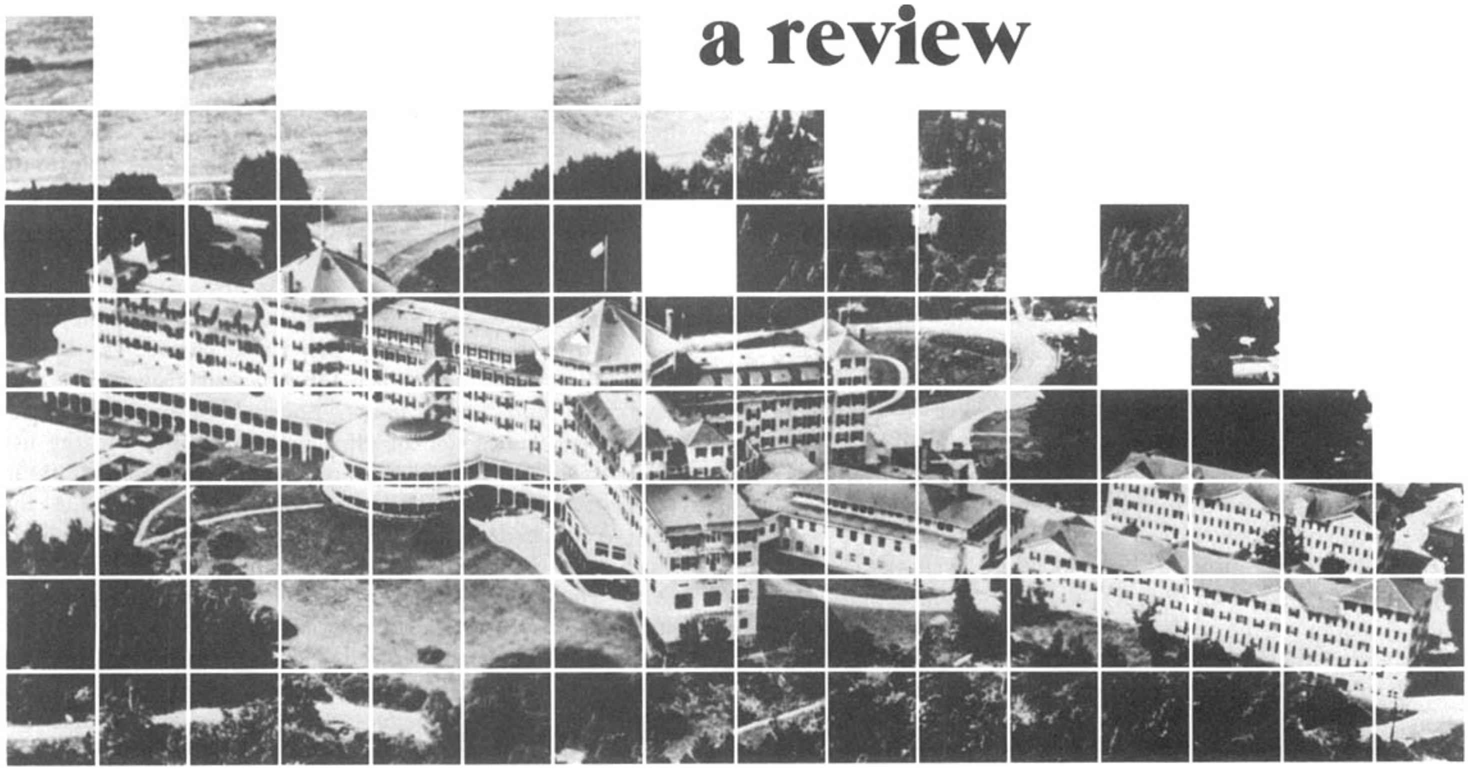
Development theory and the Bank's development strategy— a review



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The World Bank's approach to development theory and practice has changed considerably over the 30 years of its operations. The author, who has been involved with the Bank's work over most of this period, examines the Bank's lending programs and policies in relation to prevalent thinking on development economics over the years.

John H. Adler

In the last 30 years the world's views on the problems of economic development have undergone major changes—from a resigned awareness of the obstacles to an almost naive faith in the effectiveness of policies to accelerate growth through increased investment, and finally to the gradual recognition of the complexity of development and the need to do more than enhance the growth rate of the gross national product (GNP). Paul Streeten's article in the September 1977 issue of this journal on "Changing Perceptions of Development" has told that story. This article is an account of the World Bank's response to this intellectual maelstrom and of the evolution of its own development "philosophy" and strategy.

The Bank was aware of the social, economic, and political obstacles to development some 30 years ago but a critical change has occurred between the strategies pursued in 1948 and in 1977. While in 1948 the Bank merely observed these obstacles (in sorrow, it is true), in recent years it has tried, through policy advice, technical assistance, proposals for institutional reform, and greatly expanded lending operations, to eliminate them.

The evolution of the Bank's development strategy has run parallel to the changes in development doctrines of social scientists and more casual—and perhaps more perceptive—observers. The Bank, probably reflecting a wide variety of experiences through its direct contact with developing countries and their political and intellectual leaders, shied away from embracing theories and policy advice stressing one particular aspect, such as the need for better management, at the expense of all other components of theory or policy.

The Bank's need to formulate a coherent approach to development was never greater than in its early years when the command of its charter to assist in the financing of development forced it to venture into *terra incognita.*

After an initial period of two years in which the Bank concentrated its loans on Europe's reconstruction needs, the Bank turned its attention to developing countries. Here, the Bank found itself in an area uncharted by experience and without the guidance of an intellectual tradition. The Bank's Articles of Agreement provided few positive guidelines beyond a very vague statement of purposes, which mentioned "investment of capital for productive purposes," "promote the long-range balanced growth of international trade," and "arrange the loans made . . . so that the more useful and urgent project . . . will be dealt with first" (Article I). The Articles more explicitly stated their restrictions on lending activities, stipulating (1) that the Bank could lend money only if it was satisfied that "in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower," (2) that loans should be for specific projects, "except in special circumstances," and (3) that loans could be used for local expenditures only "in exceptional circumstances" (Articles III and IV).

In the absence of more specific directions, the Bank had to rely on the intellectual climate of the early postwar period to form its own development theory. The literature of the period offered innumerable explanations and virtually all are reflected in the Bank's Annual Reports of the time. The 1948 Annual Report cited lack of domestic capital, shortage of technical and managerial personnel, economic instability (that is, "mounting inflation and chaotic monetary conditions"), the lack of a "well-formulated concept of the overall lines along which sound development is most likely to make progress," "the low education level of the mass of the people," and "unsettled political conditions." While reiterating some of these observations, the 1949 Annual Report added another which, in view of recent changes in the direction of Bank lending, deserves to be quoted in full:

"Mention must also be made of the difficulties arising from the social structure of many of the underdeveloped nations where there are wide extremes of wealth and poverty. In such cases, strong vested interests often resist any changes which would alter their position. In particular, the maintenance in a number of countries of inefficient and oppressive systems of land tenure militates against increase in agricultural output and improvement in the general standard of living."

The Annual Report's comments reflect the writings of the period; many economists and other social scientists were very much concerned with "preconditions" to economic growth, conditions whose absence explained the state of underdevelopment. Recognition of the importance of these factors led the Bank to organize a large number of "survey missions." Between 1950 and 1967 these survey missions produced "development programs" for some 25 countries; the programs combined what nowadays would be called sector programs and financing plans. Virtually all survey mission reports urged the preparation of comprehensive development programs and organizational arrangements for development planning. A recommendation to the same effect was made by the Bank's President, Eugene Black, at a meeting of the Economic Commission for Latin America in 1949. The survey missions reflected the development theories and the policy mood of the time. They emphasized the enlargement of the scope of private enterprise (especially in the industrial sector), the treatment of foreign investment, the stimulation of private and public capital formation, development planning, and the improvement of economic management.

Infrastructure investment

In the framework of this broad-based approach and with the constraints, both of the Articles and of the prevailing political climate, that Bank loans be made only where foreign and domestic private investment would not be forthcoming, the financing of infrastructure investment emerged as the field most suitable for Bank operations. The emphasis on infrastructure investment was a "natural" for the Bank. The absence, or severe inadequacy, of infrastructure facilities was one of the clearly identifiable differences between developing and developed countries, and infrastructure investment lent itself ideally to the "specific project" financing called for in the Articles. Infrastructure projects, too, were considered well suited for debt financing, as distinct from equity financing, which would be at least partially required for "directly productive" investment in industry and agriculture.

From roughly 1948 to 1963, the Bank's lending operations concentrated heavily upon "typical" infrastructure projects: power generation and distribution, railways, highways, ports, major irrigation works, and telecommunications. This concentration was especially pronounced in countries considered developing. In countries such as Australia, Italy, Japan, and several of the Nordic countries, which became substantial Bank borrowers because the flow of capital from private sources was insufficient to match their investment needs, the scope of Bank lending was much wider and extended especially into industrial investment. In the first 15 years of lending by the Bank and (since fiscal year 1960/61) the International Development Association (IDA) to the developing world, loans for infrastructure investment accounted for 78 per cent of operations; since then it has declined, first to 70 per cent (fiscal years 1962/63–1971/72) and more recently to 56 per cent (fiscal years 1972/73–1976/77).

There is no evidence that the Bank took explicit cognizance of the "unorthodox" views of A. Hirschman, F. Perroux, and others who in the 1950s pointed to the advantages of sectorally unbalanced and spatially polarized growth. To the contrary, in its insistence on avoiding excess capacity in infrastructure projects and in its emphasis on development planning, the Bank showed a decided preference for balanced growth.

It took seriously, however, the objection of Hirschman and others to the use of the simple criteria of profitability in the selection of projects. In 1958 the Bank's Economic Development Institute published Jan Tinbergen's *Design of Development*, the first published modification of these profitability criteria through the introduction of accounting prices. This departure from the period's orthodox economics was in line with doubts the Bank had expressed as early as 1948. The Bank was concerned about the functioning of markets in developing countries and the distortions brought about by inflation and exchange controls, and troubled by comparisons of the cost of production in the developing world with the cost of imports at official exchange rates. It was also dissatisfied with the low rates of return of public enterprises. The Bank's concerns led to the development of better project evaluation techniques, a process which is still going on.

External debt and development

One subject which economists concerned with development tended to ignore but which, for very practical reasons, much interested the Bank was the role of external borrowing in the development process. (The first debt "models" relating external borrowing and debt service to GNP growth and the balance of payments were developed by Bank economists—G. Alter, D. Avramovic, and R. Gulhati.) The Bank was, of course, aware that low savings rates prevailed in most developing countries and had urged the adoption of fiscal policies, including financial and pricing policies for publicly owned enterprises, which would raise the rate of public and private savings. On occasion the Bank justified borrowing from abroad on the basis of the argument


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IBRD and IDA lending, FY 1948–77 [1]

	FY 1948–52		FY 1953–57		FY 1958–62		FY 1963–67		FY 1968–72		FY 1973–77	
	LDCs	Others [2]	LDCs	Others [2]	LDCs	Others [2]	LDCs	Others [2]	LDCs	Others [2]	LDCs	Others [2]
	(In per cent of total lending)											
Power	53.5	6.6	28.8	22.3	35.4	39.0	29.0	21.9	21.5	12.5	12.9	4.2
Railways	11.5	4.0	18.5	7.5	18.5	16.5	12.0	11.8	6.7	39.5	4.7	—
Highways	3.7	—	11.2	—	16.1	8.7	14.2	47.6	13.8	4.3	8.9	—
Ports	3.5	—	4.2	2.7	6.4	1.0	2.3	5.3	3.8	—	3.8	21.0
Telecommunications	0.2	—	—	—	0.1	—	3.7	—	4.7	—	2.8	—
Irrigation	4.8	—	3.9	—	7.6	1.0	5.9	—	6.3	—	9.1	—
Education	—	—	—	—	—	—	3.0	—	4.0	19.0	4.6	10.5
Other infrastructure [3]	—	3.8	2.0	1.3	2.9	—	2.7	—	6.0	3.2	8.8	—
Total infrastructure	77.1	14.4	68.9	33.9	87.0	66.3	72.9	86.6	66.9	78.5	55.5	35.7
Agriculture and rural development [4]	5.1	0.7	2.5	0.8	1.5	—	5.5	—	11.6	6.3	18.1	35.7
Industry, development banks, and tourism	3.1	14.8	18.0	8.9	11.5	25.6	11.4	13.4	16.6	15.2	20.1	28.6
Program loans [5]	1.5	70.1	10.9	56.5	—	8.1	10.2	—	5.0	—	6.3	—
Total directly productive sectors	22.9	85.6	31.4	66.1	13.0	33.7	27.1	13.4	33.1	21.5	44.5	64.3
	(In millions of U.S. dollars)											
Total lending												
Current	670	495	961	731	2,875	924	4,482	906	10,001	395	27,079	238
In 1977 dollars	1,831	1,352	2,616	1,990	7,708	2,487	11,174	2,265	17,621	688	30,495	289

Source: IBRD/IDA Annual Reports.
Note: — signifies zero.
[1] Ended June 30.
[2] All European countries except Cyprus, Greece, Portugal, Romania, Turkey, and Yugoslavia, plus Australia, Japan, New Zealand, and South Africa.
[3] Water supply, agricultural research, population, and urbanization.
[4] Excluding irrigation and agricultural research.
[5] Including technical assistance loans.

that a higher rate of investment *now* would lead to higher income and a higher marginal rate of savings *later*. In this sense it accepted the "big push" theory which P. Rosenstein-Rodan and others had developed; this justified external borrowing until savings became large enough to assure an acceptable rate of income growth.

But the Bank did not act as if high marginal savings rates could be relied upon to reduce borrowings in the medium run and assure repayment to lenders, including the Bank. Partly out of concern for the safety of its own lending, but chiefly because it was aware that the needs of developing countries for imported capital could not be met by borrowings on commercial or near-commercial terms, the Bank recommended that rich countries make grants to developing countries. Grants, it argued, would increase resources available to them without adding to their debt service and their balance of payments problems. The arguments, that grants and loans on highly concessionary terms were necessary if the flow of external resources supplementing domestic capital formation was to be large enough to assure an adequate rate of GNP growth, led in due course to the creation of the IDA. In turn, the practical problem of the country allocation of the IDA caused the Bank to face up to the widening disparity among developing countries. This development complicated not only Bank/IDA operations, but also theoretical reasoning about development.

Stages of development

In its concern about creditworthiness, the Bank was intrigued with the idea of the "big push," when capital imports were needed to supplement domestic savings which would in turn be followed by a period beyond which the need for external capital would abate and sooner or later disappear, but the Bank's formal pronouncements indicate that it at no time embraced W.W. Rostow's stage theory of development and the "takeoff into self-sustained growth." Other organizations involved in development assistance had found Rostow's theory a convenient point of departure for assurances to impatient legislators and an uneasy public about the duration and volume of foreign aid needed. Although from the early 1960s it was anxious to reduce lending to "market-eligible" countries, such as Australia, Italy, and Japan, which presumably had access, at reasonable cost, to private capital markets, the Bank was sufficiently close to the development process in its member countries to realize that in most of them the takeoff was far in the future, if indeed it were ever to come to pass.

At the same time the Bank realized that it could not rely on the stimulation of private initiative, private savings, and investment through the external economies resulting from an expansion and modernization of infrastructure. The Bank concluded that it had to expand financial support to directly productive sectors such as agriculture, industry, and tourism. The inadequacy of education and managerial skills, some of the obstacles to development which it had diagnosed as early as 1948, again drew Bank concern. It began to finance changes in the educational system of developing countries, to establish institutions for the financing of industrial investments and the provision of technical assistance in the selection and appraisal of industrial projects, and to help in the preparation of agricultural projects. The Bank continued to rely on the historical experience of the advanced countries whose industrialization and income growth had been brought about by private, entrepreneurial initiative.

An activist role

The expansion of Bank/IDA lending into "social" sectors (education and water supply) and the new emphasis on lending in agriculture and industry, in the 1960s while George Woods was President, was the beginning of an in-house re-evaluation of the Bank Group's role. Development and development aid were recognized indeed not as simple and straightforward, but as complex and variegated. The call for a substantial increase in IDA resources went out in 1966 and the announcement that the Bank was willing to supplement its traditional lending activities with an increased volume of technical assistance and operations-related policy was the first sign that the Bank was ready to play a more "activist" role. It was now providing a large volume of financial assistance and greatly expanding its assistance in the identification and preparation of investment projects and in carrying out projects which it agreed to finance, activities which it had earlier only urged others, such as borrowers and providers of technical assistance, to do.

President Robert McNamara's announcement at the 1968 Annual Meetings of a five-year lending program formalized the Bank's expanded role. The new program would double lending, with most expansion taking place in "difficult" regions, such as in Eastern and Western Africa, and in "difficult" sectors, like agriculture and education. The Bank explained this expansion of lending as an effort to exploit more fully its potential as a financial intermediary. The increase in IDA operations was justified by the great needs of the poorest countries, needs which had not been met by bilateral development assistance.

Alleviation of poverty

With the Bank's intensified efforts to provide financial assistance to agriculture came a growing realization that even in countries where income growth had been substantial, the income of small farmers, landless peasants, and rural workers had not changed significantly and was not likely to change. It became increasingly clear that a large proportion of the rural population lived, and would continue to live, on a near subsistence level, unless development policies and lending for development were explicitly redirected. These would have to be specifically focused on alleviating "absolute poverty"—a level of existence barely adequate to meet physical needs in terms of nutrition, health, shelter, and the ability to lead a productive life. The Bank's concern with the problem of distributing the benefits of economic progress coincided with the realization by a large number of economists and other social scientists that growth of per capita income was a necessary, but by no means a sufficient, condition for the alleviation and ultimate eradication of absolute poverty.

In a statement by the President, the Bank announced its new course during the 1973 Annual Meeting. Since then, the volume of lending has continued to expand. Most of the increase has been allocated to rural development loans, where the objective is to provide most of the benefits to those in the bottom 40 per cent income group.

In 1975, the Bank announced that it would also attempt to deal with the problems of the urban poor. By ensuring that lending for purposes other than rural development provides a large part of its project benefits to the urban poor, the Bank hopes to reach the urban unemployed, who make up a large proportion of the urban poor, and absorb some of their numbers in small-scale manufacturing and service industries.

This change in the emphasis of the Bank's strategy is very much in accord with more recent development doctrines. Current development theories distinguish between income growth and the growth of welfare in income groups where welfare and income are lowest and where, therefore, a given amount of income growth is likely to produce the greatest increase in welfare. The Bank has not, however, altered its original position that an increase in the inflow of capital, including grants and loans on highly concessionary terms, and the expansion of the export sector are desirable parts of development strategy. As its country economic reports and reports about lending operations indicate, the Bank believes that policies to foster these objectives, together with domestic policies which support the integration of the lowest income groups into the process of development, can do much to speed economic growth and enhance social and economic welfare and political stability.

In conjunction with its new activism the Bank has rejected the pessimistic views of those social and political theorists who find external assistance and the expansion of international trade detrimental to developing countries. In its concern for the rural and urban poor and institutional changes and reforms which would eliminate rigidities in the economy and convert economic growth into social progress and human welfare, the Bank is reaffirming its faith in development assistance as well as acknowledging the complexities and human dimensions of the development process. This change of emphasis in Bank lending also implies an important change in the Bank's development doctrine since in its early days it paid little attention to the incidence of the benefits of growth and the changes in income distribution which resulted from growth.

The evolution of the Bank's operations strategy and development doctrine took place in a period when the volume of Bank and IDA lending levels had expanded rapidly in money terms (by 170 per cent between fiscal years 1967/68–1971/72 and fiscal years 1972/73–1976/77) and, to a lesser extent, in real terms because the worldwide inflation reduced the purchasing power of loans (73 per cent). Because overall Bank and IDA lending levels expanded, it became possible to maintain "traditional" lending for infrastructure projects while allocating a growing share to alleviating poverty. The 1977 agreement on the replenishment of IDA resources will permit a 40 per cent real increase in IDA lending. At the London Summit Conference in May 1977, major member countries agreed that the Bank should also expand its operations in real terms. To meet the provisions of the Articles of Agreement limiting the volume of lending will, however, require an increase in the Bank's capital subscriptions.

Notwithstanding the substantial increase in lending operations, the Bank and IDA still account for only a small proportion (16 per cent in the last five years) of total net aid to developing countries (including "other official flows," a category which includes World Bank lending). But the Bank has an impact well beyond its share in total net aid flows. Its reports and evaluations of borrowers' performance are widely distributed to donors of official development assistance and international and regional institutions. The reports unavoidably reflect the Bank's own development doctrines and have considerable influence on the direction and sectoral allocation of other bilateral and multilateral aid. FD