans and grants), by private direct investment, and by trade finance. Official aid grew by about 3 percent a year in real terms in 1950-65. Direct foreign investment also increased rapidly, as multinational corporations sought new supplies of raw materials in developing countries. Export credits revived as a source of finance for developing countries--a mixed blessing, as their short maturities contributed to debt-servicing problems for many countries.

2.25 Several developing countries ran into debt difficulties in the 1950s and 1960s. Between 1956 and 1970, there were seventeen debt reschedulings involving seven countries (Argentina, Brazil, Chile, Ghana, Indonesia, Peru and Turkey), each of them more than once. The reasons for their difficulties varied. Argentina, Brazil, Chile, Peru and Turkey shared certain problems: large budget deficits; rapid inflation and delayed adjustments of the exchange rate; deteriorating terms of trade; declining export earnings; the accumulation of short-term external debt. Ghana and Indonesia also had these problems--though more acutely, because they launched large, long-term projects which they financed with short-term credits and executed inefficiently. In a number of other cases, including India, debt rescheduling was used to provide increased capital flows to low-income countries when concessional flows from industrial economies were constrained.

2.26 Creditors rescheduled their loans through ad hoc multilateral groups, such as the Paris Club. The International Monetary Fund was also involved in providing extra finance to support policy reforms. In general, creditors did not incur capital losses; they extended maturities, and received interest on schedule. Borrowers undertook policy reforms designed to bring their balance of payments into better equilibrium and to establish the basis for economic growth.

2.27 Although the 1960s saw a rapid expansion of world output and trade, some international monetary problems started to emerge. The United States made efforts to control capital outflows. Several countries experienced difficulty in maintaining their exchange rates, notably Britain in the mid-1960s and France and Germany a few years later. The need for reform of the international monetary system was formally recognized as early as 1963.

2.28 By the end of the 1960s, the rate of growth of industrial economies had begun to slow down and inflationary pressures to build up (see Chapter 3). Continued deficits in the United States balance of payments found their counterpart in surpluses in Europe and Japan. The dollar's exchange rate started to come under pressure. In August 1971, the United States temporarily suspended the convertibility of the dollar into gold. In December 1971, it devalued the dollar as part of a general realignment of currencies. Further pressures on exchange markets led to generalized floating of exchange rates in 1973. In the same year, the first major increase in oil prices took place. The world had changed.

2.29 <u>1973-84</u>. With the oil price increases, the financial system was faced with a major change in world current-account imbalances. The industrial economies went into deficit in 1974, but reverted to a surplus in 1975. Oil-importing developing countries had run current-account deficits which averaged slightly more than 2 percent of their GNP in the 1960s, and were at a low of 0.8 percent of their GNP in 1973. In 1974 they reached 3.5 percent of GNP, and climbed to 4.0 percent in 1975 (see Table 2.1). Current-account deficits did not return to historical levels until 1976-78, when developing countries benefited from recovery in industrial economies and their own policy reforms.

2.30 The years between 1979 and 1983 saw a second series of major external shocks for developing countries. Oil prices rose sharply in 1979-80. Real interest rates increased dramatically in 1980-81 (see Figure 1.4), reaching historically high levels. There was a prolonged recession in industrial countries in 1981-83. There was a recovery in 1984. Industrial countries grew by 4.8 percent in 1984, and developing countries 4.1 percent. Fastest growing were the East and South Asian countries in contrast to sub-Saharan Africa where output continued to decline in 1984. For oil-importing developing countries as a group, current-account deficits reached a peak of $78 billion in 1981--more than 5 percent of their GNP, compared with $33 billion and 4.1 percent of GNP in 1975 (see Tables 2.1 and 2.2). The deficits of all developing countries were 4.9 percent of their GNP in 1981.

2.31 The finance for these large deficits was obtained without particular difficulty until 1982, when Mexico's debt-servicing problems caused an abrupt slowdown in bank lending. Developing countries then had to reduce their current-account deficits, and did so most commonly by cutting imports. In 1984, however, exports from developing countries grew by 8.9 percent, and many countries produced trade surpluses. Current account deficits as a proportion of GNP have declined continuously since 1981. In 1984, current account deficits of all developing countries was 1.8 percent of their GDP. But the interest payments of all developing countries in 1984 totalled $58 billion, exceeding their combined current-account deficits of $36 billion.

Table 2.1 Current account deficit as a percent of GNP of groups of developing countries (1), 1960-83

	1960(2)	1965(2)	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Low-income	-1.6	-1.8	-1.1	-1.6	-1.0	-0.9	-1.7	-2.1	-0.9	-0.7	-1.2	-1.4	-2.2	-1.4	-0.9	-1.0	-1.3
Asia	-1.4	-1.6	-0.9	-1.0	-0.5	-0.6	-1.1	-1.2	-0.1	0.4	-0.1	-0.6	-1.4	-0.5	0.2	-0.2	-0.6
Africa	-3.3	-4.1	-3.4	-7.3	-5.6	-4.4	-7.8	-10.2	-7.3	-7.6	-8.3	-7.7	-9.8	-10.5	-12.0	-10.0	9.4
Middle income oil importers	-2.9	-2.0	-3.2	-3.6	-1.2	-0.8	-4.8	-5.3	-2.9	-2.3	-2.2	-3.2	-4.1	-5.2	-4.7	-4.4	-2.7
Major exporters of manufactures	-2.7	-2.0	-3.2	-3.5	-0.9	-0.9	-5.7	-5.5	-2.8	-1.6	-1.7	-3.1	-3.6	-4.2	-4.0	-3.1	-1.3
Other	-3.5	-2.0	-3.0	-4.0	-2.2	-0.2	-1.8	-4.5	-3.4	-4.5	-3.9	-3.7	-5.9	-8.3	-7.3	-8.6	-7.4
Middle income oil exporters	-1.6	-2.4	-3.0	-3.0	-2.4	-1.1	3.3	-3.4	-2.4	-3.6	-5.1	-0.2	0.8	-3.8	-4.4	-2.1	-0.7
All developing countries	-2.2	-2.0	-2.3	-2.7	-1.4	-0.9	-1.9	-3.9	-2.2	-2.2	-2.6	-2.0	-2.3	-3.9	-3.7	-2.8	-1.8
(of which: oil importers)	-2.3	-1.9	-2.2	-2.7	-1.1	-0.8	-3.5	-4.0	-2.2	-1.7	-1.8	-2.6	-3.4	-3.9	-3.4	-3.1	-2.1
High income oil exporters	9.7	20.9	15.7	26.2	22.5	21.2	51.5	40.2	35.0	26.3	15.5	21.2	31.4	32.2	20.1	-4.7	..
Industrial countries	1.0	0.9	0.8	1.0	0.9	0.7	-0.2	0.6	0.1	0.1	0.7	.0	-0.5	.0	.0	0.3	-0.4
Memo items(3)																	
All developing countries	..	..	-2.6	-2.9	-1.7	-1.3	-2.4	-4.3	-2.8	-2.6	-3.2	-2.9	-3.3	-4.9	-4.8	-2.8	-1.8
Oil importing developing countries	..	..	-2.5	-2.9	-1.4	-1.1	-4.1	-4.1	-2.6	-2.1	-2.3	-3.4	-4.6	-5.1	-4.2	-3.1	-2.1

Source: World Bank.

(1) Based on national accounts data.
(2) Data prior to 1970 do not include net private transfers.
(3) Based on balance of payments data, excluding official transfers.

Table 2.2 Current account balance and its financing, 1970-84
(millions of current dollars)

Country Group and Item	1970	1973	1980	1981	1982	1983/a	1984/b
Low Income Asia							
Net exports of goods and nonfactor services	-1,358	-879	-15,755	-11,498	-6,831	-7,246	-8,688
Net factor income	-390	-427	78	-212	-983	-522	-604
Interest payments on medium- and long-term loans	286	375	1,363	1,560	1,515	1,598	1,833
Current account (excludes official transfers)	-1,551	-972	-9,685	-6,166	-1,363	-1,001	-3,083
Financing							
Official transfers	370	569	1,952	2,084	1,885	2,011	1,953
Medium- and long-term loans	987	1,145	4,878	3,227	3,957	4,199	6,541
Official	971	1,189	3,410	3,452	3,883	3,542	4,222
Private	16	-44	1,468	-225	74	657	2,319
Net direct investment	29	-16	159	422	488	546	643
Changes in reserves	-28	1	1,152	882	-4,127	-4,224	-3,184
Low Income Africa							
Net exports of goods and nonfactor services	-381	-607	-5,385	-5,959	-4,642	-4,359	-3,787
Net factor income	-161	-373	-901	-1,098	-1,004	-1,029	-1,291
Interest payments on medium- and long-term loans	80	143	698	643	567	662	1,000
Current account (excludes official transfers)	-538	-990	-5,837	-6,419	-5,432	-4,900	-4,594
Financing							
Official transfers	300	649	2,109	1,851	1,515	2,008	1,925
Medium- and long-term loans	277	911	3,349	2,863	2,198	1,910	2,025
Official	247	412	2,366	2,249	1,858	1,922	2,231
Private	30	499	983	614	340	-12	-206
Net direct investment	173	164	236	221	223	211	86
Changes in reserves	-38	-374	781	555	945	171	607
Middle Income Oil Importers							
Net exports of goods and nonfactor services	-7,064	-6,572	-47,071	-50,683	-35,135	-12,130	10,077
Net factor income	-2,728	-4,364	-22,246	-31,510	-38,583	-42,139	-49,153
Interest payments on medium- and long-term loans	1,565	3,272	19,337	25,055	29,272	26,872	33,841
Current account (excludes official transfers)	-7,423	-4,508	-53,823	-65,758	-57,894	-39,712	-24,367
Financing							
Official transfers	1,085	2,237	5,569	5,829	5,840	5,832	6,272
Medium- and long-term loans	5,337	8,882	33,190	42,027	36,917	24,535	28,272
Official	1,667	2,939	10,996	11,258	10,732	11,685	12,959
Private	3,670	5,943	22,194	30,769	26,185	12,850	15,314
Net direct investment	1,225	2,976	6,009	7,981	7,244	5,868	5,731
Changes in reserves	-1,160	-7,547	488	126	13,547	7,372	-9,092
Middle Income Oil Exporters							
Net exports of goods and nonfactor services	-915	1,286	14,628	-10,713	-13,701	7,981	16,798
Net factor income	-2,207	-4,313	-16,186	-19,008	-23,982	-22,758	-24,823
Interest payments on medium- and long-term loans	693	1,296	11,454	13,903	16,660	17,463	21,252
Current account (excludes official transfers)	-2,930	-2,652	1,501	-27,302	-35,683	-11,052	-3,543
Financing							
Official transfers	595	1,213	2,008	2,483	1,919	1,917	1,809
Medium- and long-term loans	1,643	5,396	16,998	23,559	20,503	18,133	13,323
Official	762	1,433	4,800	4,706	5,314	3,660	6,194
Private	881	3,963	12,198	18,853	15,190	14,473	7,129
Net direct investment	890	1,312	4,192	6,369	5,283	3,717	2,922
Changes in reserves	-309	-2,884	-15,602	4,730	17,542	3,549	-7,339
All Developing Countries							
Net exports of goods and nonfactor services	-9,717	-6,772	-53,582	-78,853	-60,308	-15,754	14,399
Net factor income	-5,486	-9,477	-39,255	-51,828	-64,553	-66,449	-75,871
Interest payments on medium- and long-term loans	2,624	5,086	32,851	41,161	48,014	46,596	57,925
Current account (excludes official transfers)	-12,442	-9,122	-67,844	-105,645	-100,373	-56,665	-35,588
Financing							
Official transfers	2,350	4,668	11,638	12,246	11,159	11,769	11,959
Medium- and long-term loans	8,243	16,333	58,414	71,675	63,575	48,778	50,162
Official	3,646	5,972	21,572	21,665	21,786	20,810	25,606
Private	4,596	10,361	36,842	50,011	41,788	27,969	24,556
Net direct investment	2,317	4,436	10,595	14,992	13,237	10,342	9,383
Changes in reserves	-1,534	-10,804	-13,180	6,292	27,907	6,868	-19,008

Note: Data are based on a sample of 90 developing countries (for country coverage, see Technical Note).

/a Estimated.

/b Projected

The changing nature of capital

2.32 Two major shifts in international capital have occurred in the past two decades: from equity to debt, and from official to private finance (see Figure 2.1). The more advanced developing countries obviously obtained the bulk of commercial capital. However, even in low-income countries the share of private flows (including trade finance) increased. In low-income Africa, it did so in the mid-1970s; in low-income Asia, only after 1979.

2.33 Official supplies of foreign capital, concessional and nonconcessional, provided 50 percent of all the developing countries' inflows in 1970; for the low-income countries, their share was 78 percent. By 1983, these figures had fallen to 46 percent and 45 percent respectively (see Table 2.3). Even in nominal terms, official ODA has fallen since 1980; by contrast it rose sharply after the first rise in oil prices, by almost 80 percent (or 21 percent a year) between 1973 and 1976. Taking bilateral ODA alone, in the 1970s it declined as a proportion of total inflows for every group of developing countries--and fastest of all for the low-income countries. The falling share of bilateral aid was partly offset by more multilateral flows, particularly for low-income countries. In the 1980s, retrenchment by developing countries cut the supply of counterpart domestic finance, so even multilateral aid declined.

2.34 The weight of foreign capital in the recipients' economies was considerable. During the 1970s, gross receipts of medium- and long-term loans financed between 15 and 20 percent of gross domestic investment in developing countries. There were, however, great variations among groups. Total capital flows, public and private, averaged 1 percent of the GNP of low-income Asia, varying little from year to year. In low-income Africa--much more dependent on external capital--the ratio increased in the mid-1970s. It was six times

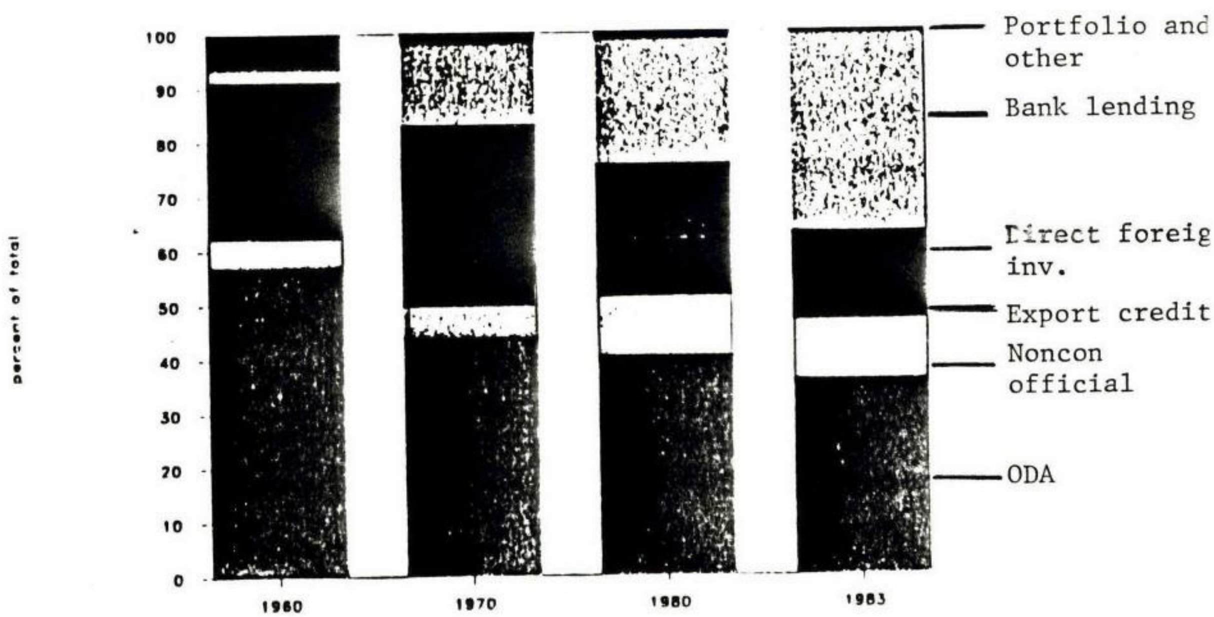
Table 2.3 Total net resource receipts of developing countries from all sources, 1970-83

	1970	1975	1980	1981	1982	1983
I. ODA	8.1	20.1	37.5	37.3	34.7	33.6
1. Bilateral	7.0	16.2	29.7	29.4	27.2	26.1
2. Multilateral	1.1	3.9	7.8	7.9	7.5	7.5
II. Grants by private voluntary agencies	0.9	1.3	2.3	2.0	2.3	2.2
III. Nonconcessional flows	10.9	34.3	59.4	70.5	60.4	63.9
1. Official or officially supported	3.9	10.5	24.5	22.2	22.0	19.6
a. Private exports credits (DAC)	2.1	4.4	11.1	11.3	7.1	5.5
b. Official exports credits (DAC)	0.6	1.2	2.5	2.0	2.7	2.1
c. Multilateral	0.7	2.5	4.9	5.7	6.6	7.0
d. Other official and private flows (DAC)	0.2	0.8	2.2	2.0	2.6	3.0 (1)
e. Other donors	0.3	1.6	3.8	1.2	3.0	2.0 (1)
2. Private	7.0	23.8	34.9	48.3	38.4	44.3
a. Direct investment	3.7	11.4	10.5	17.2	11.9	7.8
b. Bank sector (2)	3.0	12.0	23.0	30.0	26.0	36.0
c. Bond lending	0.3	0.4	1.4	1.1	0.5	0.5
Total 19.9	55.7	99.2	109.8	97.4	99.7	
Memo items:						
Short-term bank lending	..	..	26.0	22.0	15.0	-2.0
IMF purchases (net)	0.3	3.2	2.6	6.2	6.4	12.4

Source: OECD, Development Assistance Committee (DAC)

(1) Estimates
(2) Excluding bond lending and export credits extended by banks which are included in private export credits

Figure 2.1 Net flows to developing countries by type, 1960-83



greater than in low-income Asia in the mid-1970s, seven times greater in 1979-81. In low-income Asia, gross medium- and long-term disbursements were equal to 4.9 percent of gross domestic investment in 1980. Among the middle-income countries, the major exporters of manufactures financed only 18 percent of their domestic investment in the 1970s by medium- and long-term flows, whereas for other middle-income oil importers the ratio was almost a third.

2.35 The increased lending by commercial banks was the main reason for the dramatic increase in external financing. Accordingly, although private direct investment continued to increase in nominal terms, its share in total external finance declined from 20 percent in 1970 to less than 9 percent in 1983. The increase in commercial bank lending was accompanied by a large increase in export credits, which maintained their share of total foreign financing between 1970 and 1980. In the early 1980s, however, export credits declined sharply.

2.36 The growth of borrowing during the past ten to fifteen years has produced a corresponding rise in external debt. Between 1970 and 1984, the outstanding medium- and long-term debt of developing countries, as recorded in the World Bank's Debtor Reporting System (DRS), increased from $66 billion to $686 billion, an average increase of 16.6 percent a year. The 1984 figure is inflated by an estimated $25 billion of short-term liabilities consolidated into long-term debt through reschedulings. Including countries not covered by the DRS, as well as short-term debt borrowings from the International Monetary Fund, the total external liabilities of all developing countries reached almost $900 billion in 1984 (see Box 2.2).

2.37 Debt-service payments increased from $9.3 billion in 1970 to $97 billion in 1984. While interest payments were about one-third of total debt service in 1970, they had increased to over one-half in 1984. The rise reflects both the increased amount of debt and also the higher level of interest rates.

2.38 The terms that developing countries obtained on medium- and long-term finance changed significantly during the 1970s. The average maturity of their total debt shortened from 20.4 years in 1970 to 14.2 years in 1982, because private loans (the fastest growing component) carried shorter maturities--8.2 years in 1983. The reduction in grace periods was less dramatic, from 5.5 years in the 1970s to 3.9 years in 1983. In 1983, the average maturity and grace periods for new lending were the shortest ever recorded for developing countries.

2.39 Among the important changes in the structure of developing countries' debt was the increasing use of floating-rate loans and of debt denominated in dollars.

o The share of floating-rate debt in total outstanding disbursed debt rose from 16 percent in 1973 to 43 percent in 1983. The increase was concentrated among the middle-income countries, particularly in Latin America, which borrowed heavily from private sources. For low-income countries, the share of variable-rate debt did not increase much (see Table 2.4). Interest rates on new long-term loans to public borrowers, which had averaged 8.8 percent in 1974-76, increased to an average of 13.3 percent in 1980-82 before falling to about 10 percent in 1984 (see Figure 2.2).

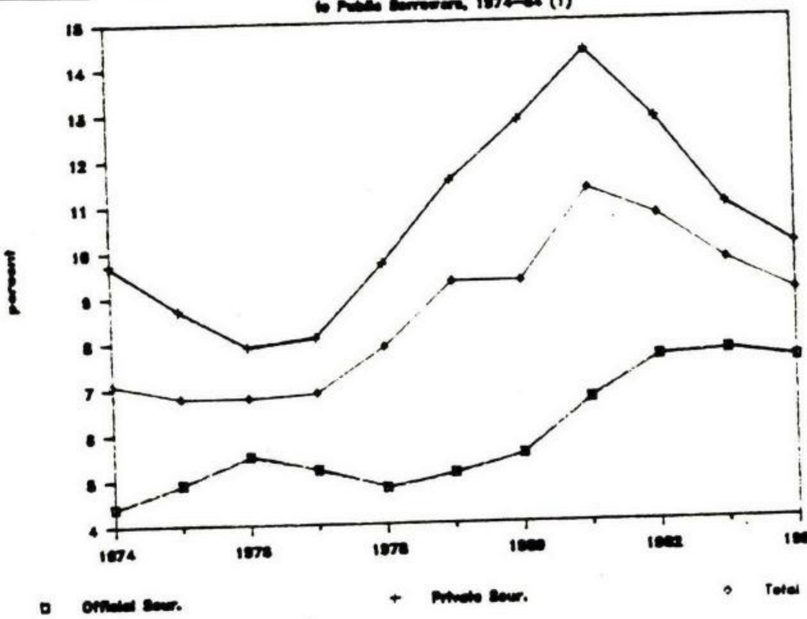
o The share of long-term public and publicly guaranteed debt denominated in dollars rose from 65 percent in 1974 to 76 percent in 1983 (see Table 2.5). Again, there were regional differences: the ratio was almost 90 percent for Latin America, 68 percent for East Asia and only 54 percent for sub-Saharan Africa. For many countries, the rise in the dollar has increased the cost, in terms of domestic goods, of servicing the debt. The desirability

Table 2.4 Share of floating interest rate loans, 1974-83
(percent of total)

	1974	1976	1978	1979	1980	1981	1982	1983
Low-income Asia	-	-	0.4	0.6	1.8	2.9	3.3	3.9
Low-income Africa	8.5	8.1	6.7	6.8	7.0	9.4	9.1	7.6
Middle income								
Oil importers	18.5	26.6	30.3	35.2	36.5	40.2	41.4	43.7
Oil exporters	23.9	30.4	34.9	40.1	41.7	45.2	48.3	54.6
All developing countries	16.2	23.0	27.3	31.8	33.2	36.7	38.7	42.7
Memo item: Major Borrowers	18.4	26.8	32.5	39.0	40.5	45.0	46.7	51.2

Source: World Bank.

Figure 2.2 Interest On New Long-Term Commitments
to Public Borrowers, 1974-84 (1)



Source: World Bank, Debtor Reporting System (DRS).

1/ Defined as the weighted average interest on new loans at the time of commitment. For loans on floating interest rates, interest actually paid will vary with changes in market rates.

2/ Estimates from a biased sample accounting for no more than a quarter of total commitments in 1984.

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Table 2.5 Shares of key currencies (by currency of denomination) in public long-term debt: 1974-83
(percentages)

Currency	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
U.S. dollars a/	65.1	69.0	70.3	67.8	64.8	66.8	68.1	71.8	73.4	76.3
Deutsche mark	8.8	7.3	7.6	8.2	9.2	8.6	7.3	6.3	6.0	4.8
Japanese yen	3.8	3.8	4.1	5.4	7.2	5.9	6.9	6.2	6.0	6.0
French francs	4.3	4.3	4.1	4.4	4.8	4.9	4.6	3.8	3.6	2.9
Pound sterling	5.6	4.3	3.3	3.1	2.7	2.5	2.3	1.9	1.6	1.5
Swiss franc	0.8	0.7	0.8	1.1	1.6	1.5	1.3	1.4	1.3	1.0
Canadian dollars	1.5	1.5	1.5	1.3	1.1	1.1	1.1	1.1	1.0	0.9
Others	10.1	8.9	8.4	8.6	8.7	8.8	8.4	7.6	7.2	6.5
Total	100	100	100	100	100	100	100	100	100	100

Source: World Bank.

a/ The share of U.S. dollars includes "multiple currency" lending, predominantly in dollars, at variable interest rates, and accounting for an 8-10 percent share of external debt during 1974-83. The share of U.S. dollars is therefore an "upper bound," but the trend is unaltered, with the dollar's share rising by 11 percentage points in a decade.

of developing countries diversifying the currency composition of their borrowings and debt is discussed in Chapter 5.

Trade and debt indicators

2.40 As a group, developing countries expanded their exports considerably in the 1970s, from about 13 percent of their GDP in 1970 to over 23 percent in 1983. In low-income Africa, however, the share of exports in GDP fell steeply. Then the world recession of 1981-82 reduced commodity prices, and slowed the growth in the volume of developing countries' exports. The volume of oil exports fell, as did the oil price, hitting the middle-income oil exporters. The economic recovery since 1983 has raised the growth of exports, but the terms of trade of developing countries have deteriorated since 1980 (details of trade are in Annex I/Tables 2 and 5).

2.41 The composition of the developing countries' exports has also changed considerably over the past two decades. The share of manufactures rose from about 15 percent of the total in the early 1960s to nearly 50 percent in the early 1980s, while the relative importance of all primary products declined. While this greater diversity of exports has reduced the vulnerability of developing countries to world recession, the increased share of manufactures has made them more vulnerable to protectionism in the industrial countries.w

2.42 Despite this robust export performance, the rapid growth of borrowing combined with big increases in interest rates contributed to the deterioration in the main debt indicators (see Table 2.6). For all developing countries, the ratio of debt service to exports for all developing countries rose from 15 percent in 1970 to 21 percent in 1982 then declining slightly to 19.6 in 1984; the ratio of debt to GDP increased from 14.0 percent in 1970 to 33.8 percent in 1984. The ratio of debt to exports also increased, from 109 percent (1970) to 135 percent (1984); and the ratio of interest payments to GDP more than quintupled, from 0.5 percent in 1970 to 2.8 percent in 1984.

Table 2.6 Debt indicators for developing countries, 1970-1984

	1970	1974	1976	1978	1980	1981	1982	1983	1984
All developing countries									
Ratio of debt to GNP (%)	14.1	15.4	18.1	21.0	20.9	22.4	26.3	31.0	33.8
Ratio of debt to exports (%)	108.9	80.0	100.2	113.1	89.8	96.8	115.9	130.7	135.2
Debt service ratio (%)	14.7	11.8	13.6	18.4	16.0	17.6	20.5	19.0	19.6
Ratio of interest service to GNP (%)	0.5	0.8	0.8	1.1	1.6	1.9	2.3	2.3	2.8
Total debt outstanding and disbursed ($b)	68	141	204	313	430	488	546	620	686
(of which: % share of private)	(50.9	(56.5)	(59.0)	(61.5)	(62.9)	(64.1)	(64.6	(65.8)	(65.0)
Low-income Asia									
Ratio of debt to GNP (%)	7.0	7.2	8.2	7.8	7.8	8.1	8.8	9.0	9.7
Ratio of debt to exports (%)	183.6	128.4	131.6	120.7	96.7	89.5	95.1	98.9	99.9
Debt service ratio (%)	12.4	7.8	7.7	7.2	8.0	9.3	10.9	8.3	8.4
Ratio of interest service to GNP (%)	0.2	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Total debt outstanding and disbursed ($b)	12	18	22	29	38	40	43	46	53
(of which: % share of private)	(6.9)	(5.4)	(4.1)	(5.6)	(17.3)	(14.7)	(13.6)	(13.9)	(18.7)
Low-income Africa									
Ratio of debt to GNP (%)	17.5	23.8	27.7	26.9	39.8	43.4	47.7	52.0	54.5
Ratio of debt to exports (%)	75.2	99.5	135.3	162.3	175.8	216.5	260.6	282.8	280.6
Debt service ratio (%)	6.1	8.6	8.5	9.6	12.5	13.8	15.7	16.7	20.1
Ratio of interest service to GNP (%)	0.5	0.7	0.6	0.7	1.3	1.2	1.1	1.4	2.1
Total debt outstanding and disbursed ($b)	3	7	10	15	21	23	24	25	27
(of which: % share of private)	(33.5)	(39.3)	(36.6)	(38.9)	(29.8)	(29.3)	(26.9)	(22.4)	(18.1)
Major exporters of manufactures									
Ratio of debt to GNP (%)	16.2	18.0	20.1	22.1	22.8	24.7	27.9	34.4	37.6
Ratio of debt to exports (%)	91.5	76.0	90.9	92.4	77.3	81.7	97.1	105.2	109.1
Debt service ratio (%)	15.1	13.7	14.2	17.7	16.1	17.1	19.3	16.2	16.0
Ratio of interest service to GNP (%)	0.7	1.1	1.1	1.4	2.0	2.5	2.9	2.9	3.6
Total debt outstanding and disbursed ($b)	24	57	82	124	167	191	216	242	267
(of which: % share of private)	(73.2)	(75.5)	(75.9)	(76.7)	(77.0)	(77.8)	(78.6)	(78.5)	(76.9)
Other middle-income oil importers									
Ratio of debt to GNP (%)	21.4	20.3	21.1	24.9	29.7	33.4	40.2	47.5	53.0
Ratio of debt to exports (%)	111.0	88.7	98.3	122.7	120.7	136.4	155.4	175.5	183.9
Debt service ratio (%)	13.6	11.4	14.8	20.9	17.2	20.8	22.7	23.1	24.9
Ratio of interest service to GNP (%)	0.8	0.9	1.0	1.3	1.9	2.4	3.1	3.3	3.9
Total debt outstanding and disbursed ($b)	12	21	27	43	68	79	89	98	108
(of which: % share of private)	(42.9)	(42.1)	(43.8)	(47.8)	(51.0)	(51.6)	(51.5)	(49.6)	(49.0)
Middle-income oil exporters									
Ratio of debt to GNP (%)	18.4	18.0	22.4	30.1	24.7	24.9	32.0	39.6	43.9
Ratio of debt to exports (%)	115.3	67.2	102.1	136.0	87.4	98.5	123.3	157.0	163.4
Debt service ratio (%)	18.1	11.0	14.5	22.9	17.8	19.8	25.0	26.0	27.9
Ratio of interest service to GNP (%)	0.7	0.9	1.1	1.6	2.1	2.2	3.1	3.3	4.0
Total debt outstanding and disbursed ($b)	18	38	63	103	136	155	174	208	232
(of which: % share of private)	(57.2)	(63.3)	(66.5)	(67.7)	(69.4)	(71.2)	(71.8)	(75.3)	(75.0)

Source: World Bank.

2.43 There were, however, major differences among developing countries. With the exception of low-income Asia, the debt-GDP ratio increased significantly for all groups. The rise was sharpest for low-income Africa, from 18 percent in 1970 to 55 percent in 1984. Although the absolute size of Africa's debt is small--$27 billion in 1984--in relation to income and exports it is the highest among developing countries.

Reschedulings

2.44 Although about 100 developing countries have avoided debt difficulties so far in the 1980s, the deterioration in debt indicators was reflected in a spate of debt reschedulings. The number of formal reschedulings for World Bank members rose from an average of fewer than four a year in 1975-80 to thirteen in 1981 and thirty-one (involving twenty-one countries) in 1983. At least that number of debt negotiations took place in 1984; but formal agreement was reached on only twenty-one, involving sixteen countries and just over $11 billion by the end of the year. Although more than $115 billion was under negotiation in 1984, three countries--Argentina, Mexico and Venezuela--accounted for $93 billion, four-fifths of the total.

2.45 Creditors have rescheduled debt on a case-by-case basis, mostly through the adaptation of well-established channels (see Box 2.3). The terms of reschedulings were generally easier in 1984 than in 1982 and 1983. Maturities and grace periods were generally longer; spreads over the London Interbank Offered Rate (LIBOR) on rescheduled debt ranged from 1-7/8 to 2-1/2 percentage points in 1982 and 1983, but fell to 1-1/8 to 2 percentage points in 1984. Rescheduling fees are also known to have declined.

2.46 The approach to reschedulings has varied, mainly in response to the concerns of the commercial banks. They have wanted assurances of the soundness of countries' policies. Multilateral institutions--and particularly the IMF--have been involved in designing packages which included policy reforms, debt restructurings and new money. Central banks have made important contributions, either indirectly through the Bank for International Settlements (BIS) or directly, as in the case of the Federal Reserve Board. Latin American debtors have been the main beneficiaries of this approach. A path-breaking multi-year rescheduling of $49 billion of Mexico's debt to commercial banks was agreed in principle in 1984; this was followed by a multi-year rescheduling of $21 billion of Venezuela's debt. At the end of 1984 discussions were in progress on a multi-year rescheduling of about $50 billion of Brazil's debt. These and other negotiated agreements have relieved the debt constraints on growth of some major borrowers. Despite this, some observers have suggested that debt difficulties need to be treated more radically (see Box 2.4).

2.47 Aside from the major borrowers, reschedulings have been on a year-by-year basis. In varying degrees they have involved official flows (including guaranteed export credits) from bilateral sources as well as commercial flows. Official debt has been rescheduled under the aegis of the Paris Club, often with parallel exercises for commercial debt. This approach has ensured equal treatment of creditors. It is also one which has been best suited to dealing with liquidity problems and restoring normal debt servicing in the expectation that a debtor's exports will recover.

2.48 However, year-by-year rescheduling has certain shortcomings. In 1983-84 alone, twenty-five countries (including Cuba and Poland) have rescheduled--mainly their guaranteed and insured export credits, which were originally provided by private lenders. These reschedulings have put great strains on the resources and solvency of export-credit and insurance agencies in creditor countries. In addition, a number of African countries have rescheduled. Their difficulties often arise from structural weakness, not from a short-term lack of liquidity. For them, as well as for middle-income countries that depend heavily on exports of primary commodities, rescheduling has not produced the benefits that Latin American countries have obtained. Only in the case of Sudan did a country's creditors and donors consider its long-term financing needs, in a meeting organized by the World Bank and the IMF. In a later meeting, the Paris Club members provided debt relief over an extended period.

Conclusion

2.49 During periods of global economic stability, such as the 1950s and 1960s, international finance has contributed significantly to economic growth. In periods of volatile change, such as the past fifteen years, it has played a dual role. On the one hand, it helped countries adjust to external shocks, as happened during the 1974-75 recession. On the other hand, it was an additional channel for the transmission of external shocks, as in the 1981-83 recession.

2.50 Within the total flows of capital to developing countries, shifts from equity to debt and from official to private sources were perhaps to be expected. As developing economies grow and their structures change, their relations with the world economy increasingly resemble those of the developed countries. As infrastructure projects require a smaller share of investment, as industry expands, as exports shift from primary to manufactured products, as the domestic financial system matures, so developing countries increase their ability to exploit opportunities in international financial markets.

2.51 However, the flow of private external capital to developing countries did not increase slowly, in line with their economic progress. It expanded suddenly in the 1970s and was accompanied by unprecedented imbalances in international payments. The potential for using foreign capital to expand investment was therefore limited by the immediate need to pay for dearer oil.

2.52 Despite the economic shocks of the past dozen years, some developing countries made enough progress to qualify for increased access to international financial markets under "normal" circumstances. Those that managed to avoid a debt crisis in the early 1980s had for the most part fulfilled the key prerequisites for commercial borrowing. They had a prolonged period of growth before entering the market, they had expanded their traded-goods sector, and had diversified exports. Although they borrowed heavily in the 1970s, they were able to withstand reasonably well the unprecedented rise in real interest rates, world recession and volatile exchange rates in the early 1980s. At the center of the historical experience and the outlook for the future, therefore, are the policies of industrial countries and developing countries. These are taken up in the next two chapters.

Box 2.1 The Bretton Woods Conference and its twin institutions

The International Monetary and Financial Conference of the United and Associated Nations was convened its Bretton Wood, New Hampshire on July 1, 1944. By the time the Conference ended on July 22, 1944, based on substantial preparatory work, it had defined the outlines of the postwar international economic system. The Conference also resulted in the creation of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD or the World Bank)--the Bretton Woods twins.

The World Bank was to assist in reconstruction and development by facilitating the investment of capital for productive purposes. The International Monetary Fund was to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income. Also discussed at Bretton Woods were plans for an International Trade Organization (ITO). This institution did not materialize, but some of its proposed functions are performed by the General Agreement on Tariffs and Trade (GATT) which was established at a later date.

The discussions at Bretton Woods took place with the experience of the interwar period as background. In the 1930s, every major country sought ways to defend itself against deflationary pressures from abroad--some by exchange depreciation, some by introducing flexible exchange rates or multiple rates, some by direct controls over imports and other international transactions. The disastrous consequences of such policies--economic depression with very high unemployment--is well known. The participants in the Bretton Woods Conference were determined to design an international economic system where the "beggar-my-neighbor" policies which characterized the international economic community when World War II began, did not recur. There was also a widespread fear that the end of World War II would be followed by a slump, as had the end of World War I.

Thus, the central elements of the system outlined at Bretton Woods were the establishment of convertibility of currencies and of fixed but adjustable exchange rates, and the encouragement of international flows of capital for productive purpose. The IMF and the World Bank were to assist in the attainment of these objectives. The economic accomplishments of the postwar period are in part the result of the effectiveness of these institutions.

Box 2.2 External liabilities of developing countries

Both the quantity and quality of information on international finance have improved considerably in recent years. The main sources of information are:

The World Bank's Debtor Reporting System (DRS). Comprehensive data on debt with a maturity of more than one year, plus annual figures on commitments, disbursements, amortization and interest payments. Publication: World Debt Tables (annually).

Developing-country governments report public and publicly guaranteed debt on a loan-by-loan basis. Figures on private nonguaranteed debt are incomplete, so are supplemented by staff estimates. By convention the DRS excludes the use of IMF credit, which is treated as a "monetary movement" rather than a medium-term loan. For some low-income countries, however, obligations to the IMF are a large part of their nonconcessional external debt.

The International Monetary Fund's Balance of Payments Statistics. Comprehensive balance of payments data compiled according to the standards of the Balance of Payments Manual and reported periodically to the IMF. They include internationally comparable data on private- and public-sector grants and all capital flows, including direct investment, long-term borrowing, short-term borrowing and reserve movements. Publication: International Financial Statistics, Supplement on Balance of Payments (formerly, Balance of Payments Yearbook).

Both the DRS and the IMF data are limited by the ability of developing countries to marshall primary statistics. However, both have become more comprehensive in recent years, partly as a result of intensive technical assistance to member countries by both the Fund and the World Bank.

Information on debtors can usefully be supplemented by figures on creditors and bank lending. The main sources are:

The OECD. It obtains figures from (1) the annual aid questionnaire prepared by the 17 countries that are members of the Development Assistance Committee (DAC); this shows annual disbursements and repayments of official grants and loans to each developing country. (2) Its Creditor Reporting System, which provides loan-by-loan reports on all official long-term loans, plus summary information on export credits. The OECD estimates financial flows from OPEC and centrally planned economies, building on DRS data. It then prepares comprehensive estimates of developing-country debt.

Publications:

Development Cooperation and External Debt of Developing Countries (both annually).

The OECD figures on long-term intergovernmental loans are a valuable cross-check on DRS data. However, its figures on officially guaranteed export credits contain, in some instances, future interest due; and it excludes export credits that are not guaranteed in the creditor country. A more general drawback is that the OECD's primary statistics are not global in their coverage, although DAC countries are the chief source of financial flows to developing countries.

The BIS. It compiles figures on lending by banks in fifteen countries. A quarterly series classifies banks on a residency basis, and a six-monthly series on a nationality basis (that is, "United States loans" are those made by mainland American banks plus their offshore branches). The six-monthly series classifies loans by maturity, and so provides the main estimates of developing countries' short-term debt. Unfortunately, the figures are compiled according to the time remaining to maturity, so they are not comparable with DRS and OECD data, which document loans by their original maturity. Publications: International Banking Developments (quarterly); The Maturity Distribution of International Banking Lending (six-monthly).

IMF Banking Statistics. These collate international banking assets and liabilities. They are comparable to those of the BIS, but ultimately come from a wider group of banking centers. The figures were first published in 1984, as the first stage of a project to integrate all data on the external debt of developing countries. Publication: International Financial Statistics.

Joint OECD/BIS external debt project. A project designed to integrate data on (a) officially guaranteed trade-related bank credits collected by the OECD and (b) developing-country debt to commercial banks. So far, the project has eliminated the duplication of figures on officially-guaranteed export credits extended by banks, which had appeared in both sets of data. Publication: OECD, Development Cooperation (1984 Review).

Table External liabilities of developing countries 1980-85
(billions of U.S. dollars)

Country group	1980	1981	1982	1983[a]	1984[b]	1985[b]
DRS Reporting countries[c]	540	629	699	760[e]	810[f]	880
Long-term debt[d]	412	470	525	598[e]	655[f]	710
from official sources	160	174	191	209	225	245
from private sources	252	296	334	388[e]	430[f]	465
Short-term debt[g]	119	145	155	134[e]	122[f]	
						{170
Use of IMF credit[h]	9	14	19	29	33	
Other developing countries[i]	70	73	76	82	85	90
Long-term debt[d]	59	58	57	60	62	64
from official sources	17	18	19	20	20	21
from private sources	42	40	38	40	42	43
Short-term debt[g]	11	15	16	20	20	
						{26
Use of IMF credit[h]	0	0	3	2	3	
Total	610	702	775	843	895	970
Memo item						
Growth of total liabilities (percent)	n.a.	15.1	10.4	8.8	6.2	8.4

a. Data for 1983 are preliminary.
b. Data for 1984 and 1985 are estimated.
c. Includes data for 104 developing countries for which standard and complete reporting is made through the World Bank's Debtor Reporting System (DRS).
d. Debt of original maturity of more than one year.
e. Reflects the rescheduling of $22 billion of short-term to banks into long-term debt during 1983.
f. Reflects the rescheduling of $25 billion of short-term debt to banks into long-term debt during 1984.
g. Debt of original maturity no more than one year. Data are estimated from information on bank claims on developing countries as reported by the Bank for International Settlements, and are amended to take account of information on short-term debt reported by individual developing countries.
h. Excludes loans from the IMF Trust Fund; they are included in medium-term and long-term debt.
i. Includes data for developing countries that do not report through the DRS and for those that either have reported inconplete data through the DRS, or report in a form that does not admit publication in the standard tables. Excludes debt of the high-income oil-exporting countries, and includes estimates for developing countries that are not World Bank members but are included in the global analysis underlying the World Development Report.

Box 2.3 Changing nature of debt renegotiations

There are two institutional arrangements for debt relief: the Paris Club for debts to governments and guaranteed export credits; and consortia of commercial banks (sometimes called the London Club) for uninsured debts to financial institutions. The Paris Club was born in 1956 when a group of creditor countries met in Paris to renegotiate Argentine debt. Although the Club has no written rules, it has evolved a standard approach based on experience and precedent. By contrast, formal renegotiations with commercial banks have really developed only since the late 1970s.

o The Paris Club. The scope of its debt relief has been extended to cover service on all bilateral loans (including concessional credits) in addition to guaranteed export credits. Consolidation periods are normally for only one year, but follow-up agreements are common: debt relief has been extended continuously for five to ten years to Liberia, Senegal, Sudan, Togo and Zaire. Previously rescheduled debt is now consolidated if circumstances require. In this way, the Paris Club, while still considering debt relief in the context of short-term liquidity problems, has attempted to address the more deep-seated problems of sub-Saharan Africa.

Debt relief is normally restricted to current maturities. The proportion rescheduled varies from 80 to 100 percent. This consolidated portion is repaid over eight to ten years, with a grace period of four to five years. For countries with severe balance-of-payments problems, the nonconsolidated portion may be repaid over the grace period; in such cases, debt relief approaches 100 percent of eligible maturities. Arrears are occasionally rescheduled, but they are normally repaid at a faster rate.

An essential condition for Paris Club relief is an effort by the debtor country to address its underlying economic problems. An IMF program with upper credit-tranche availability is therefore a pre-requisite to a Paris Club agreement, and follow-up debt relief requires continued eligibility for IMF resources.

Paris Club arrangements present difficulties for countries that have had three or more successive reschedulings. Their amortization payments start to bunch up as the series of eight- to ten-year repayment schedules overlap. The Paris Club's response has been to reschedule previously rescheduled debt. This procedure capitalizes interest on rescheduled debt--eliminating the immediate liquidity pressure, but adding to the ultimate debt-service burden.

Moratorium interest can also be a problem for Paris Club procedures. On the one hand, interest on rescheduled bilateral loans can be highly concessional; but interest on rescheduled commercial credits are based on the current cost of funds to each export-credit agency. Recently, several agencies--and some governments--have shifted moratorium interest from a fixed to a floating rate. Countries with serious debt difficulties have therefore become more exposed to fluctuations in world interest rates.

o <u>Commercial bank debt</u>. Since the bulk of this debt consists of syndicated loans, and the number of creditor banks may be in the hundreds, the banks are represented by an "advisory" committee which negotiates with the debtor-country government. When they reach an agreement, it must be approved by each creditor bank.

Commercial banks reschedule mainly current maturities of long-term debts, and occasionally arrears of principal as well. They do not reschedule interest; any arrears of interest must be settled before rescheduling agreements become effective. Some agreements have consolidated short-term debts. In many recent reschedulings, fresh long-term loans and trade-credit facilities have been extended as part of a debt-relief package, in effect offsetting interest payments. The negotiations have been flexible; some have arranged year-to-year deferments of debt while comprehensive longer-term agreements were still being discussed. Repayment of consolidated debt ranges from six to nine years, including two to four years grace. Interest charges vary from a margin of 1-7/8 to 2-1/4 points over LIBOR. Debt rescheduling is normally accompanied by a commission charge of 1-1/4 to 1-1/2 percent.

Year-to-year rescheduling has effectively overcome immediate debt-servicing difficulties, but it leaves uncertainty over the debtor's future position which can prevent it returning to normal market financing. In Mexico's case, the commercial banks agreed in principle in September 1984 to consolidate public-sector debts falling due in 1985-90 and accept repayment over fourteen years. A similar agreement was reached with Venezuela shortly afterwards, and an agreement with Brazil is in the final stages of negotiation. These multiyear agreements are reserved for countries that have made substantial progress in adjusting their balance of payments.

Table Multilateral debt renegotiations, 1975-84
(millions of U.S. dollars)

	Number of renegotiations 1975-84	1975-1980		1981		1982		1983		1984	
		Paris Club	Commercial bank	Paris Club	Commercial bank	Paris Club	Commercial bank	Paris Club	Commercial bank	Paris Club	Commercial bank signed or agreed in principal
Argentina	2		970								(23,241)
Bolivia	2				444						(536)
Brazil	3							(3,478)	(4,532)		(5,350)
Central African Rep.	2			55				(13)			
Chile	2	216							(3,400)		
Costa Rica	2							97	1,240		
Dominican Republic	1								497		
Ecuador	4							(200)	(1,835)		(5,065)[b]
Gabon	1	105[a]									
Guyana	3		29				14				(24)
Honduras	1										(122)
India	3	436[c]									
Ivory Coast	2									(153)	(306)
Jamaica	4		126		103					(106)	(148)
Liberia	6	30		25			27	18		(17)	(71)
Madagascar	4			142		103				(120)	(195)
Malawi	3					24		(30)	59		
Mexico	3							1,550[d]	(23,625)		(48,725)[c]
Morocco	3							1,225	475		(530)
Mozambique	1									(200)	
Nicaragua	3		582		188		102				
Niger	3							33		(22)	28
Nigeria	1								(1,920)		
Pakistan	1			263[c]							
Peru	6	478	821					(450)	(380)	(1,000)	(1,415)
Philippines	2									(685)	(4,904)
Romania	4					(234)	(1,598)	(195)	(567)		
Senegal	4			77		84		64			(97)
Sierra Leone	4	68								88	(25)
Sudan	5	373			638	174		502		(245)	
Togo	6	170	68	(92)				114	74	(55)	
Turkey	5	4,696[c]	2,640		3,100						
Uganda	2			(56)		(22)					
Uruguay	1								(815)		
Venezuela	1										(20,750)
Yugoslavia	4							(988)[d]	(1,586)	(500)[d]	(1,246)
Zaire	6	1,594	402	574				(1,317)			
Zambia	3							(285)		(150)	(75)
Total	113	8,166	5,638	1,284	4,473	641	1,741	10,559	41,005	3,341	112,853

Note: Data cover arrangements expected to be signed by the end of 1984 plus commercial bank reschedulings agreed in principle but not signed through December 31, 1984. Figures indicate renegotiated amounts as reported by the countries or, if in parenthesis, as estimated by staff members. Cuba and Poland, which also renegotiated debt-service payments with official creditors and commercial banks are not members of the World Bank and therefore are included from this table.

a. Denotes an agreement of a special task force.
b. Includes one agreement (for $590 million) signed, and another agreed in principle.
c. Denotes an Aid Consortium Agreement.
d. Technically this was an agreement of a creditor group meeting, not a Paris CLub.
e. Includes debt of $23,625 million previously rescheduled in 1983.

Box 2.4 Recent proposals for dealing with debt servicing difficulties

Numerous "solutions" have been offered for the "debt crisis". They can best be evaluated by considering four elements which go the heart of the relationship between debtors and creditors.

o The distinction between the collective interests of creditors and their individual interests. If the creditors of debtor countries cannot be paid full debt service, it is in their collective interest to defer payment--perhaps even to forgive part of the payment--rather than provoke a moratorium or repudiation by debtors. Individual creditors, however, have an incentive to hold out for repayment, in effect by being bought out by other parties. Any debt-reform scheme must provide an answer to this "free rider" problem. Some of the proposals advocate a once-for-all restructuring of developing countries' debt into long-term low-interest loans. Most proposals argue that debts should be taken over by a new international agency.

o Limits to debt service. Debtor countries have now shown their ability to run big trade surpluses to service their debt. For some countries, at their present levels of development, it may be difficult to keep running trade surpluses large enough to pay all interest, particularly if interest rates rise. So a feasible debt-reform plan must not only reschedule all principal; in some cases, it may also have to reduce the current interest burden.

In order to reschedule principal, most proposals suggest that bank loans should be converted into some other long-term asset, particularly long-term bonds. To reduce the burden of interest payments, some proposals argue for relending interest; others suggest an automatic process of relending interest by capitalizing interest payments. A few proposals advocate new instruments--such as replacing fixed claims on a country with shares in country's foreign-exchange earnings, or with equity in state-run enterprises.

o Continuing uncertainty. Any scheme that attempts to settle the debt problem at a stroke must either reduce the expected burdens on countries so much that a second rescue will not be needed; or it must make some allowance for future contingencies, such as world recession or higher interest rates. It must also offer inducements for banks to keep lending in the future.

Several proposals contain measures to deal with uncertainty, ranging from stabilization funds for fluctuations in oil prices and interest rates to establishing a formal insurance scheme to avoid another crisis. It is less clear how these proposals ensure future lending by banks.

o Maintaining the solvency of the banking system. Major banks hold claims on developing countries equal to several times their capital. Any scheme which implies a large write-down of debt must therefore provide for the continued operation of these banks. Most proposals attempt to minimize write-downs, so that banks remain solvent. Others include the use of official capital to buy part of developing-country debt.

The current debt strategy has an answer for each of these four issues. Abstracting from important details, it deals with the free-rider problem through *ad hoc* pressure and suasion on banks; it relies on conventional reschedulings to reduce the interest burden by relending; it copes with uncertainty by keeping the banks involved, and therefore it preserves the ability to demand additional loans from existing creditors; and it copes with the solvency problem by avoiding write-downs. There is no reason in principle why this strategy cannot work. So far it has worked better than many had expected.

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