September 1978 / Volume 15 / Number 3

Finance & Development

A quarterly publication of the International Monetary Fund and the World Bank

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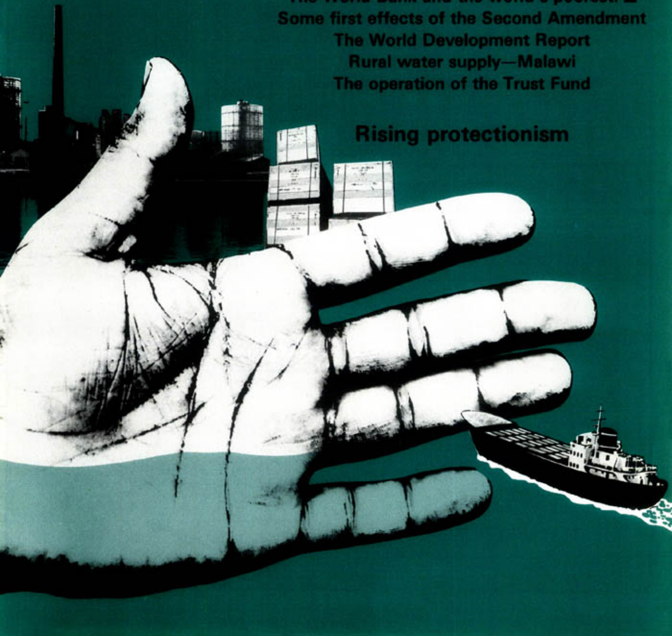
Rising protectionism



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Finance & Development is published quarterly in English, French, and Spanish by the International Monetary Fund and the International Bank for Reconstruction and Development, Washington, D.C. 20431, U.S.A.

A German language edition is published by the International Monetary Fund and the International Bank for Reconstruction and Development in collaboration with HWWA—Institut für Wirtschaftsforschung-Hamburg, and produced by Verlag Weltarchiv GmbH.

Readers wishing to receive the German edition should write directly to *Finanzierung & Entwicklung*, HWWA—Institut, 2 Hamburg 36, Neuer Jungfernstieg 21, Germany.

A selection of articles from each issue is published in Arabic and issued as a supplement to *Al-Iqtissadi*, c/o Al-Ahram, Cairo, Egypt. Individual copies of this selection are also available on application to The Editor, *Finance & Development*, International Monetary Fund Building, Washington, D.C. 20431, U.S.A.

A selection of the contents of *Finance & Development* is published annually in Rio de Janeiro, Brazil, in cooperation with the United Nations Information Center, in Portuguese.

Controlled circulation postage is paid at Lancaster, Pa., U.S.A.

New readers who wish to receive *Finance & Development* regularly may make an application through an appropriate institution, or individually, to be added to the mailing list. Individuals should briefly state the reasons for their request. Please indicate which language edition is wanted—only one edition will be sent. Applications should be mailed to *Finance & Development*, International Monetary Fund Building, Washington, D.C., 20431, U.S.A.

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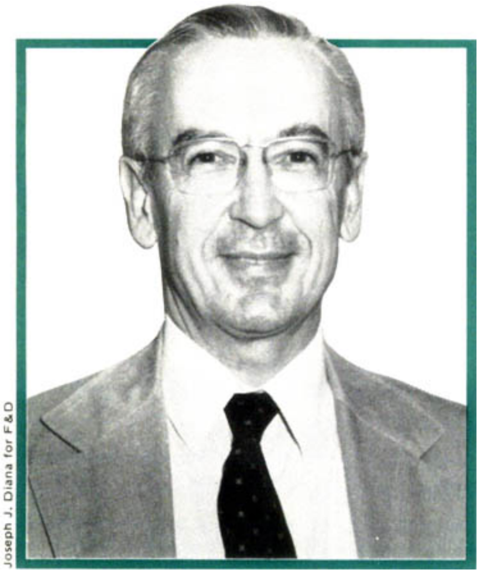
The contents of *Finance & Development* are indexed in *Business Periodicals Index*, *Public Affairs Information Service* (PAIS), and *Bibliographie Internationale des Sciences Sociales*.

An annual index of articles and book reviews is carried in the December issue of *Finance & Development*.

Jacques de Larosière is new Managing Director



Joseph J. Diana for F&D

Mr. Jacques de Larosière de Champfeu, of France, has been appointed Managing Director and Chairman of the Board of Executive Directors of the International Monetary Fund. He assumed his duties at the Fund on June 17, 1978, succeeding Mr. H. Johannes Witteveen, of the Netherlands, whose service ended on June 16, 1978.

Mr. de Larosière, 48, was Director of the French Treasury since 1974. He represented his Government at many international conferences as well as on the boards of major industrial and financial concerns. Education at the University of Paris with degrees in Arts and Law, and at the Political Studies Institute of Paris and National School of Administration preceded his designation as an Inspecteur des Finances in the French civil service.

Following assignments to the French Embassies in London (1962) and in Algeria (1963), Mr. de Larosière joined the Department of External Finances in the Ministry of Economy and Finance in 1963. He was subsequently transferred to the Treasury where he became Assistant Director in 1967 and Deputy Director in 1971. While on these assignments, he chaired the Economic Development Review Committee of the Organization for Economic Cooperation and Development (OECD) and was in charge of the development assistance programs managed by the Ministry of Economy and Finance. He was Personal Assistant and Director of the Cabinet Office of Mr. Valéry Giscard d'Estaing, Minister of Economy and Finance, January-May 1974.

Fund activity

Alternate Governor of the Fund for France since 1974, Mr. de Larosière has participated in the work of the Committee of Twenty on International Monetary Reform and the Interim Committee, as well as in that of the Development Committee on the Transfer of Real Resources to Developing Countries. He has been Chairman of the Deputies of the Group of Ten since September 1976, and has served on Economic Policy and Development Assistance Committees of the OECD.

Mr. de Larosière has represented the French Government on the Boards of Régie Nationale des Usines Renault, Banque Nationale de Paris, Compagnie Nationale Air France, Société Nationale des Chemins de Fer Français, Société Nationale Industrielle Aérospatiale, Caisse Nationale des Télécommunications, Banque de France, Crédit National, Comptoir des Entrepreneurs, and Crédit Foncier de France.

The Fund during the Witteveen years

Mr. H. Johannes Witteveen ended his term as Managing Director of the Fund on June 16, 1978. He had been Managing Director of the Fund since September 1, 1973.

During Mr. Witteveen's tenure of almost five years there was an unprecedented increase in the use of the Fund's resources, accompanied by a number of important changes in the form of the Fund's financing of members' balance of payments deficits. By the end of his term in office, members' cumulative purchases from the Fund since the beginning of its operations amounted to SDR 48.2 billion (including undrawn balances under stand-by arrangements), reflecting an increase of SDR 23.1 billion since Mr. Witteveen became the Fund's Managing Director. In all the preceding years cumulative purchases had amounted to SDR 25.1 billion.

This large-scale expansion in the use of the Fund's resources, which began in 1974, was partly financed through the Fund's own resources and by borrowing SDR 8.6 billion, including SDR 6.9 billion borrowed under the oil facilities in effect in 1974, 1975, and part of 1976. These funds raised the gross cumulative total of borrowed resources to SDR 11 billion by June 6, 1978. In addition, the Fund almost doubled the number of currencies it uses in its transactions, thereby spreading the financing of Fund activities more widely among its membership. Additional resources were made available to members by liberalizing their access to the compensatory financing facility in 1975.

In terms of the volume of resources made available to members, the peak of the Fund's financial activity was achieved in 1976, approximately midway in Mr. Witteveen's term of office, when total purchases from the Fund amounted to SDR 7 billion, including an unprecedented SDR 2.3 billion made available to members through compensatory financing purchases and more than SDR 2.1 billion through oil facility purchases. Total repurchases were SDR 1,272.0 million in that year. The previous peak was in 1968 when total drawings were almost half those in 1976. Thereafter, the oil facility was terminated and compensatory financing purchases declined sharply, only partly offset by a near-doubling of credit tranche purchases, from SDR 1,477.6 million in 1976 to an unprecedented SDR 2,895.2 million in 1977.

In addition to the provision of a high level of balance of payments assistance to members, with extensive drawings under both the Fund's regular tranche policies and the compensatory financing and oil facilities, Mr. Witteveen's term of office was marked by progress in major policy matters affecting the Fund's structure and operations, including:

- The successful completion of the work on the Second Amendment to the Fund's Articles of Agreement, culminating in its acceptance by members and its entry into force on April 1, 1978. (See "Some first effects of the Second Amendment" by Joseph Gold in this issue, and "The Second Amendment of the Fund's Articles of Agreement: a general view," I and II by Mr. Gold in the March and June issues of **Finance & Development.**)
- The completion of the Sixth General Review of Quotas, culminating in the consent

Previous Managing Directors

Camille Gutt, Belgian	1946–51
Ivar Rooth, Swedish	1951–56
Per Jacobsson, Swedish	1956–63
Pierre-Paul Schweitzer, French	1963–73
H. Johannes Witteveen, Dutch	1973–78

of members to quota increases that will raise the total of Fund quotas from SDR 29.2 billion to SDR 39.0 billion when all members will have consented to the full increase proposed for them. The successful conclusion of the Sixth General Review of Quotas cleared the way for the initiation of the Seventh General Review of Quotas.

- The agreement on the principles for the guidance of members with respect to their exchange rate policies and on procedures for Fund surveillance over those policies.
- The enlargement of the General Arrangements to Borrow and the activation of these Arrangements in connection with drawings under stand-by arrangements made by two industrial countries.
- The initiation of the Fund's gold sales, both to the market through auctions and for distribution to members.
- The establishment and initiation of operations by the Trust Fund whose resources—gold and currencies sold, donated, or lent to it, income from investments and loans, and the proceeds from repayments of loans—are to be used to provide additional balance of payments assistance on concessional terms in support of the efforts of eligible developing members that qualify for assistance to carry out programs of balance of payments adjustment. (See "The operation of the Trust Fund" by D. Gupta in this issue.)
- The approval of stand-by arrangements for members for periods of more than one year, as well as a major review of the Fund's financial position and changes in the rates of charges paid by members for the use of the Fund's resources.
- The establishment of the Fund's oil facility, financed by borrowings from 16 members, and Switzerland. Total borrowings by the Fund in connection with the oil facility amounted to SDR 6.9 billion and final purchases from the Fund by members were made under the facility in the first half of May 1976.
- The work on the establishment of a supplementary financing facility of a temporary nature (the so-called Witteveen facility) that would enable the Fund to expand its financial assistance to those members that in the next several years will face payments imbalances that are large in relation to their economies and quotas in the Fund.

Aldo Zanzi

Fund transactions in first half of 1978

Total purchases from the Fund by its members in the first six months of 1978 amounted to SDR 532.22 million, of which SDR 237.75 million was purchased under the compensatory financing facility. Purchases under the reserve and credit tranches during that period were SDR 98.57 million and SDR 181.91 million, respectively. Total repurchases in the six months ending June 30, 1978 were SDR 2,267.9 million. By way of comparison, total repurchases in all of 1977 amounted to SDR 2,939.4 million, while purchases in that year were SDR 3,424.4 million.

There were 17 stand-by arrangements in effect at the end of June 1978. The total amount approved under these stand-by arrangements was SDR 5,057.20 million, and the undrawn balance available at the end of June 1978 was SDR 3,101.64 million, subject to phasing of the amounts. Purchases in June were SDR 73.56 million, and repurchases in that month were SDR 379.36 million. During June the Fund also made the third payment under the subsidy account to 18 member countries for an amount totaling the equivalent of SDR 24.95 million. The first two subsidy payments totaling the equivalent of SDR 41.3 million were made to the same members in 1976 and 1977. The subsidy account was established by the Fund's Executive Directors in 1975 to assist the Fund's most seriously affected members to meet the cost of using the oil facility. The subsidy account is funded by contributions from 24 members and Switzerland.

Fund holdings of gold and SDRs, and commitments as at June 30, 1978
(In millions of SDRs)

Holdings in the General Resources Account			
Gold		4,468.8	
Special drawing rights		1,332.1	
Stand-by arrangements	Amount agreed	Amount purchased	Undrawn balance
Argentina	159.50	—	159.50
Gabon	15.00	—	15.00
Haiti	6.90	—	6.90
Italy	450.00	90.00	360.00
Madagascar	9.43	9.43	—
Mauritius	7.97	—	7.97
Panama	25.00	—	25.00
Peru	90.00	10.00	80.00
Portugal	57.35	—	57.35
Romania	64.13	51.13	13.00
Spain	143.19	—	143.19
Sri Lanka	93.00	55.00	38.00
Turkey	300.00	50.00	250.00
United Kingdom	3,360.00	2,250.00[1]	1,720.00
Uruguay	25.00	—	25.00
Western Samoa	0.73	—	0.73
Zambia	250.00	50.00	200.00
Subtotal	5,057.20	2,565.56	3,101.64
Extended Arrangements			
Jamaica	70.00[2]	14.00	56.00
Kenya	67.20[3]	7.70	59.50
Mexico	400.00[4]	100.00	400.00[5]
Philippines	217.00[6]	198.75	57.00[7]
Total	5,811.38	2,886.00	3,674.13

[1] Includes augmentation by repurchase equivalent to SDR 610 million.
[2] First phase through June 30, 1979 of a three-year arrangement totaling SDR 200 million.
[3] Third phase through July 6, 1978 of a three-year arrangement totaling SDR 67.2 million.
[4] Second phase through December 31,1978 of a three-year arrangement totaling SDR 518 million.
[5] Includes augmentation by repurchase equivalent to SDR 100 million.
[6] Third phase through December 31, 1978 of a three-year arrangement totaling SDR 217 million.
[7] Includes augmentation by repurchase equivalent to SDR 38.749 million.

Gold auctions in 2nd quarter of 1978; procedures reviewed by EDs

The Fund awarded 1,519,600 fine ounces of gold to competitive bidders in the three monthly gold auctions held for the benefit of developing countries during the second quarter of 1978. In addition, 925,200 fine ounces of gold were awarded to member countries submitting noncompetitive bids.

Awards to competitive bidders were made at the prices actually bid in each of the auctions; average prices in the three auctions ranged from US$177.92 (April 5 auction) an ounce to US$183.09 (June 7 auction) an ounce. Competitive bids were received for a total of 5,543,400 ounces in the three auctions.

Awards of 925,200 fine ounces of gold to noncompetitive bidders were made at the average auction price of US$183.09 an ounce in the June 7 auction. As previously announced, developing member countries entitled to receive directly a share of the profits on gold sales conducted by the Fund were given the option to submit noncompetitive bids for up to that part of 25 million ounces that corresponds to their share of total Fund quotas on August 31, 1975.

Net of payment for the capital value of the gold (equivalent to SDR 35 an ounce) the second quarter gold sales yielded US$333.3 million for the benefit of developing countries. This raised the total accrued from all auctions held before the end of June 1978 *and from the proceeds of the sales to non-*competitive bidders to about US$1.51 billion.

During May the Executive Directors of the Fund reviewed, in the light of the experience gained in the first two years of the sales program and of the amendment of the Articles of Agreement, the policies and procedures used in gold sales for the benefit of developing countries. They agreed on the terms and conditions for the auctions to be held during the next 12 months. Consistent with the understanding on gold sales reached in May 1976, the Fund will also entertain noncompetitive bids from the authorities of developing countries that wish to acquire gold in this way.

With a few exceptions, the modalities for the auctioning of gold to the private market in competitive bidding will remain unchanged. The auctions will continue to be held on the first Wednesday of each month, the minimum bid will remain at 1,200 ounces, a deposit of the higher of US$10 a fine ounce or US$25,000 will continue to be required, delivery as in the past will be at one of the Fund's major gold depositories, and as hitherto payment will have to be completed approximately seven business days after the auction. It is planned from now on to conduct all auctions on the bid price method. In view of the amendment of the Articles of Agreement, monetary authorities of member countries are no longer prohibited from submitting bids, and terms and conditions for the auctions to be held in the forthcoming months do not restrict such participation in the auctions. The Fund will monitor official gold transactions in the light of the objective of reducing gradually the role of gold in the international monetary system.

Value of SDR set

The Fund recently made an important change in the calculation of the amounts of each of the 16 currencies that will determine the value of the special drawing right (SDR). Effective July 1, 1978, the value of the SDR will be the sum of the values of the following currencies:

U.S. dollar	0.40
Deutsche mark	0.32
Japanese yen	21
French franc	0.42
Pound sterling	0.050
Italian lira	52
Netherlands guilder	0.14
Canadian dollar	0.070
Belgian franc	1.6
Saudi Arabian riyal	0.13
Swedish krona	0.11
Iranian rial	1.7
Australian dollar	0.017
Spanish peseta	1.5
Norwegian krone	0.10
Austrian schilling	0.28

On March 31, 1978, the Fund adopted a decision to adapt the composition of the basket of 16 currencies that determines the value of the SDR on the basis of statistics for the period 1972–76, and to revise the percentage weights assigned to each currency in the basket. On June 30, 1978, the Fund made the calculations necessary to convert these weights into units of each of the 16 currencies, as set out above, so that the value of the SDR in terms of any currency was exactly the same on that day under the revised valuation basket as under the previous valuation basket.

Fund-Bank Annual Meetings

The 1978 Annual Meetings of the Boards of Governors of the International Monetary Fund and of the World Bank will be held at the Sheraton Park Hotel in Washington, D.C. from September 25–28. The meetings will last four days, one day less than heretofore. Tengku Razaleigh Hamzah, Finance Minister of Malaysia, will be Chairman of the Joint Meetings this year.

Tengku Razaleigh Hamzah

The Interim Committee of the Fund Board of Governors is scheduled to meet on Sunday, September 24. The Joint Development Committee is scheduled to meet on Saturday, September 23 and Wednesday afternoon, September 27.

Separate reports on the Fund and the Bank meetings will be published in our December issue.

The 1978 Per Jacobsson Lecture

The 1978 Per Jacobsson Lecture will be held in Washington on September 24, 1978, immediately before the Annual Meetings of the Fund and the Bank Gabriel Hauge. Chairman of the Board of Manufacturers Hanover Trust Company, and Erik Hoffmeyer, Governor of the Danmarks National Bank, will speak on "The International Capital Market and the International Monetary System". Lord Roll of Ipsden will act as commentator.

A report on the lecture will be found in the next issue of *Finance & Development.*

Bank increasing energy lending; loans now for oil and gas development

Bank activity

The Bank is the largest external lender in the energy sector, and it is expected to continue expanding this lending over the next few years, mainly due to the sharp increase in oil and energy prices in 1973–74 and the growing balance of payments deficits of oil and energy importing developing countries. About one fifth of all past World Bank financing has gone toward the development of energy resources. This has included over 300 loans amounting to more than $9 billion for power projects, principally electric power, in 69 countries. Coal mining and the transportation and processing of oil and gas have also been financed.

The Conference on International Economic Cooperation held in Paris as part of the "North-South Dialogue" had urged the Bank in June 1977 to increase its support in this area. In the 12-month period since June 1977 the Bank has sent missions to 16 developing countries for the identification and preparation of oil and gas projects.

Over the last five years the Bank has lent $4.5 billion for 90 power projects. These figures are projected to increase to $6.9 billion for 106 projects over the next five years. Special emphasis is being given to non-oil sources of energy—hydro, coal/lignite, and geothermal. A larger proportion of assistance will be allocated to investments in distribution systems to provide service to the poor, especially in rural areas. The Bank will concentrate its lending in countries, especially in Africa, which are not able to secure capital from private capital markets.

The Bank has loaned $750 million for 15 projects aimed at developing oil and natural gas resources (mostly for pipeline projects) and for 4 coal development projects. Until recently it had not financed petroleum production because international prices for oil were low and supplies abundant, and because finance was readily available from other sources. The situation changed significantly with the quadrupling of oil prices in 1973–74. The Bank made its first loan for oil and gas production at the end of fiscal year 1977—a $150 million loan to India for the development of the Bombay High offshore field.

In July 1977, a greatly enlarged program for fuel development was approved by the Bank's Executive Directors and a new Petroleum Projects Division was established within the Bank. The Bank's lending for oil and gas projects is expected to increase steadily to cover eight such operations by fiscal year 1981, and the amount of annual lending is expected to rise from $150 million in 1977 to $500 million. Studies completed by the Bank indicate that while 14 oil importing countries are producers of oil and/or gas at present, 50 to 60 have a potential for production. Production costs for crude oil would range in these countries between $3 and $6 per barrel, comparing favorably with the price of imported oil of over $12 per barrel. Intensive petroleum development in these countries would reduce their dependence on oil imports from 80 per cent of their needs in 1977 to below 50 per cent in 1990, despite continued increases in consumption. However, most of the oil importing developing countries lack the technical skills and the financial resources to develop this potential. The Bank's increased lending to these countries is expected to cover only between 10 and 20 per cent of project costs, but could encourage finance of up to about $3 to $4 billion a year from other sources, such as foreign investors, suppliers' credits, and private banks.

The Bank also plans to increase its technical and other assistance to member countries to enable them to attract investments for exploration, including geological and geophysical surveys, drafting petroleum legislation and model agreements, and hiring advisors to assist in negotiations with foreign investors.

Pushpa Nand Schwartz

Update

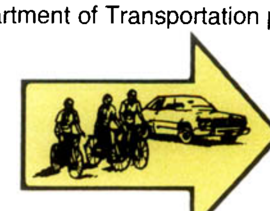
Bank traffic project in Singapore yields results that are widely applicable

In the March 1976 issue of ***Finance & Development*** *we reported on a Bank project in Singapore that was designed to assist the control of traffic congestion in urban areas ("Congestion pricing—the example of Singapore," by Peter L. Watson and Edward P. Holland). This problem is common in a growing number of cities in both the developing and the developed world. This report, by one of the authors of the earlier piece, reviews the experience of Singapore on the completion of the Bank project.*

The Singapore Traffic Restraint Study, undertaken by the Bank's Urban Projects Department, was recently completed and the final report issued. The report concludes that the form of "road pricing" used in Singapore—the requirement to purchase and display a special license to drive into the Central Business District (CBD) during the morning peak hours—is a highly successful method of reducing localized traffic congestion. Faced with the high license fee, car drivers changed the time of their trips, found new routes, formed car pools, or switched to the bus. The result was a 75 per cent reduction in the number of cars entering the CBD during the restricted hours. Delays and frustration were reduced; pollution levels fell; pedestrian conditions improved; and public opinion was in general favorable. No adverse effects on business were reported.

Bank staff believe that this type of urban transport policy is an essential part of the "toolkit" of a modern transport planner and are disseminating the results widely. Already, a similar scheme has been included in a Bank loan for Kuala Lumpur, Malaysia, and one is being planned for Bangkok, Thailand. Bank loans to Brazil and Costa Rica include funds to study the applicability of the concept in those countries. In addition, preliminary reports have been used to assist urban transport planning discussions in London, Manila, and Nairobi.

At a more general level, Bank staff associated with the Singapore study have participated in an Organization for Economic Cooperation and Development working group on traffic limitation, using Singapore as an example, and in the Steering Group for a U.S. Department of Transportation program



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A conversation with Mr. Witteveen

Joseph J. Diana for F&D

Near the end of his five-year term as the fifth Managing Director of the Fund, Mr. H. Johannes Witteveen spoke with **Finance & Development** about his experience at the Fund and his view of the world economy. Here are selected excerpts from that conversation.

Q. Do you feel a sense of relief now that your responsibilities at the Fund are over?

A. Oh, certainly in one sense. It is a very heavy job with great responsibilities and an enormous amount of work. Of course, my feelings are also mixed with some regrets because I leave a very unique position. I have had great satisfaction in exercising my responsibilities through the full cooperation of the staff, Executive Directors, and governments. It has been a fascinating and very rewarding experience, but I think there is a time for everything and I look forward now to being free again.

Q. How would you characterize the job of the Managing Director—the role of the Managing Director in the world community and as part of the Fund mechanism?

A. What makes the job so fascinating—and is also one of its most essential elements—is the constant need to harmonize the differing views of governments as expressed in the Board by different Directors or in the Interim Committee by different Ministers of Finance. One of the crucial tasks of the Managing Director as Chairman of the Executive Board is to formulate the consensus at the end of a discussion. That is a very important function and one that makes Fund discussions much more effective than those in other international institutions. There is a readiness in our Executive Board often to accept a consensus without voting. It is important that we can vote, that we have majority rules; but it is just as important that, in practice, we very seldom vote. There is a willingness among the Directors to accept certain compromises and to recognize the task of the Chairman in formulating a compromise based on the consensus of the meeting.

Another important element is the final decision taken on important and difficult negotiations with member countries about Fund programs. In most cases, the Managing Director doesn't have to be involved very much in detail. The staff is very capable, and I get a briefing which I approve, and in most cases a successful negotiation can take place on that basis. But in some cases when there are difficulties, I have had to take final decisions and participate in final negotiations.

We also now have the Interim Committee. This has been very useful as a forum for policy discussion and has effected a strengthening of the Fund machinery. The Chairman of the Interim Committee plays a key role in formulating a consensus by agreement. Successive chairmen have done this very well. I have been very happy to cooperate with them—with Mr. Turner of Canada, Mr. De Clercq of Belgium, and Mr. Healey of Britain. Each of them has done an excellent job.

Q. How do you see the contribution of the staff in the Fund?

A. The role of the staff is much more important than the role of the Managing Director. I couldn't have done any of this without the support of the very good staff we have here. It is probably one of the most highly qualified staffs of any institution in this field. With this staff one is presented with a very clear analysis of the economic situation and economic problems both in individual countries and in the world economy in which these countries interact with each other. All negotiations with members are carried out by the staff. A staff mission of a few economists and a secretary can remain for weeks in a country where there are enormous tensions, very great problems, and where they are placed under enormous pressure by government officials because they know that much depends on the agreement with the Fund. In that situation, the staff members have to keep firm and to present the right mixture between an understanding of the country's problems that involves flexibility in the choice of corrective measures and a persistence to get the adjustment measures that are necessary. I think this is really very crucial work. In general, I have admired the way Fund missions have performed this task in spite of the great physical and mental strain.

Q. You took office in 1973 in a turbulent period. What did you think would be the major problems facing you as you think back on them?

A. At that time the Fund was still in the midst of the monetary reform exercise and I thought *that* would be the major problem on which I would have to concentrate at least in the early days. I also thought that another important element of the work would be negotiations with member countries to overcome their balance of payments (BOP) difficulties.

Q. What aspects of your work at the Fund have given you the most satisfaction?

A. Different aspects of the work are interrelated and have all given me satisfaction, but the greatest satisfaction perhaps has been that we could follow world economic developments so closely here. Even with the great changes and disturbances that occurred, policies could be adjusted in such a way that difficult problems could be overcome. I found it very satisfactory that we could do this. Another aspect of the work has been in negotiating changes in policy with members, and finally reaching agreement. The diplomatic aspects of this side of the work in trying to reach agreement among different groups of countries has given me great satisfaction.

Q. Could you look back over the past five years and tell us your experience with the practical side of economic interdependence in terms of several ideas: first, the coordination of national policies?

A. We have to recognize that, although this task remains difficult, it must remain a very important part of the work of the Fund. Of course, we do a lot about it. We have consultations with all member countries, which we discuss in the Board; and we also have general discussion on the world economic outlook, which have some influence. Where there are big differences of view among major countries, however, it remains very difficult to coordinate policy. In fact, one can say that the present flexibility of exchange rates is necessary precisely because there is only very limited coordination of policies.

Q. Secondly, the control of international liquidity?

A. That, I think, remains one of the most difficult problems, and one where we have not made any progress. Indeed the situation has even deteriorated since I came to the Fund. The present situation, which combines inconvertibility of the dollar with the growing role of uncontrolled offshore money and capital markets, really means that there is practically no deliberate, international control of world liquidity. It is also evident that such control will be very difficult to achieve.

Q. Thirdly, the availability of balance of payments finance for deficit countries?

A. This has been a much more satisfactory aspect of the world economic situation in recent years. In this period we have had to face very large payments imbalances. First there was the oil price increase that led to the large surplus of oil exporting countries and the complementary deficits of oil importing countries. More recently, large disequilibria between the major industrial countries have developed. As a result, very large deficits have had to be financed. Here, of course, the growing Euromarkets and offshore financial markets have played a very useful role.

The Fund has also played a more important role than formerly in providing balance of payments assistance, first through the oil facility and later through the liberalization of the compensatory financing facility. I hope this role will continue in the future with the activation of the supplementary financing facility. Greatly expanded possibilities of providing finance for countries with BOP deficits have thus arisen. In some cases, in fact, the expansion may have been too much—a number of countries have been able to postpone adjustments of their deficits for too long a time. In such cases, the problems have become more serious and are forcing some countries to face very difficult policy choices.

Q. What were your aims in proposing the supplementary financing, or "Witteveen," facility?

A. The proposal is related to what I have just been saying. Although in general many countries have made progress in adjusting to their balance of payments problems, some countries have postponed their adjustment effort. These countries have large and unsustainable deficits; the supplementary financing facility is meant to enable the Fund to assist these countries more effectively. By providing more financial assistance over a longer time period, it will make it easier for such countries to take the necessary measures. Nevertheless, in this facility we must recognize that the essential thing is for these adjustment measures *to be taken*, however politically difficult or unpopular they may be.

Q. How do you respond to the charge that this facility is essentially a mechanism for bailing out the commercial banks?

A. I think that is a mistaken criticism. We want to stimulate such countries to take measures to restore reasonable equilibrium in their economies and in their external accounts. That may, in time, also make it possible for them to repay outstanding loans; but our experience shows that they would also become eligible to borrow again from the banks—which they would not be able to do without the corrective measures. Suppose that countries with debt difficulties do not take corrective action and so are not able to repay the banks—I don't think that situation would be to anyone's advantage. Some people who talk about "bailing out" the banks create the impression that they hope that the banks would be faced with defaults! Again, I don't think this would be a very good thing for their depositors or for the world economy.

Q. What are your views about the growth of the Eurocurrency markets?

A. Despite the help such markets have given to individual countries in financing their deficits, I'm afraid that in the future they could be a danger. Such a large source of international liquidity which is quite uncontrolled means that there is a gap in our de-

fenses against inflation. That is a problem that gives me great concern.

Q. So, do you believe it necessary then to try to do something to control the growth?

A. I think it would be very desirable to develop some sort of control of these markets. I recognize that this is very difficult because it requires quite extensive cooperation between different monetary authorities in countries. But it seems to me that, just as in a domestic system, one can hardly control inflation without having some control of the money creation by the banking system, so, too, one must control world liquidity in order to influence world inflation. I think that governments will find out over time that, without any control of this growing and very important market, even their internal monetary policies will be weakened and undermined. And that important defense against inflation will become less and less effective.

Q. What essential steps need to be taken to make the SDR the principal reserve asset?

A. We certainly have a long way to go. In view of the very minimal quantity of SDRs that has been created until now, I think it must remain a long-term goal. However, one has difficulty in seeing a permanent monetary system based on the use of one individual currency as a reserve asset. It has certainly had its disadvantages. To move in that direction there is clearly a need to create more SDRs. But, if at the same time one doesn't wish to create surplus liquidity, one must also aim to reduce increases in holdings of reserve currencies. The Fund staff have been doing a lot of research on this and they have been able to show, I think rather convincingly, that allocation of SDRs should, in most cases, reduce the need of countries to borrow in capital markets in order to maintain their reserves at a required level or to bring them up to a required level. Accordingly, one could expect an allocation of SDRs generally to lead to a substitution of SDRs for reserve currencies, especially dollars. Nevertheless, one cannot be certain that this will always happen.

In the future, one might also hope for an arrangement whereby SDRs would have to be used in a certain proportion with other reserve assets in settling international balances. In that way, they could really become the *principal* reserve asset without necessarily having to be the *largest* one. One could then, by determining internationally the amount of SDRs issued, have a great influence on the total amount of international liquidity. That's the idea I suggested some time ago in my speech in Frankfurt. I still think it is a good idea but the world is not yet ready for it. It's something for the future, however.

Q. Why have you paid so much attention to the problems of world economic recovery and BOP adjustment in your speeches?

A. This has been one of the major problems in the world economy during the last few years. We have passed through different phases of world disequilibrium. In 1974, the increase in oil prices and resulting BOP disequilibria pushed the world into a serious recession and the major concerns were clear: reducing inflation and bringing about satisfactory recovery in the world economy. We have learned since, I think, that these two things are related: that one has to reduce inflation if one wishes to achieve a healthy recovery of the world economy. In addition, economic recovery is related to BOP adjustment. So long as there are large BOP deficits, one cannot really expect economies to recover.

Q. Did the problems of the developing countries take more or less of your time than the problems of the industrial countries?

A. I think that's very difficult to say, as I've never counted how many hours I've spent on one country or another. What I would say is that a very large part of my time was spent not on any particular group of countries but on the world economy as a whole—problems concerning the membership of the Fund as a whole. We don't have credit facilities for any particular group of countries. All the Fund's facilities are available for all member countries. I was of course very happy that, for example, the oil facility was extremely useful to the developing countries. A large number of these countries used that facility and it enabled them to face up to their problems. But industrial countries have also used our facilities. For example, negotiations with the United Kingdom and with other such countries with large deficits also took a good part of my time. Overall, my attention was probably fairly evenly divided among all members.

Q. How does protectionism impinge on the substance of the Fund's work and how is the Fund able to affect the current trend toward protectionism?

A. This is a very serious danger. We encounter it in many of our negotiations with member countries about programs to take care of their BOP difficulties. Very often the alternative to a Fund program is to fall back on restrictions on imports. We feel that this is always a great disadvantage for the country imposing restrictions and for its trading partners, because it would reduce world trade and therefore impede our efforts to get satisfactory world economic recovery. An important element in many of these negotiations is to persuade such countries that a much better way of tackling their economic problems is to restore equilibrium—to reduce the growth of spending more than that of national income, and perhaps to adjust exchange rates so that these countries' exports become more competitive in world markets and strengthen the balance of payments without creating unemployment. Such a policy alternative is much better both for the country itself and for the world community. Supporting such a policy has been an important element in many of our negotiations. In this way, I think, the Fund has been very helpful and effective in countering the tendency towards increased protectionism.

Q. Of course, it must be very difficult to persuade a country that it should act for the good of the world?

A. That's why I say it's also in the interest of the country itself. I have seen that restrictions very often seem the easy way out—whereas tax increases are always unpopular. Such a view is superficial because the restriction of imports creates *scarcities* and in that way pushes up prices. Moreover, it often creates very great opportunities for corruption among those who receive import licenses. Further, very often it affects production and employment adversely because no spare parts or new raw materials are available. I've seen so many cases of developing countries where one finds a lot of spare capacity just because spare parts or raw materials cannot be imported because they are restricted. Such a policy is really one of the major stumbling blocks to development.

In fact, I remember one case that gave me great satisfaction, the case of India in 1974 after the oil prices were raised. India used to rely greatly on import restrictions. When I visited that country for the very first time, I helped persuade them to change that policy, to liberalize imports and to use the oil facility of the Fund to finance the increased purchases. Indian officials have moved in that direction and we are all very gratified to see that the development of India since that time has been much more favorable.

Q. How do you personally react to criticisms of the Fund and its programs in countries?

A. Let me say two things about that. On the one hand, of course, it is understandable that the Fund's programs are criticized because in a situation where there is a large BOP deficit—which always involves national overspending—any measures taken to reduce that overspending are painful and unpopular. In that sense, one cannot expect anything but criticism of such a Fund program.

On the other hand, I do think that some of the criticism that is now being expressed is extremely shortsighted because the critics do not indicate any policy alternative. For example, I may read today in the paper about the situation in one member country where there are worries that Fund recommendations are leading to rioting in the streets. Such civil disturbances may then, perhaps, lead to the postponement of democratic elections. Our critics will then say, "All this is bad, so the Fund program is bad." I think such criticism is dishonest unless it also indicates what the alternative should be. If the member does not adopt corrective measures, the international community would have to stand ready to finance that country's BOP deficits indefinitely. I have not seen any indication from any one of the critics that there is any readiness to do that. If the international community is not willing to finance indefinitely such large BOP deficits, then the country has to adjust. As I said before, it would be much better if countries come to the Fund at an earlier stage when the deficit is not yet so serious; in that case, the adjustment measures need not be as draconian.

Q. You came to the Fund after you had been a professor of economics and also a government official. As you think back, has your experience led you to change your views about some of the international economic problems?

A. That is an interesting question. I do not think that I have had to change my economic views in any major way. Perhaps I have seen more clearly, as have a number of economists and politicians, that in many situations it may no longer be possible to increase employment by more government spending. To get a more healthy growth it may even be necessary to reduce government spending and to give more room to the private sector.

That is, I think, a feature that we have seen in a number of member countries, and at first sight it might seem to be a contradiction of Keynesian prescriptions. In reality, I think it is not. In the mixed economy, the private sector needs sufficient room to live, and to breathe, and to grow. That is a lesson that I have seen clearly.

Also, I've seen more clearly, although it involves no change in my views, problems created in many countries, and especially in developing countries, by policies that regulate prices and output in the economy too much in detail by controls. They don't work very well, and they lead to inefficiencies, corruption, and so on. I have observed this in so many cases where our staff has had to recommend some liberalization because the costs of these controls were so clear. And in most cases where governments have moved in that direction we have seen that the economy works much better. This is just one of the reasons why I've found my stay at the Fund so worthwhile. F&D

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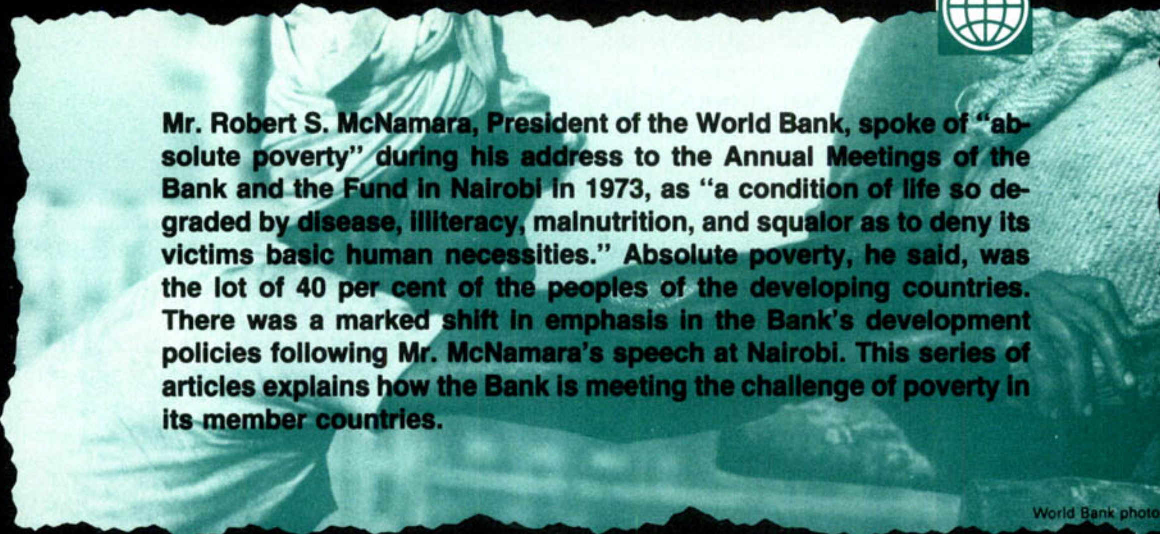
The Editor

The World Bank and the world's poorest: II



Mr. Robert S. McNamara, President of the World Bank, spoke of "absolute poverty" during his address to the Annual Meetings of the Bank and the Fund in Nairobi in 1973, as "a condition of life so degraded by disease, illiteracy, malnutrition, and squalor as to deny its victims basic human necessities." Absolute poverty, he said, was the lot of 40 per cent of the peoples of the developing countries. There was a marked shift in emphasis in the Bank's development policies following Mr. McNamara's speech at Nairobi. This series of articles explains how the Bank is meeting the challenge of poverty in its member countries.

World Bank photo

The Bank and urban poverty

In September 1975, Mr. McNamara outlined in his address to the Governors of the Bank at their Annual Meeting a major new undertaking for the Bank—a program to help national governments alleviate poverty in the rapidly growing cities of the developing countries. This article, the second in the series, sets out the background to this major effort, outlines the basic strategy that has been developed, and reports on progress to date.

Edward Jaycox

The reason why the Bank is undertaking a major offensive against urban poverty is readily understandable in the light of the realities faced by most less developed countries today. Over the past 25 years, the urban population of developing countries has increased at the unprecedented rate of close to 5 per cent per annum—nearly twice the rate of the overall population growth of these countries. Over 550 million people have been absorbed by the cities in the developing world in a single generation. Today these cities contain over 840 million persons, or about 28 per cent of their total population. About 25 per cent of the total population in Africa and South Asia lives in urban areas; the proportion rises to between 30 per cent and 40 per cent in East Asia and North Africa, and to nearly 60 per cent in Central and South America. So while the pace of urbanization over the past 25 years has been faster than ever before, the level of urbanization is still relatively low.

This makes the challenge of the future even greater. The United Nations estimates that by the year 2000 another 1.2 billion people will have to be absorbed by the existing and new cities of the developing world. Africa's urban population will triple. In Latin America urban dwellers will exceed 75 per cent of the total population. Except for the poorest countries of South Asia and Africa, at least half of the developing world will live in urban areas. About half these urban newcomers will come from natural population growth and the rest from migration to the cities from the rural areas. Most of these new city dwellers will be poor and unskilled. The resources available for accomodating this urban growth are, and will remain, severely limited. The pressures on these cities and national governments are already enormous and, by and large, the developing countries are not ready—in terms of attitudes, policies, management capacity, or ability to mobilize the financial and other resources required—for the task ahead.

The heart of the problem of urbanization lies in the rising numbers of the urban poor. If a city's population is growing at twice the national rate, the poor—in their illegal, unserviced squatter settlements, unemployed or underemployed in low productivity jobs—are typically growing at twice or three times the rate of the city's population as a whole. The Bank estimates that currently almost one third of the urban dwellers in the developing countries lack the incomes and therefore the consumption sufficient to maintain a productive life. Over 250 million of them lack reasonable access to minimal nutrition, safe water, minimal sanitation, and basic education and shelter. We also estimate that these numbers are growing by perhaps as much as between 15 and 18 million persons per annum, and that unless much more is done to alter present trends, by the year 2000 over 600 million urban dwellers will be found living in these deplorable conditions. The implications of this explosion of the urban poor for overall economic and social progress as well as for political stability are indeed stark. Appropriate national strategies to cope with this situation are generally lacking and overdue and must now be formulated in haste.

Population and rural development

Clearly any responsive strategy has to involve attempts to stem the overall rate of increase in population and to attack the backlog of inattention typically paid to rural development. These are major thrusts of the World Bank's operations and will be covered in later articles in this series. Only by significantly slowing population growth and increasing productivity in both urban and rural areas can any real gains be achieved in employment rates and per capita incomes for the very poor.

Even with much greater efforts in rural development, however, there are limits to what can be achieved. The amount of land that can realistically be brought under cul-

tivation in most countries is either quite limited or can only become productive at high and increasing costs—for clearance, infrastructure, irrigation, and settlement. Furthermore, even with greatly increased output per hectare, which assumes the continuing spread of technology, fundamental questions remain. How much labor can be productively absorbed in the development process? Can per capita rural incomes be raised to reasonable levels without a substantial exodus of people from the land? The problem is most dramatic in Asia. In the Philippines, for instance, assuming that agricultural productivity grows at 5 per cent per annum over the next 25 years (which would be an unprecedented feat) rural per capita incomes (now about $75) will probably not exceed $125 unless the urban areas absorb some 30 million people. To achieve $125 rural per capita income in Pakistan by the year 2000 will require nearly 6 per cent per annum real growth in farm productivity, plus a shift of over 40 million people from agriculture to dependence upon nonfarm employment. If the cities and towns cannot absorb and employ these people, then even these modest levels of rural income are not likely to be achieved.

As far as population planning is concerned, it is already too late to affect the immediate future. Persons who will join the labor force every year up to the mid-1990s have already been born. Clearly we cannot expect rural development or population planning to reduce significantly the pace or scale of urbanization in the remaining years of this century. Utter failure on these fronts would no doubt unnecessarily

aggravate the problems of increasing urbanization, but even rigorous and successful efforts will not resolve these problems in the near future.

The cities of the developing world, therefore, have an enormous if not overwhelming economic task to perform, assuming even the most favorable increases in rural productivity and decreases in human fertility. Effective national strategies will require not only continued gains in rural productivity and family planning but a very different and more efficient approach to urban development.

The Bank's program

The objective of any responsible urban strategy must be to increase the capacity of towns and cities to absorb the newcomers. Absorption means providing productive employment and essential services at basic levels for the unprecedented numbers of poor people who will inevitably dwell in urban areas. This may sound obvious, but for many national and city authorities, this formulation of objectives would involve a major shift in attitude, away from concern for the preservation of unrealistically high urban standards, and toward a concern for the national economy and the efficient inclusion of the urban newcomers in the development process.

The World Bank's urban poverty program, therefore, has two complementary thrusts: (1) to create productive nonfarm employment opportunities at much lower capital costs per job and in much greater numbers than would take place otherwise; and (2) to develop programs to deliver basic services to the masses of urban poor on a very large scale, at standards which they and the economy can afford. The emphasis on low capital investment per job and low-cost standard services affordable by poor households is the key to the program. The basic concept is to spread a larger proportion of the available capital over a larger number of people, so that the poor gain access to some minimal level of individual productivity and to essential services they can afford to pay for. This emphasis on affordability is to ensure that these programs are financially replicable on the large scale that is needed and that unnecessary subsidies are minimized.

The program encompasses not only Bank lending for projects and programs that advance these purposes, but, more importantly, it is intended to eventually influence national policy frameworks that would have far wider effects than any projects the Bank might help to finance.

In order to make the Bank's urban poverty program operational, a continuing priority has been to refine and deepen our understanding of the nature and extent of urban poverty in specific countries. The statistical information necessary for a sound analysis of urban poverty and appropriate interventions is lacking for most countries. There is a general need to improve this data base, to "map" urban poverty in terms of employment, income, consumption of basic needs, and physical location. This work is now a part of the routine country economic analysis done by Bank staff.

The country economic work of the Bank is also beginning to focus increasingly on questions of demographic, employment, and income distribution trends, and to examine implicit and explicit national strategies with respect to these trends. In this work, the complementary relationships between urbanization and rural development, and the policy variables that are important for managing equitable growth are being explored. Special studies have been launched in a number of countries where urbanization and urban poverty problems are particularly severe.

This economic work, together with special studies of particular sectors or issues, is intended not only to provide guidance for project selection and design, but more importantly to provide a sound basis for policy dialogues within governments and between the Bank and its borrowers.

The sectors of Bank lending which have the greatest potential to create employment and provide services to the urban poor are small-scale, labor-intensive enterprises, integrated urban projects (community development, slum upgrading, and serviced sites for shelter), water supply and sanitation, education, and health, nutrition, and family planning. The Bank's operations within each of these sectors have been examined in detail to illuminate the potential beneficial impact of our lending on the productivity and welfare of the urban poor. Prototypical projects are being developed in each sector. The performances of these "new style" projects are being monitored to ensure that the experience is accumulated and can be synthesized for further development of project designs.

Giuseppe Franchini for F&D

Edward Jaycox

a citizen of the United States, has been a Bank staff member since 1964, serving as a loan officer, country economist, and project economist. Since 1969, he has been Chief of the Railways Projects Division, Director of the Transportation Department, and is currently the Director of the Urban Projects Department, and Chairman of the Urban Poverty Task Group. Mr. Jaycox is a graduate of Yale University and of the School of International Affairs and the Institute of African Studies of Columbia University (U.S.A.).

Labor-intensive production

The generation of nonfarm employment opportunities at low capital cost is a major component of the urban poverty program and probably the most difficult to achieve. Most developing countries have very little capital available for investment relative to the number of people that need employment. In most countries the gap between the average amount of capital available per work place (job) and the average cost per work place in the modern nonfarm sector is enormous. Scarce capital is being concentrated on a relatively few workers, increasing their productivity greatly, but leaving most of the work force without access to capital and with very low productivity.

The Bank's traditional operations in manufacturing and mining adhere to this general pattern. In heavy industry, work places financed by the Bank have cost well over an average of $100,000 each, whereas in the average operation financed by the Bank through local intermediary development finance companies work places have cost about $25,000. The average capital available, however, for each work place needed is $1,000 in India, $1,800 in Kenya, and $13,000 in Mexico. This is not to say that the traditional projects are not economically justified; all indications are that this lending has been highly justified and has used capital sparingly relative to the manufacturing process being financed. However, it does mean that for the Bank to be involved in large-scale employment generation at appropriate costs per job created, it must find ways of reaching the poor directly in areas that it has hitherto not touched—such as service enterprises, small-scale operations, the self-employed, artisans, and cottage industries. It also means that the Bank, in many instances, must help its established intermediaries develop new modes of operation or must find new kinds of intermediaries—commercial banks, cooperatives, credit unions—capable of reaching borrowers at the "grass roots" or "curb side."

Many borrowing countries, too, lack experience in directly assisting their low-capital, small-scale sector. Basic policy deci-

sions to redirect investment have not been made and the capacity to implement programs often does not exist. In many countries, the policies and institutions are even hostile to the small-scale, labor-absorptive operations to which the Bank is now turning attention.

The typical "urban poverty project"—defined as such by virtue of its performance in employment creation—is one which creates employment at less than the national average amount of capital available per work place. This "new style" project is essentially labor-intensive, but nevertheless fully justified in economic and financial terms. It is typically financed through intermediaries, often at two levels: one national and one very local. It includes a technical assistance or "urban extension" service, either financed and managed by the financial intermediaries or separately organized. The loan to the beneficiary bears a real positive interest rate reflecting the opportunity cost of capital and ensuring that employment is not reduced by subsidized capital. There is heavy emphasis on the strengthening of intermediary institutions and the development of a policy environment conducive to appropriately labor-intensive production technology. The project is carefully monitored for its actual impact. In 1977 the Bank financed about a dozen projects containing components with these essential characteristics. There were over 90 under preparation at that time. By 1981 the Bank aims to lend over $400 million per annum (in 1978 dollars) for such projects.

Integrated urban projects

The aim of these projects is to give security of residence and access to basic services to the very large numbers of urban poor who already live or will otherwise live in unserviced, illegal settlements. Essentially there are two types of integrated urban projects: the upgrading of existing slum and squatter settlements and the creation of serviced sites for additional low-income residence. Most often the projects contain elements of both types. Each project is, of necessity, tailor-made to the specific problems, needs, and institutional environment of each borrower. However, these projects have certain common characteristics. Their emphasis is on self-help, and they supply public finance only for those services that people cannot provide for themselves. The design of the service levels and layouts of these communities is based on what the residents can afford, given reasonable access to longer-term credit. Since we are talking of very poor people, the service levels are very low by international standards and executing the projects often requires abandoning existing unrealistic building and zoning codes. Upgrading is accomplished with an absolute minimum of relocation. New sites are selected on the basis of their access to employment centers.

The integrated urban projects attempt to cover those aspects of the community development that are critical to the productivity, health, and welfare of the people. Education, vocational training, nutrition, family planning, small business credit, and technical assistance elements are commonly included as integral parts of the project. Each project is aimed at initiating or promoting a long-term program. Great emphasis is placed on whether the project can be duplicated on a scale commensurate with the size of the problem. If not, it cannot meet the Bank's lending criteria, which rule out support of the unsustainable, highly subsidized "showcase" project. Self-financing through recovery of full costs from the beneficiaries not only helps to assure the ability to duplicate a project but also maintains discipline over design standards and costs. Because the beneficiaries are expected to pay the costs, it often becomes not only desirable but essential that they participate in the decisions in planning and implementing the project.

The Bank has now financed 35 of these integrated urban projects in 25 countries. Up to now they have been the major component of the urban poverty program. Over 70 of these projects are under preparation, many of them "repeater" projects in countries where previous projects have been successfully implemented. By 1980 the Bank aims to lend about $600 million per annum (in 1978 dollars) for integrated urban projects benefiting at least 5 million persons per annum (equivalent to about one third the annual increase in squatter population). Each of the basic urbanization projects is being carefully monitored to allow in-depth, ex-post evaluation and feedback to new projects.

Sector approaches

Quite apart from the water and waste disposal components in integrated urban projects, and more important in terms of dollars invested and people served, are the "new style" projects which address the water and sanitation needs of the poor on a city-wide or national basis. Typically, these projects involve public standpipes and communal washing and toilet facilities or pit latrine building programs. They involve appropriate integration of this part of the system with, and the development of, the needed trunk and source or treatment facilities. These projects require imaginative thinking about systems design, cost recovery methods, pricing strategies, and coordination with urban development programs.

Nearly all the urban-located water and sewerage lending of the Bank involves important direct benefits to the urban poor. The aim is to increase these benefits to overcome the backlog of inattention to the poor and keep pace with their growing numbers.

In 1977 it was estimated that about $130 million lent for water supply and sanitation provided direct benefits to the urban poor. By 1981 this is expected to rise to $350 million.

While school enrollment ratios in urban areas are typically much higher than those in rural areas, these averages mask marked educational disadvantages for the urban poor, who usually have about the same lack of access to education as their rural counterparts. "New style" education projects are being developed to directly benefit the urban poor. These projects increasingly emphasize nonformal education, functional literacy, primary schooling, vocational training, and adult education. More attention is now being paid to the location of schools within the low-income neighborhoods and to encouraging the demand for basic education and skill development.

There is a great deal of evidence that in many countries the health and nutrition status of the poor in urban areas is inferior to that of the rural poor, due to unsanitary crowded conditions, lack of access to proper and adequate food, less breast-feeding of infants, and generally higher costs of living. Also with heavy migration by the young, the fertility of the urban population is often increasing. The main health, nutrition, and family planning aspects of the urban poverty program have up to now been mainly addressed through components within integrated urban projects, but sectoral approaches to these problem areas are planned for the future.

Overall target

The overall target for Bank lending to combat urban poverty is that by FY1980 at least one third of all urban-related lending will provide *direct* benefits to the poverty group. This proportion roughly corresponds to the proportion of the poor in the total urban populations of the developing world and would involve a substantial gain for the poor above their normal share of benefits from public investments. However, the target is essentially arbitrary to challenge the Bank itself to make the breakthroughs in design, to take the initiatives, and to change its own comparative advantages to be able to help its borrowers with this high priority work.

The resurgence of protectionism

From a study by the Fund's Trade and Payments Division, under the direction of **Bahram Nowzad,** of the protectionist trade actions taken in recent years by major industrial countries.

The postwar trend in international trade has been toward an increasingly more liberal system. However, many countries have, in recent years (and particularly since 1974), been demonstrating a shift in the opposite direction. Although it is difficult to quantify the net effect on world trade of the trade actions adopted recently, the evidence indicates that it has been relatively limited. Nevertheless, the recent shift away from liberalization is a cause for serious concern.

The general argument against protectionist trade measures is that they provide no real solution to the underlying problems of the protected industry—indeed, they may compound the difficulty of finding long-lasting solutions—and that they ignore the more fundamental reasons why domestic industries may be losing ground to foreign competition. The immediate impact of a protective measure—whether in the form of increased customs tariffs or other import charges, import quotas, or tariff quotas—is an increase in the price of the imported goods in the market of the importing country. This increase gives the domestic producers of the import-competing product a relative price edge that may be sufficient to stimulate domestic sales or, at the very least, to protect their share of the market. In turn, this may benefit labor employed in the protected industry by preventing layoffs, or increase the return on shareholders' equity in the protected firms.

Protection also brings increased costs, however, which are ultimately borne by the economy as a whole. First, the prices of goods rise on the domestic market; this cost is paid by consumers. Second, protection means that relatively inefficient industries are able to hold or attract resources, while the economy forgoes the higher level of income and employment that would have gone to more efficient industries in the absence of protection. Protectionist measures, moreover, once adopted, tend to become entrenched as the sectors that benefit develop a vested interest in preventing their removal. For a major intermediate goods industry, such as steel, the higher costs are likely to be transmitted throughout the economy in the form of higher prices for the products, such as automobiles and construction materials. Furthermore, the inflationary impact of import restrictions on products such as steel is likely to have an immediate adverse effect on steel-using products, resulting in demands for additional protection against foreign competitors in the affected industries and/or affecting exports adversely.

Trade restrictions also have direct adverse effects on the exporting country, whether it is developed or developing. They reduce access to foreign markets, impinge on the exporter's ability to share fully in the benefits of increased international trade, and thus also affect the exporting country's willingness to assure foreign suppliers access to its own market. The effects of protectionist measures are likely to be especially serious on developing countries, which depend on a relatively small volume of trade in a still relatively narrow range of products. Thus, measures with a seemingly minor impact from the developed country's point of view can have serious consequences for the developing country's exports. Furthermore, most developing countries faced by reduced access to certain foreign markets may encounter difficulties in finding substitute outlets for their exports, especially in the short run. Such substitution possibilities are often limited by the nature of the export product (which may be specifically designed for certain markets), and by the historical and cultural ties that often determine the direction of their trade. Even if such substitution possibilities exist, the process is often slow and costly, and exporters may fear that redirection of sales may itself provide restrictions in the new markets.

The historical setting

In contrast to the extensive pattern of trade barriers erected in the 1930s, the years following World War II have generally shown a progressive movement toward a liberal world trading system. This process, which began with a series of conferences convened in 1944–48 at the initiative of the United States, culminated in the coming into force of the General Agreement on Tariffs and Trade (GATT). The GATT was based on the premise that international cooperation, an agreed code of conduct, and a stable framework were essential to prevent the pursuit of narrow national interests that could lead to the escalation of trade restrictions and eventually to a fall in the level of trade. The GATT thus represented a major step toward replacing the chaotic trade relations characteristic of the interwar era with a system founded on reciprocity and nondiscrimination, a set of ground rules for the conduct of international trade, and a mechanism for further trade liberalization.

Since then, barriers to trade have been successively reduced in six rounds of multilateral trade negotiations ending with the Kennedy Round (1963–67). By the end of the Kennedy Round, the weighted average tariff for the major trading nations had been reduced to 7.7 per cent on all industrial products, 9.8 per cent on finished manufactured products, 8 per cent on semifinished products, and 2 per cent on raw materials. In spite of the remaining restrictions—such as those applied to much of the agricultural sector (which had generally escaped the liberalizing trend), the remaining tariffs on industrial goods and raw materials, and a variety of nontariff barriers—trade in industrial products after the completion of the Kennedy Round was substantially free of restrictions. Internationally negotiated and "bound" tariffs applied to the bulk of world trade, and a considerable degree of certainty and stability existed regarding the general conditions for international trade. The postwar movement toward liberalism in trade, complemented by a stable monetary framework, fostered an unprecedented rise in international trade, which increased more than sixfold between 1948 and 1973.

Against this background, there has been a retreat from the liberal trading system in recent years. It may seem somewhat paradoxical that this development has coincided with new international efforts to liberalize trade and to improve the rules for world trade in the context of the Tokyo Round of Multilateral Trade Negotiations, formally launched in September 1973 and pursued intensively since early 1975. But, in fact, the agreement of major trading nations to enter into a new round of negotiations was motivated in part by fears of a major lapse into protectionism. Following

the breakdown of the 1971 Smithsonian agreement on exchange rates, there was considerable concern that in the absence of effective rules on exchange arrangements during a period of widespread balance of payments problems, countries might resort to trade restrictions. These fears were sharpened in the wake of the external adjustment problems related to the oil crisis in 1973 and the onset of the worldwide recession in 1974. (See Table 1 for the effects of the recession on world output and trade.)

Trade actions taken

While various types of restrictive trade action have been taken by a large number of countries in recent years, this article focuses on the causes and implications of the more important measures adopted by the principal industrial nations that are also major world traders—on the grounds that the trade actions of these countries have the greatest impact on international trade. The review on which this article is based covered the restrictive trade actions taken by Canada, the European Economic Community (EEC), Japan, and the United States, which collectively represent about 60 per cent of total world imports. Although the bulk of world trade is effected between these countries, many smaller countries—especially developing countries—are highly dependent on their exports to these markets.

While a selective approach was adopted toward country coverage, it is important to recognize that the problems of restrictive trade actions and their impact are much broader than the findings might imply. First, there is considerable evidence of restrictive trade actions taken during the period under review by industrial countries other than those covered in the survey. Second, trade restrictions have also been adopted by many developing countries, including some that are relatively more developed and whose actions have an important impact on the trade of other developing countries.

The study of the trade measures taken by major industrial countries showed that so far such actions have tended to be concentrated in certain industrial sectors, such as textiles, clothing, footwear, steel, shipbuilding, and a variety of other manufactured products, especially electrical consumer goods. A number of other products, in particular beef, have also been affected by recent measures. Although these actions—particularly the measures on steel—have had an effect on trade among the industrial countries of North America and Western Europe, their main impact has fallen on exports originating in Japan and a number of developing countries. More generally, the trade actions adopted have affected sectors in which many developing and primary producing countries have an actual or potential comparative advantage, and where the proliferation of restrictions can seriously jeopardize their scope for export expansion and economic growth.

Various types of trade action have been used recently by the countries surveyed. There has been increasing resort to "escape clause" actions (to protect domestic industries against injury from imports), although the GATT escape clause provisions themselves have been invoked relatively infrequently. Antidumping and countervailing duties have been used with increasing frequency. In this connection, particularly significant is the adoption in December 1977 by the United States and the EEC of minimum prices for steel imports, and the announced intention of the latter to negotiate bilateral agreements with suppliers. Increasing use of nontariff measures (such as health and quality standards) that may have the effect of impeding imports is also evident in some industrial countries. Another important development is the increased reliance on various types of bilateral arrangements that quantitatively limit trade and often remain outside existing international rules, thus escaping multilateral surveillance.

Antidumping and countervailing duty actions are considered a legitimate form of protective reaction against actions taken by other countries (see box). In times of depressed demand, as competition for a smaller volume of available orders heightens, it is possible that in some instances exports may be subsidized or sold below domestic prices or cost. There is, however, considerable controversy as to what is protection and what constitutes dumping or subsidization and how the degree of dumping and subsidization should be determined. An important question, therefore, is whether antidumping and countervailing duties are being used to counteract dumped or subsidized exports, or whether they have the effect of disguised protectionism.

Employment crucial factor

Many factors, both structural and cyclical, seem to underlie the resurgence of protectionist sentiments and the increasing

Table 1

Growth of real output in the industrial countries and the volume of world trade, 1962–77

(In per cent)

	Average,[1] 1962–72	1973	1974	1975	1976	1977
Real output of the industrial countries						
Real GNP	4.6	6.0	0.1	−0.9	5.4	3.9
Industrial production	5.8	7.4	0.8	−7.6	9.3	2.4
Volume of world trade						
Imports by the industrial countries	9.5	12.3	1.3	−7.5	14.6	4.9
Imports by all areas, except centrally planned economies	9.0	13.5	4.6	−4.9	12.3	5.4

Sources: National reports and Fund staff estimates.
[1]Compound annual rates of change.

willingness of governments to adopt trade-restrictive actions even while reiterating their basic commitment to an open and liberal trading system. The Fund staff study led to the conclusion that the issue is complex, that a multiplicity of factors—economic and social—are at work, and that explanation must be sought in terms of their interaction.

Some of the longer-term factors underlying recent protectionist actions have been present for some time. These include the growing structural problems of industrial countries in a number of sectors associated with shifts in the pattern of world consumption and production, the failure of relative wages to reflect wide divergences in the rates of growth of productivity and thus to encourage intersectoral labor shifts, large additions to productive capacity in certain sectors, and the increasing competitiveness of imports from Japan and a number of developing countries. The favorable economic conditions that prevailed throughout much of the postwar period, while affording an opportunity to address some of these problems, also tended to mitigate or veil their seriousness.

The exceptionally severe and tenacious worldwide recession of 1974–75, however, brought in its wake a surge of protectionist actions. In particular, recent experience suggests that perhaps the most crucial factor—and the one most likely to influence policy choices toward protection—is the extent and duration of unemployment, at the global or sectoral level, or the threat of increased unemployment (see Table 2). In a period of high unemployment (such as that following the onset of the recession in 1974), especially when it occurs in sectors open to competition from imports, the de-

The framework of world trade

The economic, legal, and institutional framework within which most international trade takes place is contained in the General Agreement on Tariffs and Trade (GATT). Its most fundamental component is a negotiated balance of mutual tariff concessions among contracting parties which commit themselves not to raise import tariffs above the negotiated rates "bound" in the schedules of concessions annexed to the General Agreement. (Countries applying the General Agreement are referred to as contracting parties to the GATT.) The bound tariff rates negotiated are generalized to all contracting parties through the most-favored-nation principle. While aiming at "developing the full use of the resources of the world and expanding the production and exchange of goods," the General Agreement does not explicitly envision total liberalization of all tariff and nontariff trade barriers; instead, it emphasizes "reciprocal" and "mutually advantageous" arrangements among contracting parties. Thus, the present world trading order accepts protection of domestic industries through the use of tariffs; however, any increase in bound tariffs is subject to certain well-defined safeguards that ensure that the legitimate interests of other trading nations are not adversely affected.

The General Agreement also contains provisions prohibiting or limiting the use of nontariff barriers to trade. These provisions include some exceptions but only for reasons not directly related to the need to afford protection to local industry. Although quantitative import restrictions on industrial products have been substantially liberalized since the inception of the GATT, lowering of other nontariff barriers has proved more difficult. Even the identification of such barriers is sometimes a complex matter, and trading nations frequently have different views on whether a particular practice represents a legitimate domestic measure or a form of protection in its intent or application.

In order to provide safeguards against injurious import competition, the General Agreement authorizes the importing country to suspend temporarily or to reverse its trade liberalization policy in certain narrowly circumscribed situations. If, as a result of unforeseen developments and the effect of the trade liberalization obligations incurred by an importing country under the GATT, increased imports of a product cause or threaten to cause serious injury to domestic industry, the country may introduce as an "escape clause action," tariff or nontariff restrictions on such imports "for such time as may be necessary" to remedy the problem. In the past, GATT members have invoked the "escape clause" provisions relatively infrequently, although analogous "escape clause" actions, under national or regional legislations and without invoking the GATT provisions, have been utilized more often.

The General Agreement also contains provisions that authorize importing countries to take compensating action against trading partners found to be dumping goods in their markets or increasing sales through subsidization of their exports. On the occasion of dumping, the importing country may impose antidumping duties whenever and to the extent that the sale of imported goods takes place in the importing country's market at less than its "normal value" and results in material injury to the domestic industry. In an analogous fashion, the General Agreement also authorizes an importing country to impose offsetting countervailing duties on goods benefiting from production or export subsidies in the exporting country, when these result in material injury to the domestic industry. In both cases, the fundamental objective is to provide legal grounds for affected countries to take offsetting measures when threatened by dumping or subsidization. However, the antidumping or countervailing duties that are considered as being consistent with the General Agreement should not result in net additional protection of the affected industry in the importing country, since these duties are not to be imposed at rates higher than would be necessary to offset the margins of dumping or subsidization.

In practice, the effectiveness of procedures for justification of restrictive measures under GATT rules often depends to a considerable extent on the policy stance of the restricting country and of the affected country. In the absence of voluntary recourse to GATT provisions by these countries, or protests by third countries whose interests may also be adversely affected (for example, by the diversion of exports from the traditional trading partners to third markets), trade restrictive actions may not come formally to the notice of the GATT. Although eventually some of these "extralegal" actions may be brought within the purview of the GATT in subsequent trade negotiations, at any given moment countries apply a variety of trade restrictions, some of which remain outside multilateral surveillance. Accordingly, over the years, the need to strengthen the GATT framework has come to be increasingly recognized.

mand for the authorities to take action may become politically difficult to resist. The case for affirmative government action may appear all the more compelling if the affected industry is heavily concentrated in certain regions, thus making the economic well-being of those regions dependent on the maintenance of activity in that industry. These difficulties have been exacerbated where large additions to capacity from previous investment came on-stream at the very time that demand began to stagnate. With slackening demand, pressures may have multiplied to increase exports and import substitution to maintain profits and employment.

One of the most frequently cited arguments for trade restrictions is related to import penetration—that is, imports as a proportion of domestic consumption (see Table 3). If this ratio rises suddenly, the suggestion is often made that imports have disrupted markets, injured domestic industry, and caused unemployment. There seems little doubt that in some product

Table 2

Selected OECD countries: unemployment rates, 1970 –77[1]

(In per cent)

	1970	1971	1972	1973	1974	1975	1976	1977
Canada	5.7	6.2	6.2	5.6	5.4	6.9	7.2	8.1
United States	4.9	5.9	5.6	4.9	5.6	8.5	7.7	7.0
Japan	1.1	1.2	1.4	1.3	1.4	1.9	2.0	2.0
Belgium	1.9	1.8	2.2	2.3	2.4	4.3	5.7	6.3
Denmark	1.5	1.8	1.7	1.1	2.5	6.0	6.1	7.3
France	2.4	2.6	2.7	2.6	2.8	4.0	4.4	5.1
Germany, Fed. Rep.	0.7	0.9	1.1	1.3	2.6	4.7	4.6	4.5
Ireland	7.2	7.2	8.1	7.2	7.9	12.2	12.3	11.8
Italy	3.1	3.1	3.6	3.5	2.9	3.3	3.7	4.3[2]
Netherlands	0.9	1.3	2.3	2.3	2.8	4.0	4.3	4.2
United Kingdom	2.6	3.4	3.7	2.6	2.6	3.9	5.4	5.8

Source: National statistical records.
[1]The data are based on labor force sample surveys (Canada, Italy, Japan, and the United States), unemployment office statistics (Belgium, France, the Federal Republic of Germany, the Netherlands, and the United Kingdom), unemployment insurance statistics (Ireland), and trade union benefit statistics (Denmark).
[2]Fund staff estimate.

Table 3

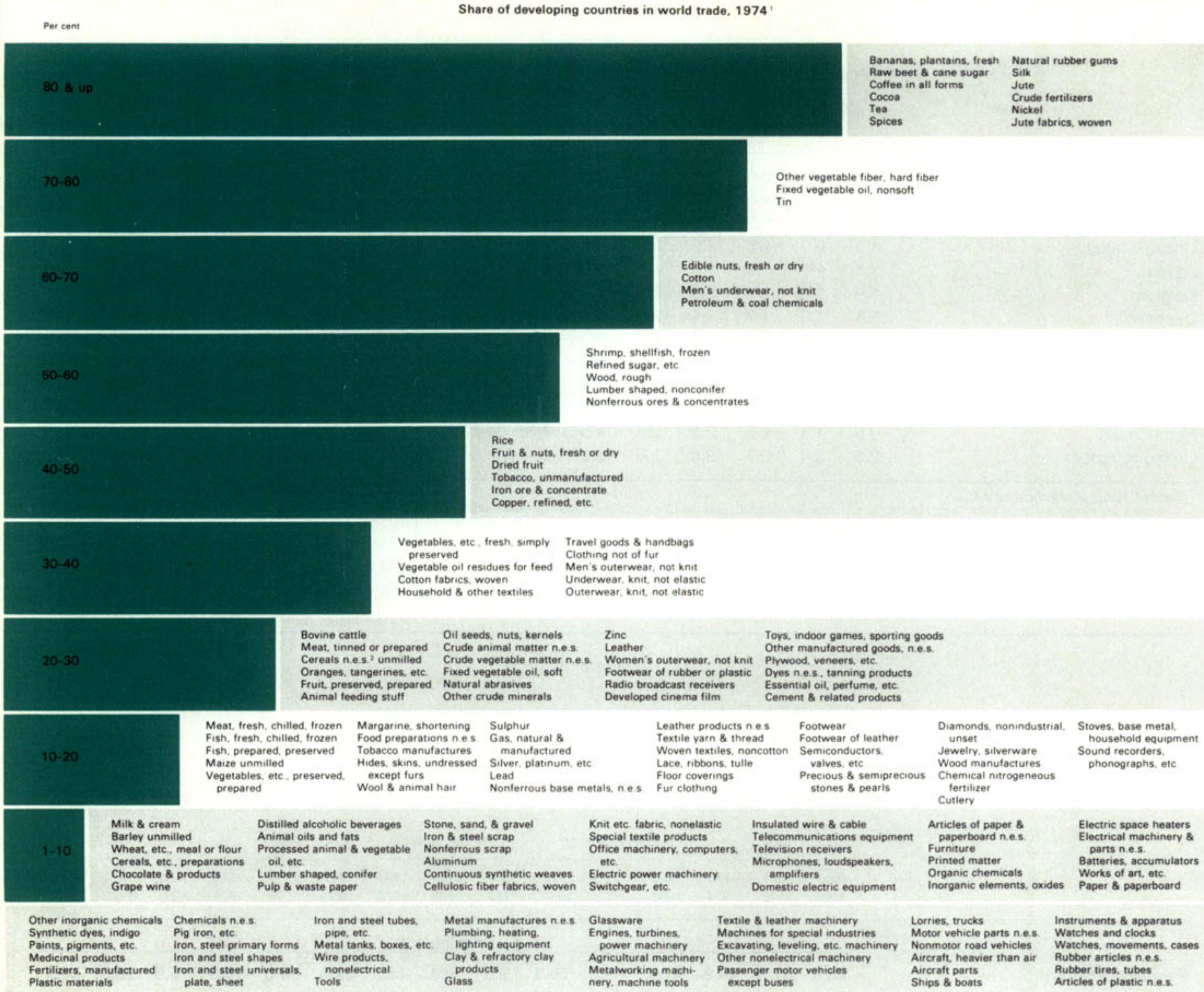
Selected industrial countries: import penetration ratios[1]

(In per cent)

	EEC[2]			United Kingdom			United States			Japan			Total		
	1959-1960	1971-1972	1973-1974	1959-1960	1971-1972	1973-1974	1959-1960	1971-1972	1973-1974	1959-1960	1971-1972	1973-1974	1959-1960	1971-1972	1973-1974
	Total imports														
Primary products	**28.0**	**31.5**	**40.8**	**41.8**	**49.9**	**60.8**	**9.3**	**9.3**	**14.2**	**23.8**	**34.0**	**33.8**	**16.6**	**20.5**	**26.5**
Of which:															
Agriculture	23.6	18.4	21.2	42.3	33.6	35.9	8.4	6.7	6.3	18.0	19.2	16.3	14.5	11.7	11.1
Coal, crude petroleum, natural gas	36.4	63.3	75.5	28.8	55.7	77.9	6.5	10.5	27.8	49.2	83.7	91.7	16.9	36.8	56.9
Other mining and quarrying	54.5	70.2	72.3	83.4	156.5	188.1	24.8	27.4	32.2	52.2	80.8	79.1	34.1	52.6	58.9
Manufactures	**7.6**	**8.7**	**10.9**	**17.1**	**23.1**	**31.2**	**3.3**	**6.6**	**8.1**	**6.0**	**5.6**	**7.1**	**3.4**	**4.4**	**5.8**
Of which:															
Textiles	6.1	10.5	14.1	14.0	26.8	34.6	5.5	9.4	8.7	1.1	9.0	12.7	3.0	7.5	9.8
Clothing	2.4	8.2	12.9	9.5	21.9	30.3	3.5	12.6	13.4	1.4	8.4	17.0	1.7	8.2	11.8
Ferrous and nonferrous metal	14.5	16.6	18.2	23.4	31.7	43.5	6.0	11.3	12.7	17.9	11.5	14.7	6.9	9.1	10.6
	Imports from developing countries[3]														
Primary products	**16.4**	**20.2**	**28.7**	**21.4**	**22.2**	**31.5**	**6.6**	**5.3**	**9.5**	**12.9**	**18.0**	**20.1**	**11.6**	**13.7**	**19.5**
Of which:															
Agriculture	12.3	8.2	9.4	16.9	9.9	10.1	6.3	4.8	4.5	7.8	7.0	5.4	9.4	6.7	6.5
Coal, crude petroleum, natural gas	30.8	58.1	70.1	28.3	50.0	70.4	5.7	5.4	19.9	37.7	63.9	76.5	15.9	31.9	50.7
Other mining and quarrying	22.3	24.9	27.4	36.0	18.4	22.1	12.2	10.4	13.5	35.4	38.6	36.9	19.3	21.2	24.7
Manufactures	**1.5**	**1.3**	**1.8**	**3.6**	**2.3**	**3.6**	**0.7**	**1.2**	**2.0**	**1.2**	**1.1**	**1.8**	**1.2**	**1.3**	**2.0**
Of which:															
Textiles	0.9	2.3	3.5	5.2	5.2	6.4	1.6	2.8	3.3	0.1	1.6	3.1	1.6	2.6	3.6
Clothing	0.6	2.8	4.7	3.9	8.8	11.7	0.8	4.4	5.8	0.7	3.5	8.6	1.0	4.1	6.0
Ferrous and nonferrous metal	5.0	4.9	5.5	6.6	5.5	7.1	1.0	1.5	2.1	4.3	4.7	5.2	2.9	3.2	4.0

Source: UNCTAD, *Handbook of International Trade and Development Statistics, 1976.*
[1]*The import figures used in the computation of the import penetration ratio for the European Economic Community (EEC) exclude intra-EEC trade. Similarly, for the three "total" columns,* the import figures are defined to exclude trade between the EEC, the United Kingdom, the United States, and Japan. Percentages shown are in value terms.
[2]Original six members only.
[3]Including oil exporting countries.

Share of developing countries in world trade, 1974[1]



Source: U.N. Trade Tapes.
[1] Excluding centrally planned economies. The United Nations data on developing countries exclude the Republic of China and Yugoslavia as well as other European countries, but include Turkey.
[2] Not elsewhere specified.

lines, a sudden surge of imports, at times caused by a concentrated marketing effort, has created difficulties. From an economic point of view, however, the ratio of imports to domestic consumption or production is not by itself meaningful. Such ratios may be high or low, depending on a number of factors including resource endowment, technological change, and the degree of specialization. Traditionally, import-penetration ratios in industrial countries have been high for some agricultural products and raw materials but, except for a few specific items, relatively low for manufactured goods. Moreover, in view of the constantly evolving patterns of comparative advantage, the freezing of such ratios, or the setting of upper limits that would result from the current preoccupation with import penetration, would effectively prevent the realization of the additional gains that would result from increased specialization in production and trade.

A significant new development is the diversification of the export base of developing countries and the challenge that they present in a number of new sectors. This development has some notable features. First, industries that manufacture some of the newer products (in particular, steel, ships, and electronics) have been built up in some developing countries mainly for the export market, whereas in some of the more traditional export lines (such as textiles, clothing, footwear, and a number of other consumer products), such countries succeeded first in capturing their domestic markets before moving to compete in third markets and in the markets of the countries from which they had previously imported. Second, the coming on-stream of manufactured exports from many developing countries was a predictable consequence of earlier investments in the industrial sphere carried out at the urging—and frequently with the financial, technical, and managerial encouragement—of industrial countries. Indeed, it has been made progressively easier for many developing countries to overcome some of the traditional obstacles to industrialization, such as a lack of financial resources, a dearth of managerial talent, and the absence of a technologically oriented labor force. In certain sectors, such as electronics, the activities of transnational corporations and the establishment of subsidiaries have actively promoted the process of industrialization. Third, the growth of export capacity in the developing countries has also meant the growth of their import capacity, and, except for some oil producing developing countries, the latter has normally exceeded the former.

Thus, while increased import competition from developing countries may have caused difficulties for certain sectors in the industrialized countries, it has also enabled other sectors to expand.

Pressures will continue

The pressure for structural adjustment in industrial countries arising from the competition of imports from developing countries—which, to date, are significant in a relatively narrow but expanding band of products—can be expected to increase in coming years. The extent of the necessary readjustment will be further increased by other factors, in particular, normal changes in technology and competition in domestic and external markets from sources within the industrialized countries themselves. As a result, it will become more difficult to maintain liberal trade and high levels of employment with unchanged wage levels and profitability in affected sectors; hence, significant improvements in the process of structural adjustment in industrial countries will be essential if protectionist pressures are to be reduced.

But the process of structural adjustment faces certain impediments, and the success of programs of adjustment—whether by firms or government sponsored—depends to a large extent on the severity of these obstacles. In particular, the reallocation of resources is a slow and often costly process and one that often meets with considerable resistance from both industry and trade unions, since the gains from alternative use of resources are not perceived as such by the affected groups and economic stimuli are not sufficient. Also, it is often difficult to readapt or relocate the work force in the affected industry, since the sectors most seriously affected often employ a higher share of older, or other relatively less mobile, workers than industry as a whole. This problem is compounded where there are concentrations of unskilled labor—frequently the group that is in jeopardy—in particular regions. It must also be noted that it is considerably easier to achieve structural adjustment in a buoyant economy than when sluggish economic conditions prevail: in a vigorous economy, labor mobility is greater than in one characterized by high unemployment and reduced opportunities for the use of resources.

There is thus a serious difficulty in reconciling an open and liberal commercial policy—a stance repeatedly avowed and supported by industrial countries—with the need to cope with the problems of uncompetitive industries. The dilemma for governments in industrial countries is to choose policies from a limited range of options: to furnish import protection, which may provide short-term relief by further postponing the need to adjust at the cost of fostering inflation and inhibiting growth; to refrain from any actions in the commercial policy field, allowing possibly disruptive adjustments to take place, but at the social and political cost of a temporarily higher level of unemployment; or—perhaps the most difficult although preferred alternative from an international point of view—to encourage structural adjustments that would promote the transfer of resources to more efficient uses and to supplement the efforts of the affected industries to increase their productivity. Policymaking in this connection is influenced by the asymmetry of pressures for protection. While the diffused impact of protectionist actions and the difficulty of organizing the consuming public at large limit the possibilities for the potential losers to exert pressure on the authorities against protection, the potential beneficiaries are often well organized and more effective in bringing pressure.

Many of the factors that underlie the rise in protectionism are likely to persist in the years ahead. If, as may well be the case, unemployment in the industrial countries remains relatively high, the difficulties of effecting structural adjustments in these countries may remain serious. The problem of import competition in industrial products is expected to grow further. In the developing countries the diversification of the export base is likely to continue, thus enabling them to compete in new lines of manufacturing production, particularly where low labor costs are a major determinant of the pattern of comparative advantage. In some sectors (such as steel and shipbuilding), large excess capacities are expected to remain in existence for a number of years. Thus, even with a revival of aggregate demand, some sectors in the industrial countries will continue to experience difficulties. Nevertheless, if governments capitulate to these pressures for protection, the consequences for the international economy will become increasingly serious, especially for developing and other primary producing countries whose development and industrialization efforts are affected. Several developing countries currently facing renewed protectionist pressures in the industrial countries have incurred external indebtedness on the assumption that foreign markets will remain open. Unless this assumption is realized, the debt servicing burden of the developing countries that depend heavily on access to foreign markets may become difficult, resulting in the vicious circle of balance of payments crises, debt renegotiations, and the shrinkage of foreign capital flows.

Perhaps the most disquieting feature of recent developments is the apparent erosion of political commitment to a liberal trading system. A reflection of this erosion is the growing trend toward the organization and structuring of world trade involving quantitative regulation of trade flows. This trend originated in the textile sector in the early 1960s, where bilaterally negotiated restraint arrangements under multilateral rules were accepted because even more restrictive measures might have been imposed in their absence. There has been an increasing tendency to resort to bilateral trade restraints outside the framework of existing rules. These developments have culminated in recent proposals for the organization of international trade that appear to favor multilateralization of restraint arrangements and international surveillance of market shares. Experience with the operation of bilateral restraint arrangements—either under a multilateral framework, as in textiles, or on a purely ad hoc bilateral basis—suggests that such restraints may perhaps introduce an element of certainty in trade relations over the short term. Even so, the organization of markets does not appear to be conducive to the dynamic evolution of trade according to the principles of comparative advantage, efficiency, and nondiscrimination, especially if negotiated arrangements are unable to provide adequately for the emergence of new suppliers, technological change, and changes in relative costs of production. These developments pose two fundamental issues for international commercial policy—whether the principles of nondiscrimination and reciprocity, on which the world trading system is based, can withstand the growing pressures and stresses being placed on trade relations, and whether the existing forms and instruments of multilateral cooperation are adequate to cope with the conflict between the short-term interests of trading nations and the broader objectives of promoting growth of world trade, employment, and income.

In the light of the preceding discussion, determined and broadly conceived efforts at the national and international level will be required to arrest the drift toward protectionism, with the determining impulse for directing policies toward renewed liberalization coming from national governments.

A study, *The Rise in Protectionism*, on which this article is based, has been published by the Fund (English only) in its Pamphlet Series and is available upon request from The Secretary, International Monetary Fund, Washington, D.C. 20431, U.S.A.

Import controls and exports in

The use of import controls by developing countries is enshrined in multilateral trade agreements and is supported by an influential body of literature and thought which has emerged since 1945. This article contains a brief critical assessment of the main aspects of the theoretical debate and practical experience with controls. On the basis of recent research and analysis, the author offers the view that poor export performance and inefficient production for domestic markets can be directly related to the excessive use of trade controls by developing countries.

I.M.D. Little

Imports, and to a lesser extent exports, have been controlled by almost all developing countries since World War II. Yet the evidence indicates what theory suggests, that the more open the economy the higher is income and the better the growth rate. But reliance on controls persists. Why? In this article I shall examine the legacy of the intellectual case for import controls which was first made in the 1940s, and which still influences both the debate and the policymaking of today. I will then discuss the drawbacks of controls in the light of new analysis which contradicts the still widely accepted thesis that open trade between unequal partners damages the poorer partner.

For some countries in Latin America, controls were introduced in the depression of the 1930s or during World War II, because of worsening terms of trade. But almost invariably the controls instituted by developing countries since World War II have been the result of a balance of payments (BOP) crisis brought on by increased spending for development. Of course, World War II also left most Western industrialized countries with an almost complete array of import and exchange controls. But within a decade the import controls and most exchange controls in the developed countries had been dismantled. Why did the developing world intensify import controls long after the extreme dislocations caused by the war had vanished?

My impression is that this reliance arose mainly from the conviction among leaders of opinion and policymakers in the Third World that a poor country could not develop and manage its foreign trade and payments without controls. Of course, *all* controls protect, and sometimes protect absolutely. But there are several reasons (among them the timing of the controls, and the fact that the countries instituting these controls had few industries to protect anyway) that lead us to believe the primary motive to have been BOP management—not protection.

Furthermore, an intellectual heritage has probably played an important role in maintaining the control system, as the new intelligentsia, taught by the development economists of the 1940s and 1950s, rose in support of the system. In many semi-industrialized countries this has resulted in a strange meeting of the minds of intellectuals, businessmen, and bureaucrats.

The case for controls

The rationale for poor countries to control imports was developed in the 1950s, mainly by Hans Singer and Raúl Prebisch. Briefly, Singers's thesis was that developing countries had not got much out of international investment and trade—above all, not much industrialization. There were dark hints that these countries might have got less than nothing out of it, as foreign trade diverted activities away from industrialization, which would have played a catalytic role in development. Singer also promoted the thesis of a secular worsening in the terms of trade of the developing countries, basing his argument on a United Nations document, *Relating Prices of Exports and Imports of Underdeveloped Countries,* published by the Department of Economic Affairs in 1949. Singer presented this thesis as an "indisputable fact," and explained it essentially by an ever-increasing degree of monopoly (with labor sharing in it) in the production of manufactured goods. However, he drew no inference for BOP management.

Prebisch, and the Economic Commission for Latin America headed by him, emphasized the same worsening in the terms of trade of developing countries from 1949 onward. This thesis became enshrined in the United Nations Conference on Trade and Development (UNCTAD), and in repeated pronouncements by many development economists. The peaks in commodity prices during the Korean War, the subsequent decreases in prices followed by recovery after the early 1960s, the historically high levels of today, and the fact that all the scholarly work I know of denies any long-run trend, has probably still not fully exorcised the myth created by the 1949 UN study (which was based on the United Kingdom's terms of trade from 1876 to 1946).

To the argument of declining terms of trade was added the view that the demand for exports from developing countries would inevitably be sluggish compared with their own demand for imports—especially, of course, if domestic demand were to be steered toward investment goods for development. To this was added the acceptable argument that the price elasticity for exports was very low (at least for developing countries taken together). Thus, exports of developing countries were determined by external forces not under their control, and this was also true of aggregate capital imports. Therefore, the level of imports was also determined. The conclusion was that their own import controls and other restrictions did not restrict trade but served only to control the pattern of imports in the interest of development. Also, with the declining terms of trade, BOP trouble would be endemic, and frequent devaluation and inflation would result. Moreover, devaluation would further worsen the terms of trade in the face of an inelastic foreign demand.

However, even if we accept the elasticity assumptions, it still does not add up to a case. Export taxes could be used to prevent devaluation from reducing export proceeds. Luxury taxes could prevent low priority imports. If industrialization needed a special push, this could be achieved by tariffs or, better still, by subsidies which would not discriminate against exports. Finally, it is probably an illusion that the reduction of consumption associated with price rises that result from controls is less inflationary than price rises resulting from other policies.

developing countries

The argument could thus be fully convincing only to those who had acquired faith in planning—and by "planning" I mean here trying to manipulate quantities with some end in view, with prices as a by-product rather than vice versa. To express a disbelief in planning, at least for developing countries, in the 1950s, was a confession of confusion or worse. In Europe, Thomas Balogh and Gunnar Myrdal were among the conspicuously successful teachers of the need for controls and planning and of the view that trade between unequal partners might damage the poorer partner.

The emphasis on quantities was also connected with "structuralism." This seemed to involve the belief that a country's structure of production, and of imports and exports, was not only inappropriate but also unchangeable, except in the long run by investment, which must be controlled in order to produce eventually a more desirable structure. As far as trade and its effects on the proper pattern of production is concerned, structuralism essentially implied pessimism about the capacity of developing countries to expand exports. Export pessimism, together with the fact that most developing countries had only a tiny capital goods industry, led to the view that growth in the typical developing country was limited by foreign exchange and not by savings (which logically required the view that savings could not be transformed into investment).

Structuralism may have been conceived in Latin America, but the principles behind the Second and Third Development Plans in India were also essentially structuralist. Export pessimism, India's relative lack of minerals, and its desire to become independent of aid led structurally to the conclusion that anything needed for growth must be made at home. There was no choice! Consequently, plans based on this reasoning must be optimal. It also followed that relative prices and most other key concepts of traditional economics were irrelevant. The argument was logical, but hopelessly wrong.

Quite a few of the undesirable extravagances of the resultant import substitution policies had been recognized by Prebisch by 1964. These recognized drawbacks included capital intensity, low value added at international prices (but not value subtracted!), loss of scale, lack of competition, and the growth of "inessential" production behind the barriers to trade. There was, however, no recognition of the effect of protection on exports, nor that the developing countries' falling share of world trade was due either to this effect or to lagging agricultural production. The idea of the long-term decline in the terms of trade was still being advanced, and policies of import substitution were still favored. No distinction was drawn between protection by controls and by tariffs. The philosophy was still one of controlled trade. Neither then nor since has UNCTAD favored free trade—not even for industrialized countries. For how then could the developed countries grant preferences? Any reciprocity was and has remained anathema and a part of the asymmetry argument—what was bad for the developed was good for the developing world.

Challenging controls

In the 1960s the great majority of developing countries were married to control systems and high protection (as indeed they still are, although to a lesser extent). Thus, it is to the challenge to the controlled-trade establishment that we must now turn. On a theoretical plane the seeds were sown by 1963 by J. Bhagwati and V.K. Ramaswami, among others. At the more influential applied level it did not acquire real force until 1970, when the extraordinary average heights and variability of effective protection were exposed in a book by Ian Little, Tibor Scitovsky, and Maurice Scott, and in another by Bela Balassa, *et al* (see the related reading list). The former work also discussed the inhibiting effects of general control regimes (which had spread from simple import controls). Both books laid some stress on promoting rather than protecting industry so as to achieve, as far as possible, neutrality between the domestic market and exports. The Little-Scitovsky-Scott volume also discussed how a transition to more liberal trade, which would be more favorable to exports, might be made, and suggested that it would be very difficult to justify effective subsidization of industry, whether directly or by tariffs, of more than 20 per cent.

More recently there has been a massive ten-country study of trade regimes guided by Jagdish Bhagwati and Anne Krueger (yet to be published). Brazil, Chile, Colombia, Egypt, Ghana, India, Israel, the Philippines, the Republic of Korea, and Turkey were the countries covered between 1950 and 1972. The study found that the open or relatively open countries grew faster—faster than when they were less open and faster than the chronically "closed." Brazil, Israel, and Korea performed best of the group. The main reasons given for superior performance were as follows. Exports proved to be highly responsive to the reduction or elimination of the bias against them. The partly consequential increase in imports reduced the chaos in the pattern of import substitution incentives and ensured a freer flow of inputs, with production benefits resulting from greater capacity utilization and a reduction in required stocks. The greater value of exports also made it easier to borrow. In some countries, especially in Korea, more direct foreign investment was attracted to the relatively labor-intensive export sector.

I would put rather more stress than Bhagwati does in his summary volume on the supposition that exports are simply good business for the country. Social (that is, shadow priced) profits and savings are higher on exports than on import substitutes at the margin. That restrictive regimes result in more investment in capital-intensive sectors and plants is empirically clear for a number of countries both within and outside the Bhagwati-Krueger ten. This also has implications for spreading the benefits of growth, as well as for growth itself.

Krueger, in her summary volume, deals primarily with the conditions under which liberalization attempts have been made. Twenty-two liberalization efforts are reported for the ten countries between 1950 and 1972. All involved packages. Devalua-

tion was combined with import liberalization, deflation, reduction of tariffs, and export subsidies, in varying degrees. Most efforts were made in periods of economic crisis, usually in a situation in which the government had committed itself to an overvalued exchange rate, and in which there was a loss of reserves or debt rescheduling. Many efforts included attempts at stabilization.

Of course, if a simple devaluation is to be effective, inflation has to be stopped. It was the consequent deflationary measures, and the foreign (International Monetary Fund or World Bank) involvement, which often made these attempts unpopular, and resulted in a reversal. It must be remembered that the Fund norm was then a fixed exchange rate. But a floating rate, or a sliding peg, was used in several countries on and off.

The reasons for failure to liberalize are divergent. Either the effective devaluation was inadequate, or the bias against exports was not removed or was not much reduced (as in India and the Philippines), so that exports did not respond sufficiently. Inflation and a fixed rate continued or was reimposed (Chile under Allende). There was insufficient political and intellectual commitment (India, Chile), or an actual reversal for political reasons (Ghana), or bad monsoon luck (India again). Needless to say, manufacturers require some expectation of continuing profitability for exports if they are to invest for export production, make products designed for export, and spend money on a marketing organization. Only in a few countries was the government commitment to the change of policy sufficient for this expectation. But although failure was frequent, there was progress among the ten. The Bhagwati-Krueger phase analysis suggests an increasing degree of liberalization after the mid-1960s and comes down in favor of an export promotion strategy. (Oddly enough, Bhagwati means by "export promotion" a strategy that is neutral between the domestic and export markets.)

Export strategies

Further relevant evidence is added by Balassa in a preliminary report on his World Bank studies of exports in developing countries, where he discusses Argentina, Brazil, Chile, Colombia, India, Israel, Korea, Mexico, Singapore, Taiwan, and Yugoslavia. More material is provided by two chapters (by Maurice Scott and myself) in a new book on Taiwan. A few major points which seem to me to emerge from including a few more countries, and even more recent information, in the review are as follows:

- Of the above, only Korea, Singapore, and Taiwan have created virtually free trade regimes for exports. In these countries exporters can buy not only imports but also domestic inputs at world prices. Singapore and Taiwan are now as free trading as most developed countries. Korea and Taiwan also have free labor markets, barely affected by trade unions or labor legislation. These three countries sustained gross national product growth rates of about 10 per cent for as much as a decade prior to 1973 — a performance shared only by Hong Kong, Israel, and Japan.

- Although Israel is fully liberalized, tariffs still result in a significant bias against exports. None of the other countries mentioned are fully liberalized, and none have created the free trade regimes for exports of Korea, Singapore, and Taiwan (and, of course, Hong Kong). All, however, have made some effort at export promotion. The staggering export performance of Hong Kong, Korea, Singapore, and Taiwan is well known. However, the manufactured exports of Argentina, Brazil, and Colombia have also grown very fast, at about 30 per cent per annum in 1967–73, but from very low levels. As a consequence, the proportion of manufactured output exported remains very low: in 1973 the ratios were 3.6 per cent, 4.4 per cent, and 7.5 per cent, respectively, compared with 49.9 per cent for Taiwan and 40.5 per cent for Korea.

- The highly open economies of Hong Kong, Korea, and Taiwan all weathered the world recession of 1974–75 very well, despite their extreme dependence on imported energy. Korea's growth rate never dipped below 8.3 per cent. Hong Kong's and Taiwan's were brought below 3 per cent, but they recovered to rates of 16.2 per cent and 11.9 per cent in 1976. Despite continued sluggish world demand, and increasing protection in many industrialized countries—some of it specifically directed against these three economies—the U.S. dollar value of the exports of the three rose by 39.4 per cent, 56.2 per cent, and 52.2 per cent in 1976.

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One thing at least is certain. The more labor-intensive manufactures of the now semi-industrialized countries need no protection or subsidization. Of course, it will still be argued that the least industrialized countries need considerable promotion of manufactures, if not protection, to get going. This may be true. But need it be very heavy? And need it be protective rather than promotional?

Of course, liberalization and reduced protection cannot achieve all the miracles it has produced for the four Asian countries discussed. It is obvious that the speed of the consequential changes in industrialized countries has some limit. But the fact that there is this limit to the degree of market penetration that will be permitted at any one time by the industrialized countries (and a limit to the size even of their markets) should not be regarded as a reason to continue with a policy bias in favor of import substitution. There are still gains to be made by all countries, even if only a few more miracles can be expected.

The developed countries still produce a very high proportion of the labor-intensive manufactures they consume. Clothing imports from the developing countries account for little more than 5 per cent of consumption in the developed world. The range of labor-intensive goods for which there has been any significant market penetration is still quite limited. Yet for 15 years manufactured exports from developing countries have increased at the rate of 15 per cent per annum. With reasonable goodwill on the part of the developed countries, and appropriate policies on the part of the developing countries, this rate of growth could be maintained for a very long time. The growth of exports from Hong Kong, Korea, Singapore, and Taiwan is certain to slow down greatly because at present they export such a high proportion of their output; hence, the growth rate of exports must soon approach the countries' overall growth rate, which is unlikely to exceed 10 per cent. In this situation there should be room for sales of comparable goods by other developing countries. It must be remembered that these countries now play a role that is far from small in markets for manufactured exports (the *growth* of exports from them in 1976 was worth about $7 billion).

Furthermore, developing countries trade little with each other. Such trade is greatly inhibited by their own import substitution

policies. This has been of secondary importance because the market in developing countries is so much smaller than the market in the developed world, but its importance is increasing as markets in developing countries for tradeable items are growing faster than those in developed countries. Preferential regional trading arrangements are very much a second-best option, and they are also very difficult to negotiate. Policies of general liberalization and reduced protection can be of far greater benefit and cost much less in terms of scarce administrative talent. Yet organized and controlled regional trading remains the conventional wisdom of leaders of the developing world when trade among themselves is under discussion.

I have discussed mainly manufactured goods, but it seems also likely that considerable gains could result from more intra-trade in agricultural products and even minerals, although this seems to have been studied relatively little. Furthermore, there is little doubt that liberal trade regimes would help even if exports did not increase greatly. All the benefits arising from greater use of the price mechanism—the reduction in administration, in delays, in stocks, in corruption, and the increase in competition—occur anyway.

Transfer of technology

In the 1970s there have been renewed attacks on trade and foreign investment, much of it stemming from England. The focus is now more on the evils of inappropriate technology and its inappropriate products, on multinationals, and, indeed, on the transfer of capital in any form—including aid. It is related to the increased emphasis on income distribution and poverty. But trade is involved. It is claimed that trade has harmed the poor in developing countries. If there were no trade, none of the other alleged evils could result. If the conclusion that no trade should occur is too extreme, nevertheless trade and the transfer of technology should be carefully controlled, just as it has been for 25 years, only, I suppose, on a broader scale and more effectively (see, for example, Singer, 1971, Keith Griffin, 1974, and Paul Streeten, **Finance & Development,** September 1977).

How is it, then, that the developing countries have grown so fast as a group, that is by 5.6 per cent in 1960–65 and by 6.0 per cent in 1965–73? Within these averages, half a dozen countries have grown, without special benefit from ample mineral resources, at rates which would have been deemed inconceivable 20 years ago. The industrialized countries do not grow as fast, nor the centrally planned economies either. None but Japan has ever achieved even half the growth rates of the half dozen developing countries with the best performance. Even Japan's high growth was for nearly a hundred years based primarily on foreign technology, designed for countries with higher wage levels than Japan.

I suggest that the basic reason is plain. Such rapid growth can only be the result of catching up by importing relatively inappropriate technology. The result is technical change. Yet Keith Griffin has recently advanced the theory that growth in developing countries has come predominantly from increases in the amount of labor and capital and not from technical change. Not only are the supporting figures and analysis inadequate but the conclusion flies in the face of common sense. No one can be against making technology more appropriate—that is, more labor intensive—but this should not blind one to the fact that foreign technology can and has produced miracles. These benefits are found not only in the agricultural and industrial spheres but also in advances in public health and life expectancy. We can all agree that the poor in developing countries have not benefited from growth as much as desirable. But the claim that the mass of the poor have not benefited at all is rhetoric. Even in Brazil, where inequality has increased with fast growth, it is clear that the poorest 40 per cent of the population has benefited. Most observers will also agree that they would have benefited more if development had been more labor intensive. I am convinced that with appropriate and open policies on the part of the developing countries, more labor-intensive development would have resulted.

In the open and fast growing Asian economies, the standard of living of the relatively poor has been revolutionized in a period of 15 years. If one wants to look for millions who have scarcely benefited, or even lost out in the postwar period, there can be little doubt that one would find them most easily in the slow-growing, low-trading countries, principally in South Asia and the Sahel. To attribute this primarily to foreign technology is the greatest absurdity. The attack, mainly Western-inspired, on the transfer of technology, and on one of its modes of transfer—the multinational firm—has gone much too far, and threatens the poor.

However, I do not think that these recent arguments for import and technology controls have much effect on leaders in the developing world, as they violate common sense. Even the hatred and fear of the multinationals, and the feeling of being "dominated," seem to be dying down, as developing countries come to realize their strength. Many countries in Latin America are trying to struggle out of the trap of having established an excessively inward-looking industrial structure. The problem is that change takes many years if it is to be relatively painless for all. At the same time, potential exporters need confidence that exports will remain profitable, and this, in turn, means confidence that a government committed to change will remain in power. The tragedy is that elsewhere, especially in Africa, a number of countries seem to be falling into the old trap of anything goes provided it is capital-intensive import substitution.

Related reading list

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B. Balassa, et al, *The Structure of Protection in Developing Countries*, Johns Hopkins Press, 1971.

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J. Bhagwati, *Anatomy and Consequences of Trade Control Regimes* (National Bureau of Economic Research, New York, forthcoming).

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Some first effects of the

There have been a number of immediate changes in the activities of the Fund as the result of the entry into force of the Second Amendment of its Articles of Agreement. They include changes in the rights and obligations of members, the functions and transactions of the Fund, and certain concepts of the Articles.

The General Counsel of the Fund surveys the most important of these immediate changes and explains their significance and background.

Joseph Gold

What are the immediate effects of the Second Amendment of the Articles of Agreement of the International Monetary Fund that can be considered changes in the practice of the Fund and its members? This is a frequent question, particularly because one consequence of the Second Amendment is legalization of the exchange arrangements that were already in force when the Second Amendment became effective on April 1, 1978. Some commentators might say that the effect of the Second Amendment was merely to legalize existing exchange practices, but even if this were the sole or leading effect, the obligations associated with legalization should not be ignored. Nor should one ignore the dangers of disorder that are inevitable in the absence of an agreed legal order for international monetary relations.

The Second Amendment has produced numerous new effects even at this early date. As implied by the question that introduces the preceding paragraph, a distinction can be made between changes in practice that result from the Second Amendment and incorporation in the Articles of practices that were followed before the Second Amendment. A different classification can be made of the most important first consequences of the Second Amendment. One class includes those consequences that have followed automatically from the fact that the provisions of the Second Amendment have become effective. A second class consists of those consequences that have resulted from the exercise by the Fund of new powers under the Second Amendment. A third class consists of decisions taken before the Second Amendment became effective but taken because its effectiveness was imminent. These three classes are discussed in turn under the headings New Provisions, New Decisions, and Anticipatory Decisions.

New provisions

Exchange arrangements. An immediate effect of the Second Amendment is the abrogation of all par values that had been established under the Articles of Agreement. Any par value that is retained by a member under its domestic law no longer operates as a par value for the purposes of the Articles. A member may allow its currency to float. If it wishes, it may maintain the value of its currency in terms of the special drawing right (SDR) or some other denominator, but not gold.

The Second Amendment had no immediate effect on the exchange arrangements in force, because after the collapse of the

Second Amendment

par value system members had been deciding for themselves what arrangements to apply. The Second Amendment has legalized whatever arrangements were in force. The main change in practice will be produced by the principles and procedures for surveillance that the Fund is now required to exercise. This change is discussed later in connection with surveillance.

SDRs. A principle that was regarded as fundamental when the SDR was created as a legal concept under the First Amendment of the Articles, and that helps to give it the character of a reserve asset, is that the Fund has an obligation to designate a transferee when requested by a participant because the participant wishes to use its holdings of SDRs. Another fundamental principle is that a participant designated by the Fund to receive SDRs has an obligation to accept them and to provide currency in return for them. A participant cannot be required, however, to hold more than three times the net cumulative allocation of SDRs to it (allocations minus cancellations by the Fund), although a participant may agree to hold more.

In order to increase the likelihood that participants in strong balance of payments and reserve positions would be available for designation, the First Amendment created only limited opportunities for the Fund to consent to transfers of SDRs by agreement between participants. Transfers by agreement without the consent of the Fund were authorized only when the participants agreed that the issuer of a currency would use SDRs to redeem balances of its currency held by the other participant. The provision authorizing these transfers was adopted in the negotiation of the First Amendment at the instance of the United States, which pointed out that because it did not intervene in the market to support its currency it would not expect to transfer SDRs to obtain other currencies. The United States would be able to use SDRs effectively only if it could eliminate its currency liabilities by redeeming balances of U.S. dollars held by other participants.

Provisions were included in the First Amendment that were designed to protect the SDR against the harm that might be caused to it if participants were to rid themselves of their holdings of SDRs in favor of other assets. The First Amendment provided that although a participant's use of its SDRs was not subject to prior challenge by any other participant or by the Fund, a participant was expected not to transfer its SDRs if it had no need to use reserve assets. The Fund might determine after the event that a participant had not observed the expectation, and the participant would then be subject to designation ahead of those participants that were subject to designation for economic reasons. The importance of the principle of need was evidenced by the limited and narrow circumstances in which the Fund could waive it.

The result of the principles of the First Amendment was a system that was subject to close direction by the Fund in some ways, particularly in the emphasis given to designation and the narrow scope for transfers by agreement. An objective of the Second Amendment is to make the SDR the principal reserve asset of the international monetary system. This objective is as much an aspiration as a normative principle. The Articles do not attempt to prescribe how the aspiration is to be realized, but the drafters agreed that the characteristics of the SDR should be improved and its uses extended, including uses by a wider range of potential holders in addition to participants and the Fund itself. For these purposes, the Fund has been endowed with a range of powers on numerous aspects of the SDR. Many of these powers can be exercised only by decisions taken with a high majority of the total voting power of the Fund's members. These majorities are testimony to a division of opinion on whether some of the possible changes in characteristics or uses would strengthen or weaken the SDR. The majorities may be testimony also to differences of opinion about whether the SDR should be so attractive, and therefore so competitive with other reserve assets, as to create a strong inducement to hold SDRs instead of other assets. The Executive Board has already begun an examination of the advisability of exercising the Fund's new powers.

Meanwhile, two changes of major importance in the operation of SDRs have come about immediately by virtue of the adoption of the Second Amendment. The first is that there is now full freedom for a participant to transfer SDRs to another participant by agreement and without the necessity for the consent of the Fund. The redemption of balances of an issuer's currency with SDRs is no longer the subject of a special provision, because the authority for these transfers is part of the general authorization of transfers by agreement.

The other change is that in transfers by agreement, the participant transferring SDRs is no longer subject to the expectation that it will refrain from using them if it does not need to use reserve assets. Designation and the obligations it involves remain as essential legal elements of the system of SDRs, but the two changes relating to transfers by agreement have introduced

a flexibility into the system that would have seemed improbable when the First Amendment was drafted.

Gold. In the Fund's History of its first 20 years, this author discussed the law and practice of the Fund with respect to gold during that period under the heading "The Ambiguities of Gold" (Volume II, pp. 559-64). There may be fewer ambiguities in the provisions dealing with gold in the Second Amendment, but the future of gold is unclear, notwithstanding the agreed objective of the gradual reduction in its role in the international monetary system.

There may be fewer ambiguities in the provisions dealing with gold in the Second Amendment, but the future of gold is unclear, notwithstanding the agreed objective of the gradual reduction in its role in the international monetary system.

An indisputable consequence of the Second Amendment is that members are now free from former legal restraints in connection with the prices at which they may purchase gold. The Fund is completing the sale of 25 million ounces of gold by auction for the benefit of its Trust Fund. Sales are now made directly by the Fund in its capacity as Fund under a new power in the Articles, and not according to the former procedure of sales to members for replenishment of the Fund's holdings of currency, resale by members to the Fund as Trustee, and sales by auction by the Fund in its capacity as Trustee. The Invitation to Bid in auctions before the Second Amendment precluded bids by members, or by agents on their behalf, at prices in excess of the then official price. The Fund continues to be able to specify the bidders whose bids would be acceptable, but is no longer bound as a result of its Articles to preclude bids by members at prices above the former official price. In its first auctions after the Second Amendment the Fund has not restricted the categories of acceptable bidders.

Purchases and repurchases: selection of currencies. Before the Second Amendment, the Fund had developed policies on the currencies that were appropriate for use in purchases and repurchases by members, but there was no express basis for these policies in the Articles. Although the Fund was entitled to sell any currency or, in certain circumstances, to prescribe the currency of repurchase, the successful operation of its policies depended on the collaboration of members. In particular, the Fund's ability in practice to sell most currencies depended on the issuers' willingness to exchange balances of their currencies that were sold by the Fund for currencies that would help purchasing members to solve the problems for which they had made their purchases from the Fund. Not all currencies can be used to support a member's currency or are acceptable in international transactions. Many members, but not all, were willing to collaborate in the exchanges.

The Second Amendment provides that the Fund shall have policies on the selection of currencies for use in its transactions. Moreover, the Second Amendment requires members in certain circumstances to make exchanges of their currencies when sold by the Fund under these policies, which gives the Fund the assurance that it will be able to use all its holdings of currencies in its transactions. Finally, the Second Amendment contains a new obligation that requires members to provide their currencies to other members for the purpose of repurchase by them.

The Fund is required by the Second Amendment to formulate policies on the currencies that are appropriate for use in repurchase. In principle, all currencies are now acceptable by the Fund. Before the Second Amendment the Fund could accept only the currencies of members that had undertaken to perform the obligations of convertibility under Article VIII, Sections 2, 3, and 4, or balances of other currencies that were deemed to be balances of a convertible currency. Abrogation of this legal limitation on the acceptability of currencies in repurchase broadens the range of currencies that can be used in the activities conducted through the General Resources Account and improves the liquidity of the Fund.

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New decisions

Surveillance over exchange arrangements. Freedom for members to choose their exchange arrangements does not mean freedom from all regulation. All members, whatever their exchange arrangements, are subject, from the date of the Second Amendment, to a broad obligation to collaborate with the Fund and other members to ensure the existence of orderly exchange arrangements and to promote a stable system of exchange rates. In addition, members are subject to certain special obligations relating to domestic and external policies that can affect the balance of payments and the exchange rate. The Fund must oversee the international monetary system in order to ensure its effective operation. The Fund must also oversee the compliance of members with their general and special obligations. In order to fulfill these functions, the Fund must exercise firm surveillance over the exchange rate policies of members and must adopt specific principles for the guidance of all members with respect to those policies. Each member must provide the Fund with the information necessary for this surveillance, and must consult with the Fund on the member's exchange rate policies.

On April 29, 1977, the Fund adopted a decision on surveillance over exchange rate policies that became effective on the date of the Second Amendment. As a result, the Fund's decision of June 13, 1974 on guidelines for the management of floating exchange rates has been abrogated. These guidelines applied only to the issuer of a currency that was floating independently in the sense that the currency was not pegged, within somewhat narrow margins, to another currency or composite of currencies. The new decision applies to all members whatever their exchange arrangements and balance of payments positions may be.

The new decision sets forth three principles for the guidance of members' exchange rate policies, and for the rest deals in some detail with principles of, and procedures for, the Fund's surveillance over these policies. The Fund's objective will be to hold consultations with members at annual intervals, but discussions with a member can take place whenever certain defined situations occur. These situations are taken to be indications of a need to consider whether the principles for the guidance of exchange rate policies are being observed. The discussions can be initiated

informally and confidentially by the Managing Director.

The decision is a complex one, and it will not be examined in detail here. It deals primarily with procedure, and at some length, but, as Sir Henry Maine concluded in his classic *Ancient Law,* in some societies substantive law is secreted in the interstices of procedure. Two legal changes took place when the Second Amendment entered into force. The first relates to the obligation of members to consult with the Fund. Under the Articles before the Second Amendment, members were bound to consult with the Fund annually if they were availing themselves of the transitional arrangements of Article XIV. A member was not bound to consult with the Fund once it had undertaken to perform the obligations of Article VIII, although it could be required by the Fund to consult as a condition of the Fund's approval of practices for which approval was necessary under the Articles. Consultations with most, but not all, "Article VIII members" developed as a voluntary practice by analogy to consultations with "Article XIV members." The Second Amendment makes no change in the obligations to consult under Article VIII and Article XIV, but the obligation of all members to consult under Article IV is a new development. The Fund has decided that when these consultations are held they will also embrace the consultations that are conducted under the other provisions.

The second change relates to decisions. A consultation under Article VIII does not end with a decision of the Executive Board, except when the Fund is approving or ceasing to approve a practice subject to its jurisdiction, in which event the decision is confined to this exercise of jurisdiction. Article VIII members were willing to enter into consultations of broad scope but not if they resulted in decisions of the Fund, because decisions would constitute judgments and they might be critical. Under Article IV, annual consultations with all members of the Fund, and interim consultations with some of them in certain circumstances, will be wound up with "conclusions" of the Executive Board. These conclusions may take various forms, which may develop in the light of experience, but it is understood that whatever their form they will be the legal equivalent of decisions of the Executive Board. The conclusions can have the influence of decisions, therefore, on all members, whether their balances of payments are in surplus or in deficit, and on the international community as a whole.

The law and practice on surveillance is an illustration of the diminishing importance of the distinction between Article VIII and Article XIV members. It is true that the Second Amendment preserves Article XIV and even liberalizes it, in the sense that it is detached from the postwar transitional period to which the original Articles referred. The provision permits a diminishing derogation, however, from the obligations of Article VIII, and it would not have been a radical action if the provision had been abrogated. The obligation of all members to consult under Article IV and the adoption of conclusions by the Executive Board are not the only evidence of the blurring of the two categories of members. The provisions of the Second Amendment on the acceptance of all currencies in repurchase, whether issued by Article VIII or Article XIV members, is a further illustration of this assimilation of the two classes.

Freedom for members to choose their exchange arrangements does not mean freedom from all regulation. All members, whatever their exchange arrangements, are subject, from the date of the Second Amendment, to a broad obligation to collaborate with the Fund and other members to ensure the existence of orderly exchange arrangements and to promote a stable system of exchange rates.

Freely usable currencies. The Second Amendment introduces the new concept of the "freely usable currency." The definition of a "convertible currency" disappears, although what used to be called the obligations of convertibility under Article VIII have not been abrogated. The concept of "currency convertible in fact," which was introduced into the Articles by the First Amendment as an element in the operation of the Special Drawing Account, also disappears.

A freely usable currency is defined by the Second Amendment as a member's currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets. Freely usable currencies have special roles in both the General Resources Account of the General Department and the Special Drawing Rights Department.

In the General Resources Account, a distinction is made for the purposes of both purchases and repurchases between currencies that are freely usable and those that are not. If a member's currency purchased from the Fund is not freely usable, the member must exchange it, at the request of the purchasing member at the time of the purchase, for a freely usable currency. The member whose currency is purchased may select the freely usable currency it will supply in the exchange. If a freely usable currency is purchased from the Fund, the issuer has no obligation to exchange its currency for any other currency. If, however, the purchasing member intends to exchange the purchased currency for another currency, the member whose currency is purchased can insist that the exchange be made with the member, and it may select the freely usable currency that it will provide in the exchange.

If the Fund specifies for use in a member's repurchase the currency of another member that is not freely usable, the issuer of that currency must provide it, on the request of the repurchasing member at the time of the repurchase, in return for a freely usable currency, which the member whose currency has been specified for repurchase may select. If a repurchasing member wishes to obtain a freely usable currency that has been specified by the Fund for repurchase, the member issuing the specified currency may require the repurchasing member to obtain the currency from it. The issuing member may require that a freely usable currency be provided in exchange. Under the Fund's Rules and Regulations as revised on the occasion of the Second Amendment, the two members involved in this exchange may agree on the freely usable currency to be provided by the repurchasing member, but if they fail to agree, the Fund will select the currency. The Fund will pay due regard to the circumstances of the members, which means that it will try to act equitably by taking into account such circumstances as the currencies they hold in their reserves.

If an exchange is made as the result of any of the obligations that have been described above, it must be made at an exchange rate that accords with the Fund's principle of "equal value." This principle requires that the value, in terms of the SDR, of currency received by the parties to an exchange must be the same whatever the freely usable currency made available in the exchange and whatever the parties to the transaction. In addition, the exchange rate at which a currency that is not freely usable is exchanged for a freely usable currency must give the purchasing member the same value that it would have received had the freely usable currency been pur-

chased from the Fund in the first instance. If the exchange is made for the purpose of repurchase, the repurchasing member must receive value that is equal to the value of the repurchase it is making. In short, in both purchases and repurchases, the value received by the purchasing or repurchasing member must be equivalent to the amount of any use of a reserve tranche or indebtedness undertaken to the Fund, or the amount of the indebtedness to be discharged, as shown on the Fund's books.

The issuer of a freely usable currency has no obligation to exchange it when purchased from the Fund or to provide it for the purpose of repurchase. It is assumed, on the basis of the criteria that a freely usable currency must satisfy, that the currency can be exchanged or obtained in the market and at an exchange rate that will not be seriously affected, if it is affected at all, by these transactions.

In the Special Drawing Rights Department, the main importance of the freely usable currency is that it must be provided by a transferee of SDRs designated by the Fund to receive them from a transferor. The currency must be provided at a value in terms of the SDR that accords with equal value. The issuer of the currency provided in the transfer has no obligation to exchange it for any other currency that the transferor of the SDRs might prefer. The obligation of interconvertibility associated with a currency convertible in fact under the First Amendment (the French franc, the pound sterling, and the U.S. dollar) has disappeared. This obligation required each of the three issuers to convert its currency when provided for SDRs into any of the other currencies if requested by the recipient of the currency, at exchange rates in accord with equal value. For some years before the Second Amendment, interconvertibility was not in full operation. The issuers of five currencies (the Belgian franc, the deutsche mark, the Italian lira, the Mexican peso, and the Netherlands guilder) undertook to convert balances of their currencies when provided for SDRs into one of the three interconvertible currencies at equal value, but this undertaking also has been swept away by the Second Amendment. Nothwithstanding the changes in the law, according to the revised Rules and Regulations the Fund will continue to try to help a transferor to get the freely usable currency that it prefers.

The Fund has decided that initially the freely usable currencies for the purposes described above are the French franc, the deutsche mark, the Japanese yen, the pound sterling, and the U.S. dollar. The Fund can make additions to, or deletions from, the list at any time.

Repurchase obligations. Even after the Second Amendment, the Articles seek to avoid the impression that the legal analysis of the Fund's transaction by which it makes its resources available to members is a form of lending. The language continues to refer to "purchase" and "sale" and not "loan" or "credit," and to "repurchase" instead of "repayment." There were reasons of both law and policy for this approach in the original Articles. Among the reasons of law were the absence of any fixed period for repurchase of the currency transferred to the Fund by a member when it purchased the currencies of other members, and the right of the Fund to sell the purchasing member's currency. These sales would discharge *pro tanto* the member's potential repurchase obligation.

[The] monolithic structure has been eroded in favor of a series of policies, with separate provision for repurchases, and separate charges, and even separate financing for some policies.

In lieu of repurchase at a fixed date the Articles imposed obligations under formulae based on the level of, and increases in, a member's monetary reserves and in the Fund's holdings of the member's currency. These formulae gave rise to a body of rules, interpretations, and conventions that created dissatisfaction not only because of their complexity but also because their rigidity could produce obligations at times that were inconvenient for economic reasons. The formulae might have the reverse effect and not produce obligations at all within a period that could be considered temporary. In order to prevent an unjustifiably prolonged use of its resources, the Fund adopted a policy that called for repurchase within three to five years after a purchase, and expected members to represent, or to undertake when there was a legal basis for a commitment, that they would repurchase within this period if they were not required to repurchase sooner by operation of the formulae. When special policies on the use of the Fund's resources were adopted, the practice was followed of expecting representations, or imposing commitments whenever legally possible, with respect to repurchase at fixed dates, sometimes beyond the basic period of three to five years.

The parallel systems of repurchase under formulae and under policies became unduly complicated, with the formulae becoming increasingly unpopular. This attitude and the practice of regarding the use of the Fund's resources as credit in economic terms, except where the transaction was in the gold tranche, removed any inhibition about taking the opportunity of the Second Amendment to abolish the formulae for repurchase and to substitute three to five years in the Articles as the basic period for repurchase. In addition, the Fund was given authority to change that period and also to adopt other periods for special policies on the use of its resources.

The major modification in practice is not the adoption of fixed periods and the elimination of formulae. It is the inclusion in the Second Amendment of a primary principle, which the fixed periods reinforce because they will come into play only if the primary principle does not produce earlier repurchase. The principle was implicit in the Articles before the Second Amendment but was not applied in any systematic way. This principle is now embodied in a new provision, which the Fund must apply systematically. The provision declares that normally a member will be expected to repurchase after a purchase, other than after a reserve tranche purchase, as its balance of payments and reserve position improves. The expectation that a member's repurchase will keep pace with the improvement in its position is not an obligation, but the expectation is converted into an obligation if the Fund represents to the member that it should repurchase because of an improvement.

To achieve uniform treatment of all members, the Fund has adopted a decision setting forth initial guidelines, the observance of which will give members the assurance that they are meeting the expectation with respect to repurchase. The criterion of an improvement is that a member's position is judged by the Fund to be sufficiently strong to justify sale of the member's currency or designation of the member to accept transfers of SDRs, but a member will not be expected to make any repurchase before a stated period after a purchase. A formula has been adopted to determine the amount of the repurchase that is expected, but a member may exercise an option to have the expectation fulfilled by the Fund's sale of its currency or by some combination of repurchase and sale. It will be observed that a formula has been adopted, and even a formula based on reserves and movements in them, notwithstanding the abandonment of formulae by the Second Amendment. A member is not yet able to say, as does Don Adriano de Armado in *Love's Labour's Lost*, "I am ill at reckoning; it fitteth the spirit of a tapster." The difference, however, is that any

formula established as a policy need not be as complex as the old formulae. It can be modified by further decisions of policy if experience suggests the advisability of change.

Reserve tranche; charges. Under the Articles before the Second Amendment, the Fund had only limited powers to decide that members could make purchases under certain policies without depleting any gold tranche that might have been available. The gold tranche, which for good reason is now called the reserve tranche, is an asset that members can readily mobilize, for which reason they are often eager to retain it against the time when prompt encashment may be necessary. The Fund was authorized to permit the gold tranche to be safeguarded against depletion only in respect of purchases under the compensatory financing policy. Under the Second Amendment, the Fund is empowered to "exclude" purchases under any policies on the use of its resources from depletion of the reserve tranche. The Fund has exercised this power in relation to its policies on compensatory financing and buffer stock financing and the oil facilities of 1974 and 1975.

Before the Second Amendment, the Fund could levy charges on its holdings of a member's currency only if they were in excess of a member's quota. The result was that if a member made a purchase under the policy on compensatory financing without increasing the Fund's holdings of the member's currency above quota, no charges were payable on the holdings obtained by the Fund in the transaction. This situation has been changed by the Second Amendment, under which charges must be levied separately on holdings obtained under a special policy that is "excluded" in the sense described above, even though the Fund's total holdings are not in excess of quota. The Fund has adopted decisions imposing charges on "excluded" holdings that apply without reference to the level of the Fund's total holdings of a member's currency.

This practice carries further a transformation in the original concept of the Fund, which was that there would be a single policy for the use of its resources, under which repurchase obligations would accrue according to the same formulae, and charges would be levied under a single schedule on total holdings above the level of quota. This monolithic structure has been eroded in favor of a series of policies, with separate provision for repurchase, and separate charges, and even separate financing for some policies. The image of the monolith has given way to what are sometimes referred to in the jargon of international finance as "separate windows."

Anticipatory decisions

Method of valuation of the SDR. The Fund took numerous decisions before the Second Amendment because of the imminence of its adoption. Most of these decisions were necessary in order to put provisions of the amended Articles into operation. One decision, which provided for both an impending change and future changes in the "basket" method of valuation of the SDR, was anticipatory in a different way. The existing method of valuation of the SDR could have continued to apply after the adoption of the Second Amendment without any legal or operational difficulty, whatever might have been the philosophical problems of maintaining that method. One reason for adopting a new decision before the Second Amendment, however, was the feeling that if there was to be a revised method of valuation it should be part of the reform of the Fund that would be initiated by the Second Amendment.

A second reason was related to the special majority of total voting power that is now required for a change in the method of valuation of the SDR. Before the Second Amendment, a change could be made by a majority of the votes cast, provided that the legal fiction was preserved that the value given by the method represented gold value for the purpose of the provision defining the SDR in terms of gold. The Second Amendment abolishes the definition in terms of gold and gives the Fund authority to determine the method of valuation as it sees fit. A distinction is made, however, between two categories of decision affecting the method. Decisions can be adopted by a majority of 70 per cent of the total voting power, but if a change is determined by a majority of the votes cast to be a change in the principle of the method in effect or a fundamental change in the application of the existing method a majority of 85 per cent of the total voting power is required.

The second reason for a pre-amendment decision was the desire to rely on the necessity for a special majority for post-amendment decisions in order to emphasize the fact that a high degree of continuity could be expected in the method of valuation. A formula was adopted for future changes that would follow automatically from the formula, and therefore would not require the exercise of new discretion. The Fund could depart from the formula, but decisions would then be necessary, and could be taken only with the appropriate high majority.

The objective of continuity was not the only one that was sought in adopting the pre-amendment decision. A reasonable degree of adaptability, which would permit changes based on developing circumstances at measured but not brief intervals, coupled with predictability were other objectives. The method of valuation affects the value of the SDR as an asset held by participants and by the Fund. In addition, it is the unit of account of the Fund and of many other entities under a constantly growing number of treaties, statutes, and contracts. The objectives that have been pursued enhance the quality of the SDR both as an asset and as a unit of account.

The decision on the method of valuation adopted on March 31, 1978 provides for a change in the currencies in the basket and in their percentage weights. The change became effective on July 1, 1978. The basket continues to consist of 16 currencies, but 2 that were in the original basket do not appear in the revised basket and 2 newcomers are included. Both of the new currencies are issued by developing countries, which was cause for some satisfaction. The list of currencies and the amounts will be revised in accordance with a stated formula, with effect on July 1, 1983 and on the first day of each subsequent period of five years unless the Fund takes a different decision on the occasion of a revision.

The formula provides that the currencies shall be those of the 16 members that have the highest exports, by value, of goods and services during a defined period of five years, but, to prevent changes in the basket for insubstantial reasons, a currency will not be included in place of another currency unless the value of the exports of the issuer of the former currency exceeds that of the issuer of the latter currency by at least 1 per cent. The amount of each currency in the basket will be related to the proportion between the value of the balances of a currency held in the reserves of other members and of the exports of goods and services of the issuer of the currency and the total sum of the same values for all 16 currencies during the relevant period.

This article has concentrated on the immediate changes in the Fund after the Second Amendment. Even greater changes may lie ahead. These possibilities are recognized by the Second Amendment itself.

"On such a full sea," said Brutus, *"are we now afloat;*
And we must take the current when it serves,
Or lose our ventures."

The continued emphasis in the Second Amendment on consultation and collaboration with the Fund and among members gives assurance that the current will be taken and the ventures not lost.

The World Development Report—main themes

The past 25 years have seen substantial progress in developing countries. But there are still 800 million people living in absolute poverty in these countries, without access to the basic necessities of a productive life. This fact alone is a stark measure of how much remains to be done.

This summary presents the main themes of the *World Development Report* released by the Bank in August 1978.

Rachel Weaving

The *World Development Report, 1978* is the first of a series of analytical reviews of development issues produced by Bank staff, following Bank President Robert McNamara's speech to the Board of Governors in 1977. As Mr. McNamara stated in that speech, a prerequisite for a more effective approach to the many problems facing the developing members of the Bank is a better understanding of the domestic and international factors that affect their progress. After an overview of development in the past 25 years, the report discusses current policy issues and projected developments in areas of the international economy that influence developing countries' prospects. In this context, it analyzes the problems and choices confronting policymakers in different groups of developing countries. However, the report does not seek to deal in detail with issues currently under active international negotiation. Its statistical Annex, *World Development Indicators,* gives selected economic and social data for 125 countries. The report will be considered by the Joint Development Committee of the Bank and the Fund and the Independent Commission on International Development Issues, chaired by Willy Brandt.

Development progress so far has been neither sufficiently fast nor sufficiently broadly based to reduce the numbers of people in absolute poverty. Even maintaining present rates of progress will require large increases in the flow of capital to developing countries, determined resistance to protectionist pressures against their exports, and vigorous efforts to raise the growth of agricultural productivity. On the basis of current projections, it is clear that absolute poverty will continue to be a massive problem for many decades.

The problems that developing countries face differ in degree and in kind, which affects the choice of appropriate policy instruments. There is, however, a growing recognition that development strategies need to give equal prominence to two goals: accelerating economic growth and reducing poverty.

Rapid economic growth is fundamental to any development strategy, not only to keep pace with growth in population and to create employment for the growing labor force, but also to generate increased savings for investment. Particularly in the Low Income Countries—countries with income per person lower than US$250 in 1976—substantial progress in reducing poverty will be impossible without faster growth. But growth alone is not enough. Because the poor tend to share less than their proportion of the benefits of growth, having only limited access to productive assets, education, and employment, deliberate action is necessary in areas that affect the distribution of increases in income. These include the structure of economic incentives, the allocation of investments, and the creation of special institutions and programs to increase the productivity of the poor and their opportunities for employment.

The poor suffer not only from low incomes but also from inadequate access to public services essential to their health and productivity. Many of these services, such as sanitation and safe water supply, cannot be privately purchased. Therefore, the wider distribution of services must be an important element of strategies to alleviate poverty.

Though the main responsibility for successful development rests with the developing countries themselves, the measures that they can implement effectively and the rates of growth that they can achieve are influenced by external factors: the markets for their exports, the prices of imports, and the availability of international capital to help finance investments.

Interdependence in the world economy is not new. But the nature of the economic links between countries changes continually, and the links emerging between developing and industrialized countries are perhaps not yet fully understood. As international comparative advantage continues to shift, manufactured goods from developing countries are increasingly able to compete effectively in industrialized countries. It is not widely recognized that the developing countries now purchase fully one quarter of the total exports of industrialized countries, nor, indeed, that their import market has been of vital importance to export industries in the industrialized countries during the current recession. Developing countries have managed to sustain the growth of this market through the recent upheavals in the international economy by borrowing internationally. Their capacity to service debt depends on the foreign exchange earned by their exports, most of which are still sent to the industrialized countries. International migration of labor on a large scale and the growth of tourism have helped also to reinforce the economic links between industrialized and developing countries.

To give a perspective to the analysis of policy issues and to suggest the scope of actions that may be required, a quantitative model has been used in the preparation of the *World Development Report* to project the growth rates of groups of developing countries in the period 1975–85 under certain assumptions about their domestic policies and trends in the international economy. The faltering pace of economic recovery in the industrialized countries and the growing uncertainty affecting international trade and capital movements make the international environment less favorable for progress in the developing countries than it has been for much of the past 25 years.

Most observers agree that the industrialized economies will grow more slowly in the next decade than the 5 per cent a year that they maintained in the early 1970s. For this study, an average growth rate of 4.2 per cent a year between 1975 and 1985 is assumed for the group (Table 1). The slowdown in their economic activity will be reflected in slower growth of international trade, and is one of the causes of a rise in protectionist pressures against imports from developing countries.

Growth of protectionism

Under the provisions of the recently renegotiated Multi-fibre Arrangement, several industrialized countries have introduced severe new restraints on imports of textiles and clothing, whose increase at 20 per cent a year in 1970–75 has made them the fastest growing categories of manufactured exports from developing countries.

In many important markets, imports of other products of interest to developing countries, most notably footwear and electronics products, are being increasingly affected.

How strongly the new barriers will affect the growth of developing countries' manufactured exports will depend in part on how strictly the quantitative restrictions are administered. It is possible that, in aggregate, these exports could continue to grow at the same rate as in 1960–75—over 12 per cent a year—provided that the more advanced developing countries can speed their diversification from textiles and clothing to engineering products and other manufactures. However, the more restrictive the international trading conditions, the fewer the developing countries that will have enough flexibility to exploit the remaining opportunities for expanding manufactured exports.

For the industrialized countries, protectionism can be self-defeating in the long run: it is not worth paying the costs of reduced growth and higher inflation to avoid the unemployment that may be caused by the growth of imports from developing countries. In any event, the level of employment is affected far more by the growth of the economy as a whole than by imports from developing countries. These imports represent only a very small proportion of total supply in the industrialized countries. For example, even in clothing, the product group that has contributed most to developing countries' export growth and where the increase in market penetration has been fastest, developing countries supplied only 7 per cent of the consumption in the United States in 1976, up from less than 3 per cent in 1970.

Studies have also demonstrated that the employment preserved by protection against imports from developing countries is offset by the loss of employment in industries that export to these countries. Limitations on imports from developing countries can put at risk much larger volumes of export production: exports from developing to industrialized countries were worth about $26 billion (one billion = thousand million) in 1975, but the reverse flow was $123 billion.

Such considerations cannot allay concern about particular firms or regions that have difficulty in withstanding competition from imports. However, these cases call for special measures to smooth the process of adjustment, rather than broad protective measures that prevent adjustment. Most industrialized countries' efforts to facilitate adjustment are too limited at present. The process can be difficult and painful, but with adequate forward planning, measures can be devised to ease the transition and reduce its social costs.

Import barriers are common in the developing countries as well. Though these may be justified at an early stage of industrialization, their negative effects on industrial efficiency and growth become increasingly evident as countries advance in the development process.

As international specialization increases, active participation by developing countries in international trade discussions will become more and more important. In the past the main objective of the developing countries in international trade negotiations has been to acquire special tariff preferences. Analysis suggests that it is much more important to concentrate on resisting pressures for nontariff barriers to their imports. Their negotiating position would undoubtedly be strengthened, and the protectionist pressures in industrialized countries more effectively addressed, if nontariff barriers could be negotiated on the basis of reciprocal concessions from developing countries.

Trade in manufactured goods among developing countries has significant potential for growth: developing countries still obtain only about 15 per cent of their manufactured imports from other developing countries. So far, most of the expansion of this trade has been based on preferential treatment in regional arrangements. Faster expansion will require a more general liberalization of imports, as well as changes in the structure of industrial incentives and measures to strengthen the institutions handling transport, communications, and export credit.

Capital flows to LDCs

Even if the earnings from trade expand steadily, the resources available to the developing countries must be supplemented by an adequate inflow of external capital. The poorest countries, with the majority of their people in poverty and their limited capacity to service external debt, depend heavily on Official Development Assistance (ODA) on highly concessional terms. Flows of ODA have fallen considerably short of expectations, of need, and of the capacity to use them effectively. Assistance from members of the Organization of Petroleum Exporting Countries has increased significantly in recent years, but ODA from the Development Assistance Committee of the Organization for Economic Cooperation and Development grew at an average rate of only 1.4 per cent a year in 1960–75. The large South Asian countries were among the ones most seriously affected by the slow growth of these flows.

Net annual flows of ODA from the Development Assistance Committee are projected to grow from $14 billion in 1975 to $44 billion in 1985 (in current prices). This implies an increase of 5 per cent a year in real terms, but one which would still fall far short of the internationally accepted target of 0.7 per cent of donor countries' gross national product (GNP): the volume of ODA would rise only from 0.36 per cent of doners' GNP in 1975 to 0.39 by 1985. Even this is unlikely to be achieved unless three large contributers—the United States, the Federal Republic of Germany, and Japan—increase their commitments substantially. Statements in support of a larger aid effort have been made in all three countries, but they have yet to be translated into action.

International lending at market terms, from public and private sources, is of particular importance to the Middle Income Countries—those developing countries with income per person of more than $250 a year. The outlook for these flows depends on a mixture of fact and psychology—they have grown extremely rapidly over the past few years, and there has been some speculation about the debt servicing capacity of the developing countries. The concentration of lending in a small number of countries has made lenders sensitive to developments there. Though widespread difficulties in servicing debt do not seem likely, individual countries may run into liquidity problems. Changes in the regulations governing private lending may possibly cause more general difficulties. There

Table 1
Growth of gross domestic product, 1960–85
(Average annual percentage growth rates, at 1975 prices)

	1960–70	1970–75	1975–85
Low Income Asia	2.4	3.9	5.1
Low Income Africa	4.3	2.8	4.1
Middle Income	6.3	6.4	5.9
All Developing Countries	5.5	5.9	5.7
Industrialized Countries	4.9	2.8	4.2
Centrally Planned Economies	6.8	6.4	5.1

is a danger that actions designed to preserve the stability of the banking system in capital exporting countries might, by abruptly changing the availability of capital to certain countries, give rise to the very debt crises they were designed to prevent. The developing countries' needs for net disbursements of capital at market rates are projected to grow from $25 billion in 1975 to $78 billion in 1985 (in current prices), as Table 2 shows. This increase, of 4.8 per cent a year in real terms, compares with the expansion at 20 per cent a year during 1970–75, but there is some doubt whether the flows will actually grow as rapidly as needed. To achieve this growth it will be necessary for a larger number of banks to participate in lending to developing countries, including both smaller banks in the United States and banks in Europe and Japan.

Table 2
Medium- and long-term capital to developing countries at market terms, 1970–85
(In billions of current U.S. dollars)

	Net disbursements			Debt outstanding and disbursed		
	1970	1975	1985	1970	1975	1985
Private	4.7	21.7	67.6	17.3	90.6	358.3
Official, including multilateral	1.3	3.4	10.6	13.7	25.7	109.8
Total	6.0	25.1	78.2	31.0	116.3	468.1
Note: At 1975 prices	10.0	25.1	40.1	51.4	116.3	239.9

Another potential source of instability is the fact that private loans to developing countries generally have short maturities, particularly compared with the gestation periods of the investments they finance. The projected increase in gross disbursements from private banks for 1975–85 is three times the increase in net disbursements. Measures would be desirable to improve developing countries' access to the long-term bond markets, as well as to increase the proportion of loans from official sources, which lend at market rates but with longer maturities. During 1970–75, gross lending by the international financial institutions at market rates increased at 8.5 per cent a year in real terms. Its future rate of growth depends on the actions taken to increase the capital base of these institutions.

Policy issues in LDCs

The Middle Income Countries are a heterogeneous group in their economic structure, development experience, and level of income per person, but in general their economic growth depends more closely than that of the Low Income Countries on international economic conditions. The uncertain outlook for trade and capital flows suggests that, on average, they will grow more slowly than in the past 15 years, as Table 1 shows. Efforts to sustain the growth of export earnings will need to be supplemented by measures to achieve a more broadly based expansion of domestic demand, including the acceleration of agricultural development. Some of the main policy issues facing the Middle Income Countries are discussed in Chapter 7 of the report.

In the Low Income Countries of Asia and Sub-Saharan Africa, where the majority of the world's poor live, more than three fourths of the population depends on agriculture. Agricultural potential in these countries is such that with strenuous efforts to spread presently known production technologies more widely, and increased investments in infrastructure, they could almost double their rate of growth in this sector. The prospects of such an acceleration differ among countries because of differences in the availability of suitable technology and the potential for irrigation. If it could be achieved, the Low Income Countries could expand their economies at 5 per cent a year in 1975–85, compared with the 3.1 per cent annual rate of the previous 15 years. Underemployment would nonetheless remain a serious problem in Low Income Asia, calling for greater emphasis on creating nonfarm jobs in rural areas and systematic expansion of large-scale public works programs. Development strategies in Low Income Countries are discussed in Chapter 5 on Low Income Asia and Chapter 6 on Sub-Saharan Africa.

The illustrative projections in Table 3 show that even if the comparatively favorable trends projected above continue to the end of this century, about 17 per cent of the population in developing countries would still be left in absolute poverty by the year 2000. With the rapid increases in population that now appear inevitable, this means 600 million people. Assumptions about future progress can, of course, be varied in innumerable ways. Nonetheless, it is disturbingly clear that absolute poverty will still remain a problem of enormous dimensions at the end of this century.

Action against poverty is urgent. In the Low Income Countries, where extreme poverty affects the mass of the population, it is essential to raise growth rates, with measures to stimulate agriculture as the cornerstone of policy. In some of the more advanced developing countries, the main issue confronting policymakers is how different sections of society participate in growth. In the majority of countries, modifications of the pattern of growth are necessary to enable the poor to increase their

Table 3
Projected decline in absolute poverty, 1975–2000

	1975		Simulated result in 2000	
	Percentage of population	Number of absolute poor (In millions)	Percentage of population	Number of absolute poor (In millions)
Low Income Countries	52	630	27	540
Middle Income Countries	16	140	4	60
All developing countries	37	770	17	600

Note: It is assumed that the growth rates in Table 1 are maintained until the end of the century, and that the poorest 60 per cent of the population receives 18–25 per cent of the increments to income.

Rachel Weaving

Joseph J. Diana for F&D

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productivity and incomes. Such modifications have two essential aspects: the first is to raise the productivity of those who have some access to productive assets such as land; the second is to increase employment opportunities in both urban and rural areas, particularly by encouraging labor-intensive methods of production, both in modern industry and in small-scale enterprises.

In addition to accelerating the growth of their incomes, it is necessary that essential public services such as water and sanitation be made more accessible to the poor. In both the Middle Income and the Low Income Countries there is a good deal of scope for widening the distribution of essential public services within the same budgetary allocations: by adapting successful experiments in low-cost delivery systems, by using suitable technologies and design standards, and by relying more heavily on the self-help efforts of the communities who are to benefit. Nonetheless, covering the full population will require large additional funds for investment and maintenance.

If resources are not to be wasted, programs to improve the conditions of the poor need to have clearly defined objectives and realistic schedules for their implementation. If programs are conceived without clear targets, designs, and plans for their execution, it is hard either to assign administrative responsibility for them or to evaluate the effectiveness of different approaches to alleviating poverty, and impossible to learn from experience. Success is far more likely if governments set themselves explicit targets for the growth of incomes of the poorest groups and for the extension of basic public services, and then monitor progress regularly.

Especially in the poorer countries, the necessary development efforts will need large investment in industry as well as in agriculture, mainly financed by domestic resources. It is, however, extremely difficult to raise domestic saving at the very low income levels of these countries. They urgently require increased flows of concessional assistance if the necessary investments are to be made.

No actions in the international sphere can substitute for vigorously implemented domestic policies that reach the poor. But unless the developing countries can be assured of continuing markets for their exports, and expanded access to international capital on terms they can afford, the numbers of people in absolute poverty cannot be expected to decrease. It should be obvious that the industrialized countries too have a large stake in an international economy that supports the efforts of developing countries to sustain rapid growth and alleviate poverty as rapidly as possible.

Copies of the World Development Report *(English only) can be ordered by readers in the United States from the Oxford University Press, 200 Madison Avenue, New York, N.Y. 10016, U.S.A.; in Europe from the Oxford University Press, Walton Street, Oxford OX 1 4BZ, England; and in Australia, Canada, Hong Kong, Japan, New Zealand, South Africa, and Singapore from local branches of the Press or booksellers. Readers in the rest of the world can write for copies in English, French, Japanese, and Spanish to The World Bank, Publications Unit, 1818 H Street, N.W., Washington, D.C. 20433, U.S.A. (Arabic and German versions forthcoming).*

World Development Indicators

The World Bank has over the years built up a large economic and social data base. Data have been collected both directly from national sources, gathered through the Bank's operational missions, and from the United Nations (UN) and its specialized agencies. While the data are primarily used by the Bank in its own operational, research, and policy work, it has made such data available to the public through computer tapes and its publications. The Bank made a major effort in the area of data dissemination by compiling and publishing the *World Tables* in late 1976. The volume contained comprehensive economic and social statistics with time series where appropriate.

A statistical Annex has been prepared in conjunction with the preparation of the *World Development Report*. A principal objective of issuing the *World Development Indicators* as such an annex is to provide comprehensive data on world development in a simple format.

Contents

World Development Indicators reports data for a total of 125 countries whose populations exceed one million. In addition, limited information for a further 28 UN/World Bank member states is shown in the Technical Notes to the main tables.

The 125 countries reported upon have been grouped into five categories, namely Low Income Countries, Middle Income Developing Countries, Industrialized Countries, Capital Surplus Oil Exporting Countries, and the Centrally Planned Economies. Within each grouping, countries are ranked by their 1976 per capita gross national product (GNP) levels starting with the poorest. The volume contains 18 tables covering some 80 economic and social indicators.

In an endeavor to make the volume comprehensive but at the same time concise, time series are not shown. In the majority of cases, growth rates and ratios have been calculated for each of the countries listed in the handbook. In a limited number of cases, absolute values have been reported. In order to highlight the economic and social transformation that has taken place over the past 15 years, and to further stress recent economic performance, growth rates have been computed for two time periods, namely 1960 to 1970 and 1970 to 1975 or 1976, whenever data availability permitted such a treatment. Similarly, all ratios in the volume have been computed for 1960 and 1975 or 1976 to indicate the structural changes that the countries reported upon have undergone over the past decade and a half. A further feature of the presentation is that median values have been computed for appropriate indicators for the five groups of countries, and these provide an easy reference for making broad comparisons.

The choice of indicators has been dictated by data being available for a large number of countries, the availability of historical series to allow the measurement of growth and change, and the relevance of data to the principal processes of development.

The 18 tables provide five broad types of information. Table 1 presents an overview of economic growth, the demographic profile, and data on energy, food, and inflation rates. Tables 2 through 5 provide data on the growth and structure of production and demand. Details on trade, its structure and direction, balance of payments, capital flows, debt, and aid are shown in Tables 6 through 12. The next four tables provide information on population growth, structure and developments in the labor force, and estimates of the projected population in the year 2000. In addition, estimates of the hy-

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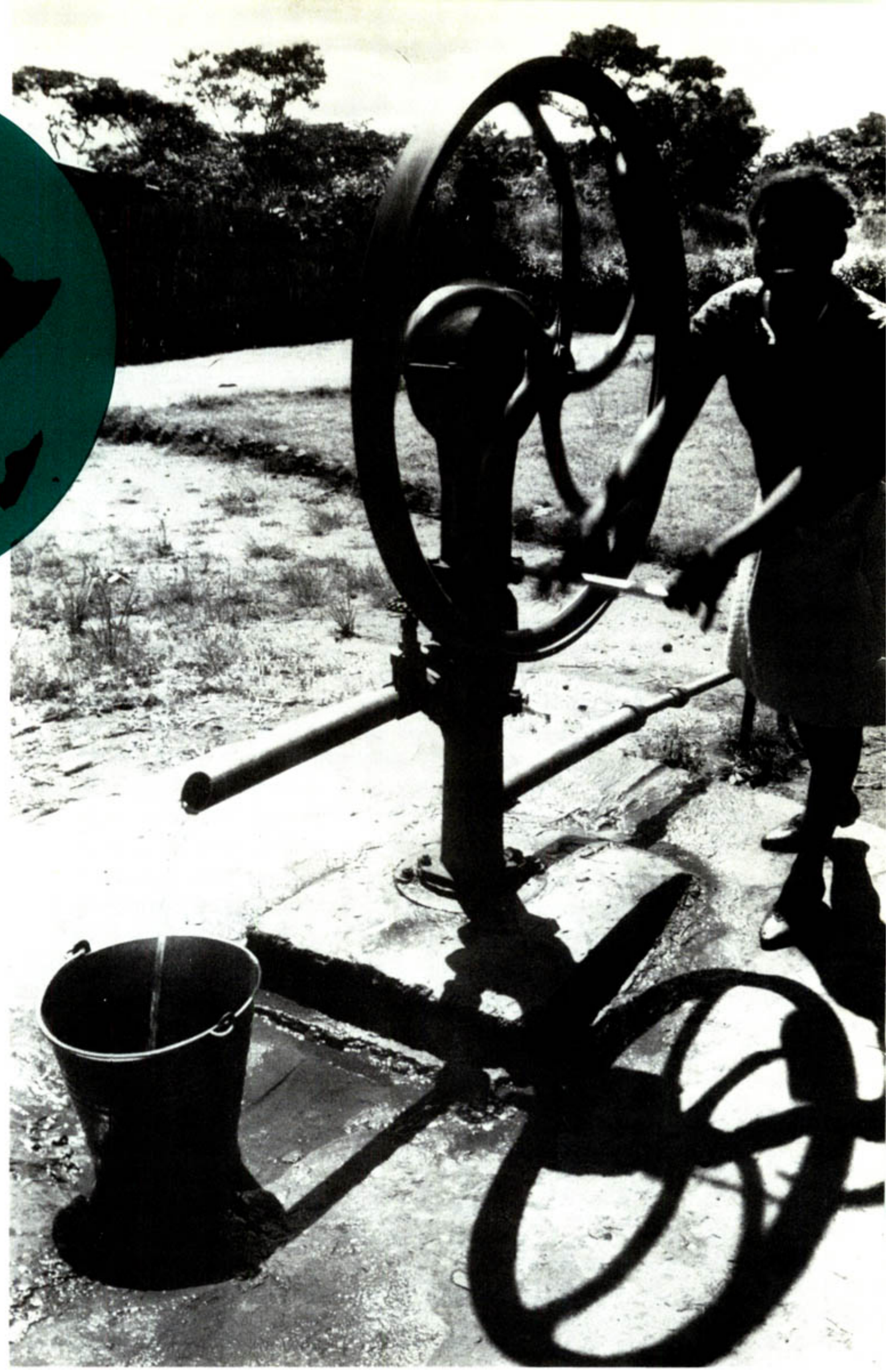


Improving rural water supply in Malawi

For development projects to be successful, community involvement in constructing and maintaining them is essential. However, this involvement is not always easy to achieve. Where it does occur, the result is low-cost, community oriented development. This article examines a successful self-help program for improving rural water supply in Malawi—an experience that could be a guide for other developing countries.

Julian Bharier

Without adequate and convenient supplies of safe water for drinking and washing, people cannot attain a reasonable minimum level of existence. Water which is unsafe for human consumption carries and spreads disease; water which is inconveniently situated leads to considerable loss of productive time, especially for women, who have to travel long distances to fetch it, and inadequate supplies of water can frustrate attempted improvements in many aspects of social welfare. Each person in the world has a basic need for a minimum of about six gallons of safe water each day. Most governments have now recognized and accepted this and, consequently, the provision of this amount, located within relatively easy reach, has been adopted as a target for 1990 at the United Nations Conference on Human Settlements (Habitat) and the United Nations Water Conference held, respectively, in Vancouver (1976) and Mar del Plata (1977). The 1980s will be

known as "The International Drinking Water and Sanitation Decade" and in the years before 1980 national strategies for the decade are being prepared.

Whether a country achieves this target depends on several factors, including: present levels of water supply; the political, economic, and financial feasibility of raising these levels to the required amount; and the commitment of the people and their government. In some cases, a strong commitment by the people themselves can offset financial difficulties. For example, Malawi is already well on its way to reaching the target, despite the fact that in terms of per capita money income it is among the poorest developing countries. Its experience provides an interesting and indeed educative example for other countries now attempting to develop strategies to attack their water supply problems.

Since its independence in 1964, Malawi's economy has been growing steadily. However, it must overcome many obstacles; it is poor, landlocked, and one of the most densely populated countries in Africa. Its natural resources are limited, and 90 per cent of its population of five million lives in the rural areas, working largely on subsistence agriculture.

Water supply systems have gradually been developed in Malawi's four largest population centers, as well as in about 50 small communities with populations ranging between 1,000 and 5,000. However, in other small, particularly rural places there is always the danger of contamination by people and animals, and safe water has always been scarce. Moreover, in the dry season, from July to November, many of the mountain streams and shallow wells dry up. Those who live by Lake Malawi have easy access to water, but many rural women and children have to walk long distances to fetch inadequate, and probably contaminated, supplies.

The first approach to this problem was the digging by various government and private agencies of boreholes—120 to 150 feet deep—with handpumps on them. By the end of 1977 about 4,000 such boreholes were spread across the country. These are adequately maintained by 20 special teams who inspect them regularly and make urgent repairs on request. The system works well, but it has one major disadvantage: both the cost of the wells and the cost of maintaining them are very high. On average, a borehole costs about $4,000 to install (or about $30 per capita for the average number of about 130 people who would depend on the borehole for water, compared with today's per capita income in Malawi of $140), while the annual maintenance cost is about $70. At this price Malawi simply cannot afford to provide boreholes for the entire rural population. Moreover, because of the techniques of drilling and maintenance, it is difficult for villagers to contribute any of their generally unskilled labor to bring costs down. Consequently the aim in general has been to find appropriate alternative techniques rather than to import expensive and perhaps inappropriate technology.

Gravity schemes

About eight years ago, therefore, the Government began considering alternative ways of providing water for villages. The Ministry of Community Development and Social Welfare has since shown that it is possible to serve at least three quarters of the rural population at a fraction of the cost of providing boreholes—if villagers want safe water and are prepared to work for it.

Malawi: basic data

	1960	1970	Most recent estimate
GNP per capita (In U.S. dollars)	40.0	70.0	140.0
Population (In millions)	3.5	4.5	5.2
Population density (Per square kilometer of agricultural land)	80.0	100.0	110.0

The major technique is based on the use of gravity. Water is taken from perennial streams, above the level of cultivation to avoid contamination, and is piped into sedimentation tanks and then directly to villages situated below this level. Since the villages are often many miles away from the intake, a major part of the supply cost is in trench digging and pipe laying, both of which can be done by properly supervised but unskilled villagers. Funds for materials, transport, and the wages of skilled workers, such as builders of the sedimentation and storage tanks (where necessary), are provided through the Government by grants from various church charities and aid agencies. Construction costs (excluding unskilled labor) per person served have averaged only $4 for the schemes completed between 1969 and 1977. The Government provides survey staff and construction supervisors.

By 1977, 19 projects had been completed, serving over one quarter of a million people. Seven-hundred and fifty miles of piping had been laid by villagers and about 1,800 taps were in operation. A further eight gravity projects to serve an additional 250,000 people are being installed, seven more have been approved, and more are expected to be approved as finance and the implementation capacity of the Ministry become available. Cost per capita of the material component for these projects is now, owing to inflation, about $6.

The success of self-help projects of this nature is not common, and it is worth examining how these gravity schemes in Malawi are brought into operation. The initiative for a feasibility study comes through various channels, but in most cases it is requested by the local District Development Committee (DDC). The DDC consists of the District Commissioner, members of Parliament, Traditional Authorities, and local leaders of the Malawi Congress Party. The Ministry of Community Development and Social Welfare then assesses the proposed water source, its quality, the pressure, the population to be served in the area, the terrain, and the existing water supply. On this basis designs are drawn, the criteria for the designs being closely related to basic needs of the villagers.

The self-help process then starts in earnest. A committee is established by the local village leaders to organize the construction work. Each member of the committee is allocated a specific task for which he estimates the labor required. The line of the pipe having been marked, groups of villagers start digging the trench, a section at a time. Usually, each village which has requested a tap provides the labor for the section nearest it, though in some cases villagers have up to 20 miles of trench to dig. A feature of this construction program, which usually starts in February or March after the rains, is that all villagers, men, women, and children, join in and provide their own tools. The first village in line is usually responsible for the construction of the intake and the main line to the sedimentation tank. The pipe is locally produced from imported polyvinyl chloride (PVC) powder and is laid by the villagers.

Siting of the village tap is decided by the village committee, which also organizes the construction of a concrete apron around it and a concrete drain into a soakaway. At the ceremony to open a village tap, a representative of the Ministry and the village headman explain, in turn, to the assembled population the right and wrong way to operate the tap. They also indicate clearly the costs which would have to be borne by the villagers if, for example, a tap is broken. The gravity schemes are maintained by village volunteers who have attended a two-week training course given by the Government. Because of this, and the villagers' own sense of pride and ownership in the projects, an extremely high level of maintenance is achieved.

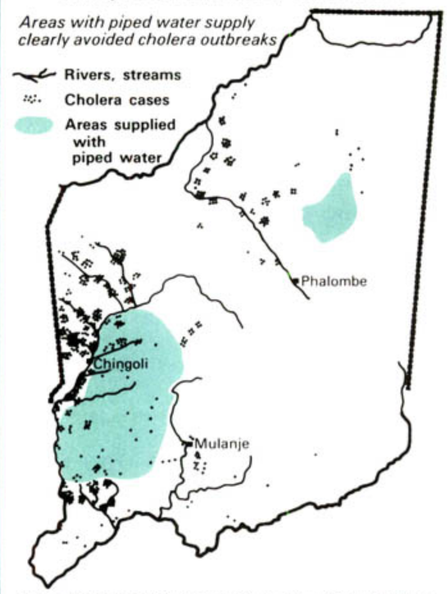
Gravity schemes are, of course, limited by the terrain. Although they will eventually provide safe water for two million rural dwellers, other inexpensive water supply schemes are necessary. Since over one million Malawians live close to "dambos"—low-lying areas with high water tables — they now make use of shallow wells, up to 30 feet deep, dug by hand. The water from these wells is plentiful and of excellent quality, but the mud walls of the wells crumble, animals use them, and the water soon becomes contaminated. The Ministry of Health and the Ministry of Community Development and Social Welfare have tried various methods to protect these wells. These methods have generally involved construction of a brick or concrete wall for the well and a raised lip. In some cases, a bucket and chain have been provided. Again, labor has been provided by the villagers and material costs by the government agencies. Progress in shallow-well protection was slow, however, since villagers could not see great advantages in such a scheme. The "protected" wells were often more difficult to operate; in many cases, for example, children were not able to lift the bucket or work the windlass. Moreover, the water was still open to contamination from the bucket or other containers.

However, the Ministry of Community Development and Social Welfare has now developed a unique indigenous shallow-well handpump, made almost entirely of locally available materials and costing only \$25–30, compared with the \$700 –1,000 pumps used on deep wells. This pump, bolted to a concrete lid, enables the shallow well to be completely enclosed so as to protect the well water and it can be operated even by children. It is planned that over 5,000 shallow wells will be protected in the next few years. As with the gravity schemes, the village committees take responsibility for providing and organizing the unskilled labor and maintaining the system. The cost per capita of supplying materials for the protected wells is of the order of \$1, and it is therefore by far the cheapest form of water supply undertaking.

In those rural areas of Malawi, mainly in the northwest, where neither gravity schemes nor shallow wells are feasible, boreholes will still be required. Although measures are being taken to reduce the cost of drilling, these will continue to be an expensive form of water supply. At least the numbers required are now nowhere near as great as they were first thought to be.

The motivation of villagers to carry out self-help schemes is closely linked to their recognition of the health benefits to be obtained. Less than one quarter of the population in Malawi is literate, yet the value of adequate sanitation is important to most people. One indication of this is the relatively large number of pit latrines found in the villages. A serious cholera outbreak in 1973–74 (in which 11,000 cases were treated) strengthened this emphasis on

Incidence of cholera cases in relation to piped water supply Mulanje District, Malawi, March 1974



Source: World Health Organization, Dr. C. Pauli and Mr. L. Robertson

health when it became clear, as the map shows, that villages with access to safe water were scarcely affected by the epidemic.

As a result of the cholera outbreak, the Ministry of Health began redirecting some of its activities to the rural area. While there is still scope for further expansion of the personal and home hygiene aspects of health education programs, the impact has already been felt. The number of cases of diseases associated with water supply and sanitation has declined each year since 1974, and there is every indication that the standard of village sanitation will rise still further during the coming years.

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Community involvement expands

Community involvement in Malawi has mainly been concentrated on rural water supply schemes. However, in a large number of villages, feeder roads, schools, and clinics have also been built by local unpaid labor. There is a strong spirit of community cooperation in development which stretches down from the various government ministries to the local committees. Much of it is extremely informal and may eventually have to be put in a more formal framework as the country becomes richer and the process of employing only Malawians gains momentum.

Similarly, as the country moves beyond the provision of basic needs to levels of welfare more akin to those expected by even the poorest in today's advanced nations, some of the ties which bind members of small communities may become more tenuous. For example, the Government of Malawi has always stressed that water should be free for all villagers. This has been a major factor in encouraging self-help schemes. In towns, on the other hand, consumers with a metered house connection pay a regular tariff in addition to the costs of the connection, whereas those without metered house connections usually purchase water from kiosks or through their housing agency. As the towns expand in number, size, and geographical area, more people will be brought into the category of paying customers, particularly when means are found to ease the one-time charge levied for house connections.

This distinction between village and urban water supplies is not of great significance while villagers are obtaining only a basic minimum supply and many town dwellers can obtain more than this minimum. However, if village water supply is to be increased to urban levels, it is almost certain that villagers will have to start paying for water. This is because the present self-help schemes will have to be replaced, or at least supplemented, by larger-scale supply networks, which will have to be financed to a reasonable extent by the consumers. This, in turn, may be difficult to handle through local community committees.

But this is in the longer-term future. The main point to be stressed is that within the next decade all Malawians are likely to have reasonable access to adequate supplies of safe water to meet their basic needs. Even with Malawi's favorable topography and political support, this is no small achievement, and it is due in large measure to people helping themselves. F&D

The operation of the Trust Fund

The Trust Fund was set up to disburse balance of payments assistance to eligible members of the Trust mainly from the profits derived from the sale of gold. Its first two years of operations were completed on June 30, 1978. This article briefly reviews how the Trust Fund was established and how it operates and gives the details of its transactions over the period.

Dhruba Gupta

In May 1976 the Instrument to Establish the Trust Fund (the Instrument) was adopted by the Executive Board of the International Monetary Fund (IMF). The objective of the Trust Fund is to provide additional assistance on concessionary terms to eligible developing member countries to support their balance of payments adjustment. Its resources derive largely from the profits from the sale in public auction of 25 million ounces of gold, after the deduction of a proportion of the profits or surplus value of the gold that corresponds to the share of developing countries in Fund quotas on August 31, 1975. The amount deducted is transferred directly to each developing country in proportion to its quota. Until the Second Amendment of the Articles of Agreement of the Fund came into effect, the sales of gold in public auction were conducted by the IMF on behalf of the Trust Fund; since then, the gold has been sold by the IMF directly. It had been agreed by the Interim Committee of the Board of Governors on the International Monetary System that the amount of gold available for sale should be disposed of over a four-year period. As a result of that agreement, the IMF decided that the operations of the Trust would be divided into two separate periods of two years each, with the first period running from July 1, 1976 to June 30, 1978, and that the profits on the sales of one half of the gold would be available for disbursement in each of the Trust's two periods. This article reviews the first two-year period of the Trust's operations.

The profits from the sale of 12.5 million ounces of gold available for the first period amounted to about US$1.3 billion (the equivalent of almost SDR 1.1 billion). Of this total, SDR 841 million was disbursed by the Trust as concessional loans to 43 low-income members that had qualified for balance of payments assistance, and the balance of US$363 million was distributed directly to developing countries. For a number of members, loans from the Trust, or the loans together with use of the IMF's resources, were a major source of the financing of their assessed payments imbalances (see table).

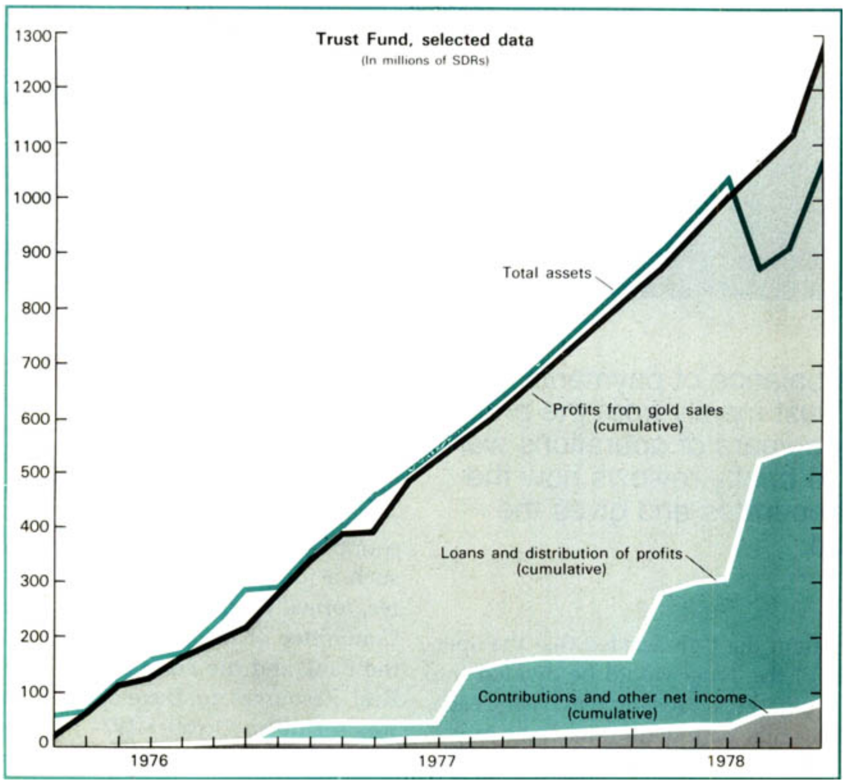
For details on the establishment of the Trust Fund see "The Trust Fund" by Ernest Sturc, **Finance & Development**, December 1976, pp. 30–31

Setting up the Trust Fund

In view of the considerable difficulties that emerged in the international monetary system in 1974, and, in particular, the balance of payments difficulties of developing countries that arose as a result of a substantial adverse shift in their terms of trade, the Development Committee, at its meeting in January 1975, invited the Executive Boards of the World Bank and the IMF to study the desirability of creating a special trust fund that would provide additional highly concessional resources to meet the requirements of the most seriously affected countries, and the possible modalities of such a fund. (The Development Committee, formally known as the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, was set up in October 1974.) At the September 1975 meetings of the Interim Committee and the Development Committee, it was agreed in principle that a trust fund should be established using profits derived from IMF gold sales, without neglecting the consideration of other possible sources of financing, for balance of payments assistance primarily to lower-income countries.

The agreement to sell part of the IMF's gold was part of a highly complicated understanding concerning the problem of gold, including the disposition of the IMF's holdings, in the context of the then pending Second Amendment to the Articles of Agreement. The Interim Committee agreed that the IMF should sell one third of its gold holdings (50 million ounces). Half that amount was to be sold directly to all members in proportion to their quotas, in so-called restitution operations. The other half was to be sold for the benefit of developing countries, of which a proportion of the profits corresponding to the share of quotas of the developing countries would be transferred directly to each country in proportion to its quota—the so-called indirect restitution to the developing countries. The remainder of the profits would provide the resources of the Trust Fund.

In January 1976, the Interim Committee, at its fifth meeting in Kingston, Jamaica, agreed that the Trust Fund should be established without delay and that its resources, which would derive from IMF gold sales over a four-year period and which should be augmented by voluntary national contributions, should be used to provide balance of payments assistance on concessionary terms to members with low per capita incomes. Initially, eligible members would be those with per capita incomes in 1973 not in excess of SDR 300. The decision of the Executive Board was adopted on May 5, 1976, and the first gold sales were held by the IMF on behalf of the Trust in June 1976.



Gold sales

The Trust is an arrangement separate from the IMF's own accounts and resources; the IMF administers the Trust Fund as Trustee. As noted earlier, the IMF, until the Second Amendment of the Articles came into force, conducted the sales of gold in public auction on behalf of the Trust Fund. Until then, it was not authorized to sell gold other than at the official price of SDR 35 per fine ounce. In order to be able to sell gold at market prices to realize profits for the benefit of the developing countries, the IMF replenished its holdings of currencies by selling just over 12.5 million fine ounces of gold to creditor members (that is, those members whose currencies were held by the IMF at less than 75 per cent of quota) at the official price, with the understanding that the creditor members would simultaneously sell the gold to the Trust Fund at the same price. The Trust sold the gold to the market and carried working balances in U.S. dollars in order to purchase the gold from the creditor members.

As a result of these replenishment operations, the IMF acquired the equivalent of about SDR 450 million of usable currencies, which provided a welcome boost in its liquidity at a time when demands for its resources were running at exceptionally high levels.

The IMF as Trustee sold 12.5 million ounces of gold in a series of 21 public auctions between June 1976 and May 1978. The profits from these sales amounted to US$1.3 billion, or the equivalent of SDR 1.1 billion (chart). All payments by successful bidders were required to be made in U.S. dollars, although the possibility existed for the use of other currencies if the IMF had so decided. Monetary authorities were precluded by the Articles of Agreement from purchasing gold in excess of the official price and could not therefore participate in the Fund's auctions prior to the Second Amendment; however, it was understood that the Bank for International Settlements would be able to bid in these auctions.

Dhruba Gupta

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Distribution of profits

As noted earlier, a portion of the profits from the gold sales was to be distributed directly to eligible developing countries according to their share in IMF quotas on August 31, 1975. There is no definition of "developing countries" in the Articles of Agreement, nor are there generally agreed criteria that may be used to identify such countries. Obviously, per capita income is one important indicator. In July 1977, and after considerable discussion, the Executive Board agreed on a list of eligible developing countries. The list was amended in March 1978; as a consequence, 104 countries that were members of the IMF on August 31, 1975 (plus Papua New Guinea) were regarded as eligible to participate in the direct distribution of profits; the sum of their quotas amounted to 27.8 per cent of total quotas and this proportion of total profits from the gold sales was to be distributed directly to eligible members.

The distribution of profits from the gold sales is made annually through the Trust Fund and is paid in U.S. dollars, based on the U.S. dollar profits realized at each of the auctions during the period. The total of the profit distribution to the 104 members for the first half of the Trust's four-year period was US$363 million.

In addition, a number of the recipient members of the Organization of Petroleum Exporting Countries (OPEC)—Iraq, Qatar, Kuwait, Saudi Arabia, United Arab Emirates, and Venezuela—made irrevocable transfers to the Trust Fund of their shares of the direct profits in order to increase the resources available to the Trust. Yugoslavia made a similar transfer of one third of its share of the profits. These amounts of irrevocable transfers amounted to about US$33 million. Romania, too, agreed to make a loan to the Trust for a period of ten years, representing 10 per cent of that member's expected share of the profits over the entire four years. The first part of this loan, amounting to US$850,000, was received by the Trust in July 1978.

Since some members wished to receive their direct profits in gold, it was decided that an eligible developing country mem-

Trust Fund loans and related data
July 1, 1976-June 30, 1978

(In millions of SDRs)

Member[1]	Quota as of Dec. 31, 1975	Projected balance of payments deficit plus repurchases[2]	Total loan assistance[3]	Total purchases during 12-month program period	Reserve tranche	Credit tranches: First credit tranche	Credit tranches: Higher credit tranche	Compensatory financing	Oil facility	Extended facility
Bangladesh (March 1978)	125	71.5	51.8	—	—	—	—	—	—	—
Benin (November 1978)	13	5.6	5.4	—	—	—	—	—	—	—
Bolivia (April 1979)	37	31.0	15.3	—	—	—	—	—	—	—
Burma (March 1978)	60	49.2	24.9	35.00	—	4.98	30.11	—	—	—
Burundi (December 1976)	19	12.1	7.9	—	—	—	—	—	—	—
Cameroon (December 1978)	35	25.5	14.5	—	—	—	—	—	—	—
Cent. Afr. Emp. (December 1978)	13	8.7	5.4	—	—	—	—	—	—	—
Chad (December 1978)	13	9.6	5.4	—	—	—	—	—	—	—
Congo, P.R. (December 1977)	13	10.2	5.4	13.23	2.03	4.70	—	6.50	—	—
Egypt (March 1978)	188	1,228.0	77.9	105.00	—	63.00	—	—	—	—
Ethiopia (May 1979)	27	79.0	11.2	—	—	—	42.00	—	—	—
Gambia, The (May 1978)	7	3.0	2.9	2.53	—	1.72	—	—	—	—
Grenada (December 1977)	2	low reserves	0.8	0.41	—	0.23	0.81	—	0.18	—
Guinea (June 1978)	24	12.4	9.9	8.70	—	8.70	—	—	—	—
Haiti (June 1977)	19	low reserves	7.9	3.00	—	3.00	—	—	—	—
Ivory Coast (March 1979)	52	55.9	21.6	—	—	—	—	—	—	—
Kenya (June 1977)	48	82.4	19.9	24.00	—	—	—	24.00	—	—
Lao P.D.R. (May 1979)	13	13.25	5.4	—	—	—	—	—	—	—
Lesotho (March 1978)	5	low reserves	2.1	—	—	—	—	—	—	—
Liberia (January 1977)	29	low reserves	12.0	4.56	4.56	—	—	—	—	—
Madagascar (December 1978)	26	16.5	10.8	9.43[6]	—	9.43[6]	—	—	—	—
Malawi (March 1978)	15	9.5	6.2	5.43	—	5.43	—	—	—	—
Mali (September 1978)	22	n.a.	9.1	—	—	—	—	—	—	—
Mauritania (December 1977)	13	20.0	5.4	4.71	—	4.71	—	—	—	—
Mauritius (December 1978)	22	10.8	9.1	16.49	5.49	—	—	11.00	—	—
Morocco (December 1976)	113	115.0	46.8	143.70	28.24	40.96	—	56.50	18.00	—
Nepal (January 1977)	14[4]	12.0	5.8	7.61	3.11	4.50	—	—	—	—
Niger (March 1979)	13	5.9	5.4	—	—	—	—	—	—	—
Pakistan (March 1978)	235	146.0	97.4	107.00	—	—	80.00	27.00	—	—
Papua New Guinea (April 1979)	20	25.0	8.3	—	—	—	—	—	—	—
Philippines (December 1976)	155	268.7	64.2	222.66	—	—	—	77.50	55.16	90.00
Senegal (September 1978)	34	17.0	14.1	—	—	—	—	—	—	—
Sierra Leone (June 1978)	25	14.0	10.4	7.00	—	7.00	—	—	—	—
Sri Lanka (November 1978)	98	134.6	40.6	55.00	—	21.93	33.07	—	—	—
Sudan (May 1979)	72	197.5	29.8	4.70						
Tanzania (December 1977)	42	n.a.	17.4	—	—	4.70	—	—	—	—
Thailand (June 1978)	134	160.0	55.5	—	—	—	—	—	—	—
Togo (November 1978)	15	15.5	6.2	—	—	—	—	—	—	—
Upper Volta (November 1978)	13	7.0	5.4	—	—	—	—	—	—	—
Viet Nam (May 1979)	62	8.3	25.7	—	—	—	—	—	—	—
Western Samoa (December 1977)	2	1.4	0.8	0.50	—	—	—	0.50	—	—
Yemen, P.D.R. (March 1977)	29	32.5	12.1	13.18	—	5.76	—	—	7.42	—
Zaïre (December 1976)	113	107.9	46.8	129.49	—	40.96	—	56.00	32.53	—
Total	2,029		841.0[5]	923.33	43.43	231.62	185.99	259.00	113.29	90.00

n.a. denotes data not available.

[1] Dates in parentheses signify end of the 12-month program period.

[2] Projected balance of payments deficit when program presented to Fund excluding possible financing by the Fund plus repurchases due in program period as provided in Section II, paragraph 3 (f) of Trust Instrument. "Low reserves" means that member has very low level of reserves and was deemed to have unlimited need.

[3] The loans were in proportion to members' quotas at December 31, 1975.

[4] Amount to which Nepal had consented as at December 31, 1975.

[5] Total resources available for loan assistance in the first period.

[6] Just prior to beginning of program period.

ber wanting gold would also have the option, after the Second Amendment entered into effect, to submit noncompetitive bids in the gold auctions for up to its share of the total amount of gold to be sold (25 million ounces). About 40 countries elected to have the option to submit noncompetitive bids, which, if exercised, would be for a maximum of approximately 3.7 million fine ounces of the 12.5 million ounces that remain to be sold at market prices in the second half of the gold sales program. It has been decided that noncompetitive bids can be submitted in one or more of the auctions held before May 31, 1979. Members electing to take the option will continue to receive their share of profit distributions from time to time in U.S. dollars. Members that submit noncompetitive bids in the auctions will have to purchase the gold sold to them in the gold auctions with foreign exchange. There is no direct link in timing or amount between a member's entitlement to submit noncompetitive bids and the distribution of profits to it.

Finance for loans

The amount available for loans for the Trust's first period was the balance after making the direct distribution of profits from the gold sales and after receipt of the irrevocable transfers and the loan from Romania mentioned earlier, plus all investment income less expenses of conducting the operations of the Trust. Income from investments pending disbursements over the two-year period totaled SDR 50 million, and SDR 1.1 million was received as income to June 30, 1978 from the loans already made by the Trust; against this were set the expenses of SDR 2 million for the administration of the Trust (including the handling of the gold auctions) and SDR 59 million for exchange valuation losses. The total available for loan assistance was SDR 841 million.

The Instrument which established the Trust provides that, with the concurrence of the member whose currency is used for investment, the Trustee may invest balances of currency held in the Trust in marketable obligations of international financial organizations or in marketable obligations issued by, and denominated in the currency of, the country whose currency is used to make the investment. The temporary investments of the Trust's liquid assets were held throughout the first period in U.S. Government obligations, with the concurrence of the United States. Since the assets of the Trust are expressed in SDRs, and the U.S. dollar weakened against the SDR over the period, an exchange valuation loss was incurred in terms of the SDR.

The investment practice of the IMF as Trustee is to invest funds, where possible, as soon as they are available, with maturities matching the expected timing and amounts of Trust disbursements. In June 1978 the Executive Board decided that since the Trust's assets are valued in SDRs, it would be desirable to maintain the currency assets of the Trust in SDRs or in a combination of currencies that would tend to maintain the value of the assets in terms of the SDR. As a start to executing this decision, the Managing Director was authorized to make SDR deposits with the Bank for International Settlements (which has decided to accept SDR deposits) from part of the proceeds of the auctions held between July 1 and September 30, 1978 if the return on these deposits is sufficiently attractive. The Executive Board will review this decision by early October 1978, and, before this review, the staff have been directed to complete arrangements for investment in the currencies of members who are included in the SDR basket and who issue obligations in their currencies that the Trust could hold.

Loans in the first two years

A member qualifies for loan assistance either by presenting to the Executive Board a program for 12 months that is similar to one that would have entitled it to a first credit tranche drawing (which both establishes a need for balance of payments assistance and shows that a reasonable effort is being made to strengthen the payments position) or through a 12-month program already presented to the IMF. The Trust Instrument provides that eligible members may qualify, with programs agreed with the IMF, for balance of payments assistance in either or both of the two separate periods into which Trust operations are divided. A total of 61 members were eligible in the first period, of which 43 qualified for Trust Fund loans (the complete list of eligible members was shown in the IMF Annual Report for 1976, pages 116 –17). For the second period, 59 members were eligible, with the exclusion of Guatemala, Mauritius, and Paraguay from the members for the first period and the addition of Zambia (see Annual Report, 1977).

As regards the amount of assistance a member may receive, the Instrument specifies that loans to qualified members must be the same percentage of their quotas at December 31, 1975, subject to any limitation of need. A re-examination is possible for disbursements after the end of the program period, if the members' circumstances have changed substantially. Such a re-examination was not necessary for any of the members whose program periods had ended in the Trust's first two-year period.

The Trust Fund loans bear interest at a rate of 1/2 of 1 per cent per annum and, unless otherwise decided, are to be repaid in ten semiannual installments between six and ten years from the dates of the loan disbursements. Moreover, there is the provision that toward the end of five years after the first interim disbursement, namely, around January 1982, the Trustee shall review the terms of repayment on the basis of uniform criteria.

On the timing of disbursements, the Executive Board has decided that the Trust shall make loans at half-yearly intervals, in January and July of each year. Three interim loan disbursements were made in the first period for a total of SDR 300 million to members that had qualified by the dates of those disbursements; the final payments, totaling SDR 541 million, were made in July 1978. All loan disbursements have been made in U.S. dollars, though loans are denominated in SDRs, and this practice is expected to continue.

The amounts of loans made in the Trust's first period were not insignificant (see table), representing over 40 per cent of the members' quotas (the equivalent of more than one and a half tranches) or one half or more of assessed need for almost three fourths of the qualified members. Moreover, 23 of these qualified members also used the Fund's resources during the period, through purchases under various facilities (see table), most of which carried the same or lesser conditionality than that needed to be eligible for Trust loans. For almost all the members that used the Fund's resources and received Trust loans, the total of Fund-related financing covered the assessed needs in the program periods. In addition, of course, all the 43 members qualified to receive loans—as well as other developing countries—received distributions of profits for the two-year period, although these amounted to only about 10 per cent of the loan disbursements. These members also participated in two distributions of gold, amounting to 12.5 million ounces, that were made to all Fund members.

Taking the two years of the first period ending on June 30, 1978, Trust assistance (including the distribution of profits) exceeded the amount of balance of payments financing received from the Fund itself; furthermore, the two sources combined amounted to about 20 per cent of the qualified members' inflow of official balance of payments and other financing during the period. On this count alone, the Trust has been very successful in its aim of providing additional balance of payments assistance to the low-income developing countries.

Book notices

Louis J. Walinsky (editor)

The Selected Papers of Wolf Ladejinsky: Agrarian Reform as Unfinished Business

Published for the World Bank, The Oxford University Press, New York, N.Y., U.S.A., 1977, xi + 603 pp., $22.00, $10.95 (paperback).

This volume contains the most important writings of Wolf Ladejinsky, a leading expert on agrarian reform who died in 1975. In addition to the 62 papers that have been reproduced in full, the volume contains a chronological bibliography of 142 papers by Ladejinsky.

I can think of no one who has written as fully about the need for the adjustment of land tenure systems as has Ladejinsky. From the mid-1930s until 1975, Ladejinsky devoted himself to the problems of land reform in East and South Asia, and such related factors as agrarian policy, agricultural and developmental strategy, institutional barriers such as lack of credit, shortcomings of extension work, insecurity of tenure, high population density, exorbitantly high rentals, and usury.

The selected writings are presented under the following headings: I. The Washington Years, 1935 to 1945; II. The Tokyo Years, 1945 to 1954; III. The Vietnam Years, 1955 to 1961; IV. the Ford Foundation Years, 1961 to 1964; and V. The World Bank Years, 1964 to 1975.

The first group of papers—written in Washington between 1935 and 1945—are based on the study of primary sources and the reports of agricultural attachés at United States embassies abroad.

Most of the later papers are based on Ladejinsky's 30 years of experience in East and South Asia. They cover his field work, personal observations, and interviews with tenants, owner-operators, landlords, and landless agricultural laborers. The papers on "Land Reform" (the last of the Ford Foundation Years series) and "Agrarian Reform in India" (the first of the series written for the World Bank) are of especially high quality. Both should be read by economists concerned with the problems of landlords, tenants, and agricultural laborers.

Ladejinsky made his reputation on his contribution to the implementation of a successful land reform in Japan in 1945. The defeat of Japan in 1945 enabled General MacArthur and his staff to insist on the drafting of an effective land-reform bill and to establish the necessary Land Commissions, which were backed by the Occupation Forces and successfully implemented the land reform. During the years he spent in Japan, Vietnam, Taiwan, and India, Ladejinsky's expert services were frequently requested in other Asian countries, notably the Philippines, Indonesia, Nepal, and Iran, although in none of these countries was he able to duplicate the striking success that he had achieved in Japan and in Taiwan.

Land reform involves a multitude of measures, such as drastic redistribution of land, abolition of absentee land ownership, low permissible retention (low ceiling) for resident landlords, genuine security of tenure, written and registered rental contracts rather than oral contracts, low rentals for tenants, easy credit, land consolidation, and more. Each country has its own problems.

In the case of India the problems differ also from state to state. The Planning Commission can only recommend reform measures; the laws have to be written by the legislatures of the various states. The Planning Commission's reform policies or guidelines are not binding upon the states.

In his work on these problems, Ladejinsky concentrated on learning about local situations through the inhabitants rather than the authorities. Dozens of field trips in many different countries followed the same pattern. Ladejinsky, accompanied by an interpreter and possibly an official who knew the area well, would spend usually eight to ten days in the field. He would interview the people involved in farming—the agricultural laborers, the tenant farmers, the owner-tenants, the owner-cultivators, and the landlords—as well as district and local officials, and representatives of cooperative banks and marketing agencies.

It was this intensive experience that led Ladejinsky to offer this summation of the problems involved in his work: "Agrarian reforms are difficult to attain. In most cases land redistribution or putting land securely under the control of a nonowner are acts by a government imposing upon the landowners economic and legal terms unpalatable to them. In effect, such policies if carried out are *revolutionary acts* (my italics) which pass property and redistribute income, political powers, and social status from one group of society to another. To the extent that legislative assemblies are still dominated by landpropertied classes, it is not difficult to see why both the enactment of appropriate legislation and its enforcement present formidable problems. It may be concluded that land reform has not only powerful economic implications but commences essentially as a political question, running head-on into a fundamental conflict of interests between the 'haves' and the 'have-nots' " (p. 371).

This collection of Ladejinsky's excellent papers will be read by students of land reform who either wish to learn how land reform was implemented in Japan and Taiwan or who want to discover the obstacles which prevented the realization of land reform in other countries. This scholarly work should find its way into the library of every agricultural and development economist.

Karl J. Pelzer, Professor Emeritus, Yale University

Robert W. Oliver

International Economic Cooperation and the World Bank

The Macmillan Press, London, England, 1975, xxii + 421 pp., $25.

Marc Nerfin (editor)

Another Development: Approaches and Strategies

The Dag Hammarskjöld Foundation, Uppsala, Sweden, 1977, 265 pp., SKr 80.

These two books complement and contrast each other. Robert Oliver's book is a major work, the definitive study of the initiation and evolution of the international governmental economic cooperation that resulted in the creation of the World Bank as a key instrument. Marc Nerfin's book is a collection of papers on proposed new social values in rich countries, and equality, basic needs, and national economic experience in five poor countries. It is mainly important as an example of current critiques of and reform proposals for the existing systems. Both books are concerned with the problems of a period when it is clear only that major changes are necessary but it is not obvious what specifically needs to be done, and the future can still be changed by new ideas, negotiations, and politics.

Oliver's book should be required reading for all persons concerned with international economic problems. It makes clear the genesis of most of the fundamental assumptions about international economic cooperation that we now take for granted without realizing that they were not always part of the natural order of things. For example, the very idea of permanent organized cooperation by governments in economic matters is historically quite new. As Oliver shows, at the end of World War I most government leaders could not even conceive of such an idea. In most of the interwar decade the only significant attempts to try to handle some of

the economic and financial problems resulting from World War I through international cooperation were made by central banks (organizations which, we tend to forget, at that time were still privately owned). Because of the absence of cooperation, the European countries were not able to recover to the 1913 levels of production until 1925, and four years later the Great Depression began. During the Hobbesian world of the 1930s, countries trying to save themselves had no compunction in using whatever weapons of economic warfare were available —among these weapons were bilateral trade and clearing arrangements, for instance, which, as developed by Schacht for Nazi Germany, brought smaller nations under the direct economic exploitation of the larger.

The economic disasters of the 1920s and 1930s led to World War II and convinced the United States and British governments that a new international economic order (in today's terms) had to be created and could not be left to chance. It is here that Oliver's book and Nerfin's book offer a striking contrast. Nerfin's contributors neither agree on analysis nor are able to offer a pragmatic program. In the negotiations reported by Oliver, H.D. White of the U.S. Treasury and J.M. Keynes of the British Treasury were able to get agreement on an analysis of what the major international economic problems were and on what organizational and policy steps could be achieved to handle the problems.

It is worth noting that several of the international economic problems now high on the agenda for international discussion were identified by the Bretton Woods founders but had either to be put aside or the first solutions are now no longer satisfactory. For example, Oliver points out that the first drafts of the Bank's charter specifically provided that the Bank might organize and finance two other international organizations to stabilize commodity prices and to help countries develop their mineral resources.

The Bank was named a "bank" because it was originally intended to have the potential to develop into a super-central bank through issuing its own banknotes. One of the questions, then, as now, was the voting power of the less developed countries in the international finance organizations. The battle, then, however, was whether they should have any voice at all. Keynes called this "... the absurd proposition of debtor countries being responsible for international investment." Representation for the developing countries went through only on the stubborn insistence of the U.S. Treasury that all nations, borrowers and lenders alike, should be represented on the governing board.

This period is also fascinating in its evocation of many other issues currently in the news: the original provision that the World Bank keep its accounts in a unit other than the U.S. dollar; the original intention that the Bank, with an initial capital of $10 billion, would be empowered to lend many times that amount (this was dropped after the *New York Times*, among others, editorialized "... how could we be sure of loaning thirty to fifty billions around the world with any prospect of its being repaid?" (Oliver, p. 160)); the U.S. Treasury insisting, over bitter British opposition, on a salary scale that provided the Bank President with a salary three times that being received by the Secretary of the Treasury himself.

While the founders of the World Bank had to *create* an order that made possible an unprecedented period of world economic growth, the contributors to Nerfin's book can base themselves on what has been accomplished and point to its inadequacies and unpleasant by-products. This is not difficult— one can point to the two thirds of mankind who still have to benefit from the spread of modern economic development, and cite the inequalities and the injustices prevalent in national and international economic orders. But then Nerfin's contributors need to come up with practical proposals and policies and, here, rhetoric in most cases substitutes for concreteness. (Ahmed Ben Salah, however, is quite concrete: he wishes to resume the task of socializing the Tunisian economy according to the program he was following when he was ousted and arrested in 1969.)

The theme that is followed by most of Nerfin's authors is the importance of satisfying basic needs in the developing world and creating simpler life styles in richer countries. The paper on Mexico by Cynthia Hewitt de Alcantara is, in fact, entitled: "Mexico: A Commentary on the Satisfaction of Basic Needs." Beyond this, however, the authors begin to vary, if not contradict each other. Jacques Berthelot states that his "... study is intended to contribute to the identification of the deep roots of the crisis in the world capitalist system" (p. 90). Johann Galtung (deliberately?) disposes of Berthelot by the perceptive comment: "... the feeling of an impending crisis may be almost a defining characteristic of western civilization, one of those things that moves people into action, mobilizes new forces and for that reason contributes to the generally expansive nature of western civilization in general and western capitalism in particular" (p. 106).

Over 30 years after the creation of the postwar economic order, it seems clear that some major changes need to be made. Even the very success of that system has created problems: the rapid rates of economic growth that have benefited some nations, groups, or regions more than others have awakened these others to demand a greater share, and made age-old poverty, disease, deprivation, and insecurity now more intolerable to bear. The unevenness of changes in the relative economic and financial strengths of nations has put strains on existing arrangements, whether exchange rates or contributions and voting power in international organizations.

Nerfin's book is a useful but hardly seminal contribution to a lasting solution of these problems, while Oliver's book is a prerequisite to any intelligent participation in the debate.

Andrew M. Kamarck

W. M. Corden

Inflation Exchange Rates and the World Economy: Lectures on International Monetary Economics

University of Chicago Press, Chicago, Ill., U.S.A., 1977, 160 pp., $11.

In his newest book W.M. Corden, like the successful national government in his model, achieves several objectives simultaneously. He provides a concise yet comprehensive outline of international monetary economics for those unfamiliar with the literature, while at the same time raising a number of provocative questions of interest to specialists. He gives a convincing synthesis of the recently elaborated monetarist theory of the balance of payments with the targets-instruments approach developed in the 1950s and 1960s to analyze payments disequilibria. Finally, he relates his model to the most important international economic issues that have arisen since 1971.

Corden's "basic model" does not per se contain any new elements, but the analysis he develops has features of special interest. His emphasis on the effects of current account adjustment on income distribution is especially timely: he shows that downwardly rigid real wages will in all likelihood prevent elimination of a current account deficit. In incorporating the monetarist adjustment mechanism into his model, Corden shows that this mechanism is insufficient to produce adjustment if money wages are rigid downward; moreover, even if adjustment does come about via the monetary process, exchange rate policy may make the adjustment less painful. This analysis, together with the introduction of capital movements into the model, leads into a penetrating discussion of how to define properly "the balance of payments problem."

The first of the policy issues to which Corden applies his model is the question of whether a floating exchange rate regime tends to be more inflationary than one of

fixed rates. After carefully analyzing, by means of a Phillips curve model, why national rates of inflation tend to converge under fixed exchange rates, Corden concludes that "inflation-prone" countries are prone to run higher rates of inflation, and "inflation-shy" countries lower rates of inflation, under floating than under fixed exchange rates. In discussing the related issue of whether inflation has been "exported" by the United States, Corden argues that other countries could have taken measures—such as permitting appreciation of their currencies—which would have resulted in less inflation than has actually transpired.

Corden next discusses the impact of the oil price increases on the general price level, economic activity, and the volume of international liquidity. The initial terms-of-trade effect on income and output is carefully distinguished from the results of policy reactions by the non-OPEC countries. The outcome of this meticulous analysis is that the deflation of 1974—75 can only be partly explained by the initial impact of the oil prices. Corden interprets the rise in international reserves as an increase in official liquidity offset by a decrease in liquidity in the private banking sector (owing to the riskier maturity structure of its assets and liabilities).

The last topic considered is why European monetary integration has failed thus far and whether a case can still be made for it. Developing his previous analysis of inflation under fixed and flexible exchange rates, Corden shows that the higher rates of inflation and the resulting increases in differences between national inflation rates has weakened the basis for monetary integration, but that, if monetary stability were restored, monetary integration might bring the area as a whole closer to an optimum rate of inflation. He discards the "snake" and certain proposals that have been made as "pseudo-unions" which give rise to speculative capital movements rather than providing a viable basis for the coordination of financial policies.

Professor Corden is one of those economists who rarely, if ever, makes a slip, and this book is no exception. However, the conclusions he comes to based on his Phillips curve model might have to be qualified by the recognition that the inflation-unemployment trade-off is not stable over the longer run, especially not when inflation is protracted and high. Another small correction is that Robert Mundell and Arthur Laffer are not, as Corden suggests, the originators of the notion of a "ratchet effect" operating on domestic prices under floating rates: the argument has been made much earlier by others—Robert Triffin, for instance. But these cavils are not important. Corden's balanced and lucid account of recent theoretical and policy controversies is illuminating for the layman and specialist alike.

Anthony Lanyi

Other books received

Charles E. Lindblom

Politics and Markets: The World's Political-Economic Systems

Basic Books, Inc., New York, New York, U.S.A., 1977, xi + 403 pp., $15.

A broad-gauged economic-political comparative analysis of the workings of the Russian, United States, and Chinese systems in a searching examination of the options facing the world community. The author regards questions about government-market relations to be at the core of both political and economic analysis for planned and market-oriented systems. The work aims to dissect and to compare the fundamental characteristics of the dominant systems in the world economy today.

Yair Aharoni with Clifford Baden

Business in the International Environment

Westview Press, Boulder, Colorado, U.S.A., 1977, x + 245 pp., $20.

This casebook, designed primarily for classroom use, draws on business management experience in Europe, Asia, Latin America, and the Middle East as well as in the United States.

P.C.I. Ayre

Finance in Developing Countries

Frank Cass and Co., Ltd., London, England, 1977, 174 pp., $22.50.

A collection of essays which first appeared in a Special Issue on Finance in Developing Countries in the *Journal of Development Studies.*

William G. Tyler

Issues and Prospects for the New International Economic Order

D.C. Heath and Company, Lexington, Massachusetts, U.S.A., 1977, v + 195 pp., $17.

A collection of papers presented at a 1976 conference at the University of Virginia, mostly by academic economists and political scientists, which focuses on topics in the debate on North-South relations, including financial and trade relations; aid, resource transfers, and external indebtedness; commodities; and the role of multinational corporations.

Stephen F. Frowen, Anthony S. Courakis, and Marcus H. Miller

Monetary Policy and Economic Activity in West Germany

Halsted Press, New York, New York, U.S.A., 1977, xvii + 249 pp., $35.

Empirical studies, primarily by European academic economists, on the conduct of policy in the Federal Republic of Germany and on the response of the economy to monetary factors. Most of the papers were originally presented to a conference on German monetary developments at the University of Surrey.

Rodney Wilson

Trade and Investment in the Middle East

Holmes and Meier, New York, New York, U.S.A., 1977, xii + 152 pp., $18.

An attempt to analyze recent trends in Middle East trade and investment and to consider their implications for the region and for the world economy.

Sanjaya Lall and Paul Streeten

Foreign Investment, Transnationals and Developing Countries

Westview Press, Boulder, Colorado, U.S.A., 1978, ix + 280 pp., $25.

A critical appraisal of the role of multinational corporations in meeting the needs of the majority of poor people. A body of new data on the effects of multinational corporations on six countries (Colombia, India, Iran, Jamaica, Kenya, and Malaysia) is presented.

Elihu Katz and George Wedell

Broadcasting in the Third World: Promise and Performance

Harvard University Press, Cambridge, Massachusetts, U.S.A., 1977, xvi + 305 pp., $15.

Broadcasting is among the most underutilized aids to development in an age when almost all developing countries have radio broadcasting facilities and many have acquired television technology from the industrialized world. The authors of this book are experts in the fields of sociology and communication, and adult education, respectively. They provide a general survey of the organization and scope of broadcasting activities in over 90 developing countries and assess the role of the medium in the fields of education and economic development. Finally, they suggest ways in which broadcasting could be allowed to develop and be better utilized for development purposes.

Raymond G.F. Coninx

Foreign Exchange Today

Halsted Press, New York, New York, U.S.A., 1978, 167 pp., $9.95.

An introduction to the technical aspects of the foreign exchange market by a commercial banker for the practical needs of commercial firms.

Bank activity *continued from page 5*

to promote a "road pricing" demonstration project in the United States. Papers based on preliminary reports were presented by the study team at international conferences in Mexico City, Rotterdam, and Warwick (England), as well as at several universities.

It is through efforts like these that the Bank attempts not only to learn about promising new techniques, but also to spread the results as widely as possible, giving the research a truly operational character.

Peter L. Watson

IDA credits approved during fourth quarter of fiscal year 1978

(Ended June 30, 1978)

Country[a]	Purpose	Amount (In millions of U.S. dollars)
Bangladesh (2)	Agricultural research, small-scale industry	13.00
Benin	Port development	11.00
Chad	Education	8.30
Egypt (2)	Agricultural development and credit, sites and services	46.00
Ethiopia	Grain storage and marketing	24.00
Gambia, The (2)	Development finance company, education	8.50
Guyana	Irrigation	10.00
Haiti	Transportation	15.00
India (7)	Dairy development, fisheries, horticulture, irrigation, seeds, thermal power	608.50
Indonesia	Rural credit	30.00
Kenya (2)	Education, urban development[b]	48.00
Lesotho	Rural development	6.00
Madagascar	Hydroelectric power	33.00
Malawi	Rural development	10.70
Nepal (2)	Irrigation, telecommunications	44.50
Niger (2)	Development finance company, forestry	9.50
Pakistan	Agricultural development and extension	12.50
Philippines	Rural infrastructure	28.00
Somalia (2)	Technical assistance, water supply	9.00
Sri Lanka (2)	Tea crop rehabilitation and diversification	25.50
Sudan (2)	Agricultural research, mechanized farming	31.00
Tanzania (4)	Cashew nuts, rural development, textiles,[c] tobacco	73.50
Togo	Feeder roads	5.80
Yemen Arab Republic (3)	Agriculture, highways, textile rehabilitation	29.00
Yemen, People's Democratic Republic (2)	Power, water supply	6.20
Zaïre	Oil palm	9.00
Zambia	Highways[d]	11.25
Total		1,166.75

[a] Figures in parentheses are the number of credits approved for the respective country.
[b] With a $25 million World Bank loan.
[c] With a $25 million World Bank loan.
[d] With an $11.25 million World Bank loan.

World Bank loans approved during fourth quarter of fiscal year 1978

(Ended June 30, 1978)

Country[a]	Purpose	Amount (In millions of U.S. dollars)
Algeria (2)	Education, sewerage	172.00
Argentina	Agricultural credit	60.00
Bolivia	Highway maintenance	25.00
Botswana	Urban development	8.00
Brazil (5)	Agricultural extension, highways, petrochemicals, rural development, urban transport	424.00
Colombia (5)	Development finance companies, electric power, industry, urban development	315.80
Costa Rica	Industrial credit	15.00
El Salvador	Telecommunications, vocational training	32.00
Fiji	Hydroelectric power	15.00
Greece	Vegetable production and marketing	30.00
Guatemala	Power	72.00
Honduras	Agricultural development	10.50
India (2)	Thermal power, telecommunications	225.00
Indonesia (4)	Industry, irrigation, nucleus estates and smallholders	246.00
Ivory Coast (2)	Rubber, sewerage	53.00
Kenya	Urban development[b]	25.00
Korea	Development finance companies	110.00
Liberia (2)	Highways, power	23.80
Malaysia (2)	Ports, land settlement	41.00
Mauritius	Electric power	15.00
Mexico (5)	Development finance companies, livestock credit, tropical agriculture, urban development, agriculture and rural development	419.50
Morocco	Rural development	65.00
Nigeria (2)	Industrial development and finance, oil palm	90.00
Panama	Highway maintenance	12.00
Papua New Guinea	Port development	3.50
Philippines (4)	Agriculture, development finance companies, rural electrification	305.00
Portugal (2)	Agricultural and fisheries credit, education	91.00
Romania	Earthquake rehabilitation and reconstruction	60.00
Syrian Arab Republic	Highways	58.00
Tanzania	Textiles[c]	25.00
Thailand	Sites and services	8.60
Tunisia	Rural roads	32.00
Turkey (3)	Forestry, livestock, steel	205.00
Uruguay	Vocational training and technological development	9.70
Yugoslavia	Hydroelectric power	73.00
Zambia	Highways[d]	11.25
Total		3,386.65

[a] Figures in parentheses are the number of loans approved for the respective country.
[b] With a $25 million IDA credit.
[c] With a $20 million IDA credit.
[d] With an $11.25 million IDA credit.

World Development Indicators

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pothetical stationary population and the dates when each of the countries shown will attain this level, based on a set of assumptions, are shown. Tables 17 and 18, which contain social indicators, provide some information on health and educational services. More extensive reporting of social indicators was hampered by the lack of consistent and comprehensive data.

Sources and methodology

The data are drawn from a variety of sources. Data from UN and other agencies of the UN family have been used extensively along with data from the World Bank's data files. The volume contains a comprehensive set of technical notes that describes the underlying concepts and methodology employed in computing the indicators being carried in the volume. Internationally published sources have been used for the most part since this approach provides a basis for maintaining international comparability. A bibliography of data sources has been included to indicate the major sources used in the preparation of this volume.

The GNP related indicators are based on Bank data and the underlying methodology used in computing GNP per capita was that employed in the *World Bank Atlas*. With this method, GNP in national currency units is first expressed in weighted average prices of the base period 1974–76 and then converted into U.S. dollars at the weighted average exchange rates for this period. The resulting estimates are adjusted for U.S. inflation between 1974–76 and then divided by the midyear population. The three-year base period is chosen in order to reduce the impact of temporary under- or overvaluations of a particular national currency vis-à-vis the U.S. dollar and thus provides a greater degree of comparability of GNP per capita between countries.

In almost all cases growth rates reported in the volume have been calculated in real terms and the least-squares method has been employed. Thus, all observations within the time period reported upon are taken into account. The resulting growth rates are thus not distorted by cyclical factors or exceptional variations in a particular year.

While all possible care has been taken to ensure accuracy, the statistics, particularly with respect to developing countries, are, by their very nature, often weak and subject to considerable margins of error. Thus users are urged to exercise caution in making intercountry comparisons. These statistics are nevertheless useful in describing broad orders of magnitude, showing trends, and generally describing major differences between countries. Readers should not attribute a degree of precision to the data which is not intended.

Reference handbook

The Bank hopes the *World Development Indicators* will provide students of development, policymakers, and officials both at the national and international level with a ready and concise work of reference. By its very nature the volume is not designed to provide historical time series and basic values. For these purposes, the various statistical publications of the UN Statistical Office and the specialized agencies, along with the Bank's own *World Tables*, are much more appropriate sources.

The Bank plans to update and improve the scope of the *World Development Indicators* and issue them annually. To better serve the requirements of its users, the Bank would appreciate receiving comments and suggestions designed to facilitate the improvement of the volume.

R. Chander