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# The World Bank and Structural Adjustment in Latin America

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## 1. Introduction

Latin America and the Caribbean have received more loans from the World Bank than any other geographic area[1]. The Bank has provided the region with over $32 billion, or one fourth of all the loans made since its inception. Chile was the first developing country assisted by the Bank, and Brazil – with 131 loans totalling over $10.3 billion – is the Bank's leading Client in the world (see table 1).

Yet the World Bank was impotent to prevent a major shrinkage of external resources to Latin America when the debt crisis erupted in the second semester of 1982. Except for speeding up its disbursements, the Bank's role in the packaging of emergency Solutions for that crisis was diminutive. The subsequent stabilization measures were adopted under the guidance of the International Monetary Fund, with the Bank mostly serving the role of a passive observer for the annulment of many of its investment programs in the region.

As a consequence of the debt crisis, the Latin American economies ended 1983 with a national income per capita about 14 per cent lower than the level they had enjoyed in 1980. Domestic investment fell dramatically by about 30 per cent in 1982-83, and in a number of countries became insufficient to compensate for the depreciation of the existing capital stock.

The question, which is now posed to Latin American policymakers, is how to strengthen the economic gains, especially on the external front, which some countries in the region experienced in 1984, setting the stage for their healthy economic recovery in the next few years. For other countries, policymakers still have to struggle to prevent further losses and to stabilize their external and internal accounts. Having failed to help prevent the downturn of the early 1980s, how much can be expected of the World Bank in shaping a Latin American upturn during the remainder of the decade? Can the Bank be an important source and stimulus of net capital inflows and of policy advice for the region? This question is receiving a good deal of attention in the current debates in Washington about the future role of the Bank, but the Latin American contribution to this reflection has been limited at best. This paper is intended to fill some of this gap, providing a bridge between Washington and Latin American capitals in the consideration of the roles the Bank might most constructively play in the region in the near future.

In the following section, we review the quantitative importance of World Bank lending to developing countries, and establish some parallels between the current needs of Latin America and those of Europe immediately after World War II. Section 3 deals with the historical patterns of the Bank's lending relationship with Latin America. We conclude that program loans are a Creative and

[1] Except otherwise noted, the expression 'the World Bank' or 'the Bank' refers to the International Bank for Reconstruction and Development (IBRD) alone, excluding its affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC).

appropriate response both to the current difficulties in Latin America and to the definition of a new role for the Bank in the international economy. Sections 4 and 5 then discuss policy-related conditionality in Bank lending, in an attempt to understand the reasons for the current difficulties of the Bank's dialogue with Latin America on this critical subject. The paper closes with a set of tentative policy suggestions to structure the future role of the Bank in Latin America.

## 2. The Bank's Contribution

The Bank's contribution to the balance of payments needs of developing countries has become significant. Prior to the debt crisis, the relative lending volumes of the Bank were small *vis-a-vis* those needs. In 1981, just before the crisis, total net disbursements of the Bank were responsible for no more than 3.3 per cent of the financing of the aggregate current account deficit of all developing countries (see table 2[2]). However, the collapse of the private capital markets in 1982 increased the relative importance of official lenders. Moreover, thanks to its Special Action Program (SAP) inaugurated in early 1983, the Bank managed to increase both the rate of disbursement of its existing credits and the share of fast-disbursing loans in its portfolio. The SAP sought to funnel credit more quickly by expanding sector loans and revolving funds, financing working capital, relaxing local currency requirements, and front-loading disbursements. By 1983 the Bank's contribution to the financing of the aggregate current account deficit of developing countries had reached 9.1 per cent, nearly three times the value of 1981 (table 2). The Bank's contribution to total net capital receipts of the developing countries grew from 3.3 to 5.1 per cent from 1981 to 1983.

A similar story is told for Latin America. In 1979, the World Bank accounted for only 4.4 per cent of the region's medium and long-term net capital inflows (table 3). The combination of the contraction in private loans and the acceleration of World Bank disbursements caused the ratio to more than double by 1983. This trend undoubtable continued in 1984. The America (as well as in parts of Southeast Asia) is more akin to the role it exercised in countries of similar incomes per capita, such as Italy and Belgium, in the immediate post-war.

During World War II, some countries today in the Western Alliance were the aggressors, while others suffered from occupation. Irrespective of their status, after the war they all benefited from reconstruction credits of the Bank. Similarly, in the Great Debt Crisis, some Latin American countries were guilty of excess spending and wrong price policies, while others were victims of external shocks.

[2] We have been unable to determine the reasons for the unusually large discrepancy in Table 2 between the figures for the current account deficit and the net capital receipts of developing countries in 1983. According to the OECD the inclusion of short-term bank lending and the IMF net purchases would add U.S. $10.4 billion to the value of net capital receipts. Hence, there is a difference of US $54 billion between net capital receipts and the current account deficit, to be explained by measurement errors and capital flight (since non-IMF related reserves accumulation by developing countries was apparently very modest in 1983).

Irrespective of their past mistakes, they all now face the simultaneous needs of controlling inflation, restructuring their economies and resuming growth. The similarities do not stop there, for then, as now, the immediate problem was the “dollar shortage”; and that of the long run, the promotion of an open and competitive economic system.

Eventually the task of reconstructing Europe and Japan was taken up by the Marshall Plan, but the Bank’s role was far from negligible. The Bank was responsible for funding large infrastructure projects. Perhaps more importantly, at that time the Bank felt no inhibition in extending “program loans” with no strings attached to the Western European countries. This is indicated in Table 4, which shows that non-project lending was responsible for no less than 35 per cent of total Bank plus IDA lending in the 1947-57 period. The reconstruction period being completed, program loans dropped to a meager 1.4 per cent in the 1958-68 period.

Today, the Bank’s task in Latin America is both simpler and more complicated. Simpler, because Latin American story is even more dramatic in terms of net resource transfers (defined as net capital flows minus interest payments). Since net resource transfers for Latin America turned negative in 1983, the World Bank’s relative contribution became infinite. This phenomenon is especially relevant for the most indebted countries in Latin America, since these countries are either already exhibiting a current account surplus (Mexico and Brazil), or are targeted to do so in 1985 (Argentina).

As more normal conditions are established in International credit markets, the relative importance of the Bank should decline again. However, this can happen only when the highly indebted Latin American countries manage to establish their creditworthiness, which depends *inter alia* on the resumption of their capacity to grow with relative price stability. Hence, both quantitatively and qualitatively, there is a critical transitional role to be exerted by the Bank in Latin America in the next few years, paving the way for the region to regain its access to private International capital markets[3]. During this transition, the Bank can itself be a source of funds, while it works to encourage private flows through cofinancing and insurance schemes.

The situation parallels that facing the Bank when it opened for business in 1947. It was then named the International Bank for Reconstruction and Development (IBRD), with the twin mandates of assisting in the reconstruction of war-torn Europe and in the development of the less developed countries. Today, in conjunction with the International Development Association (IDA – the Bank’s soft loan affiliate created in 1960), the Bank still faces the basic challenges of development in Africa and South Asia; but the IBRD’s task in the higher income countries of Latin economies are not war-torn (outside of Central America), in spite of the tremendous maladjustments from which they

[3] See Richard E. Feinberg, “Bridging The Crisis: The World Bank in the 1980s”, in John P. Lewis and Valeriana Kallab, *U.S. Foreign Policy and the Third World: Agenda for Action 1983* (Washington, D.C.: Overseas Development Council, 1983).

currently suffer. Their capital stocks were not destroyed, but rather stand misused or devalued as a result of external shocks. More complicated, because Latin America not only does not count on a Marshall Plan, but rather is being forced by its creditors and the International Monetary Fund to adopt stiff demand-constricting policies to qualify for partial rescheduling of its external debts. In this context, the Bank's ability to extend its traditional "project loans" has been hamstrung because neither governments nor private firms have the required counterpart funds to join the Bank in investment projects. During calendar year 1984 alone, the Bank had to drop 172 projects from its Latin American pipeline for reasons largely related to the recession.

Hence, the current paradox. On one hand, a group of member countries are suffocating because of the lack of external credits. On the other, the Bank has difficulty locating new investment projects to finance, and is struggling to disburse against existing commitments.

Why is it that the money of a willing development bank cannot reach the pockets of eager but solvent development borrowers? In the following sections, we consider some of the possible answers for this question, and offer a few suggestions for overcoming the difficulties.

## 3. Bank Lending to Latin America

To start answering this question, it is useful to provide a bird's eye view on the evolution of Bank lending to Latin America. The relevant information is summarized in Tables 6 to 9. Tables 6 and 7 indicate the real growth rates of overall Bank lending and of its lending to Latin America since 1954. The relevant periods were selected to indicate the most important changes of trend in overall Bank lending in the last thirty years. The McNamara years (1968-81) stand out as the longest-running period of high growth rates in Bank lending, both overall and to Latin America. Interestingly enough, during the previous ten-year period (1958-68), overall Bank lending growth was miniscule, but the expansion of its lending to Latin America was even more substantial than during the McNamara era. The whole period extending from 1958 to 1977 stands out as a "golden era" for Latin America in its access to the Bank's resources.

After 1977, however, the Bank's growth in Latin America became very limited. Particularly telling is the more recent 1981-84 period, when overall Bank lending in real terms expanded at the rate of 19.8 per cent per year, whereas it's lending to Latin America grew only at 3.5 per cent per year. Latin America's share in total Bank lending reached a height of 27 per cent in the 1958-68 period and then dropped to 23 per cent in the first half of the 1980s (table 6).

Several factors accounted for the relative decline in Bank attention to Latin America. During the 1970s, the Bank strove to give greater emphasis to the world's poorest countries, particularly those in Sub-Saharan Africa and Asia. Lending to higher-income countries was constrained by Bank portfolio rules limiting Bank lending to any individual country to 10 per cent of the Bank's loan portfolio – which capped lending to Brazil. Lending to the four largest borrowers – Brazil, Mexico, Korea and Indonesia – was set at not more than about one-third of the total portfolio of loans. These ceilings were related to the concept of "graduation" (strongly supported by the Carter Administration) – that the higher-income borrowers should eventually graduate from IBRD lending, as the Europeans had done before.

These guidelines impaired the Bank's ability to respond to the Latin American recession of 1981-83. But the Bank also failed to anticipate the debt crisis. Prior to the explosion of the debt crisis in 1982, the Bank repeatedly offered optimistic assessments of the ability of the developing countries to continue to accumulate and service their external debt. Even as the crisis emerged, the Bank was slow to appreciate its seriousness. Typical of the Bank's lethargic response was its 1982 *Annual Report*, written before the Mexican crisis but after the collapse of Argentina and well over a year after external difficulties had forced Brazil into a stiff stabilization program. In the chapter on "Bank Policies", there is not a single reference to the Latin American debt problem. Much to the contrary, the chapter's principle theme is an unusually forceful reaffirmation of the importance of the graduation principle for the Bank's overall lending strategies.

The global recession has pushed talk of graduation into the background, as many countries have moved further away from the *per capita* income trigger zones. But the recession and the related debt crisis – which hit Latin America particularly hard – have impaired Bank operations in the region. The sharp contraction of investment adversely affected the World Bank's traditional project-based operations. The region's aggregate negative net transfer of resources and consequent decline in domestic credit availability forced countries to postpone development projects. Some Bank projects were cancelled, and new Bank commitments in FY1984 actually declined to $3 billion from the previous year's $3.5 billion.

Shifts in sectoral lending strategies also explain the relative decline of Latin America in total Bank lending. Ironically, it was the Bank's shift in the 1980s toward quick-disbursing balance of payments loans that adversely affected new commitments to Latin America. Yet, it is precisely such "structural adjustment" and "sector" loans that are most appropriate for countries suffering from acute shortages of foreign exchange.

## Patterns of Sectoral Lending

Bank lending patterns have shifted over the years in response to changing Bank thinking regarding development strategies. In the 1950s and 1960s, the Bank sought to direct investment resources toward the basic "building blocks" of development. Thus, the Bank devoted the lion's share of its resources to basic infrastructure in energy, transportation and telecommunications, and to traditional export-oriented mining and commercial farms. Under the intellectual leadership of Robert McNamara, in the 1970s the Bank turned its attention to equity – to medium and small-scale agriculture and to the social sectors (education, population, health, nutrition, urban development, water supply, and sewerage). The Bank also diversified into industry, especially for development finance companies and small-scale enterprises. The share of non-project lending, however, remained miniscule (see table 4).

Tables 7 and 8 set the shares of the Bank plus IDA sectoral lending to Latin America against the background of the shares of its sectoral lending to all member countries. The preference ratios in the table indicate whether the Bank plus IDA lending to Latin America in a given sector was biased upwards (preference ratio higher than one) or downward (preference ratio lower than one). For example, the value of .2 for the preference ratio for non-project lending to Latin America in 1980-84 results from the division of the share of this sector in total Bank plus IDA lending to Latin America (which was 2.2 per cent) by its share in total overall Bank lending (which was 9.0 per cent) in the same period.

Table 7 indicates that Latin America's share in infrastructure lending has traditionally been very high, but the preference ratio of this sector declined continually until dropping to unity in 1980-84. Latin American industry was discriminated against in the beginning of the period, but at the end, it was getting more than its fair share, mostly as a consequence of the growing importance of Bank lending through development finance companies in developing countries.

The most telling figures in Table 7 are, however, those for non-project lending. Clearly enough, Latin America has always obtained less than its fair share of non-project lending. In the early days, these resources were concentrated in Europe. As indicated in Table 4, program loans practically disappeared from the Bank-cum-IDA portfolio in the ensuing 1958-68 period, but they regained some importance in the seventies. After 1980, however, under the title of ‘structural adjustment lending’ (SAL) these loans started acquiring a star status in Bank lending – but not to Latin America. Of the $5.6 billion in non-project loans approved by the World Bank and IDA for 1980-84, Latin America received only $304 million. Nor did Latin America receive many sector adjustment loans, which by 1984 accounted for 8.5 per cent of Bank and IDA lending (table 5). What accounted for this discrimination against Latin America?

## 4. Policy-Based Lending

Momentum for “policy-based” lending has been gaining ground in industrial-country governments as well as among World Bank staff in recent years[4]. Several factors have converted to gain support for balance of payments loans that carry conditions for the borrower's macroeconomic or sectoral policies. Donors found that otherwise well-designed projects could still fail if the surrounding "policy environment" was adverse; for example, donor-assisted agriculture projects could be jeopardized if the government provided inadequate credit, offered low prices for farm output, or set disadvantageous exchange rates. More pointedly, a rising chorus of voices – in the United States government, in some other European nations, in academic circles strongly influenced by the neo-classical paradigm, and in the World Bank under Tom Clausen – attached the "inward-oriented" or import-substitution industrialization (ISI) model of development. These voices argued that many Third World governments, particularly in Latin America, were administratively determining prices and thereby sending signals that produced inefficient investment decisions by both public and private firms. Government-mandated prices distorted the allocation of resources by consumers, savers, producers and investors. This critique gained strength, as the allegedly more market-oriented Asian nations seemed to adjust more successfully to the International economic environment of the 1980s than did some more "interventionist" Latin American and African States. At the same time, commercial lenders were looking to the Bretton Woods institutions to promote macroeconomic adjustment that would place a premium on debt service and the restoration of creditworthiness. While the IMF was considered the first line of attack, as bankers came to see the debt crisis as a long-term problem, they began to urge the World Bank to enter the battle for structural reform. Through consultative groups or other coordinating mechanisms, the Bank could help provide a framework for macroeconomic policy and project selection to guide the actions of the donors and the borrowing nation.

Many World Bank staff shared at least portions of the criticism of the ISI model. Moreover, the institution saw that the retreat of private lenders placed the World Bank in a more commanding position to press for reforms in recipient countries. Capital-hungry nations could no longer as easily bypass the Bretton Woods institutions by turning to commercial lenders as they had done in the 1970s. In short, Bank leverage was greater. Finally, the Bank had an institutional motive for balance of payments lending. The global recession reduced the demand for investment capital; what was needed was loose foreign exchange for the rehabilitation or maintenance of existing infrastructure or capital equipment, or for the imported inputs needed to keep factories running.

Since their creation in 1980, SALs have grown to over 8 per cent of Bank and IDA lending

[4] The Reagan administration's support of stiffer policy conditionality in Bank's lending is vividly expressed in the Department of the Treasury, *United States Participation in the Multilateral Development Banks in the 1980s*, Washington, D.C., February 1982. The Bank's own justification can be found in Pierre Landell-Mills, "Structural Adjustment Lending: Early Experience", *Finance and Development*, December 1981. For a passionate defence of the SAL program by a former senior vice president of the Bank, see Stanley Please, *The Hobbled Giant: Essays on the World Bank*, (Boulder and London: Westview Press, 1984).

(Table 5). Their future expansion, however, is constrained by the decision of Bank management to limit SALs to about 10 per cent of new commitments and to about 30-40 per cent of lending to any given country. This caution on the part of the Bank is partly the result of the attitudes of the IMF and the U.S. Treasury, which have been uncomfortable with SALs on two grounds. First, they have been concerned that SALs blur the distinction between the IMF and the World Bank by putting the Bank into the business of balance of payments lending with macroeconomic conditionality; secondarily, they have sometimes worried that the provision of SAL funds without strong strings might enable borrowers to skirt IMF conditionality. As Secretary of the Treasury James Baker told the interim and Development Committees of the Bank and the Fund in April, 1985: "(SALs) have been effective and we believe it should be retained and even prudently expanded, as long as there is a serious need and desire for more SALs linked to appropriate policy reforms"[5]. In opposing a new allocation of SDRs, Baker warned against easy money: "We also remain concerned that creation of a large amount of unconditional liquidity could send the wrong signals about the need to continue to fight inflation as well as detract from the necessary focus on adjustment efforts". Eduardo Wiesner, The Director of the IMF's Western Hemisphere Department shares the view that there is often a trade-off between adjustment and finance: "... if there is easy availability of finance, it is also highly likely that this will reduce the discipline on countries to adopt better economic policies"[6].

Structural adjustment lending is also limited by the overall size of the Bank. Bank management would like to negotiate a General Capital Increase (GCI) during 1985, to allow for Bank lending to expand to $45-50 billion over three years. In the absence of a GCI, there is a distinct danger that some borrowers will begin to experience a net transfer of resources to the Bank. Nevertheless, Baker told the interim and Development Committees that it would be both "unnecessary and unwise" for the Bank to consider a GCI "at this time":

> "The IBRD can lend up to $13 billion annually indefinitely without a capital increase. This is a substantial sum. As we are well aware, demand for lending has dropped significantly and this year's IBRD commitments could well be below $11 billion. It is not clear to us how the Bank can increase its lending program significantly at this time, without weakening lending standards or displacing alternative sources of finance in creditworthy countries"[7].

This stringent approach to balance of payments problems is being stretched to its outer limits

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[5] James Baker, "Statement of the United States Concerning a Blueprint for Global Growth", Washington, D. C., April 17-19, 1985. The Reagan administration views are also expressed in Department of the Treasury, *op. cit.*, and reaffirmed in Department of the Treasury, *Foreign Direct Investment and Commercial Capital Flows: The Role of Multilateral Development Banks* (prepared for the Congress of the United States), Washington, D. C.: mimeo, 1984.

[6] Eduardo Wiesner, "Domestic and External Causes of the Latin American Debt Crisis", *Finance and Development*, March, 1985, p. 26.

[7] James Baker, op. cit.

in the Washington-based conceptualization of the policy of conditionality that should be associated to the Bank's structural adjustment loans. Influenced by the Reagan administration and traditional IMF thinking, the new wave at some quarters of the Bank is the idea that "policy reform" and "external financing" are two alternative ways of obtaining a given growth objective: if there is more of one, there is less need for the other.

## Conditionality and Latin America

Only five countries in Latin America and the Caribbean have received structural adjustment loans: Jamaica has received three, while Bolivia, Guyana, Panama and Costa Rica have signed one each. The results so far have not been very heartening. The 1980 Bolivian experiment quickly fell victim to a change of government. The 1981 Guyanese program ended when the IMF-supported stabilization efforts fell apart. The World Bank staff considers that it still too early to reach any firm conclusions about the success or failure of the Jamaican programs, although there is clearly some disquiet over the performance of both the balance of payments and fiscal accounts. The November 1983, Panamanian and the 1985 Costa Rican agreements are also too recent to assess.

The relative scarcity of SALs in Latin America is due to constraints on both supply and demand. The Bank has hesitated to increase lending to some countries due to their poor credit ratings. The Bank has also been cautious about adding further debt to countries whose debt Service ratios are already foreboding (although some Bank staff recognize that the decision not to lend could eventually prove equally damaging to the nation's economy and hence to the probability of non-payment of existing debts, including those owed to the Bank). In other countries, the Bank has found governments unwilling to undertake the required adjustment measures, or unable to sustain IMF stabilization programs measures, or unable to sustain IMF stabilization programs which are generally the precondition for a SAL. In Central America, the Bank has felt displaced by U.S. bilateral programs whose primary purpose is to bolster governments considered supportive of U.S. security objectives and which carry less economic conditionality[8].

Some Latin American countries have preferred to avoid loans that would subject their macroeconomic policies to World Bank surveillance; anxious to rid themselves of the IMF, they have no desire to expose themselves to continuing outside intervention. Even less are they interested in joint IMF-World Bank programs that would involve multiple, simultaneous conditionality[9]. The Bank has encountered this resistance elsewhere in the Third World, but resistance may be especially great

[8] Richard E. Feinberg, "U.S. Economic Assistance to Latin America", Testimony before the U.S. House of Representatives, Committee on Appropriations, Subcommittee on Foreign Operations, April 18, 1985.
[9] For example, see Communique of The Group of 24, *IMF Survey*, April 29, 1985, p. 134, paragraphs 59-61.

in Latin America, where existing ISI strategies place governments in direct confrontation with SAL objectives.

Instead of negotiating SALs, the Bank has used the Special Action Program (SAP) to funnel quick disbursing credits to Latin America. Latin America has accounted for about 43 per cent of all operations and about 56 per cent of the total commitments under the SAP. These agreements have included sector loans to Brazil and México, and more recently to Colombia. For the most part, however, the SAP serves more to improve the timing of disbursements than to increase their total amount.

## 5. The Concept of Conditionality

There is a basic difficulty facing the implementation of the Bank's macroeconomic conditionality. The Fund's medicine is arguably fool proof when the objective is the improvement of the trade balance. The more a country swallows of it, the better its trade balance will look afterwards, though perhaps at the cost of unemployment, worsened income distribution, reduction of the fixed investment share in domestic spending, and inflation acceleration. The same, however, does not apply to the Bank's "policy reforms", given its fundamental mandate of encouraging "the development of productive facilities and resources in less developed countries", as stated in article 1 of the Bank's Articles of Agreement. Reaching this objective is frequently not a question of more or less of a given measure, but rather hinges on the quality of the policy measures themselves.

For example, there was a period during which the Bank staff marvelled at the speed with which Chilean economy after September 1973[10]. More recently, this enthusiasm has given way to a much more sober judgment on the nature, the speed, and the sequence of the liberalization measures in Chile[11].

The implication is that the Bank cannot be like the Fund, because economists do not have a recipe on how to raise a country's productivity, which would always work. By contrast, demand contraction and demand switching should always succeed in improving a country's balance of payments[12].

Hence, the Bank's approach to policy formulation necessarily needs to be much more

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[10] See *Chile – An Economy in Transition* (Washington, D.C.: World Bank, 1979).

[11] For example, see Nicholas Barletta, Mario Blejer and Luis Landau, eds., *Economic Liberalization and Stabilization Policies in Argentina, Chile, and Uruguay – Applications of the Monetary Approach to the Balance of Payments*. (Washington, D.C.: World Bank, 1983).

[12] This a priori conclusion is brought out in a number of Fund staff studies, such as Thomas M. Reichmann and Richard T. Stillson, "Experience with programs of balance of payments adjustments: stand-by arrangements in the higher credit branches, 1963-72", *Staff Papers 25*, June 1978, pp. 293-309; and Donald J. Donovan, "Macroeconomic Performance and Adjustment under Fund Supported Programs: The Experience of the Seventies", *Staff Paper 29*, June 1982, pp. 171-203.

experimental and country-based than that of the Fund. And, unless it expands its staff enormously, which seems unlikely, the Bank will not have enough trained professionals to deal at an operational level with the myriad of specific development problems of each of its member countries. Consequently, the pursuit of the present course towards policy-based loans can only lead the Bank to a subordinate role to the IMF. This is indicated by the fact that after five years of operations SALs have up to now been approved only for 16 countries. This result is contrary to all interests concerned – those of the donor countries and the private international banking community, and most certainly those of the developing countries and of the Bank itself.

This suggests that the Bank may be an important ally to Latin America in the latter's efforts to reshape the former's structural adjustment programs, provided that a set of sensible proposals is put forward for negotiation. Some suggestions follow.

## 6. Policy Suggestions

The Bank's decision to increase balance of payments lending are intelligent responses to the current needs of many developing countries. However, for program lending to be more effective, we believe that a number of additional reforms should be considered.

*The World Bank should devote more resources to structural adjustment and sector loans in Latin America and the Caribbean.*

The Bank should overcome the contradiction of falling commitments to a region in desperate need of external finance. This Paradox can be resolved by addressing the various constraints to program lending. The Bank should be more willing to take risks in lending countries whose commercial credit rating is not strong, provided of course that the government agree to take measures to improve its long-term debt Service capabilities. The Bank should relax its self-imposed constraints that limit SALs to about 10 per cent of total lending and to 30-40 per cent of lending to a particular country. The Bank should also temporarily relax its requirements regarding the percentage of local cost financing (counterpart funds) required in project-related loans. However, if SALs and sector loans are to become more voluminous and effective, additional reforms will be needed regarding the Bank's overall size and the content of its program loans.

*The Bank should be enlarged*

In light of the commercial banks deepening reluctance to increase their exposure in many parts of the Third World, including Latin America, enhanced official flows are required to meet the capital needs of developing countries. Moreover, the World Bank needs more resources for two additional reasons. First, its structural adjustment and sectoral loans can be large enough, and can be additional to project loans already scheduled, only if the Bank's overall capacity is increased. Second, at current commitment levels, the Bank will soon become a recipient of net resource transfers from some countries, especially from the older borrowers in Latin America. Such a resource transfer would contradict the very purpose of the Bank.

Bank resources can be augmented through several mechanisms. The most traditional approach, and the one favoured by Bank management, is a General Capital Increase. Other methods include altering the current highly conservative 1-to-l gearing ratio – the ratio of the Bank's loans to its capital base. In order not to affect the ratings of existing World Bank bonds, the Bank might establish a subsidiary "Bank's Bank" with a gearing ratio of say 10-to-l, to finance the early maturities in co-financing operations with the IBRD. In addition, the Bank could get more mileage out of its existing capital by selling off more loans to private investors.

*The Bank should reconsider the conditions placed on its structural adjustment and sector loans*

Policy-based lending in Latin America can only take its proper place if the reticence of governments can be overcome. The bank should establish an outside review panel to examine its SALs (as it has done in other areas, including population and health). This expert review should consider the following issues:

- Have SALs been based on realistic assumptions regarding the probable responses to changes in prices, or have staff been overly optimistic regarding the elasticities of savers, investors, and exporters? Has there been a chronic tendency to underestimate the inflationary impact of proposed reforms?
- Have reforms been phased within a reasonable timeframe? Under what conditions do gradualism or rapid adjustment make sense? Particularly, does it make sense to require simultaneous liberalization of trade and capital markets, or to seek a rapid reduction of import Controls and duties at a time of pent-up demand, falling fiscal revenues and foreign exchange shortages?
- Are SALs becoming too ambitious and complex? SALs seem to be attempting to promote increasingly detailed reforms in a wide variety of policies and institutions. Does the Bank have the knowledge and information to design and monitor such broad reforms? How can the Bank judge the overall success of a program when so many variables, including many not easily quantifies, are involved?

- Have programs been politically realistic? There is little point in pressuring governments to sign agreements that are not politically sustainable. Where at all possible, programs should be designed to produce some quick results so as to encourage support for the overall effort.

- Are SALs paying adequate attention to equity? Global financial pressures, ideological winds among donor governments, and staff changes within the World Bank have shifted concern from "basic needs" to efficiency. Yet the Bank should strive to minimize the inevitable social costs of structural adjustment, and should suggest offsetting measures to assist injured groups.

- Has the Bank become overly ideological in its policy recommendations? The Bank has a legitimate interest in seeking to rationalize the operation of public-sector enterprises, but at times the Bank now seems to be questioning the very existence of parastatals. The Bank has given inadequate attention to the equity and growth implications of its drive to dismantle the State in some developing countries.

- Have the criteria for judging SALs been appropriate? Bank internal assessments seem to be based overly on actions taken (such as devaluation) rather than on ultimate objectives (the improvement in the trade account of job creation in the export sector).

- Is the Bank playing second fiddle to the IMF? Are IMF monetary and fiscal targets constricting World Bank-supported investments? Is the IMF's protection of its traditional "turf" – such as exchange rate policies – unduly inhibiting Bank analysts?

Increased dialogue between Bank and Fund staff is clearly desirable, but the Bank needs enhanced ability to design macroeconomic and sector programs, if it is to avoid being dominated by Fund strictures.

The Bank should release the conclusions of this expert review of SALs to the public as part of a general effort to engage wider sectors of public opinion in the policy dialogue. Indeed, the Bank – with agreement of the governments concerned – should publically release the "letters of development" that accompany SALs. Governments are more likely to persist with structural reforms if the programs enjoy wide public support. Moreover, a broadened development dialogue could stimulate the Bank to regain the intellectual leadership and dynamism that it demonstrated in earlier years.

*The Bank should undertake organizational reforms*

To improve its ability to sustain a constructive dialogue with developing countries on macroeconomic and sectoral issues, the Bank needs to revamp its own internal structures.

First, an alteration of the relative weight of the donor countries and the developing nations might enhance the legitimacy of the Bank's advice in the Third World. Some observers have also suggested that unweighted voting should prevail when the Board is considering the economic policies of individual countries[13]. The dominant industrial nations, however, will certainly continue to resist this redistribution of power. More feasible is a fortification of the current trend toward improving the balance of nationalities among the staff. The importance of such changes in management and staff has been underlined by Stanley Please, a former senior Bank official involved in the original design of SALs:

> Action to address this criticism of the voting system and the composition of the staff and management is, in fact, not only consistent with, but probably also a necessary condition for, achieving the substantive refocussing of World Bank activities toward supporting policy and institutional reform rather than project objectives[14].

Second, the Bank might decentralize its operations by implementing Section 10 of Article V of its Articles of Agreement, which prescribes:

> The Bank may establish regional offices and determine the location of, and the areas to be covered by a regional Office. Each regional Office shall be advised by a regional council representative of the entire area and selected in such a manner as the Bank may decide.

The core of each regional office might be the current staff of the regional bureau in Washington, and segments of the other (overhead and service) departments[15]. The resulting reduction of the staff at headquarters would reduce bureaucratization and hopefully speed the loan approval cycle. The creation of what in effect would be four to six regional banks under a World Bank umbrella might place bank economists closer to the realities of the countries under their jurisdiction and result in more politically sensitive and intellectually innovative programs.

Third, regional decentralization would force the Executive Directors to devise policy guidelines on the delegation of authority. One suggestion would be that the Executive Directors not approve individual loans but rather decide on country operations and lending programs. This idea is given qualified support in a recent U.S. Treasury Department study:

> To provide more time for discussion of individual country policies by the Multilateral Development Banks' (MDB) Executive Boards, apart from projects, consideration could be given, for example to reducing the time these boards, particularly the World Bank because of

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[13] For example, see G. K. Helleiner et al., *Towards a New Bretton Woods: Challenges for the World Financial and Trading System* (London: Commonwealth Secretariat, 1983).

[14] Stanley Please, *Op. Cit.*, p. 13.

[15] Such decentralization has been repeatedly advocated by observers of the Bank. For example, see E. Reid, *Strengthening the World Bank* (Chicago: The Adlai Stevenson Institute, 1973); and Aart van de Laar, *The World Bank and the Poor* (The Hague: Martinus Nijhoff Publishing, 1980), p. 245.

> its loan volume, devote to individual loan review. However, any new procedures must be crafted carefully to ensure there is no sacrifice in the equality of loan review. Two possibilities to increase available time are: a) increase the minimum loan size that warrants automatic review by an MDB board; and b) establish committees composed of board members, or alternative members or technical assistants, to review the loans below such a threshold[16].

Fourth, the developing countries should take greater care in the appointment of their Executive and Alternate Directors, to insure a quality and continuity of expertise and leadership so as to maximize their impact within the Board. These representatives should also make greater efforts to coordinate their positions on key policy issues.

*The Bank should intensify its efforts to increase the flow of private capital to developing countries*

Ultimately, private capital will return to developing countries once they have regained their creditworthiness. SALs and Bank-led Consultative Groups (consisting of donors and a recipient nation) can contribute to this end as well as help to promote projects among private sources of capital. In the interim, the Bank can reduce the perceived risk in lending through a number of mechanisms, including cofinancing. Instead of financing entire projects by itself, the Bank has since the mid-1970s sometimes delegated a portion to private lenders. Co-financing allows the Bank to gain greater mileage from its own limited resources and to stimulate private lending. The Bank ties some, but not all, co-financed private loans with formal memoranda of agreement and "optional" cross-default clauses. To make such arrangements even more attractive, the Bank in 1983 announced several new "B-loan" mechanisms for increasing its linkage to the commercial portion of the commercial loan for its own portfolio, or agree to refinance the final commercial maturity under certain conditions. However, as it seeks to make its cofinancing schemes more attractive, the Bank needs to be certain that the private finance is additional to what would have gone forward without Bank support. Similarly, Bank experiments with loan guarantee schemes are worthwhile, so long as they do not detract on a 1-to-l basis from Bank lending capabilities.

The recent decision to double the capital of the International Finance Corporation (IFC) was a wise one. This will permit the IFC to expand its level of real net investment in support of private firms (domestic and foreign-owned) at about 7 per cent annually over the next five years. The proposed multilateral guarantee agency (MIGA) might further increase the flow of equity capital, but to be effective in Latin America its arbitration rules should be consistent with the Calvo Doctrine of national sovereignty.

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[16] Department of the Treasury, *Foreign Direct Investment and Commercial Capital Flows: The Pole of the Multilateral Development Banks*, Op. Cit., p. 21.

Such guarantee and insurance schemes should avoid making lenders less willing to restructure debts because of their association with the Bank (which has resisted rescheduling its own loans). Nor should they be used to unite creditors in an effort to gang up on a developing country.

*The Bank and the IMF might agree to substitute SALs for IMF standbys in some cases*

Some highly indebted, middle-income countries will decide not to renew current IMF programs, or to avoid standbys altogether. Consideration should be given to the idea – suggested only tentatively here – that some of these nations might instead be able to sign reshaped SAL programs with the Bank, and agree to parallel enhanced Article 4 consultation with the Fund (patterned on the recent Mexican arrangement with the IMF, hence including targets but not performance criteria).

Such SALs could be more effective if they enjoyed greater financial support. Perhaps the General Arrangements to Borrow, or some other financial mechanism, could be used for this purpose. As compensation, the beneficiaries could agree on a timeable for their partial graduation from the World Bank, conditioned on the success of their adjustment programs and their regaining access to the International private capital markets. Graduation would not, however, apply to "basic needs" loans, to which Latin American countries should continue to have access.

These reforms would enable the World Bank to assume a leadership role in responding to the debt crisis. The Bank could at once become a chief source of capital and of ideas – two items that in recent years have been in short supply.

## 7. Summary

As a result of the contraction in private capital markets and the expansion in its own lending, the World Bank has become a more significant source of funds for Latin America. However, the Bank has had difficulty disbursing funds because the region's financial crisis has reduced the availability of investment projects and of counterpart funds. The Bank's enhanced emphasis on balance of payments lending through structural adjustment and sectoral loans is an appropriate response to these problems.

SALs and sector loans have not, however, played as constructive and important a role in Latin America as their potential allows. They have been constrained by several limits regarding their funding and the content of the accompanying conditionality. This paper sets forth a series of suggestions for releasing these constraints. The overall size of the Bank should be enlarged, probably through a generous General Capital Increase, while a higher proportion of Bank resources should be devoted to SALs and sector loans in Latin America and the Caribbean. The Bank also needs to reconsider the conditions placed on these loans, and should establish a panel of outside experts to review the experience with structural adjustment lending to date. At the same time, in order to facilitate the adjustment process, the Bank should intensity its efforts to increase the flow of private capital to developing countries through selective expansion of its cofinancing, guarantee and insurance schemes.

In addition, the Bank should consider decentralizing its operation in order to place staff in closer touch with governments and thereby improve the quality of policy dialogues. For their part, the developing countries should take greater care in the appointment of their Executive and Alternative Directors, to insure a greater quality and continuity of expertise and leadership.

Table 1
Bank/IDA Lending to Latin America and the Caribbean Countries
(Cumulative Total, March 15, 1985)

| Country | Bank | IDA | Total* |
|---|---|---|---|
| Argentina | $ 1,918.3 | $ — | $ 1,918.3 |
| Bahamas | 22.8 | — | 22.8 |
| Barbados | 60.2 | — | 60.2 |
| Belice | — | 5.3 | 5.3 |
| Bolivia | 299.3 | 104.8 | 404.1 |
| Brazil | 10,313.6 | — | 10,313.6 |
| Caribbean Begion** | 43.0 | 14.0 | 57.0 |
| Chile | 752.2 | 19.0 | 771.2 |
| Colombia | 4,423.7 | 19.5 | 4,443.2 |
| Costa Rica | 407.4 | 5.5 | 412.9 |
| Dominica | — | 5.0 | 5.0 |
| Dominican Republic | 296.3 | 22.0 | 318.3 |
| Ecuador | 694.4 | 36.9 | 731.3 |
| El Salvador | 216.1 | 25.6 | 241.7 |
| Granada | — | 5.0 | 5.0 |
| Guatemala | 346.0 | — | 346.0 |
| Guyana | 80.0 | 38.5 | 118.5 |
| Haiti | 2.6 | 246.4 | 249.0 |
| Honduras | 503.6 | 83.2 | 586.8 |
| Jamaica | 697.1 | — | 697.1 |
| Mexico | 7,316.1 | — | 7,316.1 |
| Nicaragua | 233.6 | 60.0 | 293.6 |
| Panama | 545.3 | — | 545.3 |
| Paraguay | 458.1 | 45.5 | 503.6 |
| Peru | 1,694.4 | — | 1,694.4 |
| St. Vincent | — | 5.0 | 5.0 |
| Trinidad and Tobago | 124.8 | — | 124.8 |
| Uruguay | 520.4 | — | 520.4 |
| Venezuela | 383.3 | — | 383.3 |
| Total | $ 32,380.0 | $ 735.9 | $ 33,115.9 |

* Original amount, round numbers, in millions of U.S. Dollars.
** Through the Caribbean Development Bank.
Source: World Bank.

Table 2

World Bank's Contribution to the Developing Countries Balance of Payments
(Billions of current U.S. dollars)

| Year | 1970 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| Developing countries' c/a deficit (1) | 12.7 | 69.6 | 107.8 | 97.6 | 56.2 |
| Total net capital receipts of developing countries (2) | 9.9 | 99.2 | 109.8 | 97.4 | 99.8 |
| Net loan disbursements of the World Bank (3) | 0.5 | 3.2 | 3.6 | 4.5 | 5.1 |

NOTES: (1) Source is the *World Development Record 1984*, Table 2.10, p. 30.
(2) Source is *1984 Review - Development Cooperation* (Paris: OECD, November 1984), Table IV-1, p. 64. This total excludes short-term bank lending as well as the IMF net purchases.
(3) Same source as (2), Table II.C.l, p. 214.

Table 3

Net Capital Flows to Latin America and the Caribbean, by source, 1974-83 (US$ millions)

| Year | 1974 | 1976 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|---|---|---|
| Net transfers[1] | 5,875.1 | 8,980.7 | 12,212.7 | 9,349.1 | 3,536.8 | 6,076.7 | 3,036.8 | -774.9 |
| Official Creditors | 1,577.9 | 803.0 | 1,123.8 | 450.4 | 2,286.0 | 2,457.6 | 2,940.7 | 1,655.2 |
| Multilateral | 536.6 | 342.0 | 564.6 | 825.3 | 1,309.8 | 1,321.0 | 2,266.6 | 505.4 |
| IRBD | 314.5 | 58.7 | 39.8 | 251.9 | 555.7 | 532.6 | 562.1 | 787.5 |
| IDA | 22.0 | 32.1 | 32.7 | 27.0 | 55.4 | 64.8 | 24.8 | 25.3 |
| Bilateral | 1,042.2 | 461.0 | 559.2 | -374.9 | 976.2 | 1,136.6 | 674.1 | 1,149.8 |
| Private Creditors | 4,297.2 | 8,177.7 | 11,088.9 | 8,898.7 | 1,250.8 | 3,619.1 | 96.0 | -2,400.1 |
| Net Flows[2] | 7,955.1 | 12,347.4 | 18,319.7 | 18,428,5 | 16,362,1 | 21,380.3 | 21,625.9 | 17,775.5 |
| Official Creditors | 2,165.9 | 1,695.2 | 2,442.9 | 2,006.5 | 4,051.4 | 4,446.9 | 5,181.6 | 4,093.0 |
| Multilateral | 910.7 | 847.4 | 1,367.4 | 1,714.6 | 2,309.6 | 2,400.6 | 3,465.0 | 1,948.8 |
| IRBD | 579.1 | 394.2 | 524.1 | 818.5 | 1,190.8 | 1,200.4 | 1,298.1 | 1,625.1 |
| IDA | 23.3 | 34.0 | 34.9 | 29.5 | 58.5 | 68.1 | 28.4 | 29.2 |
| Bilateral | 1,255.2 | 847.8 | 1,075.5 | 291.9 | 1,741.8 | 2,046.3 | 1,716.6 | 2,144.2 |
| Private Creditors | 5,789.2 | 10,652.2 | 15,876.8 | 16,422.0 | 12,310.7 | 16,933.5 | 16,444.3 | 13,682.5 |

Source: World Bank, World Bebt Tables.
1. Net transfers are not flows minus interest payments or disbursements minus total debt service payments.
2. Net flows are disbursements minus principal repayments.

Table 4

Sector Shares in Total Lending (IBRD and IDA) (per cent)

| Fiscal years | Infrastructure | Agriculture | Industry | Social | Non-project |
|---|---|---|---|---|---|
| 1947-57 | 48.2 | 5.0 | 11.2 | 0.4 | 35.1 |
| 1958-68 | 67.9 | 8.8 | 18.3 | 3.7 | 1.4 |
| 1969-79 | 36.6 | 27.4 | 17.7 | 12.8 | 5.6 |
| 1980-84 | 35.6 | 26.2 | 16.0 | 13.2 | 9.0 |

Notes: Infrastructure includes energy, telecommunications and transportation. Industry includes industry proper plus development finance companies and small-scale enterprises. Social includes education, population, health, nutrition, urban development, water supply, and sewerage. Non-project includes non-project proper plus technical assistance and tourism. The source for lending values (loan commitments) are the Bank's Annual Reports. The data for the 1947-81 period was taken from Samuel Lichtensztejn and Monica Baer, *Politicas Globales en el Capitalismo: El Banco Mundial*. Mexico: CIDE, 1982, Tables 4A to 4C, pp. 136-8.

Table 5

Commitments by Main Category of Lending Instrument

FY1980, FY1981, and FY1984, (Bank and IDA)

| | Million $ | | |
|---|---|---|---|
| | FY80 | FY81 | FY84 |
| Specific Investment | 6,941 | 6,064 | 6,414 |
| Sector Operations | | | |
| a) Sector Investment | 1,941 | 2,533 | 4,113 |
| b) Financial Intermediaries | 1,765 | 2,314 | 2,043 |
| c) Sector Adjustment | 90 | 244 | 1,318 |
| Structural Adjustment & Program Loan | 355 | 782 | 1,272 |
| Technical Assistance | 125 | 279 | 324 |
| Emergency Reconstruction | 265 | 75 | 40 |
| Total | 11,482 | 12,291 | 15,524 |
| | Percentages Shares | | |
| Specific Investment | 60.5 | 49.3 | 41.3 |
| Sector Operations | | | |
| a) Sector Investment | 16.9 | 20.6 | 26.5 |
| b) Financial Intermediaries | 15.4 | 18.8 | 13.2 |
| c) Sector Adjustment | 0.7 | 2.0 | 8.5 |
| Structural Adjustment & Program Loan | 3.1 | 6.4 | 8.2 |
| Technical Assistance | 1.1 | 2.3 | 2.1 |
| Emergency Reconstruction | 2.3 | 0.6 | 0.3 |
| Total | 100.0 | 100.0 | 100.0 |

Source: World Bank.

Table 6

Real Growth Rates of Bank Lending, Overall and to Latin America (per cent per year)

| Fiscal Years | Real Lending to Latin America and the Caribbean | Real total Lending |
|---|---|---|
| 1954-58 | 0.2 | 21.2 |
| 1958-68 | 11.4 | 1.1 |
| 1968-77 | 9.6 | 14.1 |
| 1977-81 | 2.6 | 0.6 |
| 1981-84 | 3.5 | 19.8 |

Notes: To calculate real lending, the figures for loan commitments in each fiscal year, as taken from the Bank's Annual Reports, were deflated by the International Financial Statistics' index for the unit value of exports of industrial countries.

Table 7

Sectoral Shares in Lending to Latin America and the Caribbean (IBRD and IDA) (per cent)

| Fiscal Years | Infrastructure | Agriculture | Industry | Social | Non-project | Total |
|---|---|---|---|---|---|---|
| 1947-57 | 87.7 | 6.7 | 4.5 | - | 1.1 | 23.3 |
| 1958-68 | 82.9 | 10.3 | 4.5 | 2.2 | 0.0 | 26.6 |
| 1969-79 | 43.6 | 22.3 | 18.0 | 12.4 | 3.7 | 24.3 |
| 1980-84 | 35.7 | 25.5 | 20.9 | 15.7 | 2.2 | 22.9 |

Notes: For sources and the definition of the sectors, see notes to table 4. The column 'total' indicates the shares of Latin America in total bank lending.

Table 8

Latin America and the (IBRD and IDA) Caribbean: Sectoral Preference Ratios

| Fiscal years | Infrastructure | Agriculture | Industry | Social | Non-project |
|---|---|---|---|---|---|
| 1947-57 | 1.8 | 1.3 | 0.4 | - | 0.0 |
| 1958-68 | 1.2 | 1.2 | 0.2 | 0.6 | 0.0 |
| 1969-79 | 1.2 | 0.8 | 1.0 | 1.0 | 0.7 |
| 1980-84 | 1.0 | 1.0 | 1.3 | 1.2 | 0.2 |

Notes: The sectoral preference ratios result from the division of the share of a given sector in IBRD + IDA lending to Latin America (which is displayed in Table 7) by the share of the same sector in total IBRD + IDA lending (which is displayed in Table 4). The sources for loan commitments are the World Bank's Annual Reports. The data for the 1947-81 period was taken from Samuel Lichtensztejn and Monica Baer, *Politicas Globales*, Op. Cit.