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To McN - Nov. 18
see McN comments

(4)

November 18, 1969
711/5/5

Hold
(per memo of
Nov. 24)

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 12 concerning Aid Coordination

Recommendation

"We therefore recommend that preparations begin at the earliest possible moment for establishment, where necessary, of new multilateral groupings which provide for annual reviews of the development performance of recipients and the discharge of aid and related commitments by donors. The World Bank and the regional development banks should take the lead in discussions to this end, and the World Bank, or another appropriate existing agency, should provide the necessary reporting services for such groups."1/

Background

This recommendation reflects the Commission's concern about the extent to which development assistance is still uncoordinated, unrelated to any agreed set of priorities in the economies of recipient countries, and insufficiently guided by and responsive to "development performance" as contrasted to other considerations, such as historical relationships between donors and recipients and political objectives of donor governments. The Commission considered that the Bank's activities in the field of aid coordination, particularly its sponsorship of coordination machinery such as consortia and consultative groups, and its staff support of aid coordination exercises

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1/ Report, page 131

sponsored by others, have made an important contribution to the solution of this range of problems. The recommendation, in effect, is that these efforts should be pursued and, where appropriate, expanded to cover additional developing countries. But the Commission also proposed that coordinating efforts be deepened and strengthened in various ways, e.g., by extending them to technical assistance and by giving the coordinating groups responsibility for reviewing not only recipient country performance but also the extent to which donor countries' aid and related commitments towards recipients have been discharged. The Commission further suggested that, for some of the smaller countries, coordination might be effected through regional groupings. Finally, it proposed, with respect to the regional development banks, that they should play some role in initiating discussions looking to the creation of new groupings, and might eventually, as and when they develop the capacity to do so, provide some of the requisite reporting services for the new groups.[1/]

Analysis

As the Executive Directors know, we are expanding our program of economic missions. Annual reviews of development performance will be prepared for 32 countries: all IDA Part II countries with a population of more than 10 million, plus a few others which have active development programs with which the Bank Group is closely associated. Reports on the other developing

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1/ Ibid., pp. 130-131

member countries will also be prepared, although less frequently, i.e., on a biennial or triennial basis. Economic reports will therefore be undertaken on a more regular schedule than has generally been the case in the past. In addition, they will be more comprehensive. They are intended to provide, over time:

(a) an evaluation of the situation and prospects of the economy;

(b) an analysis of the country's development objectives and of the major development obstacles and assets of the economy;

(c) an informed judgment concerning the appropriate development strategy to be pursued by the government concerned and the likelihood that it will take the action required to carry out that strategy;

(d) an assessment of domestic and external financing requirements and of the possibilities of meeting them;

(e) an analysis of the principal pre-investment surveys and studies required to carry out the development program and of the relative priorities of those requirements;

(f) an appraisal of the available machinery for planning and for the formulation of economic and financial policy; and

(g) an analysis of the problems of investment and resource mobilization and allocation within the economy and among sectors, of external debt prospects, of appropriate borrowing terms, and of creditworthiness.

The Bank's experience indicates that the most important element in promoting coordination for any developing country, whether or not a formal aid coordination group exists, is the provision to all interested donor governments and institutions of objective, comprehensive and up-to-date reports of this kind. Such reports are necessary to provide guidance for those who make decisions about aid programs, help all concerned to proceed on the basis of a common understanding concerning the critical development problems facing each country, indicate priority sectors for financial and technical assistance and, to an increasing extent, outline development strategies agreed between the country in question and the Bank as being both reasonable and worthy of international support.

– review the meeting schedule, past + future of these grps

Twenty-two of the 32 countries which we plan to review annually are the object of attention by some form of "multilateral groupings", which review both the development performance of the country in question and the development assistance activities, in that country, of interested donor governments. The Bank takes principal responsibility for 14 of these groups: the India and Pakistan Consortia, the Consultative Groups for Colombia, East Africa (Kenya, Tanzania, Uganda and the East African Community), Ghana, Korea, Malaysia, Morocco, Nigeria, Peru, Sudan, Thailand and Tunisia, and the Ceylon Aid Group. Several of these Consultative Groups are inactive at present for reasons beyond the control of the Bank.

The Bank also provides economic reports which serve as the basis, or one of the bases, for the deliberations of coordination and review groups covering another six of the 32 countries: the Inter-Governmental Group for Indonesia (chaired by the Government of the Netherlands); the Turkey Consortium (sponsored by the Organisation for Economic Co-operation and Development with an independent chairman); and the Inter-American Committee for the Alliance for Progress (CIAP) reviews of Argentina, Brazil, Chile and Mexico.

In addition, the Bank has provided analytical reports for the informal, although quite active, aid coordination group convened by the Government of Guyana, and has participated in the discussions of that group.

what - list by country

As the Commission recognizes, a great deal has already been achieved, through coordination, to make aid more effective. But there is no doubt that much more could and should be done. The inherent difficulty of doing so should not be minimized. Effective coordination of the aid programs of a number of donors, whose objectives and motivations may not be identical and whose approaches and systems of administration are likely to differ one from another, is a task both complex and delicate. Moreover, our own efforts have been constrained by staff limitations. I am confident that we are making progress, but I know that we have much to learn about the coordination process. We have tried to maintain a flexible attitude, and to adapt the format and the emphasis of the groupings under our chairmanship to the circumstances and needs of the particular recipient country and to the positions of donors.

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list which

I agree with the Commission that a number of countries could benefit from better coordination of development assistance. For some, this means an improvement in existing coordination machinery. It would mean the creation of coordinating arrangements for others.

Some of the poorest countries receive financial assistance from no more than one or two donors, but technical assistance from several. For these, coordination of technical assistance is accordingly more important than coordination of finance. In the existing groups chaired by the Bank, only a start has been made in the coordination of technical assistance. As is noted above, our economic missions will be seeking to determine priorities for pre-investment as well as investment activities. The U.N. Development Programme (UNDP) will be cooperating with these missions, especially with respect to the technical assistance and pre-investment aspects of the missions' inquiries, through the UNDP Resident Representatives. I am hopeful that this will contribute to better coordination in this field, to the importance of which the Commission has called attention.

As for new groupings, the Bank staff is now discussing with four coun- which tries whether, and how, coordination arrangements might be created for them. Some of these may be formal consultative groups, while others may be less formal in character. In each case, however, action by the Bank, as the Commission has recognized, is dependent upon the agreement of the recipient country as well as of donor governments and agencies.

X I am somewhat doubtful about the Commission's proposal that the groups, both new and existing, should engage in "explicit and formal" review of donor aid policies and procedures, as well as of the performance of the recipient country. Although the Bank has reviewed the terms of aid offered by the members of its consultative groups, and although participation in such a group leads obviously to comparisons of donor performance, no group has thus far served as a forum for donor performance reviews. The Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development does serve as such a forum, and also establishes general standards for the volume and terms of aid. I am not sure that it would add much to the DAC review and evaluation process if the aid coordinating groups were also to be used as forums for reviewing each member's performance with respect to the respective recipient countries. Indeed, the result of such an effort might well be to make creation of additional coordinating groups more difficult.

Start in Bank Board?

The Commission's proposal that some of the new coordinating groups should be regional in scope has attractions, particularly for areas where a number of smaller countries are seeking to develop their economies within the framework of a regional market. We have in fact organized one coordinating exercise on a regional basis: the Consultative Group for East Africa, covering Kenya, Tanzania, Uganda and the East African Community. The three countries and their Community have many common ties and, in some respects, are operating as an economic region, so that a regional mechanism seemed entirely appropriate. However, in practice it has proved necessary to conduct the activities of the consultative group for the most part on a country, rather than a regional, basis. Nevertheless, although this experience has not been encouraging, I believe that the Bank should take an affirmative approach toward creating or supporting other regional coordinating groups when it appears appropriate to do so.

The Commission's suggestion that the regional development banks should eventually take the lead in organizing or providing the reporting needed for coordination exercises in some of the smaller countries is worth consideration.[1/] In at least two of the three regional banks majority ownership is in the hands of borrowers and potential borrowers; it remains to be seen whether donor countries will accept the views of such banks on matters such as performance, external capital needs, etc., which are an essential part of a coordination exercise. The one experiment to date by a regional bank in this field was not successful. In any event, as far as the Bank is concerned, we already send our country economic reports to the regional banks, and we would certainly be prepared to make them available to, and to

1/ The role of the regional banks in country economic reporting is considered in another in this series of analytical memoranda.

participate in, any aid coordination groups which these banks might be able to organize.

It is possible, although not necessary, to read the Commission's principal recommendation as advocating annual meetings of aid coordination groups as well as annual reviews of recipient and donor performance. I do not believe that a rigid formula of annual meetings is desirable or is likely to be acceptable to any of the parties involved. Our experience has shown that such meetings, to be effective, should be held only when there are important issues to discuss. For some aid coordination groups annual or even more frequent meetings will be appropriate. But insistence on a schedule of annual meetings for other groups would entail a misdirection of staff resources both for the governments concerned and for the Bank.

Conclusion

We intend to continue our efforts to expand and improve our aid coordination activities. In the process of our review of the development prospects of each developing country, we shall consider whether and what kind of "new multilateral groupings" are desirable. We also intend, as in the past, to review periodically with the principal interested governments the experience we gain in coordinating groups, with the object of continuing efforts to improve their effectiveness. No immediate action by the Executive Directors is required. ~~However, it should be noted that the increased activity contemplated will~~ in due course ~~have staffing and budgetary implications.~~

Robert S. McNamara

1/5 to Mr. Demuth

An excellent treatment of a most difficult subject -- it is so important you, Burke, Siem, Irving and I should discuss it before submitting the memo to the Board. Please distribute the memo to them and schedule the discussion for 1/19 following the P.C. meeting.

McN

Burke Knapp
Siem Aldewereld
Irving Friedman
P.C = President's Council

1/5 To Mr. Demuth

FORM NO. 57 | INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

711/5/14

OFFICE MEMORANDUM

TO: Mr. McNamara **DATE:** December 31, 1969

FROM: Richard H. Demuth

SUBJECT: Pearson Commission Recommendation on Debt Relief

Attached for your consideration is a draft memorandum analyzing the Pearson Commission recommendation on Bank participation in debt reschedulings. As you will see, the memorandum proposes that we should preserve the "special position" which we have in the past asserted and which has been accepted by other major creditors, but it also proposes that we should be willing to participate financially (i.e., relax the terms of our loans) if the circumstances of the particular debt crisis justify it or make it essential for us to do so. I think this is the right position for you to take, and that it is probably the only one which the Executive Directors would accept. Nevertheless, given the continuing growth of the Bank's lending operations and its position as a major creditor, I believe that, in practice, it will prove necessary for us to participate to an increasing extent in rescheduling operations. However, I see no need to announce that now. The draft memorandum preserves our flexibility.

Ronnie, to whom I have shown the attached draft, is concerned about the reference to the Articles of Agreement and to the Bank's legal right to modify its loans, made in the first sentence of page 5, because he thinks it may revive the controversy that arose concerning the legal opinion he rendered at the time of the Indian debt rescheduling and which is cited in footnote 2 on that page. I believe that the memorandum is so written that it will not give rise to the kind of controversy Ronnie is worried about and that it would not be proper to send a memorandum to the Board which had no reference to the specific provision in the Articles of Agreement which deals with the subject analyzed in the memorandum.

cc: Mr. Broches

An excellent treatment of a most difficult subject. It is so important you, Burke, Siem, Irving & I should discuss it before submitting the memo to the Board. Please distribute the memo to them & schedule the discussion for 1/19 following the P.C. meeting.
[illegible]

DRAFT
December 22, 1969

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 14 Concerning Debt Relief Operations

Recommendation

"We recommend that debt relief operations avoid the need for repeated reschedulings and seek to re-establish a realistic basis for development finance. The World Bank and the IMF, as important providers of long-term and short-term finance respectively, must of course participate in rescheduling discussions."1/

Background

In the Commission's judgment, the procedures and principles for debt relief operations in recent years have often been inadequate. The report points out that the debt problem of developing countries cannot be looked at in isolation from the over-all problem of economic growth or the need for future foreign assistance. Nonetheless, the Commission found, "/t/he emphasis has usually been placed on speedy resumption of debt service payments rather than on re-establishing /a/ financial framework for orderly growth."2/

While the Commission believed that debt relief should not be provided "irrespective of the policy performance of the debtor country" and that

1/ Report, p. 157

2/ Ibid., p. 157

debt relief is not justified "/I/f a debt crisis is patently the result of mismanagement and there is no reasonable hope for a change of policy," it also stressed that "the accumulation of excessive debt is usually the combined result of errors of borrower governments and of their foreign creditors.[1/]

The Commission found that, in several instances, debt had been rescheduled on the basis of short-run accommodation which failed to ensure an orderly resumption of normal financial relations and had to be followed soon thereafter by further rescheduling operations. This "short leash" approach, in the Commission's view, creates undesirable uncertainty and hampers the efforts of the debtor to formulate the long-term plans and policies necessary to ensure renewed growth of the economy. The Commission concluded, therefore, that, when debt relief is justified, it should be given for "an adequate period to avoid a rapid succession of debt relief negotiations." It added that debt problems should, preferably, be considered in "consortia or consultative groups where the accent of the discussion is placed on development problems and policies."[2/]

The Commission's report recommends participation by the Bank and the Fund "in rescheduling discussions." The report is ambiguous as to whether the Commission intended such participation to be in an advisory capacity or to include financial participation in debt relief operations; the Commission's staff has advised that the intention was to recommend both. Accordingly, both forms of participation by the Bank are examined below.

Analysis

a) Participation in debt relief discussions

In the last 10 years, The Bank has attended the discussions for all but one debt relief operation

1/ Ibid., p. 156

2/ Report, p. 157

for its member countries, generally as an observer. In all these discussions, Bank staff, together with staff of the IMF, has provided technical information and independent advice on the economic condition and prospects of the debtor country. The Bank has been particularly concerned to stress the implication for long-term growth in the debtor country of alternative solutions to the immediate debt problem.

I share the Commission's view that "/t/here is a close connection between debt difficulties and the need for future foreign assistance."1/ I therefore agree that, when requested to do so, the Bank--in close cooperation with the Fund--should actively participate in the discussions between the creditor countries and a debtor country which is experiencing a debt crisis; and that, in such discussions, the Bank staff should continue to pay particular attention to the probable effects of any proposed relief on the future development of the debtor.

I do not believe, however, that it would be feasible or desirable to establish specific ground rules as to the type of debt relief which should be generally provided and which Bank staff should advocate in discussions. Each debt crisis differs in some degree from others, both in its origins and in the circumstances that surround it; its solution depends to a large extent on the past and present political relations and patterns of trade between the debtor country and its creditors, the degree of confidence which the creditors have in the government of the debtor country, and the financial and balance-of-payments positions of the individual creditor countries. Internal institutional constraints in particular creditor countries also influence the possible terms of a debt relief operation.

1/ Report, p. 157

Moreover, the views of developing and developed countries on debt relief operations in general are still far apart. While UNCTAD II advocated that, as a matter of generally accepted policy, where debt difficulties do arise, creditor countries should stand ready to deal reasonably with them within the framework of an appropriate forum, creditor countries have insisted that debt relief, at least in the form of debt rescheduling or consolidation, should continue to be considered as an exceptional course of action and no institutional arrangements should be contemplated to deal with such exceptional circumstances.

In the circumstances, I believe that the Bank should maintain its case-by-case approach to the solution of debt crises and should continue to stress the need for preventive measures designed to avoid, to the extent possible, the precipitation of such crises. To this end, (i) improved and intensified economic reporting and analysis, (ii) an improved system of external debt reporting, including the joint Bank-OECD arrangements, (iii) increased assistance and advice by the Fund or Bank on external debt management, and (iv) intensified coordination of external aid, including careful consideration of the terms of such aid, should help in identifying debt difficulties in advance and in indicating what measures, domestic and external, may be necessary to mitigate or avoid them.

b) Financial participation in debt relief operations

In spite of the efforts of all concerned, debt crises are still likely to occur in the future, often for reasons beyond the control of the debtor country. The Bank, as a major creditor, will have to consider in each case whether and to what extent it should participate financially in the solution of a particular crisis.

[There is a provision in the Bank's Articles of Agreement (Article IV, Section 4(c)) expressly permitting relaxation of the terms of Bank loans upon application of a member[1/], and the Bank, as a lending institution, has legal capacity in any event to modify the repayment terms of its loans if this is in the interests of the Bank and of the member concerned[2/]. Nevertheless,] the Bank has in practice agreed only exceptionally to participate financially in general debt rescheduling exercises.[3/] For a number of reasons, the Bank's position differs from that of governments which have extended or guaranteed loans. First, the Bank's loans are all long-term and extended only for productive projects; they are in a different category, therefore, from medium- or short-term export credits extended or guaranteed by governmental agencies. Yet it has been an excessive use of such export credits, sometimes for purposes of questionable priority, which has most frequently caused debt difficulties.

[1/ "If a member suffers from an acute exchange stringency, so that the service of any loan contracted by that member or guaranteed by it or by one of its agencies cannot be provided in the stipulated manner, the member concerned may apply to the Bank for a relaxation of the conditions of payment. If the Bank is satisfied that some relaxation is in the interests of the particular member and of the operations of the Bank and of its members as a whole, it may take action under either, or both, of the following paragraphs with respect to the whole, or part, of the annual service:

(i) The Bank may, in its discretion, make arrangements with the member concerned to accept service payments on the loan in the member's currency for periods not to exceed three years upon appropriate terms regarding the use of such currency and the maintenance of its foreign exchange value; and for the repurchase of such currency on appropriate terms.

(ii) The Bank may modify the terms of amortization or extend the life of the loan, or both."

2/ See R63-39.]

3/ The Bank's attitude has not been based on legal considerations, and apart from its general powers as a creditor to relax loan terms, the Articles expressly contemplate debt rescheduling for balance of payments reasons (Art. IV, Section 4(c)).

Second, because the Bank, unlike governments, has no taxing powers, it must rely on market borrowings for the major part of its resources; accordingly, maintenance of a sound financial position and its credit standing are of fundamental importance to it. ~~Yet~~ Both might be adversely affected by the Bank's participation in extensive debt reschedulings. Third, the Bank needs an assured flow of income from its loans in order to meet interest requirements on its obligations; it would be difficult, therefore, for the Bank to join in debt reschedulings involving substantial waivers or even deferments of interest payments.

This "special position" of the Bank has been recognized by the principal creditor countries, which have agreed to extend debt relief in most cases without ~~urging~~ expecting that the terms of existing Bank loans to the debtor country also be rescheduled. In my judgment, this position represents the proper posture for the Bank and should be maintained. The Bank Group can ~~help~~ make its most effective contribution in situations of debt crisis by providing new funds on appropriate terms to help carry forward development programs.

This does not necessarily mean, ~~however~~, that the Bank should never participate in a debt relief operation. There may ~~will~~ be cases where, by reason of special circumstances, financial participation by the Bank in such an operation would be warranted. An example is the Indian debt rescheduling operation of 1968. The Indian debt problems did not arise from an accumulation of short-term credits but rather from the totality of external debt, much of which was the result of aid extended through the Indian Consortium chaired by the Bank. The principal problems were, in the short run, to reduce the call on India's limited free foreign exchange by postponing debt payments and, in the longer run, to make the terms of official aid more compatible with India's needs. The rescheduling discussions were held within the framework of the Consortium. Financial participation by the Bank, itself a large creditor, was considered by the other creditors to be, if not an essential, at least an important element in reaching agreement. Under these circumstances, the Bank agreed to reschedule some of the maturities on its loans. Some other creditors not only rescheduled maturities but waived interest on those maturities for 10 years. Because of the Bank's special position, it did not waive or defer interest payments on the maturities it rescheduled, but it agreed, in compensation, to reschedule a larger percentage of the maturities owing to it. ?

[Other serious debt crises may well arise in the future of such a nature that solution of the problem depends upon, or at least justifies, financial participation by the Bank, despite its special position. Precisely what circumstances would constitute such a justification cannot be defined in advance since, as already pointed out, each debt crisis is to a significant extent unique. I believe, therefore, that determination of the Bank's position on financial participation, as well as on the nature and extent of such participation if in fact it decides to participate, should continue to be made in the light of the particular facts of each case, using as a guiding principle the policy embodied in the Articles that rescheduling should be undertaken if, but only if, "the Bank is satisfied that some relaxation /of the conditions of payment/ is in the interests of the particular member and of the operations of the Bank and of its members as a whole."]

Conclusion

The Bank should continue to pay close attention to the increasing debt burden of the developing countries and the danger of debt crises and, in close cooperation with the IMF, to recommend to debtor countries and their creditors preferably within the framework of aid-coordinating groups, suitable policies and measures to prevent such crises. In its operations, particularly in determining the blend of IDA and Bank funds in countries eligible for IDA assistance and in setting the terms of Bank loans, the Bank Group should continue to pay particular attention to the effects that its financing will have on the external debt burden of its borrowers. Where, in spite of the efforts of the debtor country and its creditors, a general restructuring of the external debt of that country becomes necessary, the Bank should, when requested, participate in an advisory capacity in the rescheduling discussions. Because of

~~normally~~ be expected to

its special position as a creditor, the Bank should not participate financially in debt reschedulings ~~[as a matter of course. It should be willing to participate financially, however, whenever the circumstances are such that solution of the debt crisis depends upon, or at least justifies, relaxation of the terms of the Bank's loans. Each case must be examined on its own merits to determine whether and to what extent any such relaxation is justified as being not only in the interests of the debtor country but also in the interests "of the operations of the Bank and of its members as a whole."]~~

Robert S. McNamara

To McN Nov 18
No changes 711/5/14

November 17, 1969

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 16 concerning Joint or Parallel Financing

Recommendation

"We recommend that multilateral agencies extend the practice of joint or parallel financing of projects."1/

Analysis

This recommendation comes in Chapter 9 dealing with ways of making aid more effective. It is one of a series of recommendations in the context of a sharp criticism of aid tying and is put forward as one way in which the multilateral agencies can help to mitigate the harmful effects of tying.

The Bank shares the view of the Commission that joint financing between multilateral and bilateral agencies, where feasible, can help borrowers to obtain the advantages of wide international competitive bidding while at the same time utilizing some of the tied bilateral assistance available to them. Joint financing between the Bank and co-lenders also has other advantages. It provides a means whereby funds from other sources are channelled into high priority projects. Because of the responsibility taken by the Bank for project appraisal and supervision, the execution of jointly financed projects is likely to be more effective than might otherwise be the case. And joint financing with the Bank enables bilateral agencies, notably those in some of

1/ Report, page 174. The Commission did not say what it meant by "joint or parallel financing." As used in the Bank, "joint financing," in its narrow sense, refers to arrangements under which individual contracts for a single project or program are financed partly by the Bank and partly by the co-lender(s). "Parallel financing," as used in the Bank, refers to arrrangements under which the Bank provides all the external finance for individual contracts or separable facilities for a project or program and co-lenders provide all the external finance for other contracts or other facilities. For purposes of this memorandum, however, the term "joint financing" is used in a general sense to include all arrangements for co-lending.

the smaller aid-giving countries, to insure that their funds are being applied to sound projects without the necessity of building up large project appraisal staffs of their own. For all these reasons the Bank maintains a positive and flexible attitude towards joint financing wherever it can be carried out under conditions insuring wide international competition and without involving unduly complex procedures.

A recent review of the Bank's experience reveals a great diversity in the methods of joint financing that have been used. No one formula, and no one set of rules as to the detailed arrangements, can fit all circumstances. Attached as Annex 1 is a table showing the number of projects, total cost, foreign exchange cost, and the contribution of the Bank or IDA and co-lenders, respectively, in joint financing operations for 1955-1968 and up to October 15, 1969. The table indicates that, while joint financing has been a regular feature of Bank operations for many years, both the number of such operations and the amounts involved increased sharply in 1968 and 1969. This reflects both greater efforts by the Bank to find ways of associating Bank Group finance with funds available from bilateral sources and greater interest by a number of national aid and export financing agencies in becoming associated with projects appraised and partly financed by the Bank Group. There is being circulated separately a summary analysis of the kinds of joint financing arrangements in which the Bank or IDA has been involved through 1968.

Some types of joint financing arrangements have been quite difficult to work out and have imposed a significant administrative burden on the Bank, on co-lenders and on borrowers. Where funds of a bilateral co-lender are already untied, as are those of the Swedish International Development Agency, there is no significant administrative difficulty. On the other hand, joint financing with co-lenders providing funds tied in various ways and operating under different sets of constraints, as in the case of the Colombian power and water supply[1] and the Mexican power projects,[2] has involved extensive negotiations and detailed administration; this type of financing is therefore likely to be appropriate primarily for larger projects.

While several variations are possible, the basic necessity, if tied funds are to be "untied" by use of joint financing techniques, is to obtain credit offers from the countries likely to win orders under a system of international competitive bidding, each country so participating agreeing to finance the whole, or an agreed proportion, of the orders it receives. If international competitive bidding is to be open to all Bank members, credit offers have to be available from all the countries which are likely to be competitive.

If, however, only a few countries are prepared to participate, it may be necessary to restrict bidding to these countries. While even some competition is better than none, the full contribution of joint financing in untying tied aid can be achieved only by a broad participation by equipment-supplying countries.

In a joint financing operation, the terms on which countries are prepared to provide credit are important. It is understandable that capital goods exporting countries wish to avoid a credit race involving ever-increasing periods of credit and subsidized interest rates. It would, however, greatly facilitate joint financing if countries were prepared to adjust the terms of their lending to a reasonable extent so as to have a minimum term and a maximum interest rate agreed to by all participating countries, so that orders can be allotted purely on the basis of price. The longer this minimum term is, the more suitable the joint financing will be for the needs of the less developed countries.

1/ Loans 536 CO and 537 CO, June 3, 1968; Loan 575 CO, December 2, 1968.

2/ Loan 436 ME, December 15, 1965; Loan 544 ME, June 28, 1968.

Progress by potential co-lenders towards standardization of credit terms for projects financed jointly with the Bank would facilitate increased use of joint financing, as suggested by the Pearson Commission, thus effectively extending the field of competitive bidding and enabling borrowers to make the best use of the tied funds available to them.

Conclusion

The staff has been instructed to examine every project requiring substantial external financing to see whether it has possibilities for joint financing. Such joint financing is facilitated by the Bank's practice of maintaining close contacts with both development aid and export financing agencies in the principal capital-exporting countries that are potential co-lenders. Since the Bank's policies are consistent with the Pearson Commission's recommendation, no action by the Executive Directors is necessary.

Robert S. McNamara

JOINT FINANCING OPERATIONS BY YEAR OF SIGNATURE OF LOAN OR CREDIT

Year	No. of Projects	Total Cost	Foreign Exchange Cost 1/	Bank/IDA Contri-bution	Co-lender amount 2/	% Total Cost Bank/IDA	% Total Cost Co-lenders
Primarily development finance:		------------	------------	$ million	------------		
1955	1	26.6	18.0	18.0	2.6	67.6	9.7
1956	1	226.0	200.0	80.0	128.8	35.3	57.0
1957	2	54.0	32.3	20.1	16.5	37.2	30.5
1958	2	61.7	41.1	41.1	6.4	66.6	10.3
1959	3	195.6	160.4	60.2	32.3	30.7	16.6
1960	7	279.7	230.2	113.0	56.3	40.4	20.1
1961	5	283.4	151.6	75.1	63.7	25.4	22.5
1962	1	196.0	118.0	47.0	51.0	23.9	26.0
1963	3	97.6	64.6	43.6	22.9	44.6	23.5
1964	8	445.4	284.5	145.6	99.5	33.2	22.3
1965	2	37.8	25.1	15.7	17.1	41.5	45.2
1966	1	39.0	24.0	19.2	4.8	49.2	12.3
1967	4	125.0	94.3	53.2	18.0	52.5	14.4
1968	9	586.4	264.8	145.9	150.3	25.2	25.7
1969 thru Oct. 15	10	577.8	242.4	153.4	101.8	26.5	17.6
Total	59	3,232.0	1,951.3	1,031.1	772.0	31.9	20.8
Indus Basin 3/ and Tarbela	2	1,626.0	1,030.0	173.4	1,191.5	10.7	73.3
Total	61	4,858.0	2,981.3	1,204.5	1,963.5	24.7	40.2
Export Finance							
1968	5	536.6	320.7	250.0	51.4 4/	46.5	9.6
1969	1	247.4	80.0	60.0	19.7	24.3	7.9
Total	67	5,642.0	3,382.0	1,514.5	2,034.6	26.8	36.0

1/ Includes some estimates.
2/ Excluding public issues but including private placement through banks.
3/ The saving of $324 million in the Indus Basin Fund has been deducted from both the total cost and the co-lenders' amount and pro-rata, 60% from the foreign exchange cost.
4/ Amounts likely to be utilized following pattern of award of contracts.

F11/5/2

November 14, 1969

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 7 concerning IFC Policies

Recommendation

"We . . . believe that the international agencies should play a more active role in advising developing countries in their policies toward foreign investment. . . . We hope that a reorientation of IFC policy /less emphasis on profitability and more on the economic implications of its investments/ is possible. . . ."1/

Background

This recommendation appears in the context of a discussion on ways in which developing countries might realize greater advantages from foreign investment. While many of IFC's investments have benefitted the host country, others, the Commission finds, have contributed only marginally, if at all, to economic development, rarely being preceded by an analysis of their impact on the country's economy. This, the Commission says, is because profitability has been IFC's principal investment criterion. While it does not suggest that IFC should ignore profitability, it urges that IFC reorient its policies "for the sake of the economic impact of its own investment and even more for that of the new investments which . . . it is well placed to promote."

Analysis

As the Commission recognizes, profitability is an essential investment criterion for IFC. The IFC Articles direct it to undertake its financing on terms and conditions which take account, among other considerations, of "the terms and conditions normally obtained by private investors for similar financing."2/ In addition, it is directed to "seek to revolve its funds by

1/ Report, page 114-115.

2/ Art. III, Sec. 3(v).

See new page

selling its investments to private investors whenever it can appropriately do so on satisfactory terms."1/ IFC wants partners in the enterprises in which it invests, it wants to revolve its funds by selling seasoned securities out of its portfolio and, above all, it wants to encourage the growth of private productive enterprise in the developing countries. Each of these objectives alone, and certainly in combination, makes the prominence of the profitability criterion inevitable.

It is true that IFC has not in the past had a strategy of development based on the needs of the countries in which it operated. It tended to consider individual projects as they came up. One reason was that, until the Bank's Articles of Agreement were amended to permit it to lend to IFC, IFC did not have sufficient resources to enable it to make a significant impact on the economies of its member countries. Another was that in the past it did not itself engage in promotional activity but instead concentrated on a catalytic role, investing in projects which either would not go forward at all, or would not go forward as quickly or as effectively, without its help.

Having said this, I must add that, in my judgment (and in the opinion of the members of the IFC Advisory Panel expressed at their meeting in October),2/ the Commission has underrated the attention which IFC has paid, particularly in recent years, to the developmental significance of the projects in which it invests. This has been a matter of increasing concern. IFC's Annual Report for 1969 declares that IFC

> "believes that in the current stage of development, and under present and foreseeable conditions of capital markets, the continued success of development in raising living standards will turn, in many places,

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1/ Art. III, Sec. 3 (vi).

2/ IFC/R69-45, dated October 24, 1969.

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See next page

to an increasing degree upon locating, and bringing into operation, development enterprises that satisfy both public and private profit motives."1/

It defines "public profits" to mean

"the usual objectives a public sector planner would have in putting to use scarce and costly capital for national purposes, including: higher national income; higher foreign exchange earnings or reduced foreign exchange outlays; higher productivity of capital and labor; higher employment; increased supplies of industrial and agricultural goods and services needed by the country; expanded and improved labor and management skills; growth of financial, service and trade businesses to connect up, finance and handle the products of the country's growing economy; growth of a national capital market and of its connections to the rest of the world, and achievement of such gains with minimum addition to the national debt service burden."2/

Although my appraisal of the current situation is, therefore, less negative than that of the Commission, I nevertheless agree that developmental significance should be given a more prominent place in IFC's investment decisions. This shift in emphasis has already begun and will be reflected in the revision of the IFC policy statement which I shall soon submit to the IFC Board for approval.

At the same time, I agree with the Commission's recommendation that IFC should be better equipped to ascertain and to take into account the economic implications of its investments. One step I have taken in that direction is to authorize IFC to appoint an Economic Adviser who will add to IFC's in-house economic strength. In addition to the attention which IFC will thus be enabled to bring to bear directly upon the implications of proposals which it is considering, IFC will have the benefit of the work of the new Industrial Projects

1/ Annual Report, 1969, p. 6.

2/ Ibid.

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1/ Annual Report, 1969, p. 6.

2/ Ibid.

Department of the Bank. As I have pointed out in another of this series of memoranda, it is my intention that the work of IFC and the new Bank Department should be complementary.

Conclusion

The paths along which IFC is proceeding are consistent with and should effectively implement the Commission's recommendation. I intend soon to submit for the approval of the IFC Board a revised IFC policy statement which will reflect this trend.

Robert S. McNamara

To McN · Nov 18
Changes in pencil = McN

November 14, 1969

To P/c Nov. 24

711/5/3

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 9 concerning IFC Project Identification and Investment Promotion Work

Recommendation

"Because the IFC and organizations like it have links with the private sectors of both developed and developing countries, they are logical agents for project identification and investment promotion work, and they should become much more active in this field."1/

Background

The Commission reports that it received the "definite impression that most low-income countries would welcome a larger flow of foreign investment." It offers four principal suggestions for ways to increase the flow, one of which is the recommendation quoted above. The Commission notes that there are bilateral programs intended to stimulate the flow of private capital, which include subsidization of investment surveys and the publicizing of investment opportunities. It comments that these programs are useful, but ovten too small and too imperfectly geared to the investor's real needs, and it recommends that they should devote more attention to inducing small and medium-sized investors to take up projects in developing countries, providing them where necessary with technical assistance. The report proposes that "similar change" should be encouraged with respect to IFC. Commenting that in the past IFC has interpreted its Articles "to mean that it should leave all project initiative to others," the Commission adds that there are signs that IFC and similar bilateral institutions are beginning

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1/ Report, p. 123.

to appreciate the role they could play in actively identifying new investment opportunities and bringing together domestic and foreign partners to execute them. There follows the recommendation that IFC and similar organizations become much more active in this field.

Analysis

The Commission is correct in stating that in the past IFC was content to leave the project initiative to others. But its reference to IFC's current approach does not fully reflect plans for the future. [what has been achieved recently]

In July 1968, I told the IFC Board that I considered that IFC had established itself in the industrial and financial community and had built up staff experience to the point at which it could usefully do more in the direction of investment promotion. Many developing countries were thought to have a low absorptive capacity with respect to industrial projects. But, if experience in other fields was any guide, some of this apparent lack of absorptive capacity could be overcome by increased preinvestment assistance. Experience also indicated that there were instances of promising investment opportunities in the developing countries where projects had not been carried out, or had been carried out inefficiently or ineffectively, because of the absence of suitable sponsors to do the necessary developmental and promotional work. We [I] therefore proposed that IFC should become more active in seeking to promote industrial projects where there was a reasonable prospect that the project would eventually be suitable for financing by IFC in accordance with its established criteria. We [I] proposed, further, that IFC should be free to suit the form of promotional activity to the needs of the proposed venture and the circumstances prevailing in the country in which the venture would be located. This might mean, in some instances, that IFC would assume responsibility for implementing a project from its inception, through the stages of a feasibility study, detailed engineering and market investigations, finding technical and financial partners and putting together a financial package. At the other extreme, it might mean that IFC would participate as one of a number of shareholders in a pilot company which would conduct the requisite investigations on behalf of a group of technical and financial sponsors already committed to proceed with the venture if the investigations demonstrated the project's viability. We [I] suggested an over-all limit of $250,000 for promotional costs. The Board approved the proposal, with a limit of $50,000 for any one project.

Under this policy, in the 1969 fiscal year IFC invested in an industrial promotional company in Honduras1/ and in two tourism promotional ventures in Colombia2/ and Tunisia.3/ IFC also committed funds to a cement project in Indonesia, taking primary responsibility for determining the feasibility of the project and organizing financial and technical support for it.

In January of 1969, the IFC Board approved my proposal that IFC should be willing to put a director on the Board of any promotional company to the shares of which it has subscribed, if in IFC's judgment this would enable its promotional activity to be carried out more effectively.

Locating investment opportunities, promoting indigenous entrepreneurial talent and encouraging the growth of private investment is a difficult job. IFC plans to increase its efforts in this area by continuing and intensifying activity of the kind described above and by increasing its contacts with individuals and institutions in both the developing and developed countries, with an eye to uncovering and exploiting investment opportunities. These plans will be reflected in a new policy statement for IFC which is now being drafted and which I shall soon be submitting to the IFC Board of Directors for approval.

1/ No. 140.
2/ No. 137.
3/ No. 152.

If these policies are to be more than pious statements of intention, it will be necessary that IFC have available staff who can spend a considerable portion of their time in the developing countries. It would be their primary function to look for investment opportunities which IFC might appropriately participate in or bring to the attention of others. This will require adding several senior professionals to IFC's staff.

Even if IFC's staff is enlarged, IFC cannot by itself accomplish all that needs to be done. As the Executive Directors know, the Bank Group as a whole has given considerable support to institutions in the developing countries which are themselves engaged in promoting private enterprise. The Pearson Commission has recommended greater help to development banks and similar institutions, and the memorandum analyzing that recommendation reviews the past activity of the Bank Group and plans for increased support in the future. However, IFC's assistance should not be limited to institutions formed by residents of the developing countries. It should, and it intends to, work with, support and help to finance institutions such as the Atlantic Community Development Group for Latin America (ADELA),1/ the Private Investment Company for Asia (PICA),2/ and other comparable organizations (including the private investment

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1/ ADELA is a private corporation, with authorized capital of $60 million, $52.65 million of which has been subscribed by 234 stockholders in Europe, the United States, Latin America, Canada and Japan. It makes equity and loan investments and, through an entity known as ADELATEC, which is in effect a firm of development consultants rendering services to ADELA and to others, it engages in a variety of other activities designed to support private investment in Latin America: underwriting, project identification and promotion, project management, market studies, resource surveys, and feasibility and pre-feasibility surveys. The ADELA Group is at present giving priority to agri-business and tourism. It is increasingly devoting its energies and resources to self-initiated sectoral studies, project identification and project promotion in these fields.

2/ PICA, whose authorized capital is $40 million, was modeled on ADELA; the two Corporations have a number of shareholders and directors in common. PICA was formally organized in February of 1969 and its operations have thus far been limited.

See revision of page

company proposed for Africa) provided that they need help, are well managed, and are carrying on investment programs that will assist the development of the countries in which they are doing business.

It is relevant to remind the Executive Directors that the Bank also intends to do more to help identify and prepare industrial projects. As the Executive Directors are aware, I have recently established an Industrial Projects Department within the Bank, which will assist governments in the field of industrialization through sector analyses and project identification work. To assure that the efforts of IFC and of the new Department, as well as the activities of the Bank's Development Finance Companies Department, are complementary, and that there is a full exchange of information and an appropriate allocation of responsibility among all Bank Group operational units working in the field of industry, I have also created an Industrial Coordination Committee composed of the Executive Vice-President of IFC, as Chairman, and the Directors of the two Bank Departments.

Conclusion

Since the plans for future IFC activity are consistent with the Commission's recommendation, no action by the Executive Directors is now required. However, it should be noted that the implementation of the plans will, as indicated above, (a) involve a revision of the IFC policy statement, which will be submitted for the approval of IFC's Board of Directors, and (b) call for additional IFC staff, which will have implications for the IFC budget.

Robert S. McNamara

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Robert S. McNamara

711/5/1

To McN Nov. 18
Changes in pencil = McN
~~UR~~ P/C Nov 24

November 13, 1969

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 10 concerning Advice on Industrial and Foreign Investment Policies

Recommendation

"International institutions, such as the World Bank ... , should expand further their advisory role regarding industrial and foreign investment policies. These activities could eventually be fully transferred to IFC if the proposed reorientation of IFC is successfully achieved".1/

Background

This recommendation appears in the context of the Commission's discussion of the potential of foreign investment, primarily direct investment, for contributing to the faster growth of the developing countries. The Commission reports its impression that most low income countries would welcome a larger flow of foreign investment, and suggests a number of ways in which that flow might be stimulated. It believes that developing countries urgently need impartial advice concerning their posture toward foreign investment. It finds that such advice has rarely been provided in the past. With respect to the Bank Group, the Commission says that the Bank has tended to delegate much of its industrial activity to IFC, but that IFC has deliberately and to the extent possible avoided involvement in issues of governmental

1/ Report, page 115. The proposal for reorientation of IFC policy is the subject of a separate memorandum.

policy and is, in any case, not equipped to ascertain the economic implications of government policies.

The Commission also observes that much of the substantial industrialization achieved by developing countries in the last two decades has been in the form of high-cost import-substituting industry and that, in many cases, new industries have become a burden rather than a benefit to the economies, with adverse effects on agriculture and on the prospects for increasing exports. Thus the advice to be given to developing countries on foreign investment policies is closely linked with advice on their industrial policies.

Analysis

In recommending that the Bank "expand further" its advisory role, the Commission implicitly recognizes that the role would not be a new one for the Bank. The principal vehicle for the provision of advice has been country economic missions.[1] The resources devoted to the industrial sector on these missions have, however, been limited. From the beginning of 1967 to date, the total of industrial specialist resources devoted to such coverage has averaged ~~about~~ only five man-years annually. There has been some ~~nevertheless been an~~ increas~~ing~~ed emphasis on industrial policy recommendations to individual countries in this work, exemplified by recent missions to, e.g., Argentina, Brazil and Mexcio in the Western Hemisphere, and India, Indonesia, Iran, Korea and Pakistan in Asia. Appraisal and follow-up of industrial projects have also provided the occasion for advice on industrial policies.

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The Industrialization Division of the Economics Department ~~is~~ was organized one year ago ~~charged with~~ to undertake research in the industrialization process and to ~~to provide, for other departments of the Bank, a basis for judgments on policies and investment priorities and for~~ provide advice on techniques for stimulating industrialization. The subjects of its studies include thus far the automotive industry; the manufacture of certain capital goods and problems of food processing industries in developing countries; the structure of protection in both developing and developed countries; industrialization patterns in South East Asia; and industrialization strategies of the industrially more advanced developing countries.

The Bank's advisory role with respect to policies of individual countries towards foreign direct investment has not been ~~less~~ well-defined. In the course of the country economic work, such policies have been the subject of attention when they appeared to be hampering development. But these policies have not been systematically reviewed, nor has any specialist been employed to deal with them.

I fully agree with the Commission's recommendation that the Bank's advisory functions should be enlarged. Many developing countries need advice on trade, fiscal and other policies which will foster industrial growth. Tariffs, import licenses, taxation, subsidies, price controls -- all can affect industrial progress to an extent often not fully appreciated by the government involved. Protection policies, which have been the subject of discussion by the Executive Directors in the context of some recent Bank Group operations, frequently foster the growth of uneconomic enterprises. The Bank ought to be in a position to advise its

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It was with this objective, among others, in mind that I recently created an Industrial Projects Department in the Bank. The functions of the Department include providing advice to governments and making recommendations on industrialization problems and policies of the Bank and its members, including advice on industrial planning and priorities, on measures to stimulate efficient and sound industrial growth, and on foreign investment policy. The Department is intended to help constructively and impartially in the complicated process of rationalizing the industrial sector in developing countries.

It is also my intention that comprehensive industrial sector studies shall in future form part of the Bank's economic reviews. As the economic missions now do for other sectors, they will be systematically analyzing the industrial capacity and strategy of individual countries and the relationship of industrial progress to over-all growth. This is a difficult process which will take some time to organize and to staff, and which will in due course have budgetary implications.

In carrying out its functions, the Industrial Projects Department will work closely with the other units in the Bank Group concerned with industrial policies: the IFC, the Development Finance Companies and the Economics Departments of the Bank, as well as the Area Department concerned.[1]

1/ As noted in the memorandum analyzing the Commission's recommendation concerning IFC project identification and industrial promotion work, an Industrial Coordination Committee ~~has been~~ is being created, composed of the Executive Vice-President of IFC (chairman) ~~and~~ the Directors of the Bank's Industrial Projects and Development Finance Companies Departments, and the Chief of the Economics of Industrialization Division of the Economics Department, to assure exchange of information and appropriate allocation of responsibility.

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We shall also look to other international organizations for assistance in their fields of specialization. The U.N. Industrial Development Organization (UNIDO), since its establishment a few years ago, has been engaged primarily in providing technical assistance for specific industrial activities. It is now widening its advisory activities, and in view of my intention that the Bank should step up its own activities of that character, closer cooperation with UNIDO seems appropriate. Arrangements have accordingly been made with UNIDO for an exchange of information about matters of common interest, on an informal basis. The International Labour Organization (ILO) and the U.N. Food and Agriculture Organization (FAO) are also concerned with some aspects of industrialization, and we shall be cooperating with these agencies as well.

I also believe that IFC could usefully play a role in considering and advising governments on measures to encourage the development of the private sectors of their economies, in particular the flow of foreign private capital. IFC has begun to collect some data bearing on this problem. As I have reported in the memorandum dealing with the Commission's recommendation for a reorientation of IFC policies, ~~I~~ we have authorized IFC to appoint an Economic Adviser. This adviser will be expected to organize the data collection work more efficiently and to evolve proposals for systematic activity by IFC in providing advice to governments on their industrial and foreign investment policies.

I am not now prepared, however, to endorse the tentative suggestion of the Commission that eventually advisory activities of this character might be performed, for the Bank Group, exclusively by IFC. The Bank

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I am not now prepared, however, to endorse the tentative suggestion of the Commission that eventually advisory activities of this character might be performed, for the Bank Group, exclusively by IFC. The Bank will be concerned in large measure with policies and projects in the public sector, and the public sector is not an appropriate concern of IFC. At least in the foreseeable future, and probably over the long term, it seems more likely that the Bank Group's advisory activities in the field of industrialization will be carried out variously by the Industrial Projects or Development Finance Companies Departments of the Bank, on the one hand, and by IFC on the other, as seems fitting in the given situation.

Conclusion

The plans for increased emphasis by the Bank on the provision of advice concerning the industrial and investment policies of developing countries are fully consistent with the Commission's recommendation. I intend that IFC, as well, should put itself in a position to provide advice to governments on policies of this character, affecting the private sector. No action by the Executive Directors is now required.

~~Robert S. McNamara~~