WORLD BANK AND THE DEVELOPING COUNTRIES : A STUDY OF ITS LENDING POLICIES IN THE 1980s.

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DAMITA GULIANI

CENTRE FOR INTERNATIONAL POLITICS
ORGANIZATION AND DISARMAMENT
SCHOOL OF INTERNATIONAL STUDIES
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI-110067, INDIA

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जवाहरलाल नेहरू विश्वविद्यालय
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI - 110067

Centre For International Politics,
Organization and Disarmament
School of International Studies

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CERTIFICATE

Certified that this dissertation entitled **"World Bank and The Developing Countries : A Study of Its Lending Policies in the 1980s"**, submitted by Ms. Damita Guliani in partial fulfillment of nine credits out of the total requirement of twenty four credits for the award of the degree of Master of Philosophy (M.Phil) of this University is her original work and has not been submitted for the award of any other degree of this University or any other Institute.

I recommend that this dissertation should be placed before the examiners for final evaluation.

Sumitra Chishti
Prof.(Mrs.) Sumitra Chishti
(Chairperson)

Sumitra Chishti
Prof.(Mrs.) Sumitra Chishti
(Supervisor)

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Last, indeed, is my esteemed respect for my parents for their unfailing patience and support to me.

However, I am totally responsible for any
error that might have crept into this dissertatio

Damita Gul

July, 1991
New Delhi

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C O N T E N T S

I N T R O D U C T I O N

The Great Depression of the Thirties had dislocated the world economy. The World War II that followed the depression, further aggravated the adverse developments in the world economy. Therefore, it was realized by a number of countries specially the leading ones, i.e., the United States and United Kingdom, the necessity of restructuring the world economy based on multilateral cooperation. This cooperation was expected to be achieved by establishing certain principles and procedures to govern the world economic relations. It was found most suitable to achieve this objective by establishing inter-governmental multilateral institutions to govern the world economy. A serious effort was made to establish a series of international economic institutions to achieve the objective. The prominent among them are the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), together known as the Bretton Woods twins, and the International Trade Organization (ITO). The IMF was expected to manage the international monetary system, while the Bank was to assist the reconstruction of war devastated countries and assist the development endeavour of developing countries; and the ITO was to take care of world trading arrangements. However, due to non-ratification of the ITO by the United

States, the ITO did not come into existence. Hence a less ambitious arrangement was made carving out a portion of ITO which came to be known as General Agreement on Tariff and Trade (GATT), to manage the world trade.

Over the last four and a half decades, these multilateral institutions and arrangements have functioned with varying degrees of success in achieving their objectives. But by far the World Bank* has emerged as the most dominant institution in directing the development programmes of developing countries. Its importance has grown in the decade of eighties when it has increasingly used its lending capacity to redirect the economic policies and strategies of developing countries.

The purpose of this dissertation is to study the lending policies of the World Bank to the developing countries especially in the eighties. This study confines to lending policies of the World Bank and does not deal with the Bank's two affiliates - the "soft loan" affiliate, the IDA and the private sector-oriented affiliate, the IFC.

Chapter-I is devoted to study the nature, inception and purpose of the Bank. As the name suggests,

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* Unless otherwise noted, the expression "the World Bank" or "the Bank" refers to International Bank for Reconstruction and Development (IBRD) alone, excluding its affiliates, the International Development Association (IDA) and International Finance Corporation (IFC).

reconstruction and development were to be its most important tasks. The Chapter details out the evolution, objectives, the organizational structure of the Bank, policy formulation, executive supervision and decision-making.

Chapter-II gives an insight into the changing pattern of World Bank lending since its inception. It is an endeavour to analyse the nature, purpose and priorities of lending in different activity sectors.

Chapter-III deals with the lending policies of the World Bank in the eighties, with special reference to Structural Adjustment Lending (SAL), its purpose, nature and sectoral types of SAL. A comprehensive evaluation of SAL programme is made as it is the central issue of this research.

In addition to the discussion of SAL, the attention is also focused on the new lending instrument of the World Bank called sector-adjustment lending. It also covers the study of the poverty alleviation programmes. An analysis of the co-financing programmes of the World Bank in the eighties has also been covered in the Chapter.

Chapter-IV gives an assessment of the World Bank lending policies since it began lending operations till the end of the 1980s.

Finally, Chapter-V gives the overall conclusions.

CHAPTER - I

EVOLUTION, NATURE AND PURPOSE

Evolution

The establishment of the International Bank for Reconstruction and Development (IBRD) under the Bretton Woods Charter of 1944, was a landmark in the history of international economic system. The realization that large sums of international finance would be required for the reconstruction of productive activities that had been destroyed during the war and also to enable the developing countries to increase their productivity and to improve the living standards of their inhabitants led to the beginning of a new era of "development with foreign aid." Economic assistance for development on a gigantic scale and more particularly of a multilateral character was in fact initiated by the Bank. However, it was the culmination of a series of events in the history of international monetary affairs that ultimately led to the establishment of the two multilateral institutions called the International Monetary Fund and the International Bank for Reconstruction and Development.

In the late nineteenth century and before the outbreak of the First World War (1870-1914), it was the 'gold-standard' around which the world monetary system revolved. The major countries of the world including Germany and United Kingdom adhered to this system whereby gold coins were in circulation and exchange arrangements were done under this gold-standard. Also, the supply of money to a particular country, balancing of price and cost relationships and balance of payments equilibrium among the various countries were determined according to the supply of gold.

The world economic scene just before the First World War was that London became the centre of all economic activity due to industrial revolution and had a highly developed capital market. As a consequence, pound sterling became highly developed and was being widely used as an international means of payment. However, with the outbreak of the war, gold standard had to be abandoned and many countries witnessed widespread inflation. With the termination of the war, there was relaxation in exchange control and the exchange value of most currencies depreciated in terms of gold. A number of monetary conferences were held during the post war period (Brussels in 1920 and Genoa in 1922) as an effort to evolve an acceptable system of international payments. As a result of these efforts, relaxation in exchange control, depreciation in exchange value of most currencies in terms of gold, liberalization in trade and tariff reduction took place.

The world Economic Conference held in Geneva in 1927 failed to be ratified. By then many countries had returned to gold standards but without gold currency in circulation. The U.S. dollar along with pound sterling became the "key' currencies tied to gold. This new system was called the, "gold exchange standard" and many countries linked their currency to this "key" currency.

Despite a recovery from the First World War in the late 1920s, international economic disequilibrium continued.

> "Disequilibrium gold-currency ratios and, hence, exchange rates; and unequal international distribution of gold; large and growing short-term assets held abroad; erratic long-term capital movements; increasingly rigid price and wage structures; war-debt and reparations obligations; high tariff barriers; and the preoccupation of central banks with domestic rather than international monetary policy".[1]

This resulted in the Great Depression of the early 1930s leading to a sharp decline in prices and creating a serious balance-of-payments crisis. In September 1931, pound sterling was delinked from gold resulting in currency depreciation all over the world, along with trade

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1. Robert W. Oliver, Early Plans for a World Bank, (Princeton, N.J. Princeton Studies in International Finance, No.29, 1971), p.6.

restrictions, exchange controls, defaults on international debts, and various restrictions on international payments. Several countries of Europe along with United States delinked their currencies from the gold-standard by 1933. Thus, the Great Depression caused the gold-standard system of balance-of-payments adjustment to collapse. Economic nationalism had become the order of the day and the need for cooperation in the field of international trade and payments became all the more clear. Also, many countries witnessed currency devaluation, leading to deflation and decline in business activity.

An attempt was make to deal with these problems in 1933 at World Economic Conference held in London. However, it did not produce any immediate results. United States somehow returned to a modified form of the gold-standard in January 1934. The United States, the United Kingdom and France singed the Tripartite Agreement in 1936 to avoid exchange disturbances in the world economy. The Declaration also called for the expansion of international trade and relaxation and ultimate abolition of exchange controls and quantitative restrictions on imports.

The outbreak of the Second World War in 1939 created an opportunity for post-war planning in international economic cooperation. Due to common military and political interests the Americans and British were primarily responsible for planning the post war international economy. In fact, efforts began shortly after the outbreak of the war in September 1939 and several proposals and plans were being put forward.

The State Department and the Treasury Department of the United States both proposed the plans for inter-American cooperation which initiated the efforts towards more multilateral institutions. A proposal for an Inter-American Development Bank was thus worked out, which was accepted in February 1940 by the Intern-American Financial and Economic Advisory Committee.

Secretary of State Cordell Hull appointed Leo Pasvolsky of the Brookings Institution as his special assistant to work on problems of the peace and economy. This was the beginning of State Department planning for the post-war world economy. By 1940, these efforts were abandoned due to war and by 1941 Master Lend Lease Agreement was drafted to provide supplies to meet the urgent calls of the war.

During the same time, i.e. in August 1941, the Atlantic Charter was negotiated between President Roosevelt and Prime Minister Churchill. The fourth and fifth principles of this Charter provided that the countries adhering to it would "endeavour...to further the enjoyment by all States ... of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity", and that these countries "desire to bring about the fullest cooperation between all nations in the economic field with the object of securing - for all - improved labour standards, economic development, and social security."[2] This broad declaration of principles underlay the planning that took place for post-war international economic cooperation.

During this time, Lend-Lease Agreement was negotiated between the United States and its allies, under which the former was to provide the latter with supplies to meet the urgent calls of the war but without precise obligations regarding payment. This was done keeping in mind the complex situation created due to huge war debts after the World War I, making recovery a difficult and mammoth task. According to the Article VII of this arrangement, "the terms and conditions ... shall be such as, not to burden commerce between the two countries but to promote mutually advantageous economic relations between them and the betterment of worldwide economic relations. To that end,

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2. Quoted in Charles L. Merwin, "The Road to Bretton Woods", Finance and Development, Vol.1, No.2, September 1964, pp. 61-62.

they shall include provisions for agreed action ... directed to the expansion, by appropriate international and domestic measures, of production, employment, and the exchange and consumption of goods, ... to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers, and, in general to the attainment of all the economic objectives set forth in ... (the Atlantic Charter) ..."

"At an early convenient date, conversations shall be begun ... with a view to determining, in the light of governing economic conditions, the best means of attaining the above-mentioned objectives ..."[3] This attitude of the United States proved that it has discarded its earlier policy of isolationism and had taken upon itself this new responsibility of international economic leadership during the world war II.

Following these developments, in February 1942, Mutual Aid Agreement was signed between the United States and the United Kingdom. They recognized that if peace were to be won, attention would have to be given not only to the immediate relief and physical reconstruction of economies

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3. Robert W. Oliver, International Economic Cooperation and the World Bank, (Mac Millan, London, 1975), pp. 100-101.

disrupted by the war but also to "the expansion, by appropriate international and domestic measures, of production, employment and the exchange and consumption of goods which are the material foundations of the liberty and welfare of all peoples...."[4]

By this time it was evident that the United States and United Kingdom would be the leading financial planners of the world economy. By Spring of 1943, both American and British governments had published their plans to correct the disequilibrium prevailing in the world economy. Known as the White and Keynes plans respectively, they were similar in origin and purpose, but there were differences in approach.

One of the earlier drafts of White Plan, presented in March 1942 and submitted to the US President in April 1942 put forth a suggested plan for a United Nations Stabilization Fund and a Bank for Reconstruction and Development of the United and Associated Nations. This suggested plan was subsequently elaborated.

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4. Article VII, Mutual Aid Agreement between the United States and the Great Britain, cited in, IBRD, The World Bank, IFC and IDA, Policies and Operations, (Washington D.C., April 1962), p. 1.

In the introduction to the plan white says,

> "no matter how long the war lasts nor how it is won, we shall be faced with three inescapable problems: to prevent the disruption of foreign exchanges and the collapse of monetary and credit system; to assure the restoration of foreign trade; and to supply the huge volume of capital that will be needed virtually throughout the world for reconstruction, for relief, and for economic recovery."5

The urgency of international action was recognized.

The White Plan presented in 1943 envisaged tackling of volatile exchange rate problem by ensuring establishment of stable exchange rates and facilitating the freely convertible currencies. To achieve these objectives an international monetary institution was envisaged.

Further, it also visualized the establishment of an International Bank which would give long term, low interest rate loans for reconstruction and development to capital poor countries.

The Keynes plan on the other hand suggested the formation of an International Clearing Union, to deal with temporary balance-of-payments problem (rather than long-term capital movements). The major purposes of the Union were the same as the Fund. The important purpose of the Clearing

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5. Edward S. Mason and Robert E. Asher, The World Bank Since Bretton Woods (Washington D.C.: Brookings Institution, 1973), p. 15.

Union was to resolve the problems of international monetary instability.

Both the proposed plans were similar in their objectives, i.e., to establish stable exchange rates, elimination of restrictions on international payments. Despite their similarities, both the plans were criticised for a number of things which both sides found wanting. However, white's plan was more acceptable than Keynes. The plan therefore was amended several times before draft was published in 1943, and modified to take note of a number of recommendations.

The process for a final agreement to the establishment of these multilateral institutions took place in various meetings. The Atlantic City meeting on June 30, 1944, was attended by representatives of a number of countries. This exercise was to prepare the agenda for Bretton Woods. The United Kingdom as mentioned earlier suggested a number of changes in its draft called "boat draft", the most important being the Bank's capital structure.

The United States suggestion was that 20% of the country's capital subscription was to be paid initially which could be increased gradually, while the United Kingdom insisted that 20% was to be the limit and not more than one-fifth was to be paid in gold. These and other suggestions were considered in Atlantic City, and the US proposal and the "boat draft" were amalgamated into a statement to be placed before the delegates at Bretton Woods.[6] Earlier a United Nations Monetary and Financial Conference had been convened for the post-war financial planning.

The draft was thus presented to the delegates at Bretton Woods, New Hampshire, U.S.A., on July 1, 1944 and three weeks later completed final drafts of Articles of Agreement for the Fund and the Bank were ready for submission to the participating governments.

The Bank's Articles of Agreement were thus submitted for ratification to the 44 governments during 1945 and entered into force on December 27, 1945 when they were signed in Washington D.C., by 28 of the participating governments. Eventually, all the Bretton Woods participating governments except for the Soviet Union joined the Bank. The reason why the Soviet Union decided not to ratify the Agreement, even though it had represented in the Bretton Woods Conference and had played an important part in drafting the Articles of the Agreement and even signed the two agreements establishing the Fund and the Bank, was on

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6. Quoted in Mason and Asher, <u>The World Bank Since Bretton Wood</u>, p.21.

account of ideological and other considerations. The Soviet Union was opposed to the idea of IBRD membership being open only to countries which are members of the IMF. The Soviet Union considered IMF as an organization which had the potential of interfering in the economic policy of the Soviet Union for which it was not prepared. At a meeting of the UN General Assembly in 1947 the Soviet representative charged that the Bretton Woods institutions were merely "branches of Wall Street", and the Bank was "subordinated to political purposes which make it the instrument of one great power."[7]

The inaugural meetings of the Board of Governors were held in Savannah, Georgia, in May 1946 and the first major issue on the agenda was the site of the two institutions. The choice was between New York and Washington. The choice fell on Washington. The decision in favour of Washington guaranteed that they would not become "just two more financial institutions"[8] if they were situated in New York - a financial centre.

The second major issue was of duties of Executive Directors of the two institutions. The question that

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7. Mason and Asher, The World Bank Since Bretton Woods, p. 29.

8. Ibid., p. 38.

divided the British and the US delegations concerned the time and attention of the Executive Directors and their alternates. A compromise was reached at and it was agreed that the Executive Directors and their Alternates would devote full time and attention to the business of the Bank and the Fund.

The final issue was the salary that the Executive Directors would get. The Americans proposed an annual pay of $25,000. The Canadians and the Dutch like the British favoured low salaries in order to discourage the formation of Washington based club. The salaries finally chosen were $17,000 a year for an Executive Director and $11,000 for an Alternate. The salary of the President of the World Bank was set at $30,000 a year.[9]

It was also agreed that on May 1, 1946 the first president of the World Bank, to be chosen would be an American and that of the IMF would be an European.

On June 4, 1946, Eugene Meyer was nominated and elected as the first president of the World Bank and on June 25, 1946, the Bank opened doors for business and proceeded to call up capital from its member countries.

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9. Ibid., p. 39.

As Robert W. Oliver says, the major objective of the planners of two institutions, "was to provide a world within which competitive market forces, would operate freely, unhampered by government interference, for they supposed that market would produce optimum results for the entire world."[10]

Thus, the IMF was designed to provide short term balance-of-payments relief and the IBRDs function was to provide longer-term funds for investment in productive endeavours. Lord Keynes appropriately remarked that, "the Bank should really be called the Fund and the Fund the Bank."[11]

As for Bank's membership, only governments of various countries can become its members and as already mentioned, under the Bank's Articles of Agreement, "only member countries of International Monetary Fund may be considered for membership in the Bank."[12] On this, one of the drafters remarked, "Basically we wanted to force countries to agree

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10. Robert W. Oliver, Early Plans for a World Bank, p. 3.

11. Quoted in Mason and Asher, The World Bank Since Bretton Woods, p. 11.

12. IBRD, Articles of Agreement (as amended February 16, 1989), article 11, Section 1(a).

to standards in the monetary field as a condition to get the benefits of the Bank."[13]

The World Bank Annual Report 1990 states that the IBRD is owned by governments of 152 countries.[14] Thus, one notices a sharp increase in the membership of the World Bank from 28 at the time of its inception in 1944 to a near universal 152 today. One mentions that IBRD is a near universal multilateral institution because even today a few countries of the socialist bloc including Soviet Union are not its members.

Purpose

Article 1 of the Articles of Agreement of the International Bank for Reconstruction and Development lays down the purpose of the Bank. As the very name suggests the Bank was established for the purpose of Reconstruction and Development. "To assist in the reconstruction and development of the territories of members ...."[15]

The founding fathers of the Bank had thought that the Bank would play an active role in the 'reconstruction' of

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13. Ansel F. Luxford, quoted in Mason and Asher, The World Bank Since Bretton Woods, p. 19.

14. The World Bank, Annual Report, 1990, p.3.

15. IBRD, Articles of Agreement, Article 1(i), p.1.

war-shattered European economies. Hence, the paramount but temporary purpose of the Bank was to reconstruct the war-torn European economy. The first loans of the Bank, made in 1947 and amounting to $497 million, were in the nature of emergency assistance given to France, Netherlands, Denmark and Luxembourg.[16] However, it was soon realized that the demands of European reconstruction could not be met by the efforts of the Bank as the capital at its disposal was limited. Subsequently, other alternatives were thought of an soon the United States took upon itself this responsibility and ,announced the Marshall plan or the European Recovery Programme (ERP) in 1948. The Bank, thereafter turned its priorities from reconstruction to its other major responsibility - the financing of development, that is to long term financing of "productive projects in less developed member countries in order to promote their economic development."[17] Thus, the World Bank is a development Bank, engaged in promoting development by supplying long-term capital with the purpose of financing a variety of projects of the recipient countries which helps in their overall economic development.

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16. Mason and Asher, The World Bank Since Bretton Woods, p. 25.

17. IBRD, Question and Answers, The World Bank (Washington D.C., March 1976), p.3.

The Bank soon came to realize that its function as a development agency could not be confined to just giving development loans because a more important point was that the applications for loans needed technical assistance. This became necessary particularly in the context of developing countries. Its first annual report publicized the Bank's own willingness to supply technical assistance in the preparation of loan applications.[18] The second annual report emphasized that the Bank could not supply technical assistance from its own staff on any large scale but that it could help members select and procure private technicians.[19] Technical assistance in the World Bank consists of aid in developing plans, assistance in the choice of priorities among projects, and recommendations by the staff on the administration of selected projects. Thus, providing technical assistance to the developing member countries became one of the major purposes of the World Bank.

The purpose of lending for economic development by the Bank involves three major activities. The first activity involves the (co)-financing of specific development projects. The second range of Bank activities involves

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18. IBRD, First Annual Report to the Board of Governors, September 27, 1946, p.5.

19. IBRD, Second Annual Report to the Board of Governors, 1946-47, p. 14.

advise by the Bank to the borrowing governments on general and specific economic policies at macro and sectoral levels. Finally, the third activity is to bring about studies and reports of operations conducted.

Another purpose of the Bank is "to promote the long range balanced growth of international trade and maintenance of equilibrium in the balance of payments of member countries."[20] There are certain means of doing this. In doing so the Bank makes an overall assessment of the economy of the borrower country and sees to it that the project in question is viable through surveys. It insists that the borrower meets the local expenses such as on labour and material as far as possible. The losses caused are shared proportionately by the members upon the insistence of the Bank. The Articles also contains that the Bank is to impose no conditions requiring the proceeds of its loans to be spent in territories of any particular member or members, i.e. the Bank has promoted multilateral trade and investment by permitting the borrower to spend the proceeds of a loan in any country.

Two other purposes that the Articles of the Bank state, are to insure that adequate financing exists for

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20. IBRD, Articles of Agreement, Article 1 (iii).

"more useful and urgent projects"[21] and to pay due regard to the effect of its operations on business conditions of its member countries.[22]

Organizational Structure of the Bank

Article V of the Bank's Articles of Agreement, specifies the organizational structure of the Bank and also lays down policy formulation and Executive supervision. Although Article V, Section 2(a) vests all the powers of the Bank in the Board of Governors (which consists of one representative from member country), the real power is exercised by the Executive Directors which is chaired by the President of the Bank. The former meets once a year and is a big body while the latter is a small body consisting of twenty-two members. It has three principal functions. They are:

(a) control of annual financial and operating programmes and administrative budgets,

(b) review overall policy proposals (Bank's capital requirements, financial policies, lending terms, sectoral priorities), and

(c) review evaluations of completed Bank projects.

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21. Ibid. Article 1(iv).

22. Ibid. Article 1(v).

The President is the chief of the operating staff of the Bank and conducts under the direction of the Executive Directors, the ordinary business of the Bank.

In appointing the officers and staff the President shall, subject to paramount importance of securing the highest standards of efficiency and of technical competence, pay due regard to the importance of recruiting personnel on a wide a geographical basis as possible.[23]

Decision-Making

All matters before the Bank are to be decided by a majority of votes cast, with certain exceptions. World Bank has weighted voting system linked to the capital contribution by the member country. The subscription of the member government serves as the basis for voting. Each member receives an initial 250 votes and then one vote for every share of Bank stock it holds. As a consequence of this weighted voting system the United States, Japan, FRG, UK and France have a virtual vote power on all major decisions taken in the organization, as they are the largest share holders today (Table 1).

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23. IBRD, Articles of Agreement, Article 5, Section 5(d).

Table-1.1

Ten Largest Shareholders of IBRD and Percent of their Voting Power (June 30, 1990) Expressed in thousands of US dollars.

	Subscriptions			Voting Power	
Member	Shares	Percentage of total	Total Amounts	No. of Votes	Percentage of total
United States	162,523	15.65	$ 19,605,962	162,773	15.12
Japan	93,710	9.03	$ 11,311,943	94,020	8.94
Germany Federal Republic of	72,399	6.97	$ 8,733,852	72,649	6.75
United Kingdom	69,397	6.68	$ 7,371,707	69,647	6.47
France	55,227	5.32	$ 6,662,309	55,447	5.15
Sub Total	453,316	43.65	$ 54,685,773	454,536	42.23
Next Five					
Netherlands	35,503	3.42	$ 4,282,904	35,753	3.32
China	34,971	3.37	$ 4,218,727	35,221	3.27
India	31,692	3.05	$ 3,823,164	31,942	2.97
Italy	25,140	2.42	$ 3,032,764	25,390	2.36
Saudi Arabia	25,140	2.42	$ 3,032,764	25,390	2.36
Others Sub-total	585,041	56.35	$ 42,159,554	621,821	57.77
Grand Total	1,038,357	100.00	$125,262,197	1,076,357	100.00

Source: World Bank, Annual Report , 1990.

Capital Structure of the Bank

Subscription by member countries is the basis of the capital of the Bank. Subscriptions by member countries are based on each members quota in the International Monetary Fund which is designed to reflect the country's economic strength.[24]

The Bank's capital stock is available for subscription by members, at one share equal to $100,000.[25] The Bank is an inter-governmental institution, but corporate in form, all its capital stock being owned by its member governments.

Further, the capital subscription at the time of its inception was divided into three categories:

(i) 2% payable by member governments

(ii) 18% in local currency

(iii) 80% to be paid in when called.[26]

This capital structure sought to assure that every country - rich and poor - would participate in providing

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24. IBRD, The World Bank, IDA and IFC, Policies and Operations, June 1971, p. 8.

25. IBRD, Articles of Agreement, Articles II, Section 2(a).

26. IBRD, Articles of Agreement, Article II, Sections 5 and 7.

capital (the 2 per cent portion); it recognized that countries temporarily impoverished and in balance-of-payments difficulties would be able to contribute usable capital later (the 18 per cent), and it embodied the expectation that the mobilization of capital from other sources would be much more important than the use of Bank's own assets (the 80 per cent).[27]

This capital structure provides the Bank both with substantial loan resources from its own paid-in-capital and with guarantees enabling it to borrow even more sizable resources, mainly through the sale of Bank obligations to investors. capital markets are the largest single source of funds employed by the Bank to finance its lending operations.

It was further decided that the Bank would raise funds mainly by guaranteeing loans by private investors to such needy countries and not use its own capital. However, when it could not get private capital on reasonable terms, then it would use its own capital to finance projects for productive purposes. This the Bank would do by selling its own securities in the capital market. The Articles of Agreement of the Bank clearly state that the purpose of the

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27. Mason and Asher, The World Bank Since Bretton Woods, p. 105.

Bank is "to promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors."[28] Indeed, it is one of the unique features of the Bank that, although it is an inter-governmental organisation, it mainly relies upon private investors for its financial resources.[29] The borrower may be a member government, a State, a business set-up, but if the borrower is other than the government, the loan must be guaranteed by the member government in whose territory the project is related.

World Bank's President and His Role in Influencing Policies

World Bank's President has emerged as a powerful executive over the decades of its existence. The first President of the World Bank - Eugene Meyer - resigned six months after being named President. During his presidentship, he was confronted by a strong Board of Directors, led by the young well-informed energetic and ambitious U.S. Executive Director. Much of his time and energy was spent in battling with the board for leadership of the institution. He was naive to the balance-of-payments

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28. IBRD, Articles of Agreement, Article 1(ii).

29. IBRD, The World Bank, IDA and IFC, Policies and Operations, (June 1969, Washington D.C.), p.3.

crisis, foreign exchange versus local currency requirements, and some of the other unprecedented problems that would have to be dealt with by the Bank.

Another of Meyers' preoccupation was sounding out the private capital market on raising money for the Bank. It was earlier assumed that the Bank would operate by guaranteeing securities issued by others rather than issuing bonds of its own but before the end of 1946, the Bank decided to give priority to issuing its own securities.

The principal frustration of the Bank's first President was his feeling of having responsibility without authority, of having to battle the U.S. led directors for stewardship of the institution and before any private capital had been raised on loan applications, he resigned as the President, effective December 18, 1946.

The second President, John J. McCloy, made a strengthening of the President's role vis-a-vis that of the executive directors, a condition of acceptance of his job. He brought with him Robert L. Garner as Vice-President and Eugene R. Black as the Executive Director. "When McCloy, Black and Garner took over, the Bank was at its lowest ebb, its reputation considerably tarnished, its accomplishments nil, and its problems mounting because of the worsening economic situation of Western Europe."[30] Under new guidance, the Bank was rescued from its shape of suspended animation. It sold its first bonds and made its first loans for the purpose of European reconstruction. Soon the Bank withdrew from reconstruction field and made its first loan to a developing member country. A Press release stated that, "the reconstruction phase of the Bank's activity is largely over", and "the development phase ... is under way."[31]

World Bank and the United Nations

During McCloy's Presidency, the Bank, in addition to tightening its internal organizational structure, completed an agreement formalizing its relationship with the United Nations (UN), although, initially the Bank was very fearful of becoming a specialized agency of the UN. It apprehended that the UN would subject it to undesirable political control or influence and hurt its credit rating in Wall Street, despite the government guarantee behind its bonds. There were differences of view between the executive directors and the management as to which should run the Bank, they were unanimous that no encroachments from outside should be allowed. On November 15, 1947, the Bank became a

30. Mason and Asher, The World Bank Since Bretton Woods, p.49.

31. Ibid., pp. 60-61.

specialized agency of the United Nations along with the Fund. However, the text of the draft agreement emphasized the independence of the Bank from the UN as seen in the following "by reason of the nature of its international responsibilities and the terms of its Articles of Agreement, the Bank is, and is required to function, as an independent international organization."[32]

Under the presidency of Eugene Black, the Bank's third President, who served for thirteen years of the Bank's life, the Bank became active in achieving its objective. Under him the Bank achieved internal harmony which was essential to external effectiveness. When he took over as the President on July 1, 1949, it was clear that by then the medium term job of financing post-war reconstruction was beyond the capabilities of the Bank and it was not yet clear what the International Bank for Reconstruction and Development would be able to do in fulfillment of its other principal function - the long term task of financing development. Under his presidentship, the Bank grew steadily in size, scope and understanding of the development process as will be seen later in Chapter II.

A major organizational change took place in the Bank

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32. Quoted in Mason and Asher, The World Bank Since Bretton Woods, p.58.

in the year 1952. Earlier, all staff members responsible for relations with member countries and for negotiating loans, and most of the technical and financial staff responsible for evaluating projects, were in the Loan Department. The Loan Department also included some economists, usually those specializing in particular countries. Most economists, whether engaged in assessing the credit-worthiness of member countries, studying commodity problems, or doing general economic research were in the Economic Department. A loan decision required a favourable judgment by the Loan Department on the engineering, technical and financial aspects of the project and a green signal from the Economic Department on the credit-worthiness of a borrowing country. With the expansion of operations in developing countries and lack of harmonious relations between the loan officers and the economists it was evident that organizational changes be made and in 1952, it was decided that Area Departments were an absolute necessity. Hence the personnel of the Loan and the Economic Departments were redistributed among three Area Departments, which were set up on a regional basis (and later increased to more than three), a Technical Operations Department (which later became the Projects Departments), and an Economic Staff. After this reorganization, operational responsibility for technical assistance was assigned to the Area Departments, but the technical assistance and liaison staff retained a responsibility for recruiting personnel and advising the Area Departments on technical assistance policies.

Another landmark achieved during Eugene Black's presidency was the establishment of the Economic Development Institute (EDI) in 1955, whose function is to offer technical assistance to developing countries.

The two principal "affiliates" of the World Bank - the International Finance Corporation (IFC), was established in 1956 to enable private enterprises in developing countries to borrow from the Bank without the intervention or participation by their governments and the International Development Association (IDA) was set up in 1960 with a view to providing concessional aid to the low-income developing countries. The latter was established under the Bank despite pressures in the UN to establish separate capital fund to help developing countries.

During the latter part of his presidency, Black played a key role in establishing the India and Pakistan consortia and the developing countries were provided with loans and technical assistance for economic development.

George Woods, the Banks fourth President during his tenure broadened the Banks efforts by -

(a) providing finance in increasingly flexible ways;

(b) furnishing technical and planning assistance to member countries;

(c) building up local institution to mobilize and channel capital for productive purposes;

(d) Forming international consultative group to co-ordinate the provision of external aid.[33]

Economic and technical assistance was expanded to developing countries and new areas of development, such as agriculture and education were given increasing emphasis and financed. Also, the third affiliate, the International Centre for Settlement of Investment Disputes (ICSID) was established in 1966, with the objective of promotion of favourable investment environment in the developing countries through the settlement of investment disputes among the member countries of the Bank.

The year McNamara took over as the President of the World Bank he realized that drastic changes had to be made in the policy structure so as to achieve the goal of development in the developing countries, as he put it, "The character of international life in the next century - for

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33. IBRD-IDA, Annual Report, 1963-64, Washington, D.C., p.6.

rich and poor nations alike - will depend largely on the success of development effort.[34]

McNamara, thus, from the very beginning realized that there was need to bring about drastic changes. Development to him meant dealing in terms of tackling poverty under whose grip millions of people (nearly 40 per cent of the total population of the developing countries live). For him assessing development in economic and statistical terms had no meaning until or unless the conditions of the poor in these countries is improved. Development meant dealing directly with serious problems such as malnutrition, disease, illiteracy, unemployment and increasing population - which are a common feature and seriously affects the development process in these developing countries. Also, he remarked, "if development cannot change the existing situation, development will have failed."[35] He insisted that greater priority was to be given to growth targets in terms of nutrition, housing, literacy and employment, even if this meant reducing the pace of advance in certain narrow and highly privileged sectors of the economy where benefits accrue only to few.

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34. Robert S. McNamara, One Hundred Countries, Two Billion People The Dimensions of Development, (Praeger: New York, 1973), p.8.

35. Ibid., p.8.

In autumn 1968, six months after he took office as President, he announced that in the next five years the Bank's lending would be doubled than what it had been in the preceding five year. Not only was the target achieved but it very much surpassed it. During the first five years of his presidency, the Bank's lending totaled nearly as much as it had lent since it began operations in 1947.

Also, the Bank witnessed a geographical shift in its lending operations under McNamara. During the first two decades of lending, much importance was given to Asia by the Bank. He stressed that, Latin America and Africa were to be given importance in the next five years. Also, countries such as Indonesia and United Arab Republic were to be extended Bank's assistance.

Third major change that was witnessed was a shift in the sectoral allocation of funds. McNamara emphasized that, education, population planning and agricultural sectors needed improvement drastically.

The diversification in the Bank's lending certainly did not mean that the traditional projects for sectors such as power, high-ways, agriculture were dropped. In fact, McNamara pointed out that "there was a new target for lending to agriculture: an increase of 40% in real terms for the next five years."[36]

Thus, it was an era characterized by two major changes: a vast expansion in the flow of financial resources and a significant re-orientation in the kinds of projects these resources financed.

The 1970s also witnessed an increase in development lending by the World Bank under McNamara. Also, there was a shift in emphasis of its lending criteria it became an exponent of development financing. Finally, the Bank combines the role of a multilateral public development institution with that of an investment agency dependent on different capital markets, looking after the interests of both the creditor as well as borrower interests.

Thus, under President Black, Woods and McNamara the Bank had flourished, launched the affiliates, that account for the name "World Bank Group" and has taken other steps towards transforming itself from financier of the foreign exchange costs of loanable projects to development financing institution, a term not used during the Bank's early years.

In the course of its institutional evolution the World Bank has undergone an important evolution of its

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36. Robert S. McNamara, 1973, p.25.

functions, becoming a major source of technical aid to developing countries in addition to its traditional function of financing development. It also assumed the role of a leading pilot agency for designing development strategies and coordinating international development aid. In doing so, it deploys its own financing instruments and its "development expertise" as a "catalyst". This catalytic function of the World Bank acquired vital importance during the 1980s, especially since the outbreak of the international debt crisis.

In the year 1981, McNamara was succeeded by A.W. Clausen. Unlike his predecessor, Clausen did not find poverty alleviation as the major objective of the Bank. It may be noted that Clausen was a banker (unlike his predecessor but like every previous President). Being a banker, he could not relate himself to the task of development as identical as poverty alleviation. He approached the matter quite differently and was of the view that developing countries could benefit if the world economy grew since in the early eighties, the world economy was under recession. He emphasized on "macro conditionality" and designed "packages of projects that were tied to such conditionality. In his view, right set of country policies are an essential ingredient for meaningful poverty alleviation. He also placed great emphasis on the problems of sub-Saharan Africa and urged a doubling of aid to the poorest African countries.[37]

Further, he considered that development can be more efficient and dynamic if private sector is free to operate. Clausen expressed his belief that, "those countries have demonstrated the best economic performance that have encouraged their private sectors."[38] Also under him Bank activities such as co-financing, structural-adjustment and sectoral adjustment gained importance as will be seen in Chapter III.

Clausen was succeeded by Barber B. Connable. He found that the World Bank organization was very unwieldy. Hence, he undertook the reorganization of the World Bank Secretariat by reducing the Bank's staff. He, however, tried to combine other objectives of the Bank with the poverty alleviation. In one of his recent addresses he has stated that, "The development agenda for the 1990s must be to harness growth and use resources creatively, so as to improve the quality of life everywhere. This is the real

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37. A.W. Clausen, Global Independence in the 1980s, Address to the Yamiuri International Economic Society (Tokyo: January 13, 1982), p.14.

38. A.W. Clausen, Address to the Brookings Institution, Seminar on the Future Role of the World Bank (Washington, D.C.: January 7, 1982), p.4.

challenge of development and the central task of the World Bank and its partners particularly the governments of developing nations."[39]

During his presidency, the Multilateral Investment Guarantee Agency (MIGA) under the World Bank Group was established in the year 1988. MIGA is expected to promote foreign direct investment in the developing countries. Hence, it provides not only information, technical assistance but also investment guarantee for non-commercial risks of the investors.

Under Connable, the World Bank became more involved in debt solution as well as development. He perceived that, "The development needs of the 1990s will be enormous, to overcome stagnation in Africa, to move beyond debt paralysis in Latin America and elsewhere, to offer growth and hope to Asia's hundreds of millions of poor people, to assist reform and renewal in countries moving away from centrally planned economies, and to reverse the degradation of developing countries natural resources."[40]

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39. Barber B. Connable, Address to the Board of Governors, (Washington, D.C.: September 26, 1989), p.6.

40. Ibid.

CHAPTER - II

LENDING POLICIES OF THE WORLD BANK: AN OVERVIEW

Over the four and half decades of its existence, the World Bank has emerged as the most important multilateral institution providing long-term development finance to developing countries. Over the years, it has devised a number of lending instruments to meet its needs. It has diversified its targets not only in terms of objectives but also in terms of sectors and countries. Thus, its lending operations have been extremely comprehensive. In the following pages a study of the growth and diversification of activities till 1980 is made.

Reconstruction Lending

The second World War had caused immense destruction in the European territories and such destruction took its toll on the economic front as well. Though the Articles required the Bank to give "equitable consideration to projects for development and projects of reconstruction alike"[1], the immediate but temporary task of the Bank was to

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1. IBRD, Articles of Agreement, Article III, Section 1(a).

reconstruct the war-torn European economy as it was a necessary prerequisite for the post war functioning of the world economy.

The problems of European reconstruction were far greater and complex than envisaged by the architects of the Bank. The economic difficulties such as improper trade, physical destruction, the industrial and governmental problems increased because of unforeseen political conflicts in Europe. The task involved rehabilitation and reconstruction of entire national economies and not just rebuilding of individual productive facilities.

The war damaged nations of Europe required the Bank to help them in the reconstruction work by supporting them in their rebuilding activities, help them in the restoration of physical structures, to work towards improving their production which would eventually lead to the improvement in the trade among all the members.

The concept of Bretton Woods had been that the relief needs of Europe after the war would be met through the donations by the United Nations Relief and Rehabilitation Administration (UNRRA); and the external financing needed for more permanent recovery programmes, to the extent that it could not be furnished from other sources, was to be supplied by loans from the Bank.

Recovery was conceived primarily in terms of the rebuilding of factories, mines, railroads and other specific facilities.[2] The focus of attention was thus mainly on the restoration of pre-war situations, whereas the requirements of war devastated Europe were far greater than anticipated and demanding greater urgency. Europe, during this transitional phase required dollar-aid for importing three basic essentials for European recovery - food, fuel and raw materials which would help increase in production and ultimately solve the problem of trade disruptions. Europe requiring American dollars for reconstruction purposes reflected -

1. that the rest of the world is not yet producing enough to enable it to obtain the necessary goods and services through domestic production and normal international trade channels;
2. that consequently these goods and services are being purchased in large part in the United States because, with its immense productive mechanism intact, the United States is one of the few countries, and certainly by far the most important one, able to supply such goods and services; and

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2. IBRD, The International Bank for Reconstruction and Development, 1946-53, (The John Hopkins Press: Baltimore, 1954), p.8.

3. that procurement in the United States requires dollars.[3]

In the early phase of European reconstruction, the World Bank gave very crucial loans to four European countries whose economies were badly damaged because of devastations caused by the war and also due to lack of American dollars.

In May 1947, the Bank made its first loan amounting to $250 million to a French semi-public corporation, the "Credit National". The loan was guaranteed by the French government, and was required to meet the cost of importing equipment and material for the purpose of reconstruction and modernization of French industry.

In August of the same year, the Bank gave a loan of $195 million to Netherlands. The proceeds of the loan were to finance reconstruction of productive facilities in Netherlands homeland.

During the same time Denmark was granted $40 million, to assist Danish economic recovery by financing the import, during 1947-48 of essential capital goods and raw

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3. IBRD, <u>Second Annual Report to the Board of Governors</u>, 1947, p.8.

materials, such as agricultural and textile machinery, machine tools, trucks, steel, textile fibres, non-ferrous metals and chemicals.

The fourth country to receive Bank assistance was Luxembourg, which was granted $12 million, to finance the purchase of equipment for the Luxembourg steel industry and of rolling stock of its railways.

These loans were made for the "general purpose" of financing a variety of essential imports to be made exclusively from the United States, in a variety of sectors such as - manufacturing, agriculture, transport and electric power. They were either in the form of raw materials - petroleum, cotton, coal and lumber - or in the form of finished goods - factory and farm machinery, railways locomotives, ships and structural steel.

In the third annual report to the Board of Governors, the Bank stated that the loans it granted to these four European countries during 1947, while, providing only a partial solution to Europe's problems, helped to prevent a disastrous drop in production and possible economic collapse by permitting the borrowing countries to sustain for a time the necessary volume of imports.[4]

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4. IBRD, Third Annual Report to the Board of Governors, 1947-48.

Nearly half of the total of Bank's lending at that time was facilitated towards this type of lending. All the major sectors such as agriculture, industry and exports witnessed a marked growth. It helped France to maintain its economic activity in the agriculture, industry, transport and employment sectors. Denmark recovered in agriculture, industry and exports while Luxembourg in steel and Netherlands in agriculture and industrial outputs. Thus, these loans, though not fully but partially helped these European countries to increase production and thereby helped in their economic recovery.

The Bank in the year 1947-48 lent a total of $497 million towards reconstruction effort, but soon realized that the demands of European reconstruction could not be met by the Bank as the capital at its disposal was limited and secondly, the war devastated countries in the Bank's terminology were not in a "credit worthy" position, i.e. prospects of being able to repay wee bleak. Subsequently, other alternatives were thought of and soon the United States took upon itself the responsibility and announced the Marshall Plan or the European Recovery programme (ERP) in the year 1948.

In his speech initiating the Marshall Plan, Secretary of State, George C. Marshall said, "the rehabilitation of the economic structure of Europe quite evidently will require a much longer time and greater effort than had been foreseen."[5]

The Bank gave its full support to the European Recovery Programme and at the same time made it clear - that the Bank's European operations for the next few years would necessarily be conditioned by developments in connection with the European Recovery Programme.[6] Also, it stated that there was a real need for Bank financing in Europe in addition to the financial assistance made available through the European Recovery Programme.[7] Hence, the Bank continued lending to European countries, though on a much smaller scale.

One criticism that is leveled against these reconstruction loans that were made by the Bank is that the Bank during 1947-48 gave extra importance to reconstruction needs of these four European countries and consequently neglected the developmental needs of its underdeveloped

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5. Quoted in Robert Solomon, <u>The International Monetary System 1945-1981</u>, (Harper and Row, New York, 1982), p.10.

6. IBRD, <u>Third Annual Report to the Board of Governors</u>, 1948.

7. Ibid.

member countries. The Bank, however, justified its stand by stating that a speedy European economic recovery will indirectly help developing economies in their developmental plans - by being in a position to provide them with goods, equipment and technical skills and the design of International Monetary System envisaged at Bretton Woods could not be fully implemented until European economies achieved recovery from devastation of war.

Development Lending

The United States of America took over the task of reconstruction of Europe through the European Recovery Programme as has already been mentioned and this allowed the World Bank to divert its attention to the task of development of the developing countries. Hence-forth the primary task was to finance development projects in Latin America, Asia, Africa and the Middle East, through long-term capital which would help to develop their overall economy. However, it continued to lend to certain European countries and Australia.

In the beginning, such development loans were given for what is known as "infrastructure projects" or those which constitute the backbone of an economy such as electric power, transportation and agriculture. Emphasis was laid on fostering development by utilizing the human and technological resources that was already available in these countries. In essence, such endeavours of the Bank was to have two outcomes. Firstly, it would help to raise the standards of living of recipient countries, and secondly, it would eventually lead to increasing world trade. "For in the very magnitude of the development potentialities of these nations lies the best hope of the world for greater economic well-being in the future."[8]

Before going into the why and how of lending policies, it would be important to see whey the above mentioned countries are termed underdeveloped and what characterizes under-development? Essentially, under-development can be attributed to a major weakness i.e. low productivity which in turn leads to a low standard of living.

Hence, it was obvious that the World Bank, which had embarked on the path of development, would seek ways and means to remedy this weakness. The first and major obstacle in the path of development of these countries is the acute shortage of capital both foreign as well as local. It is known that capital has a many-fold importance, for buying equipment, infrastructure, for training of workers, to set

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8. IBRD, Second Annual Report to the Board of Governors, 1947.

up houses, transportation, public utilities etc. To start with capital has to come from external sources, but since it is not very reliable what is actually needed to be done is to get local capital and to give the foreign capital a role of just supplementing it. To attract foreign capital the developing countries must have some favourable conditions. A number of them did not have such conditions.

In many cases excessive defaults by debtor nations was a major obstacle to the flow of credit since debt repayment went beyond a nation's capacity to repay. In such situations credit could come in only when the creditors were convinced that a financial reform would be undertaken. This would mean a strong budgetary as well as monetary policies which while increasing production curb inflationary tendencies. The Bank was to help do this as well.

In addition, free flow of private capital could come about on the assurance that the recipients would prevent such capital from "inequitable and restrictive legislation." However, at this point it must be said that capital both foreign and domestic are always subjected to regulation in keeping with the policies that a country follows. This is done so as to protect itself from political or economic exploitation as have happened in the past. Risk capital, contrary to loan capital, is not given without assurance of fair and equitable treatment and of reasonable returns on investment.

Despite the Bank having visualized a few steps to ensure flow of foreign capital to the less well developed areas, there is no suggestion that all steps must be completed before capital actually flows in. The Bank may help a borrowing country by lending if it fulfills some requirements which will enable the borrower to become credit-worthy.

Shortage of technical and managerial personnel is the second obstacle. It applies to every aspect of the economy i.e. public administration, agriculture and industry, as it is a major impediment in economic progress. Hence, the only remedy is to seek help from foreign business enterprises, who along with capital provide technical assistance and help build up a workforce of skilled personnel. To overcome this shortcoming, the Bank actively participates in formulating plans.

Thirdly, there is the aspect of economic instability which is seen in the high inflation that these economies are facing. War, improper fiscal and monetary policies are some of the reasons.

Fourthly, there is the absence of a general pattern of development. In such a situation it becomes extremely difficult to assess what needs priority and what is in short supply.

Fifthly, illiteracy and low level of education is rampant in most developing countries. Therefore anything to do with development in the modern world is difficult to impart. For example, standard of living would improve only when per capita income increases. Finally, and equally important is the lack of political stability in such countries. Investment patterns will be influenced by such factors as well.

From the above analysis it can be noted that money or capital apart from other factors go towards furthering development. For the Bank, expansion of production can come about only through well-planned projects, and moderate flow of funds. This is how the Bank helps its members to approach development, but loans are advanced only when it is convinced that the recipient is credit-worthy.

Developmental Projects

When the Bank at the very outset, said that it would finance only those projects which lead to balanced development, it was indeed spelling out the general pattern of development of the economy concerned. All facets of the country i.e. natural resources, location, climate, population and financial and administrative sources were to be taken into consideration.

Agricultural production was a major concern. It financed modern machinery, diversification of crops and modern methods of farming. This would help to increase domestic consumption and exports.

The Bank also finances the establishment or expansion of appropriate manufacturing and processing industries. Among such industries importance is laid on consumer goods and processing industries, due to lesser capital involved and the potential to tap existing resources. As a result, heavy industries follow a close second priority with the Bank.

Nearly two-thirds of the capital available for developing countries are invested in order to develop transportation, communication, port development, power projects, water and sewage systems and other public utilities. In addition investment is also made on less directly productive purposes such as technical training, education, nutrition and medical programmes.

Essentially then, some of the broad principles which guide the Bank development lending policies are as follows:

First, only those projects which are ''strategic' or viable economically which will have no problems to production by increase output, merit investment. Secondly, investment should not only develop a country's economy but must in the ultimate analysis go towards bettering world trade as well. Thirdly, the Bank's Articles of Agreement provide that "the most useful and urgent projects, large and small alike", must be dealt with first.[9] Finally, the Bank loans must be confined to projects for which financing through private or other channels is not available on reasonable terms.

Technical Assistance

As mentioned earlier, the Bank may be called upon to help in providing technical assistance whereby skilled workforce is produced to apply modern technology to production. This may entail the Bank to participate in the formulation of these countries' plans. Technical assistance is arranged for by the Bank and it does so by arranging independent consultants and private enterprise.

While helping recipient countries to frame policies Bank has to however take care not to interfere with their

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9. IBRD, Articles of Agreement, Article 1 (iv).

internal affairs or go too much into the details of programmes. It may be mentioned here that the Articles specify that the operations of the Bank is to be governed only by economic conditions rather than political.[10] This is sought to be avoided by the following approaches.

Firstly, the Bank accepts to make a broad investigation into the shortcomings and development needs of a country only on request. Secondly, the Bank encourages member countries to make a survey of development potential and to chalk out priorities in which projects are to be undertaken. Thirdly, the Bank advises on a proper path of development without however trying to impose a programme. It does the same on improving the financial structure of a country. Fourthly, apart for its own general assistance it provides experts for various fields such as agriculture, finance and taxation to provide assistance. Lastly, while the programme is actually functioning, it keeps in touch with the respective government to get a feedback of the progress made and problems facing it.

Stimulation of Investment
from other sources

Apart from the Bank's direct assistance, the

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10. IBRD, Articles of Agreement, Article IV, Section 10.

development of a respective country is largely dependent on itself, i.e., the conditions existing and the resources, both physical and financial, that it can muster locally as well as internationally. There are cases where local resources are available but due to improper financial policies they are not channeled to development oriented activities. Although the Bank can help to stabilize conditions and policies in the member country, the initiative rests largely with the recipient member country itself.

Bank also actively participates in providing foreign direct investment. In order that there is an unhindered flow of private capital, the Bank endeavours to create certain necessary conditions that must be met by the member country. The financial and monetary mechanism must promote efficiency in industry and agriculture, restrictions on the flow of capital must be eliminated and there must be a general financial stability. Where found to be extremely viable, the Bank campaigns for the projects to private investors. It also goes to the extent of using its guarantee powers to take the risks of loans made.

Finally, the Bank makes efforts to encourage following of those principles and practices which are acceptable to capital exporting as well as capital importing countries. "It seems clear that the real measure of the Bank's effectiveness will be, not so much the number or amount of its loans and guarantees, significant as they may be, but rather its success in influencing attitudes in promoting a realistic, constructive approach to development problems on the part of its members and in fostering a great degree of confidence among investors".[11]

Thus the World Bank is a development bank, engaged in promoting development by supplying long-term capital with the purpose of financing a variety of projects of the recipient countries which will help in their economic development and providing necessary technical support to achieve their development objective.

The first development loan amounting to $16 million, to a developing country was made in March 1948, to Chile. It was made to support power development and promote food production. Power expansion was given a high priority by the Chilean government because development of cheap hydroelectric power was considered basic to the expansion of industry and improvement of agriculture.

The total of $16 million was in the form of two

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11. IBRD, <u>Third Annual Report to the Board of Governors</u>, 1947-48.

loans and both were guaranteed by the Government of Chile and were made only after a settlement had been reached between Chile and its foreign bondholders over pre-world War II bond issues ,which made Chile credit-worthy in the international investment circles.

In January 1949, the Bank granted two loans totaling 34.1 million to agencies of Mexican government for electric power development, guaranteed by Mexican Government. The first loan of $24.1 million was made to finance the purchase of equipment for completing new power generating stations and transmission lines by the Federal Electricity Commission. The second loan of $10 million was made to an official financial institution to enable both to finance a loan to the Mexican Light and Power company for part of the cost of equipment needed in carrying out a programme for the expansion of electric power generating and distributing facilities.

The third development loan was of $75 million, granted by the Bank to the Brazilian Traction Light and Power Company Ltd., a Canadian Corporation to finance most of the foreign exchange costs of the hydroelectric power and telephone facilities of the company's Brazilian subsidies. The loan was guaranted by the United States of Brazil.

The Bank made a small loan of $5 million to Mexico for the importation of agricultural machinery. Also, in the late 1950s' the Bank approved two smaller power loans. The first a $3.53 million loan for power development and the second was a $2.6 million loan, again for power development in early 1951, a $16.5 million was granted for highway construction and rehabilitation.

India was a major recipient of Bank's development lending in the early years of the Bank's lending. The Bank's first Asian loan - to India in 1949 was just for railway rehabilitation. The proceeds of the $32.8 million loan were used for importing railway locomotives, spare bodies and miscellaneous spare parts. It was a high-priority project of the Indian Government so as to improve efficiency of national railways.

Another loan of $75 million was for the purpose of importation of agricultural machinery needed to clear reclamation of large tracts of land in central India which would help in the production of foodgrains. The third loan to India also made in the year 1949, was a $18.5 million for the purpose of power development project. It was a first step in a large scheme for developing the Damodar Valley of Eastern India. Another loan of $19.5 million was given by the Bank for projects within the plan, such as electric power development, flood control and irrigation. This was for the second phase of Damodar Valley Development.

A close analysis of the early development lending by the Bank reveals that these loans to the developing countries were overwhelmingly concentrated in the areas of power and transportation. Bank loans during the years immediately following four reconstruction loans were predominantly for power development. Transportation sector was the second highest receiver of the Bank's finances. Agriculture was the third major recipient. Thus, the loans were made for public entities - power and transportation - supporting development programmes covering an entire country or region. By the end of fiscal 1952, a total of $391 million was lent to power sector, whereas transportation received $179 million and agriculture received a total of $128 million.

An agreement is reached between the Bank and the borrower as to how the capital is to be utilized, when a loan is sanctioned only after the satisfaction of the Bank. Under the Articles of Agreement the Bank is required to "make arrangements to ensure that the proceeds of any loan are used only for the purpose for which the loan was granted, with due attention to considerations of economy and efficiency.[12]

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12. IBRD, <u>Articles of Agreement</u>, Article III, Section 5 (b).

Before making a loan, the Bank ensures that the following conditions are fulfilled after a thorough investigation. They are, the economic condition of the country including the foreign exchange that it has, viability of the projects to be financed, ability of the borrower to complete the project to raise local capital to meet local costs and needs that the project will meet when completed. The loans, however, are given only when the borrower gives evidence that the money will be spent in accordance with the agreement. Finally, the Bank gets regular reports regarding the progress of work and also sends its representatives for an on the spot appraisal.

Bank has also a programme of assisting developing countries through general survey mission - a group of experts, especially organised to make a first hand study of a country's resources and formulate recommendations designed to serve as the basis of a long term development programme.

A similar type of assistance is the special survey mission - organised to make a first hand study of a particular sector of a country's economy and make recommendations for its development.

In addition to these, the Bank also gives assistance by providing staff members and nominating experts to advise on programming development and in working out specific development problems in various sectors.

However, the most innovational activity of the Bank in the early years of its lending was the establishment of Development Finance Companies, also known as Development Banks or Development Corporations in developing countries. They were to play a particularly valuable part in stimulating the growth of private enterprises in developing countries. These institutions are designed to provide medium and long-term loans and equity capital for industrial and other private productive ventures.

1. Credit Worthiness and Repayment Prospects

Under the provision of the Articles of Agreement "In making or guaranteeing a loan, the Bank shall pay due regard to the prospects that the borrower, and if the borrower is not a member, that the guarantor will be in a position to meet its obligation under the loan." The Article further enjoin the Bank to act "prudently" in the interests both of the particular member in whose territories the project is located and of member as a whole.[13]

Judging the credit-worthiness of the borrowing

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13. IBRD, Articles of Agreement, Article III, Section 4(V).

country is an important prerequisite to the granting of a loan by the Bank. In doing so the Bank takes into account various economic considerations of the country concerned. The Bank makes a thorough study of agricultural, industrial and mineral resources available in the country. The state of its external trade, balance of payment position and conditions of its internal finance particularly its budget and currency position are also taken into consideration.

The country's attitude towards its foreign debt is also an important consideration towards judging a borrower as credit worthy. A country which shows willingness to maintain debt at the expense of, if necessary, sacrifices in consumption standards, is plainly better than a country, even with a potentially somewhat stronger economy, which does not treat its foreign obligations with equal seriousness.

The Bank makes a general examination of the economy of the borrowing country with a view to determining (a) the approximate amount of additional external debt of the country can afford to service and at the rate at which it can effectively absorb such debt, (b) the general order of priority of the projects under consideration from the standpoint of their contribution to the country's development, and (c) the appropriateness of the government's economic and financial policies to further the development process.[14]

2. The specific project provision

Before a Bank loan is granted, there has to be an agreement between the borrower country and the Bank, as to the types of goods and services to be procured and the use to which they would be put. This was done in order to make sure that the loan was effective in the purpose of raising the level of production. The Articles of the Bank provide that "loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development."[15]

One criticism against the specific project provision is that the Bank examined the merits of particular projects in isolation, without reference to the overall needs of the borrowing country. But it is not always true for the Bank does the opposite.

However, the Bank also makes loans for the general development purposes, though comparatively on a smaller

14. IBRD, Fifth Annual Report to the Board of Governors, 1949-50, p.12.

15. IBRD, Articles of Agreement, Article 1(i).

scale as compared to the lending for specific purposes. In the year 1949-50, it was stated that, "the Bank would prefer to go further wherever that is feasible, and base its financing on a national development programme, provided that it is properly worked out in terms of the projects by which the objectives are to be attained.[16]

3. Selection and Analysis of projects

The Bank selects a project only after a thorough analysis of the overall economic position of the borrowing country, and the priority of the project in the country's development needs i.e. consideration is given to high priority projects.

Analysis is done by determining the goals of the project being financed and by assessing the relative productivity to be achieved. Also the Bank must be satisfied by the technical, financial and administrative aspects of the project concerned. Thus, the Bank finances projects which tend to strengthen the economy of the borrowing country.

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16. IBRD, Fifth Annual Report to the Board of Governors, 1949-50, p.8.

4. Types of Expenditures Financed

The Bank finances only a part of the total cost of any project or programme. The Bank loans are normally used to cover the direct import needs for the development financing requirements of the borrowing country and at the same time assuring that the proceeds of the loan will be used for productive purposes. The borrower is however expected to mobilize the resources and finances already available in the country. However, if a country is not in a position to do so, the Bank also provides portion of the local expenditures.

5. Procurement and End-Use Supervision

The Articles require the Bank to make certain that its funds are used exclusively "for the purpose for which the loan was granted, with due attention to consideration of economy and efficiency."[17] Thus, the proceeds of the loan can be used by the borrowing country to make purchases anywhere in the world as the loans are not tied to make purchases in any one country. However, the Bank does supervise so as to ensure that purchases are made in the cheapest possible market and in the most satisfactory

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17. IBRD, <u>Articles of Agreement</u>, Article III, Section 5(b).

fashion. Also, it supervises that Bank financed supplies and equipment are used for the purposes and at places for which the loans have been given. Procurements are made through international competitive bidding.

The objective of international competitive bidding, as it has evolved, has been two-fold:

(a) to serve the interests of both the Bank and the borrower by obtaining goods in the lowest-cost market consistent with satisfactory performance;

(b) to give all member countries a fair chance to supply goods financed by Bank loans.[18]

As for end-use supervision, the Bank since its very first loan has been involved in checking the arrival of Bank-financed goods in the borrowing country and their use on projects.

6. Lending Rates and Maturities

The Bank established its first policy on loan charges in 1947. The main element of the interest rate charged was the cost at which the Bank could borrow in the market plus a margin sufficient along with income from

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18. Mason and Asher, The World Bank since Bretton Woods, p.187.

capital to cover the Bank's operating expenses and yield a modest amount for a reserve against contingencies. Thus, a commitment fee of 1.5% on undisbursed amount was set, and the lending rate to be charged from the day of disbursement fixed at 0.25% above the Bank's cost of borrowing for the same maturity. Also, the Bank charged a uniform 1% a year commission on the outstanding amounts of loans whether they were made from borrowed funds or paid in capital.

A major review of lending rate policy was undertaken in late 1967, when the market rates wee at historically high levels. It was agreed that the rate should be kept as low as compatible with the maintenance of the Bank's ability to raise the capital markets of its members, or otherwise borrow, the funds it needs.[19]

In 1976, the lending rate policy was again subjected to a major review, and a new formula was put into effect on July 1, of that year. The lending rate is now to be reviewed at the end of each quarter and adjusted to the average weighted cost by amount and maturity of funds borrowed by the Bank in the preceding twelve months. To this calculation a positive spread of 0.5% is to be added to arrive at the interest rate that the Bank will charge

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19. Quoted in Aart Van de Laar, The World Bank and the Poor (The Hague: Martinus Niijhoff, 1980), p.28.

borrowers on new loans approved in the ensuing quarter.[20]

As for Bank's maturity of loans, till the early 1970s, the Bank loans were given seven years grace and 25 years maturity, repayable in annuity form. The Bank reviewed and subsequently modified its repayment policy in the year 1976. Accordingly, loan principal was to be repaid in equal amounts rather than in gradually ascending amounts over the amortization period. Also, the average grace period was not to exceed 3.8 years and the final maturity was not to exceed 19 years. Further, the countries were to be grouped according to income levels for the determination of terms.

The attitude of the Bank Towards the Problem of External Debt

The Bank in the 1960s became concerned about the mounting problem of external debt of its developing member countries. With the limited capital available with the Bank as compared to the demands of these member countries and also because of Bank's dependence on international capital markets, it had to adopt a very cautious approach towards this problem of external debt.

In the 1950s and early 1960s, the problem was not

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20. Ibid.

that severe as it became in the latter half of the 1960s. The total external debt of less developed countries stood at approximately $60 billion at the end of 1969, and this debt has continued to grow at the rate of 14 per cent a year.[21] Also, the Bank estimated that debt service payments by these countries amounted to about $5 billion in 1969, which was nearly 40 per cent of the total flow of funds to these countries.

The major reason why the Bank became increasingly interested in this problem was because large proportion of this debt, i.e. nearly 16 billion was owed to the Bank. It thus could not help being aware of the debt problem and could not afford the subsequent danger of default.

Taking the seriousness of the situation into consideration, the Bank decided to follow a policy so as to ease the problem of external debt of these countries. Debt negotiations, re-negotiations, debt rescheduling, postponement of debt service payments, and debt management, thus became a common feature of Bank's development policy. Under its Articles of Agreement the Bank is authorised to reschedule its debts by modifying the terms of amortization, extending the life of the loan, and by accepting payments in

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21. World Bank, Annual Report, 1971, p.50.

the debtors' currency for a period of up to three years.[22]

The Pearson Commission, appointed by the Bank in its report Partners in Development recommended that, "debt relief operations avoid the need for repeated rescheduling and seek to re-establish a realistic basis for development finance." Also, "The World bank and the IMF, as important providers of long-term and short-term finance, respectively, must of course participate in rescheduling discussions."[23]

The countries facing this problem of external debt can be classified into two broad categories. The first group of countries face this problem due to accumulation of short-term maturities, mismanagement of their economy and debts, sudden increase in imports or a temporary decline in export earnings. Several Latin American countries, Iran, Ivory Coast, Philippines, Turkey and Tunisia fall under this group and owed as much as one third of external debt of developing countries.

One common feature among countries of this group was the large reverse flows of valuable foreign exchange earned

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22. IBRD, <u>Articles of Agreement</u>, Article IV, Section 4(C).

23. Report of the Commission on International Development, Lester B. Pearson, Chairman, <u>Partners in Development</u>, (Praeger, New York, 1969), p.157.

by these countries as debt service payments, which were generally very high. "Debt service payments constitute a major claim against export earnings and thereby endanger the debtor country's ability to use foreign exchange earnings for development purposes."[24]

All that the Bank could do to overcome these problems was to guide these countries to frame economic policies with respect to debt management, by giving them more time to make repayments along with additional IMF assistance.

Project Lending

The World Bank since its very inception adopted a very cautious approach towards its lending and was determined not to repeat the mistakes committed earlier, in the international lending. The experience of the international lending by means of general purpose financing in the 1920s and 1930s resulted in a series of defaults. The lending in those years suffered from weaknesses - such as proceeds of the loans being used for unspecified purpose, lack of evaluation of performance or judging the credit-worthiness of economies. Hence, the Bank adopted "project

24. Lewis, John P. and Kapur, Ishan (ed.), World Bank Group, Multilateral Aid and the 1970s, (Lexington Books, 1973) p.113.

lending" as a cautious approach towards development lending.

Under the Articles of Agreement, the Bank is required to lend its funds except in special circumstances for specific projects and to ensure that the proceeds of these loans are used for this purpose. The intention was to ensure that funds were well used, and the founders sought to do this by tying funds to the projects.[25]

As according to Bank's interpretation, project lending is limited to the financing of specific and independent installations. This type of specific investment lending aims to promote investment by creating new productive assets and it also aims to restore economic and social infrastructures to full capacity or to ensure their maintenance. The purpose of project lending is to ensure that the funds are invested in sound, productive projects with the purpose of contributing both to the borrowing country's capacity to repay and to the development of its economy.

John A. King Jr. as a commentator on the Bank project lending comments that "they can consist of an

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25. IBRD, Articles of Agreement, Article III, Section 4 (vii), Article III, Section 5(b).

investment to build something entirely new, quite specific and virtually a unit in itself ... or of investments for the expansion or improvement of existing facilities ... or a much more generalized investment involving, a great many facilities and activities ..."[26]

According to two officials of the Bank, a project may be defined as "an optimum set of investment - oriented actions, based on comprehensive and coherent sector planning, by means of which a defined combination of human and material resources is expected to cause a determined amount of economic and social development ...Each Bank project constitutes a discrete unit of operation, with its own appraisal, negotiation of terms and conditions, board presentation, disbursement procedures, and supervision. Depending on the circumstances, the Bank loan may finance a minor or major part of the items packaged in a project, and the project itself may be limited to a small fraction of the development programme for the sector or embrace the whole programme."[27]

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26. John A. King Jr., Economic Development Projects and Their Appraisal, (John Hopkins Press, 1967), pp.3-4.

27. Bernard Chadenet and John A. King Jr., "What is a World Bank Project?", Finance and Development, Vol.9, No.3, September, 1972, pp.4-5.

However, one of the significant characteristics of project lending is its flexibility to adapt to the needs of the particular situation i.e. the Bank's conception of projects and project lending is fairly broad and flexible as is evident from its attitude towards lending over the years of its functioning.

Also, the Bank's policy of project lending involves comprehensive sector planning. The Bank makes a thorough study of the sector to which the project belongs and determines its economic priority. These studies are made either by the Bank staff or in collaboration with the staff of other international agencies, providing the basis for a sound sector strategy. "Bank projects are based increasingly on a study of the sector which analyzes the needs for various types of facilities and determines their economic priority."[28]

Thus, the Bank finances projects which lead to economic development of the borrower country which is required to pay an adequate rate of return. The Bank along with the capital provides knowledge and experience through the introduction of new technology, institutional and policy

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28. Ibid.

changes, social and human development through training and demonstrations.

For the Bank, each project that it finances has a separate identity of its own. Each project is a unit in itself, and has to go through certain common stages during its life cycle. From the time of its conception to the time of its completion of the project, there is close collaboration between the Bank and the borrower government (see Appendix-I for details).

Generally a project loan takes 4-5 years to be disbursed as it has to undergo a detailed and painstaking process called "The Project Cycle". It is argued that the Bank does not make project loans for development purposes, but on the need to convey the image to its bond holders that the Bank is a sober, responsible organisation, checking carefully on the use of its loans and the viability of the projects it finances.

Another serious criticism against the Bank's project lending is its failure to assess adequately the development consequences of its loans. End-use supervision falls short of dealing with this question.) Nevertheless Bank remains committed to project lending. But recognizing its limitations, it has embarked on programme lending as well.

Programme Lending

"Programme Loan", can be defined as a loan for the purpose of importing raw materials, intermediate products and any equipment which will enhance overall development. As Mason and Asher define it, a programme loan is designed to finance a particular kind of foreign exchange deficit - "a deficit arising from planned foreign exchange expenditures in excess of the foreign exchange prospectively available for a national development programme."[29]

Also such lending is defined as "the financing of imports that are not specifically directed to particular capital installations".[30] Further, Alan Carlin defines programme aid as assistance whose disbursement is tied to the recipients expenditure on a wide variety of items of the total needs and development plan of the country rather than any particular project.[31] (The Bank provides such aid only, when a country has a "suitable development programme" and makes an "adequate development effort". Thus programme lending implies financing of imports covering the foreign

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29. Mason and Asher, The World Bank Since bretton Woods, p.264.

30. Ibid.

31. Alan Carlin, "Project vs. Programme Aid: From the Donors Viewpoints", Economic Journal, No.305, March 1967, p.49.

exchange costs of a given volume specified in more or less detail and related to a development programme rather than to specific capital projects.

The Articles of Agreement provide for programme lending as well when they refer to financing of not only projects but also a clause "except in special circumstances".[32] This implies that financing of imports that may add to production but not necessarily to capital investment is justifiable only in "exceptional circumstances."[33] Eugene Black, President of the Bank stated that a loan for general purpose "really means a loan for a purpose or purposes unknown".

According to one of Bank's operational memoranda, important characteristics of such financing (i.e. programme lending) are that it enables "a larger amount of external aid to be made available to a country than might be possible if aid were limited to the direct foreign exchange cost of projects"; and it is "a method by which external aid can be provided rapidly..."[34]

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32. IBRD, Articles of Agreement, Article III, Section 4(vii).

33. Mason and Asher, p.261.

34. Quoted in Mason and Asher, p.265.

Local Expenditure Financing

The definition and explanation apart, one needs to at this point, mention, "local expenditure financing", which is a part of World Bank lending for development and is also classified under "exceptional circumstances". This means funding which is in excess of the foreign exchange expenditure for a project over which the Bank has no control over its use.

The conditions under which the Bank might do such financing are

1. "The Bank may, in exceptional circumstances, when local currency required for the purposes of the loan cannot be raised by the borrower on reasonable terms, provide the borrower as part of the loan with an appropriate amount of that currency".[35]

2. "The Bank, if the project gives rise indirectly to an increased need for foreign exchange by the member in whose territories the project is located, may in exceptional circumstances provide the borrower as part of the loan with an appropriate amount of gold or foreign exchange not in excess of the borrowers

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35. IBRD, <u>Articles of Agreement</u>, Article IV, Section 3 (b).

local expenditure in connection with the purpose of the loan."[36]

However, the following conditions must be met for such lending to take place:

(a) the borrowing to finance a project of urgency must be properly utilized,

(b) inadequate domestic resources to meet local currency costs,

(c) to avoid inflationary forces at times when local currency is not enough to import goods or raw materials.

The Pearson Committee reviewed the progress made during the past 20 years in terms of aid and development and further suggested ways and means of promoting development. The Committee's report "Partners in Development" made specific recommendations with respect to local expenditure financing that - "Aid givers should remove regulations which limit or prevent contributions to the local costs of projects and make a greater effort to encourage local procurement wherever economically justified".[37]

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36. IBRD, Articles of Agreement, Article IV, Section 3(c).

37. Report of the Commission on International Development, Lester B. Pearson, Partners in Development, (Praeger, 1969), p.190.

Coming to programme lending, it must be said that it got less attention during the first two decades. Until 1969, i.e. when President McNamara initiated changes in the lending policies of the Bank, only sixteen such loans were made. The often spoken about reconstruction loans to France, Denmark, Luxembourg and Netherlands which totaled $497 million are programme loans. They are so called, as the proceeds of the loans were used for import of specific goods. Austria received five loans totaling $308.5 million from 1951-57 to dollar financing of imports specified by the borrower.

Belgium Congo got a loan of $40 million. These qualified as programme loans as they were meant for foreign exchange requirements. Incidentally, this loan was the first of its kind and first programme loan to a member country and its colony.

The Italian Government was aided with its development plan, when in 1952-54, two loans of $10 millions each were granted to Cassa per Mezzogiorno to administer the development of southern half and Islands of Sicily and Sardania.

In the year 1954-55, two loans amounting to $50 million were given to Norway. In the year 1957, a loan of $75 million was granted to Iran in order to help the country to cover its foreign exchange expenditures. Also, a loan to India of $35 million in the year 1962 can be termed as programme lending.

Thus, a look at the lending policies during the first two decades and one concludes that the Bank made more of project loans and less of programme loans. The coming of Robert McNamara as its President in 1968 saw major policy changes.

With respect to programme lending, the Pearson committee recommended that - "Aid gives should adopt the forms of aid to the needs and level of development of the receiving country and recognize the great value, in many cases, of more programme aid".[38] In keeping with the recommendations made, there was an increase in the programme lending in the 1970s as compared to the first two decades. (For regional distribution of Programme Loans in the 1970s See Table 2.1).

38. Lester B. Pearson, Partners in Development, p.190.

Table-2.1

REGINAL DISTRIBUTION OF PROGRAMME LOANS IN THE 1970S. (In US$ Millions)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Eastern Africa	-	-	-	30.0	-	60.0	-	30.0	-	-
Western Africa	-	80.0	-	-	-	-	-	-	-	-
Europe, Middle East and North America	-	-	-	-	-	35.0	-	70.0	50.0	150.0
South Asia, East Asia and Pacific	-	-	-	-	-	100.0	75.0	-	-	-
Latin America	-	-	60.0	-	-	-	-	26.5	30.0	151.5
Total	-	80.0	60.0	30.0	-	195.0	75.0	126.5	80.0	301.5

Source: World Bank Annual Reports (1970-79).

The lending policies pursued by the World Bank have been considered to have paid inadequate attention to certain important aspects of development finance. For instance, the Bank took considerable time to recognize the importance of local financing in executing the project. Only after substantial time, it recognized its necessity. Further, it has been reluctant to do so particularly to the more needy developing countries.

When it came to advise on bilateral assistance for programme lending it always did so but it never showed any inclination to follow its own advise. Advise and suggestions were always a one-sided affair. It resisted suggestions to it on adopting more flexible lending policy and that it increase the volume of more programme lending. This gave it an authoritarian tinge.

Also, there has been no proper definition of the term programme loans in order that the various programme loans given could come within the definition. In essence, than the terms and definition given are vague.

In fact all these loans can be categorized as "non-project" loans. They can be termed so for two reasons i.e. (i) they were not intended to finance identifiable increases in productive capacity and (ii) the imports financed could not be traced through to find output in any precise fashion.

Another criticism is that at times programme lending tends to lead to undesirable intervention into sensitive areas of development policy of the borrowing country. Also, such loans can be an impediment to the planning efforts of many developing countries. It can also lead to neglect of pre-investment activity and project preparation.

In conclusion, it must be said that its drawbacks apart, programme loans are fast disbursing i.e. within one or two years, as a result of which the donors can easily transfer resources to the governments they are actually dealing with rather than to their successors whose policies and programmes they cannot foresee or monitor.

Lending of the World Bank over the three decades

Table-2.2 gives the total loan commitment of the World Bank over the period 1947-1979. It began lending with small amount. During the entire decade of fifties the World Bank was not making any important breakthrough in its lending. However, during the period 1953-1958, the World Bank was lending at an annual average of $ 300- $400 million. The next ten year period i.e. 1958-1968 saw a marked increase (nearly double) in the amount of lending. From a modest $ 300 - $ 400 million every year, the Bank started lending nearly $ 700 - $ 800 million annually. Except in the year 1965, when the amount lent by the Bank crossed $ 1 billion. Since the seventies the World Bank lending has grown substantially. The loan commitment of the Bank reached the high figure of $ 6989.0 million in the year 1979. In the decade of fifties, lending grew by 261 per cent over the year 1947. Similarly, in the sixties the lending of the World Bank further increased by 252 per cent over the year 1959. In the seventies, the growth was even more. It grew by more than 350 per cent. Same is true for the number of projects financed. From a meager figure of one in 1947, it stood at 31 in 1960 which shot up to 70 in 1970 and doubled in the year 1979.

Table-2.2

IBRD LENDING OPERATIONS (1947-1979)
(U.S. $ Millions)

Fiscal years	Number of loans	Amount	Fiscal Years	Number of loans	Amount	Fiscal Years	Number of loans	Amounts
1947	1	250.0	1958	74	710.8	1969	84	1,399.2
1948	5	263.0	1959	30	703.1	1970	70	1,680.4
1949	10	137.1	1960	31	658.7	1971	78	1,896.4
1950	12	166.3	1961	27	609.9	1972	72	1,966.1
1951	21	297.1	1962	29	882.3	1973	73	2,051.0
1952	19	298.6	1963	28	448.7	1974	105	3,218.4
1953	10	178.6	1964	37	809.8	1975	122	4,319.7
1954	26	323.7	1965	38	1,023.3	1976	141	4,977.1
1955	20	409.6	1966	37	839.2	1977	161	5,759.3
1956	26	396.0	1967	46	876.8	1978	137	6,097.7
1957	20	389.9	1968	44	847.0	1979	142	6,989.0

Source: World Bank Annual Reports (1947-1979).

Region-wise: Table-2.3 gives the region-wise distribution of lending of the World Bank during the decade of seventies Africa has increasingly become important. Further in the latter years of 70s the Latin America and Caribbean had become important.

Table-2.3

IBRD LENDING IN REGIONS IN THE 1970s
(US$ Millions)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	Total
Africa (East and West	281.7	347.2	192.3	234.4	370.6	648.1	507.8	570.8	465.8	583.1	4201.8
Asia (South)	435.2	429.1	185.0	408.9	715.4	269.0	260.0	394.0	330.0	300.0	3726.6
Europe, Middle East and North Africa	160.5	398.5	477.4	768.9	1246.5	1264.1	1341.9	1474.3	1660.5	2081.5	10874.1
East Asia and Pacific	-	51.0	-	-	-	972.0	1458.5	1452.0	1586.9	1791.6	9103.6
Latin America and Carribean	702.9	670.6	945.3	638.8	885.9	1666.5	1408.9	1868.2	2054.5	2232.8	13074.4
I.F.C.	100.0										
Total	1680.4	1896.4	1966.1	2051.0	3218.4	4319.7	4977.1	5759.3	6097.7	6989.0	40980.5*

* Due to rounding of figures slight variation in totaling is unavoidable.

Source: World Bank Annual Reports (1970-1979)

Sector-wise : Bank Lending sector-wise was also diversified as seen in Table 2.4. Agriculture steadily became important. In the seventies its importance grew substantially. Whereas the importance of transport also grew considerably but not to the same extent as the case of agriculture. Sectors such as Electric Power and Development Finance Companies were also major recipients of Bank loans. Education also received the attention of the Bank.

Table-2.4

IBRD SECTORAL LENDING IN THE 1970s
(US $ Millions)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Agriculture and Rural development	186.8	191.0	123.1	501.6	646.5	1221.5	1209.2	1637.8	1929.0	1566.1
Development Finance companies	-	253.0	217.0	268.0	309.0	469.5	697.1	730.7	829.5	628.6
Education	50.3	68.2	133.6	161.6	134.4	126.7	244.9	210.1	268.9	245.7
Electric power	502.1	390.2	463.8	390.2	755.9	475.7	690.3	784.5	900.0	872.5
Industry	234.5	32.0	342.0	-	309.1	665.3	501.0	720.8	364.8	721.0
Non-project	-	-	60.0	30.0	-	195.0	15.0	126.5	80.0	301.5
Population & Nutrition	2.0	3.0	-	21.5	-	25.0	25.8	42.5	25.0	17.0
Technical Assistance	-	-	-	-	16.0	-	1.5	11.0	-	13.0
Telecommunications	67.9	104.7	82.7	157.8	66.5	96.0	69.0	140.7	153.6	110.0
Tourism	-	10.0	36.0	-	30.6	30.7	21.0	98.6	50.0	66.7
Transportation	516.2	573.2	453.2	520.1	733.2	851.8	895.6	918.1	1430.9	1114.7
Urban Development	-	-	-	16.0	68.0	70.5	79.6	128.2	222.4	297.5
Water Supply	18.5	185.7	54.7	200.1	149.2	128.0	246.5	262.5	345.4	647.3
International Finance Corpn.	100.0*									
General Dev. Corporation		85.4*								
Energy									82.4*	
Total	1680.3	1896.4	1966.1	2051.0	3218.4	4319.7	4977.1	5759.3	6097.7	6989.0

* Loans were made just once during the decade.

Source: World Bank Annual Reports. (1970-79).

To conclude, Table 2.5 gives the list of twenty largest borrowers of the Bank loans till 1980 since the development lending actually began.

Table-2.5

TWENTY LARGEST RECIPIENTS OF BANK LOANS CUMULATIVE, 1946 TO 1980

Country	Amount
Brazil	5313.7
Mexico	4113.6
Indonesia	3056.0
South Korea	2948.5
India	2770.6
Colombia	2761.4
Yugoslavia	2684.1
Turkey	2407.4
Phillippines	2389.9
Thailand	1960.4
Romania	1502.8
Morocco	1437.3
Nigeria	1380.7
Argentina	1350.3
Iran	1210.7
Malaysia	1132.6
Egypt	1129.0
Algeria	1091.0
Pakistan	884.0
Japan	862.9

Source: Robert L. Ayres, Banking on the Poor The World and World Poverty, (The MIT Press, Cambridge, London, 1984).

CHAPTER - III

Lending policies of the World Bank in the eighties (1980s): With Special Reference to Structural Adjustment Lending (SAL) - Purpose, Nature, Sectoral Types of SAL

The developing countries in the latter half of the decade of seventies faced a large number of problems. Their development pace became tardy. Their average rate of growth in 1965-73 was 6.5 per cent which declined to 5.4 per cent in 1979-80. Further, they began to experience severe balance-of-payments crisis. These countries faced acute debt crisis. The total international debt of developing countries in the year 1980 was 404.5 billion. Actual implication of international debt can be seen in the debt indicators such as debt service ratio and debt GNP ratio. The debt service ratio was 13.7 per cent in 1975 and it shot up to 17.9 per cent in 1981. Similarly, debt GNP ratio also increased. It increased from 15.7 per cent in 1975 to 26.3 per cent in 1982. In fact the early eighties witnessed steady decline in the net transfer of resources. Thus in the beginning of eighties the developing countries were in bad position, as some commentators put it that development was in siege. Further international trading environment also deteriorated for the world economy was in recession and protectionist barriers affected the liberal trade. This led to the financial crisis of developing countries having a serious bearing on healthy functioning of world economy.[1] It became essential for the international community to pay special attention to this global financial crisis or else development of developing countries would be further seriously affected leading to a serious impact on the other investment programmes being carried out in these developing countries and also on other efforts such as poverty alleviation, stimulating growth and providing basic human needs. In the case of the World Bank, key reforms suggested included:

- A substantial increase in non-project lending both to assist countries coping with economic shocks and cycles and deceleration of the flow of non-official financing.
- Use of Bank's guarantee authority to help countries diversity their range of development financing instruments - including new non-bank financing and innovations in Bank financing techniques.
- An active effort by the Bank to help a country to mobilize public renegotiation before most private investors have regained confidence in the debtors' economy.[2]

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1. See for detailed discussion, Sumitra Chishti.
2. Richard E. Feinberg and Valeriana Kallab (ed.), Uncertain Future: Commercial Banks and the Third World (Transaction Books, USA, 1984), p.26.

Thus, the World Bank in order to help overcome such a situation introduced in 1980 another lending instrument of a non-project nature known as the Structural Adjustment Lending (hereafter referred to as SAL).

> In fact, prior to 1980, non-project operations were undertaken only in response to a few cases of immediate and urgent need stemming from natural disasters or "man-made" ones (such as post-war reconstruction in Nigeria or Uganda); from serious declines in terms of trade due to export price declines (such as Zambia's experience with copper or Columbia's with coffee; from import price increase (most obviously in the price of oil in 1973-74, and again in 1979); or other acute need such as India's need for help in financing imports of intermediate goods and spare parts for more fully utilizing its existing industrial capability rather than for financing new projects.3

Although lending for structural adjustment is a new form of Bank assistance which has been introduced for the first time, such assistance is a natural evolution in the traditional programme assistance that has always been (and continues to be) a part of Bank's lending operations. Previous programme lending however, has generally been designed to meet the immediate consequences of crisis. As a result, the programmes supported were concentrated on measures dealing with immediate difficulties, rather than on

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3. Stanley Please, "The World Bank: Lending for Structural Adjustment", in Richard E. Feinberg and Valeriana Kallab, (ed.), <u>Adjustment Crisis in the Third World</u>, (Overseas Development Council, Washington, D.C.1984), p.85.

finding solutions to a country's underlying long-term structural problems. Structural adjustment lending on the other hand, envisages the probability of multi-year programmes being worked out and supported by a succession of loans. Because such lending will be developed with long-term objectives in mind it is expected to have more enduring effects than the crisis-oriented operations that were characteristic of the Bank's programme lending in the past.[4]

The beginning of SAL is seen in the President McNamara's address to the Board of Governors at the 1979 Annual Meeting where he noted that he was prepared to recommend to the Bank's executive Directors considerations of requests for "structural adjustment" assistance. With this the Bank took over a new role of policy based programme lending.

Just before the Annual Meetings of the World Bank and the IMF in October 1979, the Development Committee[5] stated that "The Committee welcomed the initiative taken by the Bank to provide assistance through structural adjustment lending on appropriate terms and conditions for developing

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4. World Bank, Annual Report, 1980, p.68.

5. 20 Member Joint Ministerial Committee of the World Bank and IMF whose function is to advice and report to the Boards of Governors on transfer of real resources to the developing countries.

countries which face difficult medium-term prospects in the balance of payments. Members recognized the contribution that would be made through this type of non-project and programme lending both to rapid transfer of adequate resources and to the active pursuit of appropriate structural policies in the developing countries."[6]

As defined by the Bank, "this type of non-project lending has the specific objective of helping countries reduce their current account deficits to more manageable proportions over the medium-term by supporting programmes of adjustment that encompass specific policy, industrial and other changes designed to strengthen their balance of payments while maintaining their growth and development momentum".[7]

The Articles of Agreement of the Bank state that, "loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development".[8] SAL by the Bank is made under this clause of "except in special

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6. Development Committee Communique, April 24, 1980, cited in World Bank, Annual Report, 1980.

7. World Bank, Annual Report, 1980, p.68.

8. IBRD, Articles of Agreement, Article III, Section 4(viii).

circumstances". The SAL programme has moved the institution into non-project lending on a systematic basis and has placed policy issues rather than project issues at centre-stage.[9]

Another definition states that, "The World Bank's new structural adjustment loan which it will offer on "soft" terms to low income countries and on "hard" terms to higher income borrowers - is, in essence, conditional long-term balance of payments financing to promote changes in economic policies and programmes.[10]

Deonoy and Addison state that the term "adjustment" has come to be used in a loose and sometimes misleading fashion. It can refer to the objective of adjusting the balance of payments deficit itself, but it has also been used to describe the accommodating changes needed in the domestic economy to correct the external deficit.[11]

The same authority states that "structural

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9. Stanley Please, "The World Bank: Lending for Structural Adjustment", p.87.

10. Mariam Camps and Catherine Gwin, Collective Management - The Reform of Global Economic Organizations, 1980s Project Council on Foreign Relations, p.267.

11. IBRD, Lionel Deonoy and Tony Addison, The Alleviation of Poverty Under Structural Adjustment (The World Bank, Washington D.C. 1987), p.2.

adjustment" refers to policies designed to influence the equilibrium configuration itself by making structural reallocations and changing some of the ground rules of production and exchange (through institutional reform or privatisation for example).[12]

Further the objective of the SAL programme is, "to provide quick disbursing finance to support measures designed to strengthen recipient countries' balance-of-payment within five to ten years, without severely constraining demand in a manner that unnecessarily sets back economic and social development."[13]

Unlike project loans, finances under SALs are quickly disbursed but in accordance with certain agreed measures to help structural adjustments. Structural Adjustment Lending (SAL) has been defined as "a series of discrete lending operations ... to provide quick disbursing balance of payments support to a country which is prepared both to formulate and to reach agreement with the World Bank on a structural adjustment programme."[14]

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12. Ibid.

13. Lendell and Mills, "Structural Adjustment Lending: Early Experiences", Finance and Development, January 18, 1981.

14. Stanley Please, The Hobbled Giant, Essays on the Bank (Boulder Co., Westview Press, 1984), p.29.

Above all and primarily, as mentioned earlier, SALs are to infuse policy and institutional change in specific policy objectives such as fertilizers, pricing or liberalization of trade. Institutional change means change in the individual sectors. Thus, SAL has new elements and also aspects of old lending policies. It has been described that SAL is a "financial bridge while policy reform is taking place" a new mechanism which has been introduced by the World Bank "with the aim of giving greater urgency to its concerns over policy issues relating to structural adjustment and a more systematic involvement in programmes which address these issues."[15]

Moslay and Toye detail out three entirely separate objectives of lending under the SAL in increasing order of complexity. They are:

<u>Financial</u> - to provide resources, which would ease developing countries acute debt and balance of payments problems of the early 1980s on a medium term basis.

<u>Macro-economic adjustment</u> - to manage aggregate demand so as to optimize medium term growth prospects for the economy.

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15. Ibid., p.30.

Micro-economic adjustment - to further improve the supply side by removing policy induced distortions in specific markets, in particular the markets for foreign exchange, energy, public utilities and agricultural produce.[16]

In attempting to implement reforms, the Bank makes some suggestions while granting SALs to member countries. They include promotion of investment in non-traditional exports, adjusting domestic production to higher energy prices, emphasis on labour, intensive investments to generate employment, for making institutional changes to improve production and marketing systems.

Next, the two conditions that must be met for a country to receive SALs. Firstly, a country must experience or anticipate a serious balance of payments crisis due to reasons that cannot be reversed. Secondly, the would be recipient must chalk out a time bound structural adjustment programme so as to improve its balance of payments position.

Further, the Bank on its part has formulated certain restrictions on the SAL program. However, today after 10

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16. Paul Moslay and John Toye, "The Design of Structural Adjustment Programmes", Development Policy Review, 6(4), December 1988, pp.396-97.

years of SAL operations, it has been proved that these restrictions are of a flexible nature. Accordingly, at the time of its initiation, lending under SAL, which is non-project in nature was limited to 10 per cent of the total World Bank lending in any one year and 30 per cent of the total lending to any one country.

<u>Policy Reforms Under SAL</u>

Under SAL finance, the borrowing country has to enter into agreement with the Bank promising structural adjustment with a comprehensive program of policy action. However, some of the specific areas of policy measures requested in return for SAL finance are : removal of import quotas, tariff reductions, budget reform, interest rate policy reform, revision of agricultural prices, reduction or elimination of some agricultural input subsidies, revision of industry incentive system and strengthening of capacity to formulate and implement public investment programme. (A list of the policy changes which have been requested as conditions attached to World Bank SALs is set out in Table-3.1.

Table-3.1

Types of Policy Measures Requested in reTurn ~~of~~ for SAL Finance Measures

I. Trade Policy:

1. Remove import quotas
2. Cut tariffs
3. Improve export incentives and institutional support

II. Resource Mobilization :

1. Reform budget and taxes
2. Reform interest rate policy
3. Strengthen management of external borrowing
4. Improve financial performance of public enterprise

III. Efficient Use of Resources:

1. Revise priorities of public investment programme
2. Revise agricultural prices
3. Dissolve or reduce powers of state marketing boards
4. Reduce or eliminate some agricultural input subsidies
5. Revise energy prices
6. Introduce energy conservation measures
7. Develop indigenous energy sources
8. Revise industry incentive system

IV. Institutional Reforms:

1. Strengthen, capacity to formulate and implement public investment programme
2. Increase efficiency of public enterprises
3. Improve support for agriculture
4. Improve support for industry and subsectors

Source: Paul Moslay, " Conditionality as a Bargaining Process: Structural Adjustment Lending - 1980 —86" Essays in International Finance, No.168, (Princeton University, 1987), p.7

According to a senior Vice-President of the Bank, structural adjustment loans are supported by programmes that include measures falling primarily within four areas:

- the restructuring of incentives, including pricing policies, tariff reforms, taxation budget subsidies, and interest rates.
- the revision of public investment priorities,
- improvements in budgeting and debt management, and
- the strengthening of institutions, particularly public enterprises.[17]

The Bank reaches on an agreement and understanding with the borrowing government on specific actions to be taken and a few key actions are made preconditions for the release of disbursements. Satisfactory progress in carrying out the overall programme is also a requirement. The Bank on its part makes tranched or phased disbursements (successive SALs cover a period of 5-7 years) of funds under the SAL program so as to ensure the efficient implementation of the SAL operation by the borrowing government.

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17. Ernest Stern, "World Bank Financing of Structural Adjustment", in John Williamson, ed., <u>IMF Conditionality</u> (Washington D.C., Institute of Interantional Economics, 1983), pp.93-99.

Non-Project Lending and SAL

As SAL comes under non-project lending, it is necessary to make a distinction between types of lending that is made under non-project lending.* A programme loan, simply put, is long-term balance of payment financing. The Bank makes this type of lending to be used to support governments efforts to remedy the consequences of a temporary crisis such as a civil war or a natural disaster, an unanticipated shortfall, or a sudden and substantial deterioration in terms of trade.

The SAL, also a non-project lending is designed to help developing countries difficult process of policy and institutional reforms.

As is evident from the above explanation, the programme loans intended to meet the short-term or immediate difficulty rather than dealing with the long-term structural problems of developing countries. A sector loan, on the other hand is basically financing for a package of projects in one sector of a country's economy, with some additional planning money.

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* Programme Lending, sectoral lending and structural adjustment lending all come under non-project lending.

Conditionality and SAL

In contrast to conditionality on project loans, SAL conditionality is related entirely to issues of macro-economic and sectoral policies. It raises the level of dialogue to the highest ranks of government and provides a single focus that helps ensure that adequate attention is given to the programmes' prompt implementation. Whereas in project lending, the Bank will typically be dealing with agencies or sectoral ministries, SALs are always the concern of the key decision-makers.[18] "The main feature of structural adjustment lending - its high degree of conditionality, focused on such considerations as the structures of incentives, public investment priorities, budgetary reform and institution building - has virtually precluded its applicability to emergency situation.[19]

Due to this, i.e. stringent conditionality prescriptions imposed by the Bank along with SAL finance, only a limited number of countries have resorted to this kind of assistance.

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18. Ernest Stern, "World Bank Financing of Structural Adjustment", p.104.

19. Richard E. Feinberg and Valeriana Kallab, ed., Uncertain Future: Commercial Banks and the Third World (Transaction Books, USA, 1984), p.91.

Assessment of Structural Adjustment Lending

Richard E. Feinberg points out four criticisms against structural adjustment lending by the Bank which he says are also the complaints from many Third World clients:

- The Bank is in danger of becoming like the IMF - pushing simplistic standardized formulas that slight the particular history, culture and politics of individual nations, and that are based more on preconceived ideology than on objective analysis.
- Some Bank staff are just too junior too arrogant, or too ignorant to negotiate with senior government officials who generally know more about their own countries economic and political realities.
- Structural adjustment programmes are overly ambitious,encompass too many objectives and details, and require closely spaced assessments that come up before substantial progress can reasonably be expected.
- The size of the Bank's loans is often not commensurate with the costs and risks of the adjustments that it proposes.[20]

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20. Richard E. Feinberg and contributors, Between Two Worlds : The World Bank's Next Decade (Transaction Books, Overseas Development Council, Washington D.c. 1986), p.12.

As for the expansion of structural adjustment loans, the Bank faced two difficulties, one difficulty, which is often mentioned, is the lack of expertise in the Bank to evaluate structural adjustment programmes. Secondly, expansion could only be at the expense of the Bank's valuable project lending activities. These were the difficulties and doubts faced by the bank at the time of the initiation of the structural adjustment programme in the early 1980s when the climate was that of global economic crisis and uncertainty about the scale of private finance.

In fiscal year 1980, only eight non-project loans were approved. These totaled only $525.5 million and accounted for only 4.6 per cent of the Bank's total lending.[21] Out of these only two i.e. Turkey - 200 million and Bolivia - 5- million were structural adjustment loans approved by the IBRD.

In the second year of its lending for structural adjustment nearly half a dozen countries had adopted such programmes, a number far smaller than the number of countries that needed to implement such programmes. The difficulty that governments find in gaining political acceptance for the adoption and implementation of structural

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21. World Bank, Annual Report, 1980, p.124.

adjustment programmes has been and continues to be the single most important obstacle to rapid progress by the Bank with structural adjustment assistance. Often the need for structural adjustment is greatest in those countries that find it most difficult to adopt effective programmes. In some of these countries, the Bank has supported policy improvements on a more limited sectoral basis in the hope that they could be broadened gradually.

The Bank can make SALs only from the resources available with it and also the policies related to SAL have to be flexible so as to suit the circumstances of individual countries which normally vary from one country to another. Guyana was the first country to receive a SAL of $14 million, in the year 1981. The loan was in the form of foreign exchange to be utilized for industrial and agricultural inputs both in public as well as private sectors. The Bank's aim, was to stimulate economic growth and restore balance of payments equilibrium.

In the year 1982, in an informal seminar of the Directors of the Bank, it was noted that, "while there is still much to learn, structural adjustment programme will consider, as far as possible, how the burdens of adjustment are shared among income groups, and how adverse effects the poor,... Bank research will give high priority to reducing the gaps in its knowledge of the effects of the poor of macroeconomic policies, including alternative routes toward structural adjustment."[22]

The year 1983 witnessed an increase in the World Bank lending in the form of structural adjustment as compared to the lending in the first three years. However, it was assessed that "structural adjustment lending has been limited both in the number of countries participating - sixteen to date - and in the volume of World Bank funds allocated to SAL operations, which has risen from approximately $700 million to $ about $1250 million in 1983".[23] (See Table-3.2).

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22. World Bank, Annual Report, 1980, p.37.

23. Stanley Please, "The World Bank: Lending for Structural Adjustment", p.86.

Table-3.2

IBRD Structural Adjustment Lending - 1980-89
(US $ Millions)

Fiscal Year	No. of Loans	Amount	% of Total Lending
1980	3	305.0	2.7
1981	6	717.0	5.8
1982	6	1,071.0	8.2
1983	7	1,285.0	8.9
1984	6	1,082.0	7.0
1985	3	163.0	1.1
1986	7	610.0	3.7
1987	13	665.0	3.8
1988	7	1,520.0	10.2
1989	7	1,392.0	8.4
Total		8,810.0	7.3

Source: IBRD, Peter Nicolas, The World Bank's Lending for adjustment, and interim report, (Washington, D.C, 1988) and World Bank Annual Reports, 1988-1989.

Special Assistance (or Action) Programme

In the year 1983, structural adjustment was incorporated in a broader Special Action Programme (SAP) initiated by the Bank, which was established for two years. This programme was described to help developing countries restore their development efforts despite adverse current economic environment. The programme's major elements included -

1. expansion in lending for high-priority operations that supported structural adjustment, policy changes, production for export, fuller use of existing capacity, and the maintenance of crucial infrastructure;

2. sector adjustment support in the form of laons for export development and modernization of existing facilities, and provision of agricultural inputs as part of a programme to improve incentives;

3. financing of an increased share of project costs, including part of local currency costs, especially in the poorest countries, and

4. coordination with other international lending institutions and bilateral donors.

The programme involved financial measures and policy advice to help those countries that were demonstrating a willingness to cope with the adverse environment through policies aimed at improving export competitiveness, mobilising additional domestic resources, and adjusting overall expenditures to diminished foreign and domestic resources in a manner least damaging to their future prospects of growth.[24] This programme certainly did not intend to finance balance-of-payments deficits of the countries facing severe economic crisis. Instead it was a time bound programme to help those countries that are already pursuing appropriate policies with additional financial measures and policy advice by the Bank with the expectation of world economic recovery during that period.

The Bank announced that within this programme it would be willing temporarily to allow structural adjustment loans to exceed the limit of 30 per cent previously imposed on that component of its total lending to a country. It also intimated that it would be prepared to exceed the 10 per cent limit previously imposed on structural adjustment loans in relation to its total lending.

The estimated increase in IBRD disbursement as a result of this programme was $ 2 billion over the period fiscal 1983-85, an 8 per cent increase in total projected disbursement for those years. Net transfers (disbursements less interest and amortization) were expected to increase by nearly 25 per cent in this period as a result of the program (see Table-3.3).

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24. World Bank, Annual Report, 1984, p.47.

Table-3.3

Projected IBRD Disbursements and Net Transfers Under Special Assistance Programme*
(US $ Million)

	Fiscal Years			
	1983	1984	1985	Total
IBRD				
Disbursement without Programme	7300	8300	9400	25000
Net Resource Transfers	2600	2550	2200	7350
Additional disbursements from Programme	150	1000	850	2000
Additional Net Transfers from Programme	145	925	680	1750
Increase in disbursements (%)	2	12	9	8
Increase of net Transfers (%)	6	36	31	24

* Projected as of 1983.

Source: World Bank Annual Report 1983.

In March 1984, an assessment on the progress of the SAP operation for the year 1983 was made by the Bank's Executive Directors. The report stated that there was an expansion in the lending for "adjustment" operations as was expected when this programme began. The Bank approved twelve new operations under this programme during the first ten months - which included two SALs, six sector-adjustment loans, and four supplemental loans. Also, twenty-eight programmes already under Bank consideration were modified to include SAP elements. As expected, substantial increase in the Bank disbursements under this programme was witnessed.

In order to achieve the objectives of the programme the Bank expanded its advisory services for both structural as well as sector adjustment programmes included in the SAP. As one of the objectives of the Bank in the implementation of SAP was to "urge other members to make similar efforts" for a successful completion of the programme, the review stated that it had achieved its objective as far as Sudan and Ghana were concerned. The programme had achieved a positive response from various bilateral donors as well.

In march 1985, the Directors of the Bank after reviewing the SAP operations for a second consecutive year, stated in a progress report that:

1. It had facilitated the completion of some 260 priority projects, supporting a total investment of about $50 billion, by ensuring the timely availability of financial resources;

2. Its fast-disbursing assistance allowed imports of critical raw materials and spare parts needed for the

better use of existing production capacity, thereby making the adjustment process less painful;

3. It had provided a good opportunity for identifying and resolving bottlenecks of efficient project implementation; and

4. The perceived responsiveness of the Bank in adopting its procedures and practices to ameliorate the economic difficulties of its developing members was beneficial to the policy dialogue the Bank has with its developing member countries, in addition, the flexibility demonstrated by the Bank affected the action of other donors.[25]

Under the SAP forty-four countries received about $4.5 billion during the period 1984-86. It indicates an increase, almost twice the amount given when the SAP was first started. However, the SAP has not been able to play an important role in the 1980s. In fact there was a rise in economic activity but it cannot be attributed to SAP.

Recently the components of SAP such as structural adjustment and sector adjustment lending, use of revolving funds, financing of working capital and recurrent costs,

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25. World Bank, Annual Report, 1985, p.54

have been absorbed into normal Bank operations. This makes it easier for the Bank to undertake policy adjustments for countries on a case by case basis.

Sector Adjustment Lending

Sector-adjustment lending was another form of instrument adopted by the World Bank in the year 1979, along with structural adjustment lending. Sector adjustment lending was designed to support, within an acceptable macro-economic framework, sectoral programmes of policy and institutional change, including restructuring of capacity, and to increase resource mobilisation and in ways in which resources are allocated. It was the adverse world economic environment that led the Bank to resort to this type of non-project lending. The objective of sector-adjustment lending is to promote the introduction and effective implementation of sector policies necessary for sustained rapid growth.[26]

This form of lending involves major changes in macro-economic policies of the borrowing country. Its focus is on major sectoral issues and investment programmes, especially incentive framework (tariffs, prices, taxes), and institutional capability. The condition for a sector adjustment loan is that the borrower country has to agree on

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26. World Bank, Annual Report, 1986, p.47.

a specific monitorable programme of action in these areas on specific schedule and on investment programmes for the sector.

Sector adjustment loans are usually given to countries which lack administrative and political skills to formulate and implement comprehensive economy - wide structural adjustment programmes. Also, countries where SAL are considered to be too comprehensive and not needed sector-adjustment loans are provided. These loans are generally used for imports required in a particular sector so as to bring about reforms in that sector. These loans are generally disbursed in between two to six years. These operations are normally tranched or phased, and the release of the second tranche is linked to the progress of sector adjustment programme (see Table 3.4 for details in sector-adjustment lending and operations for the period 1979-1989).

Table-3.4

IBRD Sector Adjustment Lending 1979-89

Fiscal Year	No. of Loans	Amount	% Total Lending
1979	1	31.5	0.3
1980	1	65.0	0.6
1981	3	137.0	1.1
1982	-	-	-
1983	8	640.9	4.4
1984	8	1,317.9	8.5
1985	13	1,475.1	10.3
1986	18	2,283.5	14.0
1987	18	3,452.5	19.5
1988	10	2,420.1	16.3
1989	12	3,887.0	23.6
Total	82	15,710.5	13.1

Source: IBRD, Peter Nicolas, The World Bank's Lending for Adjustment, An Interim Report, (Washington: D.C.1988) and World Bank Annual Reports, 1988-89

Sub-Saharan Africa

World Bank for the first time adopted a developing region for intensive support through various lending programmes and policy dialogue and reforms in the eighties.

Sub-Saharan Africa emerged in the early 1980s as the region of greatest concern to the development community because of its poverty, rapidly rising population and declining living standards. The World Bank realized that this region deserved greater attention to sound investment planning so as to deal with the problems facing the sub-Saharan African countries. In 1981, the World Bank issued the first in the series of its reports, "Accelerated Development in sub-Saharan Africa: An Agenda for Action". This special programme of action was to deal with problems of Africa's slow growth. The region was witnessing a decline in per capita income as well as agricultural output during this period. The report emphasized on reforms in domestic as well as external policies.

The former, i.e. domestic reforms included the elimination of inefficient trade regimes and over valued exchange rates that have led to the region's poor export performance. Also, it stressed on the establishment of an appropriate institutional framework in order to increase agricultural production. It also suggested greater efficiency in parastatal bodies and development of increased capacity for project evaluation and policy formulation.

Alongside domestic efforts, the report emphasized for an "equally profound commitment ... from the international community ... to increase aid and to provide assistance in ways more suitable to Africa's needs and in support of the reform programmes, defined by the African governments".[27] In order to deal with the problems of this region along with the policy reforms suggested in the report, it also stated that the official aid to the region in the decade (1980-90) should be doubled.

In the next two years of the publication of this report, the countries of this region witnessed a worsening economic climate, a sharp decline in world trade, falling prices of exports, rising debt service commitments, and stagnating levels of official development assistance.

Reviewing the existing economic climate of the region, the World Bank in the year 1984 published second in the series of reports on sub-Saharan Africa called, "Sub-Saharan Africa: Progress report on Development prospects and programmes". This report highlighted on problems being faced by these countries in designing and implementing programmes of reforms, examined the changes due to the World Bank operations and reviewed the response of the donors to increased aid to this region. In September 1984, the World Bank published the third in a series of reports on the

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27. World Bank, <u>Annual Report</u>, 1982, p.62.

problems of and prospects for, sustained development in sub-Saharan Africa: A Joint Program of Action. It stressed that "the better use of investment both domestic and foreign is the key issue".

> It notes - "Experience demonstrates that too much investment has gone into projects that have failed to generate significant increases in output. Genuine mistakes and misfortunes cannot explain the excessive number of "White elephants". Too many projects have been selected either on the basis of political prestige or on the basis of inadequate regard for their likely economic and financial rate of return. Changing the structure of an economy still requires strict adherence to criteria for project selection and design in order to maximize the return on investment. External financial agencies have shared the responsibility for this inadequate discipline over the use of investment resources".28

This programme traced the unsound investments and pricing policies in the region, examined the effects of long term constraints on development and proposed a programme of action that would lead the region's realization of its potential for sustained development. This programme emphasized on six major elements:

- efficient national economic management by policy planning geared towards rehabilitation and development;

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28. World Bank, Towards Sustained Development in Sub-Saharan Africa: A Joint Programme of Action (Washington D.C., 1984), pp.1-24. Quoted in Warren C. Baum and Stokes M. Tolbert, Investing in Development - Lessons of World Bank Experience, (Oxford, 1985), p.11.

- monitorable and coordination and donor programmes;

- external support for reform programmes should be in the form of adequate, timely and sustained financial assistance;

- emphasis should be on rehabilitation and maintenance of existing infrastructure in support of policy reform rather than on new investments.

- emphasis should be on basic programmes for development/education, health, population etc.; and

- external finance both bilateral and multilateral should be increased.

On its lending to Africa, the Bank decided that it will resort to its different types of lending instruments. Majority of the lending will be in the form of specific investments or project lending, efforts in support of policy reform will be through sector adjustment and structural adjustment loans and to lesser extent, programme loans.

Another major activity of the Bank in support of the action programme in the region was to strengthen the non-financial assistance. Also, the Bank decided to support for more aid coordination in the region by other agencies such as IMF and UNDP. Finally, the most important activity that this programme called for was the creation of Special Assistance Facility in support of reform programmes undertaken by African governments.

On July 1, 1985, the Special Facility for sub-Saharan Africa began operations. The resources available amounted to $255 million and was expected to increase to $ 1.2 billion. It was a programme for three year (1986-1988) period. This facility was a crucial component of the joint programme of action in so far as it provided the means to facilitating the formulation and implementation of reform programmes, and of supporting governments in the difficult decisions needed to make the over all flow of resources to Africa effective. It also stressed on issues such as debt rescheduling and increased and multilateral assistance to the region.

During the year 1986, Special Facility Operations totaling $782 million were approved to fifteen countries.[29] During 1987, twelve operations were financed with facility credits totaling $421 million. Special joint financing amounted to $192 million.[30] In 1988, African Facility Credits amounted to about $1.1 billion, and approximately

29. World Bank, <u>Annual Report</u>, 1986, p.22.

30. Ibid., 1987, p.30.

$800 million was allocated under special joint financing.[31]

Addressing Poverty Alleviation in the 1980s

In the 1980s poverty alleviation was to be a key and integral part of the Bank's development programme. The Bank was to lay emphasis on economic growth along with efficiency and equitable distribution. Managing the global economy and financing the alleviation of poverty were the two most important tasks of the World Bank.

The Bank in the 1970s had laid special emphasis on direct measures to alleviate poverty under President McNamara's leadership. It was a reaction to the world wide recognition that growth was not reaching the poor majority in many developing countries. Hence lending for sectors and sub-sectors considered more directly beneficial to the poor-rural and urban development, primary education, population, health and nutrition, small-scale industries, water supply etc. were given special emphasis. Trends by the end of the decade showed that many countries had made a steady progress in the fight against poverty but still the total number of people living below the poverty line continued to mount despite efforts made by the developing countries

31. Ibid., 1988, p.36.

concerned as well as by the international community.

At the time when McNamara made his final address to the Board of Governors on September 30, 1980, "Absolute Poverty", he said, "is an open insult to the human dignity of us all, to the poor themselves, because simply as human beings they have deserved better ... for we have collectively had it in power to do more to fight poverty and we have failed to do so".[32]

The 1980s began with the world witnessing a severe economic crisis. The crisis as discussed earlier occurred due to two and a half fold increase in the oil prices which resulted in severe economic constraints on the economies of the developing countries and led to stagnant or negative growth in low income countries of sub-Saharan Africa, Latin America, and some parts of Asia. This economic decline almost brought the development to a standstill and in many cases reversed the advances in poverty reduction achieved during the earlier decades as has already been noted.

The World Bank, thus, faced a mounting challenge in the 1980s to reduce poverty which was accentuated by the deteriorated global economic climate, combined with limited

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32. IBRD, John L. Maddox, The Development Philosophy of Robert S. McNamara, (Washington D.C., 1981), p.47.

economic growth and worsened due to rapid population growth in the developing countries.

Various lending policies of the Bank such as Structural Adjustment, Sectoral Adjustment Lending involved "macro conditionality". With the departure of Robert McNamara and the arrival of A.W. Clausen the Bank shifted its explicit "focus on poverty" to what Clausen called a "balanced strategy", i.e. one of faster economic growth combined with pragmatic measures to reduce "absolute poverty".[33] The Bank's new President was of the view that there can be no meaningful poverty alleviation without the right set of country policies.

The Bank, thus, in the 1980s put much greater weight on prices, markets and agricultural research and technology. The Bank's approach was to integrate the core of the poverty concerns of the 1970s into growth and market oriented concerns in the 1980s. The Bank was of the view that once growth had revived in these countries, progress in reducing poverty would automatically resume.

In the year 1982, the Annual Report of the World Bank stated, "While there is still much to learn, structural

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33. IBRD, A.W. Clausen, Address to the Board of Governors, (Toronto, Canada, September 6, 1982).

adjustment programmes will consider, as far as possible, how the burdens of adjustment are shared among income groups and how adverse effects on the poor .... Bank research will give high priority to reducing the gaps in its knowledge of the effects on the poor of macro economic policies, including alternative routes toward structural adjustment".[34] Also in early 1982, an integral task force on the Bank's poverty focus circulated a report whose principal conclusion was that "the poverty focus should remain an integral part of the Bank's overall development lending".

The World Bank has addressed poverty alleviation as its major concern over a long period of time. Despite efforts by the governments of developing countries and the Bank assistance it has remained the most difficult task. All the efforts and achievements are halted by one particular factor i.e. population growth. Hence, the Bank considers that addressing this problem is essential for reversing the stagnation of per capital incomes and promoting lasting development.

To increase the effectiveness of programmes to reduce poverty, the World Bank is focusing more directly on poverty in its lending. The Bank's efforts to reach the poor

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34. World Bank, Annual Report, 1982, p.37.

emphasizes improvements in efficiency, productivity and growth in sectors which concern the poor. Lending by the Bank is for rural and urban development, agriculture, social sectors, and small scale industry - which are all related to the poor in the developing countries. Emphasis is also being given to targeted employment, food security and social programmes.

Thus, Feinberg appropriately remarks, "its new potential to influence macro-economic policies may prove especially valuable for stimulating new economic opportunities for the very poor, thus improving efficiency and equity simultaneously.[35]

To make this approach operational, the Bank is implementing initiatives in the context of adjustment lending as well as its direct lending for poverty. as far as adjustment lending is concerned, there are three areas in which the Bank helps countries in designing programmes to protect the poor during adjustment -

(a) re-designing adjustment programmes when the poor suffer unnecessarily from specific policies;

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35. Richard E. Feinberg and contributors, Between Two Worlds: World Bank's Next Decade, p.19.

(b) maintaining wherever possible, social expenditures that benefit the poor and improving targeting of other expenditures such as food subsidies etc.; and

(c) designing short-term compensatory programmes that benefit identifiable poor groups affected by adjustment.[36]

The context that structural adjustment provides for the alleviation of poverty - first, if structural adjustment reduces price distortions, enhances competition and erodes monopoly profits and economic rents, the incomes of the wealthy are likely to fall and those of the poor to rise. The reduction in market distortions brought about under adjustment may therefore enhance both efficiency and equity. Second, if structural adjustment ultimately promotes economic growth, the alleviation of poverty will undoubtedly be an easier proposition. But unless structural adjustment strategies are well designed, the benefits of economic growth will bypass some poverty groups. The challenge facing policy-makers, especially in countries with chronic poverty is to direct structural adjustment toward the poor -

36. IBRD, Development Committee, No.19, Strengthening Efforts to Reduce Poverty, (Washington D.C., January 1989), p.18.

to identify a strategy of adjustment with equitable growth.[37]

Adjustment policies in the developing countries however may adversely affect the poor in two ways. In the short-run such policies may reduce the real income and consumption of poverty groups. Second, even over the long-term, some poverty groups may not benefit from the process set in motion by the adjustment effort. Adjustment policies shape development and influence, distribution of income for years into the future and have different effects on the poor. The relationship between adjustment and poverty therefore extends beyond a notion of social cost that features only short-run effects.

In April 1987 the Development Committee considered a paper prepared by the World Bank entitled "Protecting the Poor During Periods of Adjustment". This report noted that during the recent period of economic difficulty and adjustment many of the poor appear to have suffered a severe deterioration in social conditions. Both the low-income African countries and highly indebted middle income countries suffered negative growths during the first half of the 1980s.

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37. IBRD, Lionel Deonoy and Tony Addison, The Alleviation of Poverty Under Structural Adjustment, (Washington D.C., 1987), p.5.

The report identified three types of transitional cost of adjustment associated with policy reform. First, adjustment measures designed to balance aggregate demand and supply usually though not inevitably depress output, employment and consumption. These costs are typical of a recession. Second, there are changes in the structure of incentives designed to stimulate the reallocation of resources between sectors and activities. Third, some transitional costs also arise because productive resources do not move effortlessly and instantaneously among alternative uses in response to changes in relative prices.[38]

The report further noted that the Bank's early support for economic adjustment focused almost extensively on improving efficiency of resource allocation and strengthening institutions ... with a view to restoring growth and improving the balance of payments in adjusting economies. This support reflected judgment that the quick restoration of growth was the most effective way to help the poor.

President Conables' address to the Board of Governors at the 1987 annual meetings rededicated the World Bank to a

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38. IBRD, Peter Nicolas, The World Bank's Lending for Adjustment: An Interim Report (Washington, D.C., 1988), p.3.

more effective role in combating poverty. "...the World Bank is ready to play a reinvigorated role in the fundamental tasks of development : to promote economic growth and to combat poverty ... Restoring and strengthening growth are essential for achieving our greatest goal - to reduce the poverty, misery and destitution that blight our world."[39]

In the recent years, the Bank has broadened its efforts to help adjusting countries include a more direct concern with the social effects of adjustment. Measures to protect the poor have been divided into two categories. The first one is the refocusing of social expenditure, particularly in health and education, towards the poor. The second is cost-effective compensatory programmes, particularly in the areas of nutrition and employment.

The recent Development Committee report prepared by the Bank points out that in order to implement more effectively strategies for reducing poverty, the Bank is making its practices in some areas more flexible and responsive to the needs of borrowers. First, poverty programme credits and loans might be used where appropriate to support sectoral policies, resource allocation and

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39. IBRD, Barber B. Conable, Address to the Board of Governors, (Washington D.C., September 29, 1987).

institutional efforts to improve the welfare of the poor, especially the poorest of the poor. Second, in most cases projects that have as their primary and direct object the reduction of poverty will be evaluated according to either cost-effectiveness (least cost) considerations, for example, in education and in population and health - or economic rate of return calculations for example in agriculture. Third, the Bank will continue to deal pragmatically and flexibly with subsidies, recognizing that they are justified when targeted to the poor.[40]

Another major and recent concern of the World Bank is to provide food security to the low income sub-Saharan African countries. It is estimated that a quarter of Africa's population - more than a hundred million people - do not get enough to eat. This problem existed in the 1970s but mounted in the 1980s due to rapid population growth, adverse terms of trade and an unfavourable economic environment. The World Bank, along with the formation of Task Force on Poverty Alleviation in the year 1988, also formed another Task Force on Food Security in Africa, in order to develop improved approaches to meet the goal of food security by the end of the century.

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40. IBRD, Development Committee, No.19, <u>Strengthening Efforts to Reduce Poverty</u>, (Washington D.C., 1989), p.13.

"Assuring African food security", the Task Force report noted, entails meeting two conditions. First, food must be available and second, households must have the ability to acquire it. The report concluded that, "effective action to combat both chronic and transitory food insecurity must focus also on the root cause of food insecurity: insufficient real income of households either to grow or buy food".[41]

In its efforts to solve the problems of food insecurity and as a response to the recommendations made by the Task Force, the World Bank is launching new initiatives to increase agricultural production in sub-Saharan Africa. This in turn would lead to increase in per capita income and solve the problem at least to a certain extent. All this will involve framing and implementation of correct agricultural policies, developing programmes and policies to stabilize increases and prices and strengthening institutional capabilities. All these efforts along with growth oriented policies would lead to long-term food security and for achieving short-term food security, the Bank has decided to implement measures to improve households' and countries ability to cope with transitory food insecurity.

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41. World Bank, Annual Report, 1989, p.85.

The Bank has also decided to take country specific actions to deal with the problem in a more systematic and organized manner. Also, the Bank is collaborating with various non-governmental organizations (NGOs) to work at specific country level to tackle the problem of food security. The World Bank's food security strategy also includes actions to improve women's economic opportunities and increase their food security. The Bank also intends to co-sponsor with other United Nations agencies such as United Nations Food and Agricultural Organization (FAO) activities to enhance food security in the region and to create greater economic opportunities for African women farmers. Food aid has, as Poverty and Hunger noted, "long been the main way of the helping low - income countries sustain domestic food supplies and protect the income of vulnerable groups against temporary shortfalls".[42]

Food aid can often be used to support poverty alleviation measures, either directly through the provision of food to participants or indirectly through the earmarking of counterpart funds generated by local sale of food.

Thus, after reviewing the recommendations of the two

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42. IBRD, Poverty and Hunger: Issues and Options for Food Security in Developing Countries, (Washington D.C., 1986), p.52.

Task Forces we come to the conclusion that poverty alleviation and providing food security to the developing countries are the two fundamental objectives of the Bank in recent times. Hence, economic growth must be supplemented by additional efforts to ensure that development reaches the poor. A continued support to improve agricultural sector and structural reforms are both necessary for economic growth and poverty alleviation.

(Co)-financing

Another major activity of the World Bank in lending in the 1980s was strengthening of its "traditional role as a catalyst for private investment". Article 1 of the Articles of Agreement states specifically that one of the purposes of the Bank is "to promote private foreign investment by means of guarantees as participations in loans and other investments made by private investors".[43] The world economic conditions in the beginning of the 1980s (discussed in the beginning of this chapter) and decline in the flow of official development of assistance to the developing countries along with increasing constraints on its own lending capacity faced the Bank to review its policy of Co-financing.

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43. IBRD, Articles of Agreement, Article 1(ii).

Co-financing is specifically designed to assure a continual flow of capital from private sources to developing countries for "high priority investments, to encourage extension of commercial loans on more favourable terms, to increase the contacts between banks and borrowers, and to establish a foundation for future financial dealings".[44]

The term "Co-financing" refers, in general, to any arrangement under which funds from the World Bank are associated with funds provided by other sources outside the borrowing country in the financing of a particular project.[45] The three sources of co-financing funds are the official aid agencies, export credit institutions, and private lenders, primarily commercial banks.

Although the Bank has been involved in Co-financing operations since the early 1970s but it was in the beginning of 1980s that it expanded its Co-financing activities. (See Table-3.5) "Co-financing with private financial institutions has become the single most important source of co-financing

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44. Brenda S. Bishop, "World Bank's New Co-financing Initiatives: Legal Mechanisms for Promoting Commercial Lending to Developing Countries", Law and Policy in International Business, 15(3), 1983, pp.918-19.

45. IBRD, "Co-financing; Review of the World Bank Activities", (Washington D.C., 1976), p.5.

...and provides the greatest potential for expansion.[46] Co-financing provides a vehicle through which the World Bank can leverage its limited resources to overcome the impediments to private bank lending for specific projects. Formal association with the World Bank gives private lenders access to all the pertinent, non-confidential information the Bank has about the project to be financed. Also, the World Bank saves time and efforts of private lenders by identifying and making initial contacts with borrowers, and providing information about potential projects.

Table-3.5

IBRDs (Co)-financing Operations in the Eighties
(US $ million)

Year	IBRD Contribution	Total Project Cost	% of Total Project Cost
1983	3,587.8	22,144.4	16.2
1984	4,641.6	21,727.2	21.3
1985	4,749.3	23,733.3	20.0
1986	4,026.8	24,204.4	16.6
1987	4,994.6	22,440.9	22.2
1988	3,755.3	18.294.7	20.5
1989	9,247.4	35,814.4	25.8

Source: World Bank, Annual Reports, (1983-1989).

46. World Bank, Annual Report, 1982, p.14.

Project lending in the Eighties

The previous pages focused the attention on the discussion of new lending instruments of the World Bank in the eighties. Although adjustment lending increased dramatically in the eighties, it does not however mean that the World Bank neglected its traditional lending instrument, i.e. project lending. "The Bank remains a development institution that commits the majority of its funds in support of specific investment projects that emphasis will continue, for basic investments are the foundations of sustained growth.[47] The following table (Table-3.6) gives a clear picture of project lending in the eighties. The share of project lending is $119,788.7 million in the eighties. This constitutes 90.8% of the total lending in the decade. Hence only 9.2% of the total was in the form of non-project lending.

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47. World Bank, Annual Report, 1987, p.21.

Table-3.6
IBRD Lending to Borrowers in the 1980s
(US $ millions)

Fiscal Year	No. of Loans	Total Lendings	Non-Project Lending
1980	144	7,644.2	280.0
1981	140	8,808.9	789.0
1982	150	10,329.6	990.7
1983	136	11,136.3	1,174.7
1984	129	11,949.2	1,026.9
1985	131	11,358.3	435.0
1986	131	11,178.8	900.0
1987	127	11,188.2	8,490.0
1988	118	14,762.0	1,020.0
1989	119	16,433.2	2,692.0
Total	1,325	119,788.7	11,098.3

Source: World Bank, Annual Reports (1980-89)

Region-wise Lending

Table-3.7 gives the region-wise distribution of lending of the World Bank during the decade of the eighties. The Table shows that Latin American and Carribean countries were the largest recipients of World Bank finance. Also, Asia in the later years of the eighties had become important.

Table-3.7

IBRD Regional Lending in the 1980s
(US $ Million)

Region	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Eastern Africa	150.5	304.0	107.9	326.6	445.2	74.5	198.1	35.0	725.1*	1,507.6*
Western Africa	739.2	554.8	853.8	126.5	710.2	419.1	403.1	830.8		
East Asia and Pacific	2,107.5	2,227.9	2,641.4	3,549.0	2,873.0	2,654.3	3,101.8	2,762.4	5,751.6**	5,657.1**
South Asia	125.0	430.0	1,146.0	1,631.1	1,865.0	2,169.0	2,216.2	2,525.0		
Europe, Middle East and North Africa	2,174.0	2,173.2	2,317.6	2,464.5	3,052.4	2,387.1	258.4	3,040.4	3,133.3	3,511.8
Latin America and Carribean	2,595.0	3,119.0	2,962.9	3,396.6	3,003.4	3,654.3	901.2	4,994.6	5,152.0	5,703.7

* Total lending for Eastern and Western Africa

** Total lending for Asia

Source: World Bank, Annual Reports, (1980-1989)

Sector-wise Lending

Table-3.8 gives the sectoral distribution of the World Bank lending during the decade of the eighties. Agricultural and rural development sector was the largest recipient of the World Bank assistance. Power and Transportation followed a close second. Assistance to development finance companies also gained importance during the decade. Most striking feature during this period was the increase in non-project lending by the Bank.

Table-3.6

IBRD Sectoral Lending in the 1980s
(US $ Millions)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Agriculture and Rural Development	1,700.4	2,406.0	2,180.2	2,386.3	2,062.7	2,389.6	3,961.7	1,946.3	2,932.1	2,066.1
Developmental Finance	743.0	1,042.0	957.8	1,177.3	762.3	506.1	1,324.7	2,204.9	1,490.0	2,223.0
Education	360.1	374.6	428.4	296.4	491.2	514.9	577.7	173.5	654.9	441.6
Energy	328.5	564.0	720.6	979.1	749.4	1,193.7	213.0	605.4	325.1	549.5
Power	1,584.5	1,282.5	1,432.9	1,529.2	2,266.3	2,171.6	2,423.2	2,857.0	1,908.0	2,858.5
Industry	393.5	475.8	910.4	625.1	503.0	635.0	457.2	411.4	2,062.7	1,858.0
Non-Project	280.0	789.0	990.7	1,174.7	1,026.9	435.0	900.0	1,790.0	1,020.0	2,692.0
Population, Health and Nutrition	65.0	12.5	13.0	60.5	68.5	160.9	166.9	33.3	109.0	399.5
Small Scale Enterprises	222.0	157.5	228.0	516.1	595.6	535.1	264.5	405.5	493.0	585.0
Technical Assistance	-	49.5	24.8	25.7	14.5	44.5	60.1	15.0	15.2	41.0
Telecommunications	66.0	-	338.3	-	166.5	59.6	24.5	654.5	36.0	53.1
Transportation	1,205.0	763.0	1,379.5	1,406.1	2,243.4	1,866.9	1,253.8	1,145.8	2,217.2	1,137.7
Urban Development	249.8	459.0	324.8	328.3	447.0	204.6	944.5	1,234.6	1,108.5	959.0
Water Supply and Sewerage	446.4	433.5	400.8	630.9	549.9	622.8	507.3	711.0	490.3	569.2
Total	7,644.2	8,808.9	10,329.6	11,136.3	11,949.2	11,358.3	11,178.8	11,188.2	14,762.0	16,433.2

Source: World Bank, Annual Reports (1980-1989)

Finally, to conclude, Table-3.9 gives a clear picture of regional distribution of the World Bank non-project lending in the eighties. Non-project lending as already stated had increasingly become important due to structural and sectoral adjustment lending. The table shows that this type of lending was popular in low-income African countries and middle-income European countries. However, in the second half of the eighties many of the Latin America and Carribean countries were also increasingly receiving this form of assistance. Very few South Asian countries received non-project loans.

Table-3.9

Non-Project* Lending to Borrowers in the 1980s, By Region
(US $ Million)

Region	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Eastern Africa	192.5	217.0	70.0	130.9	145.0	45.0	95.0	105.0	760.0**	1,294.0**
Western Africa	-	60.0	150.0	80.0	326.7	119.2	321.0	202.0		
East Asia and Pacific	-	218.0	400.00	477.8	300.0	-	-	600.0	500.0	390.0
South Asia	50.0	115.0	240.0	110.0	170.0	30.0	200.0	240.0	-	62.5
Europe, Middle East and North Africa	80.0	27.0	76.2	60.2	60.2	435.0	705.0	1,050.1	277.0	1,492.0
Latin America and Carribean	80.0	27.0	76.2	60.2	60.2	435.0	705.0	1,050.8	277.0	1,499.0

* Non-Project lending includes programme, sectoral and structural adjustment loans.

** Total lending for Eastern and Western Africa.

Note: The amounts include IBRD loans as well as IDA credits. IDA credits are not significant as revealed in the Annual Reports of the World Bank.

Source: World Bank Annual Reports (1980-1989).

CHAPTER - IV

ASSESSMENT OF THE WORLD BANK'S LENDING POLICIES

The World Bank has emerged over the last four and a half decades of its existence as the most important multilateral institution which is channeling financial and technical assistance to the developing countries. In the last three chapters, we have seen the steady growth of the World Bank as a developmental financial institution.

The World Bank is considered a specialized agency of the United Nations. The Bank formalized its relationship with the United Nations by signing a Memorandum of Understanding. The Bank preserved its autonomy and is not subject to the supervisory control of the United Nations. Hence, the role of the United Nations in determining the course of the Bank's lending policies has been limited. Any move on the part of the developing countries to build an institution within the UN system to provide concessional finance was thwarted by the United States. It was directing all its support to make the World Bank to be the leading institution in development finance. The scope of the World Bank operations was, therefore, widened by establishing new institutions under its fold such as the International Finance Corporation for financing the private sector and the

International Development Association to provide concessional aid to the poor countries. "The exposure of the World Bank to the poorest countries through IDA operations has humanized an institution which might otherwise have been indistinguishable from a New York Commercial Bank ... IDA lends to the World Bank a unique world-role and a developmental focus."[1]

The World Bank consists of "unequal partners" as the United States has almost a veto power because of the weighted voting system. As a consequence the borrowers i.e. the developing member countries are increasingly facing the erosion of their voting rights. This is an important concern for the developing countries as it has reduced their say in the lending policies of the World Bank. As according to the latest World Bank Annual Report,[2] the five major industrialized countries, i.e., Unites States, Japan, Federal Republic of Germany, United Kingdom and France control the major policy decisions in the Bank as they hold 42.23% of the total voting power and the rest is shared amongst the remaining 147 member countries.

Also one notices growth and diversification in the

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1. V. Venugopal Reddy, World Bank - Borrowers' Perspectives, (Sterling, New Delhi, 1985) p.111.

2. World Bank, Annual Report, 1990.

World Bank lending over the years. As mentioned earlier, in the early stages of its working the Bank was financing reconstruction but soon the emphasis shifted to development and the Bank henceforth concentrated all its energies towards the development of developing countries. Ever since, the purpose of the Bank is to provide investment capital for raising productivity, the standard of living and conditions of labour in the member countries.[3]

From the time the Bank began lending for development purposes marked shifts were witnessed every ten years. In the 1950s the Bank was laying emphasis on developing basic "infrastructure facilities", so necessary to start development. It included electric power, transportation and agriculture.

The similar sectors continued to be financed in the mid and late 1950s. However loans advanced were rather disproportionate. June 25, 1956 was the tenth anniversary of the day on which Bank began its operations. In retrospect for the fist ten years, one cannot deny that the Bank had helped improving the general economic environment in the developing countries.

In the fiscal year 1956, the Bank made 26 loans amounting to $396 million. One significant activity in this

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3. IBRD, Articles of Agreement, Article 1.

year was the Bank's increased activity in Asia where lending totaled $166 million.

Looking at the lending pattern one notices that in the early years, Bank's lending went largely for electric power than for any other purpose. Loans for transport had taken a second place. The remaining, apart from post-war reconstruction loans, has been for industry, agriculture and other development purposes in that order.

The trend continued in the year 1957. Bank's lending during the fiscal 1957, continued at approximately the rate of the previous three years. The 20 loans made during the year amounted to $388 million and brought the gross total of Bank loans to $3,108 million. Electric power continued to be a major purpose for which the Bank had lent. Equally important was loans for industry. Loans for agriculture and transport were nearly equal.

The ten year period i.e. 1958-68, saw a marked increase (nearly double) in the amount to lending. From a modest $300 - 400 million every year, the Bank started lending nearly $700 -$800 million annually. Except in the year 1965, when the amount lent by the Bank crossed one billion.

The economic growth was slower in the second of the post-war decades than in the first and the problems of these developing countries continued to be severe. Despite the greater emphasis placed by the Bank on agriculture, industry and education during the preceding years, the largest part of the financing had continued to be concentrated on high priority projects to strengthen the infrastructure of the developing countries economies.

Nevertheless, food production in the developing countries had declined or stagnated, loans were given while not in keeping with the existing realities. Mass illiteracy and population seemed to be the stumbling block.

In 1961, the Bank had realized the gravity of the problems relating to lack of education and started financing education projects. Skilled manpower was an important ingredient of development. Emphasis was laid on projects for general secondary education, vocational and technical training at all levels and teacher training.

Realizing the inadequacy of skills at various levels in developing countries, as seriously limiting economic growth, the Bank laid equal emphasis on providing technical assistance. Such assistance was mainly geared to help establish priorities for investments in major economic sectors, or to prepare development projects. The Bank, however, stands ready to help in the preparation of applications to the UNDP, and to act on request as the Executing Agency for selected UNDP pre-investment projects. Due to increased lending, the Bank's market operations expanded.

By 1967, most colonies had gained independence and were in the race to speed up the process of development. One such sector where development and hence heavy investment was required to be made was agricultural sector. Food problem was paramount task of almost all these countries. Hence 1968 marked a sharp increase in finance provided for development projects in the agricultural sector to which nearly one-fifth of the Bank's lending was directed. Close to agriculture, followed the need to expand and improve education facilities. While the Bank's efforts to assist agriculture and education intensified in these years a substantial part of the Bank's financing continued to be concentrated on improving basic services - power, railways and roads.

Looking at the 1960s and particularly under George Woods Presidency, one finds that the activities in both volume and range, of the Bank had expanded considerably. The Banks efforts were broadened by -

(a) providing finance in increasingly flexible way,

(b) furnishing technical and planning assistance to member countries,

(c) building up local institution to mobilize and channel capital for productive purposes, and

(d) forming international consultative group to coordinate the provision of external aid.[4]

The Bank greatly expanded its economic studies, both in support of its operations and on broader issues of economic development. Technical assistance provided to member governments was also increased. Along with economic and technical assistance that was expanded to these developing countries, new areas of development such as education were given increasing emphasis and financed. In the late 1960s debt negotiations, re-negotiations, debt rescheduling, postponement of debt service payments and debt management became the Bank's broad policy towards the debt burden of its member countries.

As for the Bank's role in helping these countries to overcome the problem of their external debt and its rescheduling is concerned, it has first and foremost spent large amounts of human and financial resources towards accessing information and data for the purpose of analysis

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4. C.P. Bhambri - World Bank and India, (Vikas, New Delhi, 1980) pp.53-54.

and projecting the debt position of the most important developing countries on a continuing basis. Secondly, keeping in view the limitations of the borrowers i.e. the developing countries towards debt servicing capabilities, the bank has very intelligently blended IDA credits with Bank loans. Thirdly, the Bank has taken an active role in consortia and consultative groups to help ensure that the total lending package is concerned with development needs and liquidify requirements. "That the World Bank has taken an interest in the problem of world indebtedness is another indication that the Bank indeed has gone a long way from a development financing institution, concerned not only with financial aspects, but involved in the full range of relations between the developed and the developing countries."[5]

The 1970s was different in the sense that Robert McNamara took over as the President of the Bank. He brought about drastic policy changes. Two major changes that the Bank witnessed under his presidency -

1. a vast expansion of the flow of financial resources from the Bank to the countries of the developing countries, and

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5. Lewis and Kapur (ed.), The World Bank Group, Multinational Aid and the 1970s. p.117.

2. a significant reorientation in the kinds of projects those resources financed.

Bettina Hurni in her study on lending policies of the World Bank in the 1970s comes to the conclusion that external finance provided to any developing country is not more than 5 per cent (a small portion) of total domestic investment. Although this portion is very small it nevertheless is important for any national development.

This is no way diminishes the role of the World Bank lending

(i) as a multilateral, essential supplement to domestic investment,

(ii) as a locomotive for attracting additional public and private funds into a country which the Bank has found credit worthy, and

(iii) as a means for influencing national economic policies on macro-economic and micro-economic levels, normally to the advantage of the borrowing country.[6]

Another noticeable feature in the 1970s was that there was a slight increase in the programme lending. From 1971 to 1976, 72 per cent of programme lending went to South Asia, which shows that the Bank had been helping the poorest countries.

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6. Bettina Hurni, The Lending Policy of the World Bank in the 1970s : Analysis and Evaluation, p.117.

Also, the Bank focused on attacking poverty. The Bank in order to help make the poor more productive expanded its lending for more experimental, complex, integrated rural projects with social services, such as extension work, water supplies and sanitation, schooling, credit, basic health care, and employment creation etc.

Agriculture was one sector where lending by the Bank increased substantially. The Bank encouraged labour intensive technology, improvement in food production, promotion of small farmers, building of institutions like (Development Finance Companies etc.), assisting the landless through non-farm rural employment, promotion of small-scale enterprises etc. Thus, rural development was the main thrust for implementing poverty-oriented lending policy. Two new ways of financing were also introduced by the Bank, i.e. co-financing and rural credits. Also, two new instruments of financing such as the third window and more blending of IBRD loans and credits were introduced. The Bank during this period gave importance to production of energy in order to make development less dependent on oil imports.

Though there was a steady increase in the World Bank lending till the year 1979, it is pointed out that it was not sufficient to meet the developmental needs of the developing countries. It may also be noted that the concessional finance from the developed countries was not growing in the seventies. Consequently, the developing countries had to cope with the problem of securing finance from private sources such as commercial Banks and foreign direct investments which make different kinds of demands on them. All these factors lead to the severe world economic crisis in the 1980s.

The lending of the World Bank is not very concessional. Hence, the repayment of loans has been at considerable costs. It is the final maturity of loans which is fifteen to twenty years, with the repayment of principal beginning about four to five years that attracts the borrowers.

The World Bank has been innovative in introducing new lending instruments in responding to the new complexities of the developing countries. For the purpose of its lending operations the Bank from the very beginning resorted to specific instruments of lending. The Bank is basically a project lender and majority of its lending is for specific projects which in turn create new productive assets and restore economic and social infrastructures in the developing member countries. The purpose of the project lending is to ensure that the funds are invested in sound, productive projects with the purpose of contributing both to the borrowing country's capacity to repay and to the development of its economy.

> "The evolution of the Bank and its functions over time provides a very interesting, but rather complex story. With growing induction of the consideration of policies and the development strategies of the borrowing countries with its lending operations and also with its concern and commitments for certain theology of development paradigm, the Bank seems to have developed in it the characteristics of an Economic Development Institute rather than remaining merely a Development Financing Institution."8

While the Bank's Articles provide primarily for project lending, it is the innovative capacity of this organization which has used its Articles of Agreement flexibly by seeking various types of instruments. Another kind of lending instrument which came into prominence in the early 1970s under McNamara was programme lending of non-project nature. This is for importing raw-materials, intermediate products and equipment which enhance the overall development. Programme loans include institutional reforms as features, although their basic objective remains focused on relieving specific constraints in the economy and addressing the policy issues associated with these

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7. J.L. Bajaj and V.R. Panchamukhi, RIS Occasional Paper No.30., Aid in the 1990s with special reference to the World Bank and IDA, New Delhi, 1990, p.13.

constraints. However, as compared to project lending, this type of quick disbursing programme lending has been minimal.

Technical assistance is yet another form of lending instrument of the World Bank. While it is often made as a part of project assistance, many a times it is independent also. This form of assistance is particularly helpful to those countries lacking in human skills and institutional structures.

The World Bank functions as a project lender could not have given it a dominant role that it has acquired in influencing the economic policies of the developing countries. The World Bank is expected to play an important role only when it influences macro-economic policies. Therefore, it intelligently and creatively used the space provided by the Articles of Agreement by devising various lending instruments without violating the principle objective of the World Bank. These new lending instruments (seen in Table-4.1) have given the World Bank extraordinary powers to influence the developing countries which could never have achieved if it had remained purely a project lender.

Table-4.1

A Bird's eye view of the World Bank Landing Instruments

Instrument	Objective	Focus and content	Use of loan Proceeds	Disbursement Period [a]
1	2	3	4	5
Specific investment loan	To create new productive and economic and social infrastructures, to restore them to full capacity, or to ensure their maintenance.	Focuses on technical, financial, economic and institutional viability of a specific investment and its maintenance, and on those aspects of the sector policy framework that bear directly upon the productivity of the investment (for example, input and output prices, operational efficiency of enterprises). Assists in the design for investments and in preparing management and training programmes. Investment proposals are appraised by Bank staff, Requires agreement on viability and specific of specifics of investments.	Preidentified equipment, materials, and services and civil works for specific investments.	Four to nine years.
Sector Operations				
Sector-investment and maintenance loan	To bring sector investments in line with economic priorities and ensure they are efficiently operated and maintained.	Focuses on sector expenditure, especially balance between new investments and rehabilitation and maintenance, and on institutional capacity to plan, implement, and monitor investments. Requires agreement on well-meet priority development needs, as well as on specific measures to strengthen management and policies, and a sector institution capable of carrying out the programme using agreed appraisal criteria for individual parts of programme.	Broad categories of equipment, materials, services, and civil works related to the whole, or a time slice, of the sector programme.	Three to seven years.

1	2	3	4	5
Financial intermediary loan	To provide funds for enterprises and small and medium-size farmers through an intermediary within a competitive environment.	Focuses on categories of clients, types of investments, service levels, and cost of capital. Requires agreement on criteria to select subborrowers and appraise their needs, on on-lending rates and on specific actions for institution building.	Credit for investment and working capital needs of subborrowers selected in accordance with agreed criteria.	Three to seven years
Sector-adjustment loan	To support comprehensive policy changes and institutional reforms in a specific sector.	Focuses on major issues and investment programmes especially incentive frame work (tariffs, prices, taxes), and institutional capability. Usually either in countries lacking administrative and political capability to formulate and implement comprehensive economy wide structural-adjustment programmes, or not requiring such comprehensive programmes or as follow-up to stabilization programmes to deepen reforms in a sector. Requires agreement on specific monitorable action programme in specific schedule and on investment programmes for the sector.	Mainly imports required for sector, with actual users either preidentified or to be selected following agreed criteria.	One to four years.
Structural-adjustment loan	To support, through a series of loans, specific policy changes and institutional reforms to achieve efficient use of resources and contribute to a sustainable balance of payments in the medium and long term, while maintaining growth.	Focuses on major macro-economic issues, as well as on major sectoral issues covering several sectors, especially trade policy (for example, tariff reform, import liberalization, export incentives), resource mobilization (for example, role of parastatals, budget policy, interest rates, debt management), efficient use of resources (for example,	General imports subject to negative list of prohibited imports.	One to three years.

1	2	3	4	5
		public-investment programme criteria, pricing, incentive system), and institutional reforms, economywide and in specific sectors. Requires agreement on effective stabilization programme with monitorable policy modifications in these area on specific schedule.		
Technical-assistance loan	To strengthen local institutions concerned with (i) designing and adopting policies, strategies, and institutional approaches promoting further development in a sector or in the economy as a whole, or (ii) operating specific investments, or to carry out specific tasks related to the preparation, or operation of investments.	Focuses on capacity (e.g. organization, management, staffing, methods, physical or financial resources) or institutions directly concerned with sector or economywide policies and strategies or with investments, and on specific gaps (studies and personnel) preventing efficient investments. Requires agreement on specific time-bound action programme to strengthen institution through technical assistance and training, on appointment of local counterparts, or on the carrying out of studies with agreed terms of reference.	Specialized consultants and services, studies, and training.	Two to six years.
Emergency reconstruction loan	To support rebuilding activities and rapid restoration of physical structures and productive activities after disasters.	Focuses mainly on restoring predisaster situations with emphasis on strengthening institutions to handle reconstruction effort and prepare them for future.	Broad positive list related to reconstruction needs.	Two to five years.

a. This is the normal range of expected disbursements. There may be a small number of exceptional cases where the disbursement period is shorter or longer than shown.

Source: World Bank, Annual Report, 1985.

In the eighties, adjustment lending (i.e. structural and sectoral) by the World Bank was considered to be an answer to the economic problems faced by the developing countries. This form of lending became a major part of the Bank's development assistance programme. It allowed the Bank to play an active role in helping these countries overcome the structural weaknesses that have hindered balanced and rapid development. Through its adjustment lending operations, the Bank for the first time addressed short and medium term economic policy issues.

It is evident by now that this concept of adjustment lending requires an agreement on the whole package of economic polices and this substantially enhances the capacity of the Bank to influence the economic policies of the countries concerned. The most significant feature of this type of lending was that the Bank had to help governments introduce reforms under extraordinary time pressure due to rapidly weakening external environment. The Bank extended this type of assistance to countries that came up with an acceptable programme of policy as well as institutional adjustment. The SALs were considered as necessary primarily to achieve a viable balance of payments position "at a higher level of real income and with greater attention to the needs of development policy."[8]

One of the major areas of controversy during the eighties has been the conditionalities linked with this type of aid, be it structural or sectoral adjustment. This conditionality is linked with tranched release of funds which makes the borrower country change its macro-economic policies. This comes in direct conflict with the national objectives as perceived by the borrowers. Also, domestic policy monitoring by an international agency is particularly prone to raise sovereignty issues. Hence this kind of an arrangement often comes in direct conflict with the sovereignty of the borrowing country.

Apart from the question of impingement on sovereignty there is the issue of relevance and efficacy of the macro-economic policies suggested by the World Bank. There has been no conclusive evidence to show that the policies would necessarily result in full achievement of the objectives. The World Bank studies themselves reveal that not many of the developing countries have opted for SAL loans on account of skepticism about the policy requirements.

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8. Stanley Please, "The World Bank: Lending for Structural Adjustment", p.88.

"But the single most demand constraint is undoubtedly that of loan conditionality."[9]

<u>Issue of "Cross-conditionality"</u>

With the introduction of Structural Adjustment lending, which offered medium-term balance of payments support, "in order that the current account deficits of many developing countries do not become so large as to jeopardize seriously the implementation of current investment programmes and foreign exchange activities",[10] raised an important issue of "cross-conditionality" between the two Bretton Woods siblings, the World Bank and the IMF. Earlier the Bank focused on long-term project loans, the IMF on shorter, balance of payment financing. Partial erosion of the differences of roles of the Bank and the Fund came to be reflected in the eighties. As a result the degree of cover-up over an extremely wide range of instruments, policies and objectives greatly increased. The Bank became concerned with many variables central to Fund's stabilization programmes, and developed an acute interest in exchange rates - variable deemed to be the "primary responsibility"

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9. Richard E. Feinberg and Edmar L. Bacha, "When Supply and Demand Don't Intersect : Latin America and the Bretton Woods Institutions in the 1980s", <u>Development and Change</u>", 19(3), July 1958, p.390.

10. World Bank, <u>Annual Report</u>, 1980, pp.67-68.

of the Fund. For its part, the Fund addressed variables of great interest to the Bank.

However, it may be worthwhile to mention here that the Bank has approved these loans only in those countries where IMF stand-by arrangements had been concluded previously. In effect such a policy has had mixed results. While the objective of a stabilization programme is to solve the problems of balance of payments deficit, the structural adjustment programmes aim at reducing payments deficits, resume growth and prevent future payments and stabilization problems through the necessary structural changes. As for the volume of adjustment lending of the World Bank, it has certainly increased, specially sector adjustment lending, in the recent past. This reflects a broadening and deepening of the adjustment process as countries move from an immediate concentration on overall macro-economic issues to sector issues.

There are apprehensions that these policy prescriptions have affected the poor adversely. In fact, the World Bank has itself become conscious of these adverse effects. Hence, the poverty alleviation programmes are to be integrated into the SAL and other arrangements to reduce the adverse impact on the vulnerable sectors of the population. Consequently, more attention is being given to designing adjustment programmes so as to minimize the suffering of the poor, and greater emphasis is being placed on the design of implementation arrangements. It is due to these factors that adjustment lending has become a flexible and responsive form of lending instrument. However, success of adjustment lending depends not only on the continued willingness of borrowers to undertake difficult adjustment but also on the availability of sufficient external finance.

Thus, one notices that reducing poverty is accepted as a major objective of economic development. Economic growth is generally considered to be a necessary condition for alleviating poverty. However, growth alone is not sufficient to bring about substantial reductions in levels of poverty. The World Bank lending policies in many developing countries along with promoting growth are specifically designed to improve the lot of the poor.

Despite great efforts by all concerned in the recent years absolute poverty is growing in the developing countries. The Bank in the year 1988 focused its attention on poverty reduction and food security. The objective is to facilitate production employment for the growing numbers of poor, to help them increase their physical and human assets, to improve their access to affordable basic social services and to reduce food insecurity. Hence, the objective of the Bank is to promote growth, efficiency and adjustment, along with poverty reduction.

Since the early 1980, when the Bank began to lay special stress to the sub-Saharan region and issued special programme through a series of report. By mid 1980s many countries in the region started showing signs of economic improvement due to efforts by the Bank as well as the concerned governments reform efforts.

The World Bank in an effort to support the regions development, along with its adjustment lending operations adopted "Special Programme of Assistance (SPA)", in 1988. The objective of the three year (1988-90) programme is to help eligible countries adjust and grow, while restoring and sustaining normal debtor-creditor relationships. The programme provides for substantially increased highly commissioned quick disbursing financing, as well as debt relief on softer terms to expand import capacities in adjusting countries.

In March 1989, the Bank brought about a review "Adjustment Lending: An Evaluation of Ten Years Experience", and it stated that the countries which received adjustment loans in the 1980s showed better economic performance than the countries which did not. The review also recommended that the Bank should continue with this type of lending in future but with alterations so as to be more effective.

Finally, one notices that over the years lending policies of the World Bank moved from one of reconstruction through financing of individual projects to "growing emphasis on the package of economic policies of the country concerned through the concept of SAL."[11]

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11. V. Venugopal Reddy, <u>World Bank-Borrowers' Perspectives</u>, p.73.

CHAPTER - V

CONCLUSION

i. The World Bank came into existence after the Bretton Woods Conference as a reconstruction and development finance institution.

ii. It is a sister institution of the International Monetary Fund.

iii. Membership of the International Monetary Fund is a precondition to the membership of the Bank.

iv. Its decision-making is based on weighted voting system, as a result of which the United States and the developed countries have a major say.

v. The World Bank has retained full independence in its functioning despite the Memorandum of Understanding with the United Nations.

vi. The Bank emerged purely as a development finance institution when the United States under the Marshall Plan took over the financing of reconstruction of Europe.

vii. Under the Articles of Agreement of the Bank, it should finance only project lending in public sector or with government guarantee.

viii. It borrows funds from the market to finance its lending. Hence it provides limited concessional finance.

ix. It has over the years creatively developed various instruments of lending such as project lending, programme lending, local expenditure financing, technical assistance, structural and sectoral adjustment lending.

x. The Bank also engages in (co)-financing arrangements in developing member countries with the official aid agencies, export credit institutions and commercial banks.

xi. The Bank was lending at an annual average of \$300-\$400 million in the fifties. In the sixties it started lending nearly \$700-\$800 million annually. However, in the seventies marked increase in lending was witnessed under McNamaras presidency and the Bank was lending nearly \$3500-4000 million annually. In the eighties the annual average increased to nearly \$10000-\$11000 million.

xii Regionwise distribution of the World Bank lending shows that in the fifties Asia and Middle East received \$1568.8 million. Europe was the second largest recipient accounting for \$1356.5 million and lending to Western Hemisphere totaled $1053.0. African region accounted a total of $771.9 million. In the sixties, Latin America and Caribbean received ($2639.5 million) Asia and Middle East ($2294.7 million), africa ($1090.35 million) and Europe ($1014 million). In the seventies, Latin America and Caribbean received ($13074.4 million). Europe, Middle East and North African region received a total of ($10,874 million). East Asia and pacific received ($9103.6 million), Eastern and Western African region ($4201.8 million) and South Asia ($3726.6 million) respectively. In the eighties, Asia (South, East and Pacific) received a total of $45486.3 million, Latin America and Caribbean ($35282.7 million), Europe, Middle East and North African region ($24512.7 million), and Africa ($10355.3 million).

xiii. As for sectoral distribution, in the fifties electric power and transportation were the major recipients of the World Bank lending. The former received a total of $1,604.9 million and the latter $1,526.3 million. In the sixties transportation received $3,047.8 million, and power $2,673.9 million. Agriculture and Industry • received 1,877.9 and 1,725.5 respectively. In the seventies, lending for agriculture and rural development was the greatest which totaled $9214.6

million. Transportation sector accounted $8007 million, followed by electric power totaling $6,700.9 million. In the eighties, agriculture and rural development received, $24031.4 million. Power sector followed a close second and accounted for $20313.7 million. Transportation received $14518 million and development finance companies received $12431.1 million. Non-project lending by the Bank which became prominent during the decade totaled $11098.3 million.

xiv. The Bank has also through its lending policies emerged as an institution influencing the economic policies of borrowing countries. This is through the structural and sectoral adjustment lending. It imposes conditions on the borrowers.

xv. The conditionalities consist of package of macro-economic policies which the borrowing countries have to adopt. They focus on considerations such as reforms in trade policy, sector policy, public investment priorities, budgetary reform and institution building.

xvi. These conditionality prescriptions on the economic policies of the borrowers have been a major area of controversy.

xvii. They not only impinge the sovereignty of the borrower but they have also not proved very successful in ameliorating the developing countries economies. Very often the Bank is accused of imposing standardized conditions irrespective of their specific situation.

xviii. Due to stringent conditionality prescriptions only a limited number of countries have resorted to this kind of assistance.

xix. Success of its policy lending has been mixed.

xx. The Bank has also participated in the debt rescheduling of its member countries economies.

Thus, the World Bank today is the World's pre-eminent international development institution, reaching out to all the developing countries in a spectacular manner, growing massively over the years. Its orientation in lending has resulted from an evolutionary change in policy especially in the 1980s.

Appendix - I

The Project Cycle

Project Cycle - phases of a World Bank loan project, comprising identification, preparation and appraisal, negotiations, loan approval, implementation and supervision, and evaluation.

Identification- first phase of the project cycle; reconnaissance concerned with selecting (identifying) projects that appear suitable for World Bank financing; once identified, projects are incorporated into multi-year lending programme for each country, which forms the basis for the Bank's future work in that country; projects must support a coherent development strategy.

Feasibility Studies - identify and prepare preliminary design of technical and institutional alternatives, and compare respective costs and benefits; include detailed investigation.

Sectors Review - analysis carried out by World Bank to gain understanding of development potential of a country; frames development strategy; scrutinizes infrastructure and industry, agricultural and rural development, urban sites and services, water supply, education, population, and nutrition.

Preparation - second phase of the project cycle; after a project is in the Bank pipeline; usually one to two years of close collaboration between the Bank and the borrower to consider technical, institutional, financial, and economic conditions necessary to achieve a particular project's objectives; responsibility of the borrower, with active role of the Bank; results in preparation report.

Preappraisal Mission - after project identification and preparation; primarily to ascertain aspects that need attention before a formal appraisal mission is undertaken

Project Preparation facility - arm of the World Bank and the IDA created to advance loans for project preparation.

Appraisal - third phase of the project cycle; after project has taken shape and preparation studies are near completion; direct involvement of the Bank and solely its responsibility; review of all aspects of the project, which may take three to five weeks in the field (appraisal mission); lays foundation for implementing the project and evaluating it when completed; appraisal covers technical, institutional, economic, and financial aspects

Appraisal Report - after appraisal mission; serves as basis for negotiations with the borrower regarding the loan; after negotiations it is amended and presented to Executive Directors, along with loan documents and President's report

Negotiations - fourth phase, when the Bank and borrower endeavor to agree on the measures necessary to ensure the success of the project; agreements converted into legal obligations

Board Presentation - after negotiations with the borrower and loan documents are drawn up, project presented to Executive Directors for approval, after which the loan is signed.

Loan Documents - legal documents dealing with all the principal issues raised prior to and during appraisal; ensure that the Bank and borrower are in agreement on broad objectives and specific actions necessary to achieve them and on detailed schedule for project implementation.

Implementation and Supervision - fifth phase of project cycle; after a loan is singed, during construction and subsequent operation; responsibility of borrower, with assistance of Bank as supervisor and provider of technical assistance; aided through progress reports for the borrower and World Bank field visits.

Procurement of Goods and Services - an element of project supervision; financed under the Bank loan and carried out according to guidelines incorporated into every loan agreement; through ICB or LCB; or procurement follows official Bank guidelines for efficiency and economy.

Evaluation - sixth phase; following final disbursement of World Bank funds for a project; involves a completion report and independent audit.

Source: Bettina S. Hurni, The Lending Policy of the World Bank in the 1970s. (Westview Press/Boulder, Colorado), 1980.

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