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A FRAMEWORK FOR STRATEGIC CHOICES

FOR THE WORLD BANK

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Strategic Planning Division
Strategic Planning and Review Department

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I. THE GLOBAL ECONOMIC ENVIRONMENT AND BANK STRATEGY

1. The 1990s present an exceptionally difficult global environment for development. Most developing countries are struggling with the consequences of a disastrous 1980s, and will still be doing so for some years to come. World poverty is increasing, but prospects for greater external resource flows to generate stronger growth in developing countries are bleak. The persistence of the debt crisis and the inability of the international community to find a decisive solution are fundamental obstacles to development, particularly in Africa and Latin America. The industrial countries may face renewed inflation and recession, and are having difficulty coping with profound structural changes in global economic power.

2. Yet this could also be a decade of great opportunities, if the economic dynamism in some regions (e.g. the Pacific Rim, a revitalized Europe) can be spread more widely, the technological revolution carried to poor as well as richer countries, and the enormous power of the emerging global economy and trading system effectively harnessed for development. The World Bank is the strongest and most experienced international instrument of development, and the only one which can claim truly global status. The strategic choices the Bank makes and the opportunities it grasps during the next decade will have a significant influence on how well development is served by economic and political change in the 1990s. This paper is designed to promote consideration of such issues.

<u>Global Growth Prospects and Structural Change</u>

3. The likely future global economic environment can be discussed in terms of five clusters of issues facing the Bank. A few important developments are highlighted here.

4. <u>Low Growth Scenario</u>. The most likely prospect for the world economy is a continuation of present policy patterns through the mid-1990s. This scenario foresees little substantial change in U.S. policy towards deficits, and continued willingness of Japan to finance these deficits; continued integration of European Community countries and increased trade within Europe somewhat at the expense of external trade; and, in a sluggish environment, only limited opportunities for import and export growth by major debtors and by other big economies -- e.g. India, China and the Soviet Union. World trade growth would be roughly equal to world GDP growth at around 3.5 percent through the mid-1990s. No massive shock would be anticipated in this scenario: occasional disruptions in exchange and financial markets would occur, followed by marginal policy improvements to bring temporary stability to exchange and interest rates.

5. A key aspect of this scenario is highly constrained global finance for development. Slow growth, the debt overhang and some financial market volatility would translate into restricted financial access for Bank borrowers, with flows concentrated among OECD economies rather than between them and the developing world. These relatively poor financing and trade prospects for developing countries would leave many debtor countries in severe difficulty and some in a state of crisis. They would also accentuate the trend for relatively few countries to be full participants in the global financial and trading economy, and for a large number of developing countries to become more and more marginal.

6. **High Growth Scenario**. Marked improvement in global economic performance would require much stronger positive policy cooperation among industrial countries -- to reduce long-term U.S. demand for credit, to increase the import/GDP share of other major countries and blocs, and to dampen interest and exchange rate volatility. Higher trade growth would result from accelerated diversification of trade patterns as well as from a relatively expansive environment emerging from the Uruguay Round. This scenario could result in world GDP growth of about 4 percent range and world trade growth between 5.5 and 6 percent on average through the mid-1990s. Increased confidence and liquidity could substantially improve the prospects for managing the debt, although probably not to the point where existing liabilities could be fully serviced. However, given the unexpectedly strong growth in world GDP and trade in 1988, it is possible that these high growth rates could materialize in some years even without adjustments in global imbalances.

7. **Shock Scenario**. Latent in the low-growth scenario is the possibility of world recession or a global shock. This would probably be initiated by a financial crisis surrounding the U.S. deficit, triggering exchange and financial market destabilization, OECD recession and dramatically reduced export prospects. A U.S. financial crunch would be expected to quickly spill over into a generalized payments crisis for highly indebted countries, and strong contractionary effects in most developing countries. It is an open question whether such a shock would be followed by concerted action to deal with the underlying causes which would put the global economy on a high growth path in the later 1990s, or whether a shock creates a shadow across the next decade.

8. Underlying these possible trends are long-run global political and economic changes. Financial integration is increasingly subjecting all countries to the (sometimes erratic) disciplines of a global financial marketplace. The world has become more multipolar politically and economically, and the current rapprochement between the superpowers will accelerate the emergence of more varied international relationships. These currents of differentiation are also, of course, strongly evident among the Bank's own borrowers. The re-emergence of Japan and Europe as major centers of economic and political power underlines the significance of the trend towards a multipolar world. Many of these developments will be greatly influenced by how well the Soviet Union succeeds in the prolonged process of economic and political reform which is now getting only haltingly underway.

Developing Country Challenges

9. None of the above offers an easy environment for developing countries, save under the most benign (and unlikely) set of outcomes. Over the coming decade they will have to find new answers to pressing development problems, but answers specifically tailored to an increasingly wide range of individual country circumstances. This paper is neither the place to spell out a comprehensive listing of all such issues, nor to fill in the implications for each region and country. Instead, this document focuses on three common problems identified in earlier work and confirmed to be of central importance during the Bankwide consultations.

10. First, all but a few developing countries will face severe **resource scarcity**. During the 1980s, a limited number of developing countries -- most notably the Asian newly industrializing economies (NIEs) -- have been able to make the transition from

heavy dependence on official resources to self-generated growth reinforced by easy access to external resources in the private sector. During the 1990s, a few more countries will move up the ladder in a similar fashion. But barring major policy changes, the vast majority of developing countries -- from the very poorest to the upper echelon of middle-income countries -- will find the 1990s marked by limited availability of resources for adjustment, investment and growth.

11. Second, shortages of **human resources, technological and institutional capacities** are severe constraints on development. Human resource development is critical to economic growth and poverty reduction, but it is falling behind in more and more countries -- not only in Sub-Saharan Africa. Especially in an era of explosive technological change, widespread acquisition of both broadly based general education and technical skills is necessary for development -- and the skills and knowledge required to remain competitive, grow and meet social demands are increasingly global in character. Institutions which can promote and manage the required educational, economic and technological changes are weak or absent in most developing countries, but have to be made effective at all levels from broad social governance to individual enterprises and agencies.

12. Third, **environmental sustainability** is emerging as a pervasive factor in the development process, and is posing unfamiliar technical, economic and political dilemmas for development. The relationship between environmental problems and poverty, in particular, gives rise to some of the most serious and complex problems. This is especially true in very poor countries trying to manage the pressures of rapid population growth on often fragile ecologies. Environmental factors may no longer be treated as of secondary importance, but will increasingly need to affect basic decisions made in nearly all sectors and regions.

<u>The Bank's Role and Capacity</u>

13. The Bank's management and shareholders face difficult choices about how best to position the institution to deal with the challenges of the 1990s. Some of the questions involved are diffuse, but nevertheless require the Bank to be active in providing ideas and shaping the debate -- for example, about possible changing roles of the Bretton Woods institutions in the evolution of global economic management.

14. More immediately, however, the Bank's leadership will need to make difficult strategic choices. How should the prospective financial and budgetary capacity of the institution be balanced against the growing demands likely to be made on it? Should the Bank's capacity be enlarged to permit an expanded range of options? If so, how? Questions about the Bank's growth paths, priorities and capacities form the basis of this paper.

15. The Bank has been trying in recent years to respond to virtually all the demands and needs before it. It has been dealing with an unprecedented development crisis among most of its member countries, both IBRD and IDA borrowers. It has been trying to respond operationally, intellectually and organizationally to the rapidly growing regional and country differences among its borrowers and to their growing demands for Bank services. It has introduced challenging new operational initiatives and emphases to address region-specific and more general development needs where shortcomings were perceived.

These steps have been undertaken most recently under conditions of significant budgetary and staffing restraint.

16. These difficulties can be resolved in part by budget and staff growth, if that is the choice made by Bank management and successfully achieved in consultation with our shareholders. But whether the budget grows a little or a lot, the Bank still needs to make strategic choices. A framework of development priorities is needed to guide the selection of operational emphases and the allocation of resources to support them; to provide criteria for balancing its regional and country responsibilities with its global role; and to set guideposts for how management should plan the Bank's future staffing and organization.

II. STRATEGIC DIRECTIONS

17. As indicated in Section I, there are three major overarching issues for the 1990s which require special attention in setting the Bank's strategic directions through the mid-1990s: resource scarcity, country capacity to achieve lasting development and environmental degradation. These issues are closely linked to decisions on growth paths for the Bank and would play out in different ways in different regions and country circumstances. They confront the Bank with global concerns which cannot effectively be handled on a business-as-usual basis and point towards three strategic directions which imply shifting priorities for the Bank: (a) mobilization of financial resources; (b) human capital formation, technological and institutional development; and (c) environmental sustainability.

18. Decisions on priorities such as those discussed in this paper will alter the Bank's focus over time, leading to changes in the allocation of financial and staff resources and in the range of future Bank activities. But it can no longer be assumed that **ad hoc** decisions to strengthen one area or another of the Bank's program can simply be adopted as add-ons to existing priorities. Unless there is an unexpected lessening of pressure on the budget, the Bank will need to make conscious choices, start restructuring budgets, and work out long-term understandings with shareholders, borrowers, and others active in the development business. Even with a more expansive budget, considerations of development effectiveness, efficiency and the Bank's overall manageability push in the same direction of trade-offs and selectivity. That is why the issues of overall strategic directions and priorities need to be urgently addressed.

Growth Paths

19. A number of factors will influence Bank decisions on growth. Among the most important are the (i) external financial requirements of the borrowers; (ii) efforts by the borrowers to adjust and mobilize additional domestic resources for savings and investment; (iii) growth of the global economy in general and world trade in particular; (iv) volume of capital flows from private and official sources to developing countries; (v) level of interest rates and the volume of required debt service payments from the developing countries to international creditors; (vi) willingness to borrow from the Bank; and (vii) internal constraints placed on the Bank by the limited size of its staff, the need to identify and develop quality investment projects and adjustment programs, and various portfolio, exposure and risk management issues.

20. Many of these factors cannot be altered in the short run. But over a longer period, strategic decisions by Bank management might reduce the binding nature of some constraints. For example, if the Bank plays a more active catalytic role or becomes more extensively involved in debt reduction programs, it can increase the volume of private financial resources flowing to developing countries or reduce the required financial transfers from debtors to creditors. Similarly, decisions made today about the future size of the Bank's staff, capital base, and project pipeline will affect the volume of direct resource flows from the Bank to borrowing countries.

21. In addition to the growth of IBRD lending, IDA resources will play a crucial role in overall Bank growth strategies. Concessional flows are an essential component of

Bank resource transfers to low-income countries -- indeed most low-income countries borrow from IDA only. However, IDA resources are subject to short (3-year) replenishment horizons and political uncertainties. Since IDA-5 (1978-1980), successive replenishments have not kept IDA on a steady growth path in real terms, but an expansion of IDA resources is a necessary condition for the Bank to play an important role in reducing poverty and stimulating growth in low-income borrowers.

22. A conscious decision to opt for a **much higher growth path** for Bank lending than is now planned would provide a forceful response to the immense needs for adjustment and investment finance in developing countries, and assure the institution a highly visible role in global finance and development. However, given difficult conditions in many member countries and the short run intractability of the Bank's budget constraints, rapid growth also poses considerable risk to the financial quality of the Bank's portfolio and to the quality of its operations. A particular problem is that rapid growth based on a larger share of quick-disbursing lending -- which might be easier to accomplish -- would tend to lock the Bank into further expansion of this type of lending in order to maintain positive net disbursements: it is a short step, familiar to commercial banks, from this situation to defensive lending in order to prevent arrears. Alternatively, a major expansion based on primarily an investment lending would require developing a very strong project pipeline, which in turn would necessitate relaxing budget constraints.

23. A **slow-growth path** would envisage the Bank taking a highly conservative approach to the management of risk, moving away from presently high levels of quick-disbursing adjustment lending, and trying to maintain the political consensus underlying its staff and budget strengths by emphasizing, with even greater force, high-calibre work and a cautious approach to lending. This would lead to a diminished role for the Bank in resource transfers -- already negative in many cases -- and would shift the financial burden of debt resolution and adjustment towards others (the Fund, the commercial banks, and major creditor governments). Such a growth path could preserve or increase the quality of operations, and also improve the Bank's portfolio as no bold efforts would be made to offset declining flows from other sources with increases in Bank exposure. However, this would be achieved at the cost of a possible reduction in policy influence, a diminished role in helping meet developing countries' financing and development needs, increased pressure on country relationships and on repayments as net disbursements diminished, and the potential erosion of shareholder support.

24. Bank growth can also be addressed by focusing more on how the Bank increases its impact and lending by sharing to a greater degree responsibilities and opportunities with other participants in the international financial system. This would entail building upon existing collaborative relations with other funding agencies and **maintaining an expansive stance, but one based on increased burden-sharing and shared growth.** As a result, the Bank would seek to expand further its collaboration with borrower country governments, the Fund, regional development banks, bilateral agencies (especially new or expanding entrants such as Japan), and international sources of private finance for development (see Section II below). This approach describes best management's view of the Bank's role in the next few years.

Mobilizing Financial Resources

25. The Bank's leadership faces important strategic choices about how best to support development resource mobilization in the new climate anticipated in the 1990s, about how to use its own resources to help generate required levels of international development finance, and about how to encourage efficient resource mobilization within developing countries themselves in order to support faster growth and poverty reduction.

26. Mobilizing financial resources for development is fundamental to the Bank's business; there can be no serious question about its central role as a strategic direction for the Bank in the coming decade. The environment for both international and domestic resource mobilization has changed radically, and the difficulties have increased for developing countries. The major issues surrounding this objective concern how best to achieve significant results.

27. The Bank's role in **mobilizing external finance** -- and that of other international institutions such as the Fund and the regional banks -- needs to take account of the following: scores of billions of dollars in net transfers from developing to developed countries since 1982, stagnation of official development assistance and of direct foreign investment, a precipitous decline in commercial bank lending since the mid-1980s, heavy debt service burdens and large current account deficits. In terms of **domestic resource mobilization** and investment, the Bank must grapple with widespread fiscal and (incipient) financial crises in developing countries which distort and constrain country efforts and provide a poor environment for external flows. In addition, increasing the efficient use of investment resources is a prime development contribution that the Bank makes to its borrowers.

28. Expansion of Bank Investment Lending. As indicated in the preceding section, part of the Bank's response to these problems can be addressed through its own financial capacity. While IBRD net flows to current borrowers remain positive, total net transfers turned negative and will not, on most plausible assumptions, improve significantly in the medium term. IDA's resource transfers are strongly positive, but face the different problem of short replenishment horizons and uncertainties regarding the level of donor resource commitments.

29. One obvious route would be for the Bank to expand project and, increasingly, sector lending for infrastructure, agriculture, industry and energy on which its track record and global expertise have been built. Lending for environmental projects could be very large as well. There is a massive need in most developing countries for both rehabilitation and new investment, and a major expansion of Bank project and sector lending should be possible if increased attention is focussed on this feature of the Bank's program. However, the widespread lack of institutional capacity and domestic budget resources, especially for recurrent costs, constrain the efficient absorption of investment finance in some countries. In such cases a significant increase in project and sector investments may have to be preceded or accompanied by institutional development, and by fiscal reform and domestic resource mobilization efforts on a much greater scale than presently. This having been said, there should be considerable room for growth in Bank investment lending.

30. <u>The Bank as an Investment Catalyst</u>. The Bank could also play a more active role as a catalyst to mobilize external finance from a variety of private and public sources, linking them to its own investment and adjustment operations. Considering the improbability (and even undesirability) of a resumption of large-scale syndicated commercial lending, improving the economic environment and financial systems in developing countries is critical to the mobilization of private external resources. But this will not be enough: direct encouragement of private funds will be necessary, and every catalytic method available should be used to enlarge such flows. While MIGA and IFC are increasingly important in this respect, the scale of their operations is still limited. In addition, major sector-type investments also typically give rise to important public policy and public finance issues in which the Bank's involvement is appropriate.

31. An expanded catalytic investment role would leverage Bank lending by associating additional flows from other sources with Bank operations, and may thus be perceived as offsetting declining Bank net disbursement and net transfers to borrowers. It would also enable the Bank to complement its financing role by assistance in the design of investment projects and programs that involve other sources of funds, thus increasing the total volume of lending associated with staff time.

32. The Bank could increasingly take a leading role in putting together the financial and technical components of investment packages on a sector or investment program basis, and where appropriate play a coordinating role in securing the best possible mix of financing by the Bank itself, other official donors, export credit agencies, commercial banks, equity investors and suppliers within a macroeconomic and sector framework agreement with the borrowing country. On the basis of past experience (B-loans, cofinancing), spontaneous private sector participation in investment packages is likely to be limited to the creditworthy countries, and Bank guarantees and/or a wide range of financing arrangements would be necessary to induce private investors to move to more risky borrowers. The limited experience with prototype operations (e.g., a recent Pakistan energy sector loan) also indicates that the Bank's technical capacity for investment appraisal -- and its seal of approval -- can be at least as important as any financial engineering, although additional financial skills and services would certainly be needed. A careful choice of countries, of sectors (e.g. energy) and of the elements involved in the financing package (e.g. provision of working capital) would be required to bring about new forms of international public/private investment partnerships.

33. <u>Leadership in Coordination of Resource Flows</u>. The Bank's leadership role in mobilizing official resources for investment has become increasingly demanding in recent years and could expand further during the 1990s. Consultative groups have been useful instruments for this purpose in the past and will continue to be appropriate in many cases. The role played by the Bank's Africa Region in mobilizing resources and organizing donor support on a regional (but selective) basis has moved far beyond previous levels of involvement in ways perceived as very useful by donors and recipients alike. Here and in other settings, coordination is no longer focused only on ODA flows, but on the whole range of financial flows appropriate to the country. Public expenditure reviews have become important components of enhancing effectiveness of resource use.

34. The Bank's future involvement in aid coordination requires further strengthening of development impact through better cooperation with donors at the local level, and the evolution of a sensible division of labor among donors. In this respect, the

prospective emergence of Japan as the world's largest aid donor suggests the special importance of developing a close working relationship between the Bank and Japan's development assistance programs. The Bank could also use its "convening power" and its international standing more aggressively to obtain major donor commitments and finance for regional and problem-specific programs (e.g. the Consultative Group on International Agricultural Research, the Mediterranean basin project).

35. Trade. For most developing countries trade will provide the major source of foreign exchange resources for growth. The Bank's ability to influence industrial country governments is limited but not insignificant. The Bank can strengthen its development impact by highlighting, through research, analysis, public statements and persuasion, the importance of open access to developed country markets that would enable developing countries to increase export earnings (e.g. the Bank's active role in encouraging the GATT's Uruguay Round).

36. The staff time necessary to play the catalytic investment, coordination and diplomatic roles is substantial, but does not necessarily generate additional Bank lending. It contributes instead to increases in overall financial flows, to effective use of resources and to the development effort in numerous valuable ways. These activities add to the Bank's administrative overhead unless performed on a cost recovery basis and necessitate careful review of incentives and budgetary procedures (see para. 85 below).

37. The Bank's Role in Debt Reduction. The debt overhang is a serious impediment to the resumption of investment and growth in many countries. As a result of Board decisions in May and June 1989, the Bank will play an active role in debt reduction for highly-indebted countries that are undertaking reform programs but confront steadily worsening balance of payments and debt service problems. A wide area of options may be considered: financing the repurchase of debt at a discount; providing guarantees for exit bonds involving principal writedowns or interest rate relief; helping design and monitor adjustment programs tied to debt relief, in cooperation with the IMF; and, should agreement between creditors and debtors warrant such roles, providing the technical expertise to assess a country's capacity to pay and management services for debt reduction schemes. These roles will be played without abandoning the case-by-case approach to voluntary debt reduction. In addition, mobilizing special funds from donor countries, debtors and even commercial banks would be one way to finance debt reduction operations without placing undue pressures on the Bank's balance sheet.

38. More active Bank involvement in debt reduction will mobilize external financing for heavily indebted countries but would require substantial staff involvement in the design and monitoring of adjustment programs, a willingness to take on the technical and administrative burdens associated with debt relief, and above all a willingness and ability to take a clear lead in a politically sensitive area.

39. Adjustment Lending. The main focus of resource mobilization efforts, however, must be within developing countries themselves. The Bank has two main instruments at its disposal: structural adjustment and sectoral adjustment lending, particularly financial sector adjustment (even though agricultural, industry and trade restructuring also play a significant role in domestic resource mobilization). A sound macroeconomic policy framework is necessary to increase domestic savings and improve the allocation of investment resources. Quick-disbursing adjustment lending provides external finance to

underwrite the costs of policy reforms in borrowing countries, and contributes to domestic resource mobilization. Through trade policy reforms it also improves the efficiency of resource allocation and increases foreign exchange earnings. However, because it is used for general balance of payments support, adjustment lending raises concerns about how far it actually contributes to domestic resource mobilization.

40. Quick-disbursing adjustment loans also have serious implications for the profile of net disbursements and transfers to borrowers, and for the riskiness of the Bank's portfolio. Prolonged adjustment efforts are difficult to sustain, particularly in an adverse and uncertain international environment and, assuming the initial gains from major policy reforms have been obtained, there may be diminishing returns to subsequent adjustment lending operations designed to fine-tune policy frameworks. These considerations, added to the fact that the Bank's adjustment lending program depends on country political commitments difficult to anticipate and beyond the Bank's control, suggest that -- unless the Bank decides to assume greater financial risks (perhaps as part of debt reduction exercises) -- the proportion of quick-disbursing adjustment operations in Bank lending should not exceed its present levels. Transition strategies involving "hybrid" loans or other instruments which combine quick and slow disbursement can assist in reducing the proportion of quick-disbursement lending, while minimizing the adverse net flow and net transfer problems for borrowing countries.

41. <u>Financial Sector Restructuring</u>. Even the most optimistic scenarios do not produce adequate supplies of external finance for development in the 1990s. Increased emphasis must therefore be placed on all aspects of domestic resource mobilization. Particularly important is the role of the financial system in domestic resource mobilization and allocation. Bank operations to restructure the financial sectors in developing countries are aimed at increasing savings and the efficiency of the financial system in intermediation. This requires an appropriate legal framework, effective supervision, and the capacity to enforce regulations and contracts in the banking and financial services industry.

42. In many developing countries a large number of financial institutions are effectively bankrupt, and a potentially huge restructuring of public and private financial intermediaries will ultimately be required. While there is considerable scope for the expansion of Bank activities in this area, the political sensitivities are great, and effective interventions could involve substantial amounts of lending resources and require skills and expertise presently in very short supply.

43. Alongside the resolution of financial distress, there is a longer-term task of deepening the financial system in many developing countries, and in particular of developing capital markets (as IFC has been doing in some countries), both to mobilize and allocate domestic resources and to effect better linkages with international sources of direct and portfolio investment. This is a very long-term enterprise in most developing countries.

44. These are just a few of the various lines of action which offer opportunities ways for the Bank to expand and deepen its strong commitment to resource mobilization -- including debt reduction -- in the 1990s. But a growing base of human resources, technological capacities, and effective public and private institutions is necessary for developing countries to use investment resources productively and to assure that the

benefits of economic growth are more equitably distributed. The second strategic direction addresses these issues.

Human Capital Formation and Institutional Development

45. The decline in living standards and the persistence of poverty in developing countries, as well as the sharp deterioration in social conditions during the 1980s after nearly three decades of substantial (if uneven) improvements in population, health, nutrition and education, constitute the background for the second strategic direction that emerged during the Strategic Agenda consultations: the need to strengthen the development of human, technological and institutional capabilities in developing countries. Although highly effective individual operations can be identified, these are areas in which the Bank has not had remarkable success, nor has it been a primary feature of the Bank's work. Nevertheless, its priority is so high and the constraints of past neglect so significant, that a strategy without these key elements may miss the task most urgently needed.

46. The Bank has long recognized that resource mobilization and policy advice will only be effective to the extent they are fully absorbed and institutionalized by its borrowers. It has periodically restated its commitment to human resource development during the last forty years. However, most attention and energy have been focussed on the task of providing loans for infrastructure and productive activities, and more recently to support broad policy reforms. While these loans often involve some institution building components (primarily technical assistance and training to establish or strengthen government units or agencies associated with the loan), the Bank could move well beyond an add-on approach to human capital formation and technological and institutional development.

47. Participation of grass-root movements, professional groups, community organizations and other NGOs in the design and implementation of development strategies is important to their success. Well developed human, technological and institutional capacities are necessary to make effective the potential contribution of these groups to the development process and to strengthening democratic tendencies throughout the world.

48. The social sectors have not accounted for a major share of Bank lending during the last decade. Lending for population, health and nutrition has averaged about 2.5 percent of total IBRD/IDA lending in recent years, and education projects have averaged about 4.5 percent of lending since 1962 without wide variations from year to year. The Bank has been slow in recognizing the importance of supporting the development of country capacities to generate or absorb new technologies and to innovate; investment operations have seldom treated these technological issues explicitly and only a handful of projects specifically designed to address them have been supported. In addition, although institutional development issues have received much attention in recent years, particularly in the context of public sector management reforms, the Bank could play a much more active role in view of the magnitude of the problem, and the importance of local institutional capabilities for Bank operations and development efforts in general.

49. A number of factors account for the Bank's limited involvement in human capital formation and institutional development. The complexity of the social and cultural factors, the politically sensitive nature of interventions, the lack of adequate technical staff

with skills and extensive field experience, the limited foreign exchange and import content of operations in social sectors, the reluctance of countries to borrow from the Bank for these purposes given the relative hardness of IBRD terms as compared to other sources of finance, the lack of appropriate lending instruments and services, and the structure of incentives for managers and staff have all combined to make human capital formation more a useful adjunct to investment and adjustment operations, rather than a strategic direction for the Bank. These are not simple problems to solve and can be overcome only if it were decided to make a major, fundamental commitment to these areas as Bank priority objectives.

50. <u>Human resources development</u>. The quality of human resources is critical for economic growth and poverty reduction, and investments in human capital are a prerequisite for development. The Bank can significantly expand its commitment and support for population, health and nutrition, and education programs through lending, technical assistance, policy advice, research, training and information. They are closely interrelated issues that require an explicit treatment of complementarities and linkages (e.g. women's education appears to be an effective way of reducing population growth, nutritional improvements may lead to significant achievements in education), even though this increases project and program complexity.

51. But the Bank (along with other in the international development community) does not have the answers to these difficult problems and there are limits to external interventions aimed at improving human capital. Sustained country commitment is essential for success, and this requires the willingness to introduce and sustain policy reforms, the continued provision of recurrent expenditures to support human resource development, organizational and managerial capacities to administer large-scale programs efficiently, and government openness to accept the potential contribution of community organizations and other independent local movements. Moreover, for the Bank to be actively involved in IBRD countries, especially when grant money may be available from official and private donors, it will often be necessary to associate Bank programs with resources provided by other donors.

52. Many other donors have worked in human resource development over the past 40 years, including foundations, UN agencies, bilateral aid agencies, regional banks and NGOs. Increased collaboration with such groups will be very important, seeking to achieve a balance based on comparative advantage. While there have been many individual successes and significant achievements during the last 40 years, no donor has been outstandingly and consistently successful, which attests to the inherent difficulty in achieving satisfactory results. The most successful donors have probably been the Ford and Rockefeller foundations with their programs to support research and education (prior to their financial retrenchments in the mid-1970s), USAID in the 1960s and early 1970s with its support of development administration and population programs, WHO through the 1970s and 1980s in health care programs, UNICEF in the 1980s in fields like Oral Rehydration Therapy, the Canadian International Development Research Center (IDRC) with its research support activities during the 1970s, and a few smaller NGO organizations which developed specialized knowledge in these areas. Their operations were frequently dependent on extensive field staffs with good understanding of the local situation and the ability to provide continuous and flexible supervision during implementation.

53. **Technological capacity**. Despite the importance of technology issues for development the Bank has done little to address them. The Bank could provide greater **support for the establishment of technological institutions** appropriate to country needs, and the **more efficient use of existing technological capacities** through loans, technical assistance and policy advice. As borrowers intensify their links with the world economy and as adjustment proceeds, competitiveness and supply response requirements will make it necessary to strengthen education and training institutions, research and design centers, technology extension and information services, and quality control and metrology services. An efficient network of technology service institutions is also required to support and promote productivity improvements geared to satisfy basic needs in rural and urban areas.

54. The Bank could also expand its operations to **finance technological innovation** in developing countries, supporting institutions that provide venture capital, credit lines for the development and commercialization of technology, and finance technology imports. Policy advice and technical assistance in the establishment of fiscal incentives for innovation may also be involved. Taking advantage of Bank technical expertise in selected fields, the provision of an expanded range of technology services (information, technology assessment, training) for developing countries is another option to be considered.

55. The Bank provides grant support for agricultural research through the Consultative Group on International Agricultural Research (CGIAR), and it also funds research in other fields such as health and economics. Development research needs are practically limitless and the Bank could easily **expand its research support for and in developing countries** through grants, research contracts and by sponsoring the establishment of an independent research support organization or institute, financed in part from Bank profits.

56. The Bank has limited experience in operations specifically designed to support the development of technological capacity. Technological considerations have usually been dealt with at the project level, and only a handful of sector- or nation-wide projects of this kind have been financed. These appear to be relatively small operations requiring technology policy skills that are in short supply in the Bank.

57. But the Bank's role in technology transfer and development could be even more important and have far greater impact by assisting developing countries to take advantage of the technological advances associated with the information revolution. Opportunities are continuously expanding for the use of microelectronics, informatics and telecommunications in a variety of productive and service activities. With few exceptions, developing countries have not as yet been able to take advantage of these opportunities. Indeed, many are not even aware of them.

58. **Institution building**. Institutional constraints in developing countries, including limited managerial, policy making and administrative capacities, must be removed for developing countries to carry out successful development efforts. The Bank's recognition of institutional development has increased in recent years, particularly with adjustment operations, but coverage of these issues is still uneven and unsystematic. The traditional approach adopted in project and sector lending was to create islands of institutional modernity, often augmenting the country's implementation capacity with foreign technical assistance and project implementation units that are unsustainable without continued external support.

59. The Bank is planning greatly to **expand its support for the development of the private sector**, seeking to mobilize the energy and entrepreneurship of private business for development purposes. This involves policy advice to create an enabling environment and give a greater sense of direction to private initiative; an expanded Bank lending program and more operational support for capital markets, private financing and operation of infrastructure, and the promotion of private investment; and an expansion of advisory services and operations in IFC and MIGA. These actions could remove the constraints and provide direct support for the development and consolidation of private sector institutions.

60. The Bank could **expand its support of public sector management and public enterprise reforms**, primarily through lending, training, technical assistance, research and information services. These are usually small, staff-intensive operations that involve high project preparation costs (e.g., technical assistance operations require about 4.8 times the average number of staff weeks per dollar of lending), but are essential for the success of other Bank operations. The challenge is to move beyond specific interventions and adopt a broader perspective on the institutional and administrative capacities needed to manage the economic, social and political transformations associated with development.

61. The Bank could **expand its support for the development of local policy analysis and design capabilities**, whose weakness is a critical constraint in most developing countries -- particularly in relation to macroeconomic management and adjustment. While most middle-income countries have a number of policy research centers, usually associated with universities, which concentrate well-trained and experienced policy analysts that constitute a reservoir of talent on which the public and private sectors draw, the situation is quite different in the low-income countries, and particularly in Sub-Saharan Africa. Moreover, economic and fiscal crises reduce public and private support for policy analysis and research, and often lead to drastic and sudden reductions in policy analysis capabilities.

62. This may involve assisting developing countries in setting up mechanisms to finance policy-oriented research, increasing Bank support through grants and the mobilization of other sources of research funds, the extensive use of research contracts and fellowships, expand training programs and the exchange of experiences through the Bank's Economic Development Institute, and provide information and dissemination services to policy-oriented researchers in developing countries.

63. Partly as a result of the deterioration of living standards that heightens social tensions, and of the need to adjust to a world of greatly increased international competitiveness, developing countries are facing the problem of devising and strengthening workable social institutions to achieve growth and distribute its benefits. A number of major changes and adjustments in legal systems, the role of the state,the relations between the public and private sectors, the relative balance between planning and markets, and in property rights and entitlements will be required for developing countries to deal with the complex issues of governance, social organization, and the distribution of claims on the social product. As countries struggle to establish and sustain more open and democratic forms of government, it will be necessary to accommodate the greater demands for participation made by the civil society in general.

64. The Bank could take an active role in **addressing the problems of governance and social transformation** in developing countries. Given the limited knowledge available

on these issues and the changing nature of the problems, the Bank could support research and promote the exchange of experiences, seeking to offer a fertile ground for analysis and reflection. In particular, the Bank has evolved a reasonably coherent view of the kind of economic strategies most developing countries are likely to need if they are going to restore or increase growth, complemented with ideas on how to ameliorate distributional problems. But the Bank has no comparable view about the political and institutional arrangements required to underpin those economic strategies, in general or in particular types of countries. This is an area that requires urgent attention.

Environmental Sustainability

65. The third strategic direction for the Bank represents a recognition of the severity of the environmental constraints that developing countries face now and will increasingly face in the future. Pressures on natural resources intensify daily, and hundreds of millions of people living in absolute poverty destroy the resources on which their future depends because no alternative is open to them.

66. Since the 1987 reorganization, the Bank has established its environmental effort on a broader and stronger footing, and several basic thrusts of the program have been decided upon and are now under development. These involve the **incorporation of environmental considerations into Bank operations and the development of policies and approaches to deal with national and wider environmental problems.**

67. The major start-up decisions related to this strategic direction have thus already been taken. Four regional environmental units have been created to focus on project environmental impact, introducing environmental considerations in country work and developing specific operations aimed at environmental preservation and regeneration. The central Environment Department focusses on policy and research activities in a range of technical, economic and social areas, provide support to regional staff where conceptual guidance and specialized expertise is required, develop methodological tools for environmental assessment, and establish and maintain information systems and data bases.

68. The number of activities specifically addressing environmental sustainability -- through lending, policy advice, technical assistance, project review and conditionality -- will increase significantly through the 1990s. In addition, analyses of major environmental issues and country studies will focus and disseminate the Bank's intellectual contributions in this area.

69. Bank action on regional and global issues will focus initially on the severe environmental problems in Sub-Saharan Africa, the threat of tropical deforestation, and pollution in the Mediterranean basin. These interventions involve exerting the Bank's convening power and leadership to mobilize a variety of government agencies, international organizations, bilateral agencies, scientific societies, research and academic centers, the private sector, and NGOs in devising and implementing solutions to critical environmental problems that cut across countries.

70. Several questions need to be addressed from a strategic perspective, however, basically involving judgments about the long-term development significance of environmental initiatives in the Bank.

71. Environmental work is becoming a substantive part of the Bank's activities and is gradually becoming a central component of the Bank's approach to development. The first question is whether we are moving fast enough? A more ambitious option would be to acknowledge that mismanagement of natural resources is very costly to developing countries and to regard environmental sustainability as central to the design and implementation of development strategy. If this were to be done, the Bank would need to make an even greater intellectual and operational effort to re-orient development policies in the direction of resource-conserving and environmentally benign growth.

72. A second question (which can be assessed partly independently of the first) is whether the Bank's work at the country level -- growing out of environmental assessments and action programs -- should be broadly based to cover all environmental issues, or should focus on particular major themes. Given developing country energy needs, one such theme could be energy and the environment, for example with a major Bank effort to address the environmental implications of nuclear, thermal and hydroelectric investments, and to develop better complementarity between macro- and microeconomic policy choices and the development and use of different energy resources. The Bank may also focus its attention on the environmental consequences of accelerated urbanization and of the growth of megacities in developing countries. Another choice would be to concentrate on the linkage between the environment and poverty. This would focus Bank effort on issues such as population and migration policies, household energy, the ecology of small-scale agriculture and food security, and the links between environment and basic human services such as preventive and primary health care, but perhaps give less attention to industry and major energy and construction activities.

73. A third question arises from the Bank's experience of how its global character and "convening power" can thrust it into unsought leadership. A similar process may well be getting underway in the case of the environment. One option would be for the Bank to set clear limits (difficult though this might be politically) to its environmental reach, and deliberately to avoid a wide international role. An alternative strategy would be to anticipate that such a role is desirable or inevitable, and to plan programs and resources to deliver what will be required: e.g., playing a prominent part in the likely renewal of international action over the management of the global commons (particularly the exportation of marine resources), promoting and financing cooperative research, and action on potential environmental threats such as toxic waste disposal, ocean and space dumping, and global warming.

III. OPERATIONAL IMPLICATIONS

74. The strategic directions described in the preceding section will have operational implications that relate to the regional and country dimensions of Bank work, as well as to capital requirements, the Bank's product line, staff deployment, relations with other agencies, to the special emphases and their evolution over time, and to the organization of the Bank.

75. Regional and Country Differences. A basic issue for Bank leadership is how to assure that the global character and identity of the Bank is not lost in a morass of highly specific country activities. One approach is to agree on directions such as these that have global relevance, but recognize that the relative emphasis placed on each -- as well as on the different lines of action they comprise -- will vary according to the specific conditions prevailing in each country and region. For example, the Bank's interventions as a catalyst for investment finance must be tailored to individual country situations, as each country's ability to attract capital and debt structure is unique, and as the sources of finance will differ in each case. It is also increasingly clear, however, that regional categories -- with the current exception of Sub-Saharan Africa -- are less significant now as great diversity in country situations is found within each region as well.

76. The Bank's commitment to Sub-Saharan Africa and our highly visible role in resource mobilization, added to the intractability of African development problems, deserve special consideration. Continued and substantial improvements in economic policies are essential; an emphasis on virtually all aspects of human capital formation and institutional development is necessary for economic progress in the region; the expansion and improved maintenance of basic infrastructure and productive investments are urgently needed; and sustained aid coordination and concessional resource mobilization efforts will be required to underpin African development efforts through the 1990s. The Africa Region is already far along on a major long-term strategy document that emphasizes the three overarching priorities described in the preceding section, and much more. Thus, the strategic question must be posed as to whether the Bank can manage such a broad sweep of operational responsibilities effectively.

77. Capital Requirements. Barring a major disruption in financial markets or a loss of the Bank's AAA rating, the Bank will continue to enjoy continued access to the international capital markets on the basis of its paid-in and authorized capital. The recent GCI provides the Bank with a capital base to accommodate up to about US$22 billion of annual commitments (with the precise level dependent on interest and exchange rates). Should the Bank embark on a much higher growth lending path than now planned, or on a sustained effort to finance debt reduction operations, a new capital increase could be required before 1993 (which was the date originally estimated for consideration of a new GCI). In this connection, alternatives should be explored which would permit expanded lending in the mid-1990s if another general capital increase should prove to be difficult to attain.

78. In addition, IDA-9 and future IDA replenishment negotiations will, of course, be critical for the continued expansion of Bank operations in low-income countries. During the coming decade there seems little prospect that needs will diminish significantly; in fact, currently the pressure is to find increased funds to meet expanding need from a growing group of IDA-eligible countries. Among the decisions donors will need to make

is the degree to which IDA continues its global role or whether it shifts still further toward an African focus; for IDA-9 that issue seems settled but will presumably continue to arise in the future.

79. Human resources and institutional development and technology capacity building (areas of strategic choice described above) are not likely to involve much enlarged investments, either as stand-alone projects or as part of other operations, important as they are. Therefore, even a substantial expansion of Bank activity in these directions is not likely to impose strains on the Bank's capital. An increased emphasis on environmental sustainability, however, could well place more serious pressures on resources available for lending. In any case, borrower interest, staff constraints, confidence in Bank prescriptions and, to a lesser extent, the need to adapt the Bank's product line are likely to impose more significant constraints to expansion of Bank lending.

80. **The Bank's Product Line**. The Bank's product line consists of a single dominant product (a fixed maturity sovereign loan) supported by a range of nominally "free" services. These range from highly specific project identification, appraisal and supervision support, to global comparative research and dissemination of knowledge about development. During the next decade the character of that dominant product -- the Bank loan -- will certainly undergo changes. Vehicles will be needed for an effective transition from quick-disbursing to other forms of lending in support of adjustment (e.g. "hybrid" loans and multi-year financing agreements), and variations in terms and conditions (e.g. variable loan price structures for different borrowers) may be necessary to maintain the Bank's active presence in all regions which is essential to the Bank's global outlook and mandate.

81. If the Bank is to be an effective catalyst for investment financing it will have to develop instruments to tap international capital markets and to mobilize private flows to developing countries, as well as to employ financial wholesaling techniques while resolving the problems presently experienced in lending through financial intermediaries. It will have to work out its own role vis-a-vis that of IFC and MIGA in encouraging risk, capital and in particular equity investment without introducing inefficient distortions in capital markets. And it will have to develop investment packaging techniques which utilize the Bank's core project and sector skills within a larger financing framework. This should also in time include, as part of the "shared growth" approach, greater willingness to associate our funding with lending operations appraised by other institutions.

82. For human resource development to become a major focus of Bank activity, substantial product innovation will be needed to deal with the long-term nature of returns to human resource investment (and therefore the reluctance of countries to borrow on Bank terms for these purposes), and to deal with maintenance and operational costs of human services as well as investment in the physical infrastructure (schools, clinic buildings, workshops). Alternatively, given the nature and importance of these sectors to successful development, the Bank may not wish to express its goals in quantitative lending terms. It could, for example, decide that its comparative advantage lies in its analytical work and its influence on policy and overall resource allocation priorities. Another product innovation -- necessarily limited given the sources of Bank funds -- could involve expanded grant support for developing country NGOs, training centers and research organizations to improve the delivery of social services. The Bank could also consider the establishment of an international center or other free-standing unit, supported from the

Bank's profits or from special donor financing, to carry out research, prepare programs in this area, and provide technical assistance and information services to Bank clients.

83. Technology transfer and capacity building activities would also require major innovations in the Bank's product line. Research support building upon and expanding CGIAR experience to other areas could make significant contributions in relation to the resources involved. Technology assessment and information services, technology policy advice, and technical assistance to build local capacities in selected priority areas (e.g., information technology) could be a highly valued addition to the range of Bank products and services.

84. The Bank will also need to devise more effective vehicles for tackling institutional development problems, particularly when these are "systemic" and transcend the management problems of particular agencies. Given the long-term character, and skill -- rather than capital -- intensive nature of institutional problems, the Bank needs to find better financing and programming techniques; for example, by actively sponsoring and participating in regional consortia with foundations and bilateral assistance agencies.

85. Many of these product-related issues underline the broader fact that the Bank's range of services has been growing over the years, as has expenditure on them. This tendency shows every sign of continuing and both equity and budgetary pressures suggest that they should be priced and their costs recovered to a judicious extent -- either by charging beneficiaries directly or, where appropriate, by securing additional administrative support from the international community. Attempts to have donors share costs for added Bank resources in the Special Program of Action for Sub-Saharan Africa have not proven successful, although in many other ways in Africa and elsewhere Bank programs are being supported directly by bilateral donors. This has reinforced the "shared growth" approach, but also risks distorting Bank priorities by responding to the priorities of individual and particularly generous donors.

86. <u>Staff Implications</u>. After allowing for efficiency gains, a larger Bank role in project, sector and adjustment lending would require some staff growth. Should the Bank decide to play more active catalytic investment, aid coordination, debt reduction and financial services roles, changes in skills mix and additions to the staff would also be needed. The number of additional staff would depend on decisions regarding the level of intensity devoted to the mobilization of non-Bank resources and the expansion of Bank lending.

87. As currently implemented, PHN and education operations involve relatively high project preparation cost per dollar of lending, and thus would not be the preferred sectors for expanded activity if the objective were simply to maximize Bank lending with a fixed administrative budget. PHN operations require over three times the average number of staff weeks of project preparation per dollar of lending, and the corresponding figure for education is nearly two times. Less staff-intensive approaches may be feasible and should be sought, and greater integration of population, health, nutrition and education with other Bank programs may also permit greater efficiency. But thus far there is little evidence to suggest that concentration on these human capital areas can be accomplished without substantial direct staff involvement. In addition, PHN, education and institutional development require an extensive knowledge of local conditions and prolonged

involvement in the field. A strategic set of choices is required if a substantially increased role in these social sectors were envisaged.

88. An expansion of Bank operations in technology capacity, institution building, and environmental sustainability would make it necessary to complement existing technical and economic skills and a change in the skill mix towards engineering sciences, technology policy, environmental sciences, public and private sector management, and political and social sciences.

89. In short, each of the areas highlighted for strategic choices is likely to require an increase in the quality and quantity of Bank staff, but which can be deployed flexibly to meet rapidly changing country and global needs. Savings and efficiencies are needed to assure that waste is minimized, but there will be no way to do the job required without an overall increase in Bank staff, comparable shifts from other activities, and/or savings gained by reallocation of functions based on a careful plan worked out with other international institutions. If we are not prepared to confront these possibilities, then the nature of Bank strategic choices will be quite different and much more constrained.

90. These trade-offs pose staff and management incentive issues in a sharp form. For example, are incentives strong enough to reward staff and managerial success in expanding the Bank's catalytic role in generating higher levels of resource transfers combined with Bank operations, rather than the quantity of the Bank's lending alone? Consideration might be given to separating staff-intensive, low lending-volume activities in some way from those where the emphasis is on financial transfers, to insure that they receive adequate attention. Special arrangements to lower their costs to borrowers might also be explored.

91. <u>**Relations With the Private Sector and Other Development Agencies**</u>. As noted in para. 81, the Bank now operates in a world in which the private sector and other institutions in the development community have become increasingly effective and important. The growth of IFC and birth of MIGA reflect recognition of this, but the Bank's approaches will have to adapt further to fit this new environment. The Bank needs to combine forces with the private sector and with other development finance agencies in a more active manner.

92. In trying to **broaden and deepen its relationship with the private sector** internationally and within particular developing countries, the Bank faces some difficult choices of balance and emphasis. Depending on the strategic directions chosen, the Bank could concentrate its private sector role on encouraging a market-oriented environment, broadly as it does now. Or it could take a more activist and direct stance vis-a-vis private sector entities, becoming actively involved on a large scale (as in the catalytic investment role) in putting together investment packages with heavy private sector involvement.

93. An active role in aid coordination and diplomacy demands a more systematic approach to **collaboration with bilateral donors** along the lines now being developed by the Africa Region in the Special Program for Africa. The responsibilities are enormous, but the potential payoffs are great. Of particular importance for the Bank is how to strengthen its relationship with Japan, now the second-largest source of concessional funding and a leading economic force in most other areas as well.

94. The **regional development banks** (RDBs) present difficult issues. The Bank and RDBs have many shareholders in common; increased complementarity would be welcomed by them, although to varying degrees institutional relationships have been marked by cooperation, rivalry and competition. The RDBs frequently follow many of the Bank's operational leads but in some cases can offer more attractive financial terms and conditions. They sometimes have better understanding of the political and social realities of their regions. While the Inter-American Development Bank (IDB) will move to coordinate more closely its sector operations with the Bank (at least in the short term), and the African Development Bank is a willing and rapidly growing partner not yet in position to challenge the Bank's regional leadership, the Asian Development Bank's (ADB) position is rather different. It has a greatly strengthened capital base, a substantial and growing pool of concessional finance and a large, free technical assistance facility, and it is considering a major expansion in its economic and other staff. If more collaborative efforts were undertaken and some rationalization of common activities were possible (along country, sector or sub-sector lines, perhaps beginning in countries where the ADB is just starting its program), it may be that savings of staff time could be achieved which would permit greater attention to other areas where the World Bank's contribution would be greater.

95. The course of relations with the IMF will be conditioned by the respective roles of the two institutions in macroeconomic issues, and the implementation of the debt strategy in particular. The basis for collaboration between the Bank and Fund has recently been clarified, and an expansion of Bank investment lending relative to quick-disbursing operations would tend to distinguish respective roles along familiar lines. However, it is possible that global economic and financial developments over the next decade will lead to a more fundamental reexamination of roles and institutions in the international system, within which the Bank/Fund relationship would be subsumed.

96. <u>Areas of Special Emphasis and Bank Strategy</u>. The Bank is an evolving institution. Over time the content and nature of its core business changes, primarily in response to long-term development needs but also to more proximate economic and political pressures within the Bank's constituencies in both developed and developing countries. The operational emphases stated in the President's recent Annual Meetings speeches and budgets are examples of such an evolution. Mainstream Bank activities are adapted to particular borrower needs. As described in the FY89 budget, the areas of special emphasis are:

- Poverty reduction and food security;
- Country debt management, financial intermediation and adjustment;
- Human resources, with special emphasis on women in development;
- Private sector development and public sector management; and
- Environment.

97. The strategic directions sketched out in the preceding section provide a framework for relating these special emphases to a broader set of choices for the future of the Bank. (This is **not** intended to change agreed budget categories or titles.) A strategic

framework of this kind can also help assess the long-term impact and operational implications of the special emphases. Some of these initiatives involve significant changes and additions to Bank activities; others add new dimensions to existing programs and underscore the high priority attached to them by management.

98. The President has reasserted the centrality of **poverty reduction** to the Bank's objectives. It must underpin all strategic directions and lines of action if we are to meet the President's objective of helping to reduce the worst aspects of poverty by the year 2000. As an area of special emphasis it highlights the Bank's commitment to improving the situation of the poor in developing countries, and requires that staff relate their lending, economic and sector work, and other activities to poverty reduction objectives. If sustained through the mid-1990s, this special emphasis -- and its effective monitoring -- will lead to a more substantive and visible role for the Bank in poverty reduction; it will also add an essential poverty dimension to the mobilization of investment resources, human capital formation and institutional development, and the promotion of environmental sustainability.

99. While poverty reduction permeates all Bank activities, the special emphasis on **food security** in Sub-Saharan Africa is a response to the extreme vulnerability and the extraordinary difficulties faced by countries in this region to secure a dependable source of food. If sustained through the mid-1990s, the preparation and implementation of food security action plans by the governments in close collaboration with the Bank and other donors should go a long way toward solving the worst aspects of this problem. The special emphasis on food security is a subset of the Bank's fundamental poverty reduction objective, a complement to other special emphases and the strategic directions.

100. Other special emphases can be directly related to the strategic directions and the lines of action discussed in the preceding section. Adjustment, debt reduction and financial intermediation are aspects of the Bank's strengthened strategy to assist governments to mobilize investment resources. Emphasis on **adjustment** will improve the prospects for investment and growth in those countries willing and able to sustain policy reforms; emphasis on resolving the **debt** crisis, especially through debt reduction efforts, can improve significantly the current account situation of highly indebted countries and stimulate growth through the early 1990s; and the emphasis on **financial intermediation** services, with the Bank as investment catalyst, can assist borrowers in tapping international capital markets and mobilizing private investment resources.

101. The special emphasis on **human resources**, encompasses population, health, nutrition and education activities as well as the concentration on **women in development**. These emphases match the strategic direction referring to human capital formation. **Private sector development**, designed to strengthen country capacities through the promotion of entrepreneurship, private initiative and financial sector reforms, and the emphasis on **public sector management**, aimed at improving the efficiency of government agencies and enterprises, are closely related to the strategic direction envisaged in institutional development. Attention to the **environment** in the Bank's priorities coincides with the strategic direction aimed at promoting environmental sustainability.

102. If sustained into the 1990s with adequate resources -- both staff and financial -- and greater visibility, the areas of special emphasis will change the configuration of operational activities and internal incentives in the Bank. They could be embedded within

the framework of broader strategic directions and lines of action for the Bank, which would help to consolidate the areas of special emphasis and to define priorities in full view of their relations to other Bank activities.

103. <u>Organizational Structure</u>. The Bank's major reorganization has now been in place for two years. Planning and implementing such a massive change could not possibly have been accomplished without some unanticipated results. Based on experience gained in this past year, some modifications have already been introduced and others may be needed to make sure the current structure achieves the original objectives of the reorganization. For example, if human resources development were to given a more prominent place in Bank work, there are staff and organizational implications; the expanding role of field offices may also need to be given even further emphasis. The types of staff most needed and how they would be organized might also change if the catalytic investment role gains increased prominence. These and other organizational and structural changes, designed to assure a continuation of the Bank staff's high quality, flexibility and capacity for innovation must be an important part of any integrated long-term strategic planning.

104. <u>Other Implications</u>. Turning strategic directions into operational reality requires a complex sequence of major decisions (often region-specific) about resource allocation, staff size and type, product line, relations with other agencies and areas of special emphasis. These are closely interrelated and will also have an impact on the Bank's organizational structure, incentive systems and operational procedures.

105. But some things will remain critical for the Bank's effectiveness in development, and their significance does not change very much whatever strategic choices are made within the spectrum set out above. The first is the premium the Bank must attach to **quality**, which remains essential (though with some differences in subject matter) whether the Bank is pursuing a predominantly independent path or using its financial and operational strength to bring other participants more fully into the development process. The second is the Bank's **global outlook**, the importance of which is underlined, not reduced, by regional differentiation. If the Bank cannot combine country focus and global reach with superior quality which will enable it to transfer expertise and best practice efficiently to (and among) developing countries, it loses much of its special rationale, given the advent of many other development agencies of increasing strength.

106. Third, and most obvious perhaps, these fundamental requirements combine with operational realities to place a high premium on **staff quality and commitment**. The pressure of country demands combined with a need for innovation in development may well require a larger staff during the next decade. The political consensus for administrative budget growth, however, will depend both on the perceived clarity and effectiveness of the Bank's overall strategy and -- crucially -- on the institution demonstrating **timely and flexible management of its human resources**, and a **capacity to renew its intellectual and technical foundations**. This is a task which is to be outlined in the Bank's strategy for developing, maintaining and using its own human resources.

107. Finally, even with an expansion of Bank lending and staff, it will not be possible to accommodate all country, regional and global development demands. **Selectivity and exit from lower priority activities** will be necessary, and the Bank has to improve its procedures for phasing down and reducing its involvement in lower priority

activities. The discussions surrounding the present Framework for Strategic Choices have not provided many examples of activities that should be dropped. Increased reliance on shared growth and collaboration with other institutions is offered as one approach to meeting country needs in more cost-effective and efficient fashion.

108. The design of a strategy for the World Bank entails a few major choices, each of them then involving a wider range of important but subsidiary decisions. Bank management will not be able to make most of these choices without close involvement of shareholder governments and other groups.

109. Sections II and III on strategic directions and their operational implications provide a framework for institution-wide choices and decisions on priorities. In practice, overall strategic priorities constitute guidelines for regional and country strategies, and the operational content of Bank strategy will be defined by the interplay between decisions on a country basis and institutional priorities.

IV. CONCLUDING REMARKS

110. The preceding sections have sketched out a framework for considering Bank strategy in the coming decade. The growth options, strategic directions and operational implications delineated here indicate a range of responses by the Bank to the challenges of development. During the 1990s, these challenges will emerge out of the interaction of the specific needs of developing countries, the changing international context, and the Bank's own institutional requirements. During the discussions among Bank staff of strategic choices facing the institution, three themes recurred as widely shared common concerns: the Bank's changing role in the international development finance system; the range and appropriate mix of lending instruments over time; and the capacity of Bank borrowers to sustain and implement viable development strategies. These concerns encompass a variety of issues which the Bank will need to address more systematically during the next two or three years; in due course they may require changes in priorities and areas of special emphasis. In this concluding section, an attempt is made to capture the key elements of these common concerns, which necessarily repeat some of the points made in earlier sections of this paper.

111. Shared Growth. Economic progress in developing countries depends most of all on their own efforts, but increasingly it also depends on more effective sharing of responsibility among various financial and development agencies and organizations. The same is true for the future of the Bank. As the complexity of international financial and economic relationships grows, the scope for and relevance of independent action by the Bank diminishes and the Bank's development impact increasingly depends on collaborative action.

112. This trend can be clearly observed in steps needed to meet the financing requirements of heavily indebted countries. Packages providing new money and support for debt and debt service reduction involve a wide range of private, bilateral and multilateral participants. Helping to structure such packages demands great clarity and agility on the part of the Bretton Woods institutions (and close understanding between them). The way in which the Bank plays its role in the new phase of the debt crisis will have an impact on political perceptions and support among its shareholders well beyond the immediate context.

113. Other elements of a "shared growth" approach to the Bank's role in the changing international development finance system may appear less urgent, but may be of equal or greater importance in the longer term.

114. The world of bilateral assistance is changing rapidly, affecting not only the overall environment for concessional flows (and by implication the long-term prospects for IDA), but also the immediate context of Bank operations. The Bank needs to strengthen its knowledge of and collaboration with Japan's rapidly expanding development assistance program. As European integration proceeds, European Community entities are becoming very significant collaborators in the development field, and their evolving policies will need to figure prominently in the Bank's thinking.

115. The Bank will also need to take a fresh look at the regional development banks, exploring with them the possibility of differentiating missions based on our respective

strengths and seeking the basis for a shared strategy. The desirable outcome is not a neat division of labor or a uniformity of approach. Rather we should seek broad agreement on areas and modes of complementary action: the benefits should far outweigh the supposed advantages to borrowers of institutional duplication or competition.

116. Beyond these concerns, the Bank should expand its catalytic role in mobilizing international private capital. The range of possible approaches is broad and the scope for Bank action as yet largely untested. The private sector is where most of the money available for investment will continue to be concentrated: the environment and mechanisms to encourage it to flow in adequate amounts to productive uses in developing countries need to be actively developed. The Bank's present efforts to encourage a sensible policy environment and to extend a modest amount of co-financing and other comfort are important but do not represent the limits of institutional ingenuity.

117. Growth is likely to be constrained in the 1990s, and international capital flows will not come easily. Domestic resource mobilization will need to be given high priority, but it cannot do the job itself. During the next decade, therefore, the Bank should actively try to evolve new channels, approaches and instruments to increase the flow of international finance of all types to developing countries, deploying its own resources and technical strength more and more in concert with others. The Africa Region has done this already, particularly with sources of concessional finance. Along these lines, such Bank roles as catalyst, convenor and intermediary, already of growing importance, will assume even greater significance. They are demanding of staff, but worth the effort. The evolution of new co-operative operational methods by the Bank could well be a central influence on how the Bretton Woods institutions evolve in response to changes in the global economy and its management over the 1990s.

118. <u>Transition strategy</u>. A second concern on which there is broad consensus refers to the appropriateness and resilience of Bank lending instruments and services.

119. During the last decade fast-disbursing adjustment lending has emerged as one of the key features of the Bank's product line, designed primarily to underwrite the costs of policy reforms through balance of payments support. In a relatively short period, adjustment lending has transformed the Bank from an investment and project-centered institution into a broad-based development finance agency actively engaged in macro and sector policy dialogues with borrowers. This transformation was essential for the Bank to fulfill its development mission in the 1980s, as adjustment lending to encourage changes in distorted policy environments became one of the main ways to promote economic growth. For the Bank to continue playing its development role effectively in the 1990s, further changes in the range and mix of lending instruments and services will undoubtedly be required, as the Bank's new role in debt reduction indicates.

120. Of high priority is the need to prepare staff and borrowers for the transition away from present levels of fast-disbursing loans to heavier reliance on lending instruments that disburse over more extended periods. This transition is necessary for program and portfolio reasons, including excessive dependence on injections of Bank balance of payments support and signs of diminishing returns in terms of policy reforms. The introduction of debt reduction allocations may slow this transition for a limited number of countries.

121. This is an area of prime importance to the Bank and cannot be resolved in a mechanical fashion. The issues are: How can the Bank maintain an effective policy dialogue and influence over the design and implementation of reforms while reducing a country's reliance on quick-disbursing balance of payments support? What are the financial consequences of a gradual shift away from quick-disbursing adjustment lending? What types of instruments can be utilized to combine policy concerns with investment lending operations (hybrid loans, financing time-slices of investment programs, etc.)? What are the managerial implications of different "transition" strategies in terms of investment lending pipeline, disbursement profiles and commitment of staff and other resources? And, more generally, what effect would changes have on the Bank's staff skill mix, budget and operational procedures?

122. Country capacity. A third area of broad consensus is the need to build the capacity of borrowers, particularly of low-income countries, to initiate and sustain viable development strategies. This requires better targetted and more effective Bank efforts to build local institutions capable of designing and implementing policy reforms, managing and operating investment projects, and dealing with environmental externalities. Many countries have seen their educational development lagging, social welfare declining and institutional effectiveness crumbling under the impact of economic crisis. As a result, capacity building efforts have now acquired a renewed sense of urgency in all regions.

123. The task is difficult, particularly in view of the increasing diversity of developing country situations and the specificity of capacity-building interventions. Closely intertwined with cultural and political conditions, capacity building defies easy prescriptions or the ready transfer of models. In many countries, institution building efforts will have to be accompanied -- or even preceded -- by stronger support for human resources development; in others it may be more appropriate to focus on strengthening the policy, institutional and educational framework for technological progress.

124. Continuing fiscal austerity will necessitate new ways of financing and administering human resources, institutional and technological development programs, and the scope of external support by the Bank may be limited by the relatively low foreign exchange requirements and the overriding importance of recurrent expenditures. Considering that adjustment lending has been primarily geared to provide balance of payments support for reforms with a macroeconomic dimension, additional ways must be found of encouraging and supporting policy reforms in the social sectors.

125. A major Bank effort in capacity-building will require some internal re-examination and change. The adequacy and effectiveness of Bank's interventions in human resources and institutional development is open to debate: a renewed research, analytical and operational effort is needed to devise approaches and instruments relevant to the needs of the next decade. A particular consideration will be the need to match the long-run nature of returns to capacity-building investments with appropriately financed and priced lending instruments and services.

126. An expansion of the Bank's effort in capacity-building could require changes in management and organization, probably in the direction of establishing greater and more continuous presence in the field, and of changing incentives for staff working on such low-volume "enabling" operations. There may be, ultimately, a case for some separation of

the funding and management of this range of activities for reasons both of concessional resource mobilization and of internal programming and budgeting.

127. These common concerns, on which broad agreement emerged during the preparation and discussion of this paper, provide a basis for structuring the Bank's evolving Strategic Agenda. Should they lead to changes in priorities and emphasis of the next three years, they will require the Bank to make sharper and more explicit trade-offs among its activities: save for an unlikely substantial relaxation of budget and staff constraints, the institution will have to switch resources and find new and more efficient ways of doing things, rather than merely add responsibilities in the manner of the past. Such choices can only be made in specific terms, about which activities to phase down or shed, which to increase. Such decisions are designed to be informed by a broader framework such as this document has sought to provide.

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

February 9, 1989

To All Staff:

The recent Senior Management Retreat provided a good opportunity to discuss a wide range of strategic issues confronting the Bank. I want to share with you a few of our preliminary conclusions. We shall be acting on these and others as the year progresses.

The 1990s will present difficult and complex challenges. Resource flows are limited, the debt burden persists, and poverty is widespread. But the 1990s can also be a great decade of opportunity for development, <u>if</u> the power of the changing international economy and trading system can be targeted more effectively to benefit people. A strong and experienced World Bank can make a significant difference to this outcome.

The Bank of the 1990s must maintain an expansive growth path. Our commitment of resources for development must increase, but our resources alone will be far from adequate to meet the needs of the developing world. The 1990s will require that we work in cooperation with new and expanding sources of private and official finance. The Bank's work -- and thus our members' progress -- will be strengthened by greater sharing of responsibilities and opportunities with others in a system of "shared growth."

One critical area for collaboration is debt. Global growth has bypassed many debtor countries. Commercial banks are becoming increasingly reluctant to lend to highly-indebted countries. Attitudes and the political climate in our member countries are evolving. While the debt problem ultimately will have to be resolved politically, the Bank must be ready to take a more active role, including careful exploration of debt reduction options. The Bank's debt strategy is currently being prepared for Board consideration and will pave the way for further action.

We have a particular responsibility to mobilize concessional development resources for the poorest countries and to ensure that they are used productively. IDA is the linchpin of this effort, and IDA-9 negotiations are already underway. Not only is success in this effort essential, but we must look beyond IDA-9 and be prepared to respond creatively to changes in the sources and priorities of aid in the 1990s.

The Bank must continue to help maintain the momentum of adjustment in developing countries and sustain the policy impact of our own programs. The forms of our assistance may change, however. For policy and Bank portfolio management and creditworthiness reasons, the amount of fast-disbursing lending will have to decline in some countries. Increased emphasis must be placed on growth and efficient long-term investment. We must plan now for this transition on an institution-wide and country basis. Skills updating and effective recruitment will be a critical factor, if we are to make this transition smoothly.

Development must be both efficient and sustainable from an environmental and an institutional perspective. The severity of the natural resource issues we confront requires that environmental sustainability be a central element in the design and implementation of country development strategies.

Developing human resources and building effective institutions are key components in strengthening country capacity for sustained development. They permeate and condition the rest of our work. The Bank has significant experience in these areas, but additional work and re-thinking are needed to increase our effectiveness. In the coming months, we will be taking a hard look at the problems, our own record and our potential contribution as the basis for decisions later in the year.

Our concern for sustained development has also led to heightened emphasis on poverty, food security, the environment, forestry, women in development, population and private sector development. These initiatives must not be perceived as separate activities; they must, instead, be integrated into the development of country programs. All staff members should look for ways to emphasize concern about the values these initiatives represent.

These brief comments on strategic issues demonstrate that the Bank's workload is expanding and growing more complex. I am fully aware that our objectives are ambitious. Staff are operating under intense pressures. The budget is only one -- but a very important -- factor, and I will consult very closely with the Board about the need for further budget increases. I am pleased that the recent discussion in the Board of the Medium-Term Framework indicates considerable support for a two percent real budget increase for FY90.

The Bank is well positioned to continue to play an important role in world development. 1989 should be a good year for us, full of challenge and accomplishment. The 1990s present the prospect for even tougher demands, but I am confident our whole staff will respond and lead with strength, compassion and ingenuity.

Sincerely,

Barber Conable