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OP - RESEARCH - Private Sector Development Study

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December 31, 1974
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OP RESEARCH - PRIVATE SECTOR DEV. STUDY

Form No. 27
(3-70)

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OUTGOING WIRE

TO: NGANGA

FINANCE

NAIROBI

DATE: DECEMBER 23, 1974

CLASS OF SERVICE: LT (4005) RLA

COUNTRY: KENYA

TEXT:
Cable No.:

BULCHA DEMEKSA COMMA NOW ADVISER TO SENIOR VICE PRESIDENT OPERATIONS COMMA PLANS TO VISIT KENYA JANUARY NINETEEN THROUGH JANUARY TWENTYFOUR TO DISCUSS IBRD'S ROLE IN PRIVATE SECTOR STOP HE WOULD LIKE TO MEET YOU AND KABETU OF COMMERCE AND INDUSTRY AND GENERAL MANAGERS OF COMMERCIAL BANKS AND ICDC STOP TRUST CONVENIENT STOP REGARDS

HORNSTEIN

NOT TO BE TRANSMITTED

AUTHORIZED BY:

NAME: Roger A. Hornstein, Chief
Country Programs Division

DEPT.: Eastern Africa Regional Office

SIGNATURE: RAH
(SIGNATURE OF INDIVIDUAL AUTHORIZED TO APPROVE)

REFERENCE: BLi:cdw

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CLEARANCES AND COPY DISTRIBUTION:

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cc: Mr. Demeksa, Adviser-Sr. VP, Operations

For Use By Communications Section

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INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

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Eastern Africa Regional Office
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OR RESEARCH - PRIVATE SECTOR DEV. STUDY

Form No. 27
(3-70)
INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL FINANCE CORPORATION

OUTGOING WIRE

TO: REICHELT
INTBAFRAD

LUSAKA

DATE: DECEMBER 23, 1974

CLASS OF SERVICE: TELEX
(Ext. 2607)

RC

COUNTRY: ZAMBIA

TEXT:
Cable No.: 222

~~KKM~~

BULCHA DEMEKSA FORMERLY EXECUTIVE DIRECTOR NOW OFFICE OF SENIOR VICE PRESIDENT OPERATIONS SCHEDULED TO VISIT ZAMBIA JANUARY 24 THROUGH 29 STOP DEMEKSA WORKING ON SPECIAL STUDY ON WHAT WORLD BANK CAN DO TO STIMULATE PRIVATE SECTOR DEVELOPMENT IN DEVELOPING COUNTRIES STOP WOULD APPRECIATE YOUR PREPARING PROGRAM FOR DEMEKSA STOP HE WOULD LIKE CONTACT AT HIGH CIVIL SERVICE LEVEL BUT IS NOT REQUESTING MEETINGS WITH MINISTERS STOP I WOULD SUGGEST DEPARTMENTS OF FINANCE AND INDUSTRY COMMA PARASTATALS DEALING WITH MANUFACTURING INCLUDING SMALL SCALE INDUSTRY AND ALSO FINANCIAL INSTITUTIONS SUPPORTING PRIVATE SECTOR STOP DEMEKSA LEAVING WASHINGTON 12/27 TO VISIT WEST AFRICA FIRST STOP WOULD APPRECIATE YOUR CONFIRMING BY 12/27 THAT VISIT AT TIMES INDICATED IS ACCEPTABLE STOP DETAILED PROGRAM CAN BE CABLED TO DEMEKSA LATER AND I WILL PROVIDE CONTACT ADDRESS STOP SORRY THIS LATE ADVICE STOP IN VIEW DEMEKSA'S PLAN TO MEET AT CIVIL SERVICE LEVEL I HOPE PROPOSED TIMING RAISES NO PROBLEMS REGARDS

WIEHEN

NOT TO BE TRANSMITTED

AUTHORIZED BY:

NAME Michael H. Wiehen

Director

DEPT. E. Africa, CPII

SIGNATURE

(SIGNATURE OF INDIVIDUAL AUTHORIZED TO APPROVE)

MHW:cj
REFERENCE:

CLEARANCES AND COPY DISTRIBUTION:

cc; Messrs. Demeksa
Maubouche
~~Schmitt~~
Kaini

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Form No. 27 (2-70)

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OUTGOING WIRE

TO: REICHELT INTERAFRAD LUSAKA

DATE: DECEMBER 23, 1974

CLASS OF SERVICE: TELEX (Ext. 2607)

COUNTRY: ZAMBIA

TEXT:
Cable No.:

RXH

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WIEHEN

NOT TO BE TRANSMITTED

AUTHORIZED BY:
NAME: Michael H. Wiehen
DEPT.: Director, [illegible]ca/CRII
SIGNATURE: (SIGNATURE OF INDIVIDUAL AUTHORIZED TO APPROVE)
REFERENCE: MHW:cj

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cc: Messrs. Demeksa, Maubouche

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IMPORTANT: See Secretaries Guide for preparing form

OP RESEARCH - PRIVATE BA+P
SECTOR DEV. STUDY

Form No. 27
(3-70)

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OUTGOING WIRE

TO: INTBAFRAD
KINSHASA

DATE: DECEMBER 23, 1974

CLASS OF SERVICE: TELEX
(Ext. 2607)

COUNTRY: ZAIRE

TEXT:
Cable No.: 804

FOR GUETTA

BULCHA DEMEKSA FORMERLY EXECUTIVE DIRECTOR NOW IN OFFICE OF SENIOR VICE PRESIDENT OPERATIONS SCHEDULED TO VISIT ZAIRE JANUARY 16 TO 19 STOP DEMEKSA WORKING ON SPECIAL STUDY ON WHAT WORLD BANK CAN DO TO STIMULATE PRIVATE SECTOR DEVELOPMENT IN DEVELOPING COUNTRIES STOP WOULD APPRECIATE YOUR PREPARING PROGRAM FOR DEMEKSA STOP HE WOULD LIKE CONTACT AT HIGH CIVIL SERVICE LEVEL BUT IS NOT REQUESTING MEETINGS WITH MINISTERS STOP I WOULD SUGGEST DEPARTMENTS OF FINANCE AND INDUSTRY COMMA PARASTATALS DEALING WITH MANUFACTURING INCLUDING SMALL SCALE INDUSTRY AND ALSO FINANCIAL INSTITUTIONS SUPPORTING PRIVATE SECTOR STOP DEMEKSA LEAVING WASHINGTON 12/27 TO VISIT WEST AFRICA FIRST STOP WOULD APPRECIATE YOUR CONFIRMING BY 12/27 THAT VISIT AT TIMES INDICATED IS ACCEPTABLE STOP DETAILED PROGRAM CAN BE CABLED TO DEMEKSA LATER AND I WILL PROVIDE CONTACT ADDRESS STOP SORRY THIS LATE ADVICE STOP IN VIEW DEMEKSA'S PLAN TO MEET AT CIVIL SERVICE LEVEL I HOPE PROPOSED TIMING RAISES NO PROBLEMS REGARDS

WIEHEN

NOT TO BE TRANSMITTED

AUTHORIZED BY:

NAME: Michael H. Wiehen
DEPT.: Director
E. Africa, CPII

SIGNATURE
(SIGNATURE OF INDIVIDUAL AUTHORIZED TO APPROVE)

REFERENCE: MHW:cj

CLEARANCES AND COPY DISTRIBUTION:

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Maubouche
Schott

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Form No. 27 (3-70)

INTERNATIONAL FINANCE CORPORATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL DEVELOPMENT ASSOCIATION

OUTGOING WIRE

TO: INTERFRAD
KINSHASA

DATE: DECEMBER 23, 1974

CLASS OF SERVICE: TELEX
(Ext. 2607)

COUNTRY: ZAIRE

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WIEHEN

ALS

NOT TO BE TRANSMITTED

AUTHORIZED BY:

NAME: Michael H. Wiehen

DEPT. Director, W. Africa Dept.

SIGNATURE (SIGNATURE OF INDIVIDUAL AUTHORIZED TO APPROVE)

REFERENCE: MHW:cl

CLEARANCES AND COPY DISTRIBUTION:

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Private 428 12/2

Mason

HARVARD INSTITUTE FOR INTERNATIONAL DEVELOPMENT

1737 Cambridge Street   Cambridge, Massachusetts 02138

HARVARD UNIVERSITY

Tel. (617) 495-
Cable Address: HIID
TWX No.: 7103200315

November 26, 1974

Mr. Moeen L. Qureshi
World Bank
1818 H Street, N.W.
Washington, D. C. 20433

Dear Moeen:

Yesterday I sent to Miss Butler a revised copy of my paper to be duplicated and distributed. The revisions have not been particularly numerous. I agree with you that the link between the relative significance of the public and private sectors and the stage of development is complex. To deal with it adequately would require too much space to be appropriate in a paper of this sort. It seems to me what is needed are a few pages pointing out some of the major considerations. I think my statement that the relative size of the public sector increases with per capita income is correct. This is well documented in economic history of the now developed countries and there are strong reasons for believing that the same trend exists in the developing countries. It is, however, hard to substantiate statistically since these countries define the public sector in different ways. There is no doubt at all in my mind that, up to a certain level of per capita income, investment of infrastructure increases more rapidly than total investment. I have examined this myself for transportation and power which are two of the main elements in infrastructure.

I wish you would look at a paragraph I have added on page fourteen concerning the possibilities of transferring technology and managerial skills to firms in LDC's and the possibilities of firms in western countries providing markets for LDC production. What I say there arises in part from my ASDEC connections. I have really been astounded how easily possibilities of associating western firms with firms in southern Asia have been developed.

I think now that it would probably be unwise to send people out to the 9 or 10 countries we had in mind. It might well be better if they investigate instances of successful handling of opportunities for increasing private investment. I am making a list of examples of this sort which we can talk over when I am next in Washington. I now plan to be there on December 4, 5, and 6, and I could also be there on the 9th, 10th and 11th. There are quite a number of things I want to do. I hope that a meeting of the Committee can be called for one of these periods.

With best wishes,

Sincerely yours,

Ed

Edward S. Mason

HARVARD INSTITUTE FOR INTERNATIONAL DEVELOPMENT
1737 Cambridge Street   Cambridge, Massachusetts 02138
Harvard University

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INCOMING MAIL UNIT
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With best wishes,

Sincerely,

Edward S. Mason

Private Sector
419
11/27
Mason

HARVARD INSTITUTE FOR INTERNATIONAL DEVELOPMENT
1737 CAMBRIDGE STREET CAMBRIDGE, MASSACHUSETTS 02138
HARVARD UNIVERSITY
TEL. (617) 495-
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TWX NO.: 7103200315

November 25, 1974

Miss Gillian Butler
Room 1132, Building D
World Bank
1818 H Street, N.W.
Washington, D. C. 20433

Dear Miss Butler:

I am sending you a revised version of a paper on the Private Sector. It will I think be much easier for you to duplicate the paper there than for me to do so here. I take it that it should be sent to all the members of the Steering Committee and perhaps Mr. Qureshi has indicated some others.

You will note that there are several half pages in this manuscript and that there are a number of corrections in ink. It may be that you will think it necessary to have the paper retyped before duplicating. I dont think so myself but you know more about Bank practice than I do.

Mr. Qureshi indicated that he wanted me to spend some time in Washington to discuss this paper and where we go from here. I would be available the 4th, 5th and 6th of December and also the 9th, 10th and 11th of December. I hope you will let me know as soon as possible the date set for the next meeting of the Committee.

Sincerely yours,

Edward S. Mason

Edward S. Mason

ESM:w

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Tel. (617) 495-
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Sincerely yours,

Edward S. Mason

Edward S. Mason

ESM:x

O.P. Research
Private Sector
Dev. Study

Mr. Moeen A. Qureshi

November 22, 1974

Barend A. de Vries

IFC Study of Private Sector

1. I have relatively little to add to what was said at our meeting of Nov. 18 on this study. It deals with an important topic and we would hope that the terms of reference and the outline will state more clearly (a) what are the objectives and (b) what should be the focus. Clearly the Bank Group has for long been dealing with various elements of the private sector -- usually with great sympathy -- and one approach to the study would be an analytical presentation of the Bank's activities in this field. The Bank often has played a crucial role in questions of pricing policies and resource availability. On our part, we would emphasize: (a) The policy framework; (b) The financial system and the capital market; (c) Technology transfer; (d) Foreign private investment; and (e) Small and medium enterprise. We note that these topics are covered in your questionnaire.

2. Among the countries singled out for special study we suggest you drop Peru -- where there have been rather fargoing changes in attitudes and policy toward the private sector -- and add Mexico and/or Brazil, where much can be said and considerable work has been done. Personally, I rather doubt the need for country case studies. Instead I would focus on a few key country situations and use available studies.

cc: Messrs. Stern
Glaessner
Ross/Greene
Holsen/Pfeffermann

BAdeVries/crs

Private Sector

November 16, 1974

Professor Edward Mason
9 Channing Street
Cambridge
Massachusetts 02138

Dear Ed:

I have read your draft paper with great attention. I have also sent copies to Ernie Stern, Laszlo von Hoffmann and Bulcha Demeksa (he is the person from Ethiopia who retired as Executive Director and will be assisting us in the Study). I find your paper impressive and well focussed. It should form an excellent basis for discussion by the Steering Group. I have a few points -- all relatively minor -- which I have indicated in the attachment. Demeksa is also sending you a note giving his comments. Would you please make such revisions as you deem appropriate and send us back the paper. We shall then circulate it to the Steering Group and schedule an early meeting.

Ernie Stern and I met with the Regional Chief Economists of the Bank early this week -- basically with the intention of finding out what they might contribute to the Study, especially with respect to the sample of countries which we had identified. We had circulated to them the documentation which was given to the last meeting of the Steering Group plus the 8 country memoranda prepared by Iqbal.

The Chief Economists found the subject diffuse and expressed their inability to be of much help unless they had something which was more issue-oriented -- they expressed a strong preference for the issues to be defined on a functional basis (i.e. how do we help small industry? capital market development? etc.). Your paper does just that and therefore I propose to circulate your paper to them as soon as you have revised it. I shall then take another crack at them.

I am leaving for East Africa this weekend but expect to be back by the end of the month. On the assumption that your revised paper will be received fairly soon, I have suggested to Mr. von Hoffmann that he should call a meeting of the Steering Group soon after your paper is received. It might well be feasible to do this before I return.

.../..

In addition to discussing the approach and the issues which you have defined in the paper, I believe we should firm up a work program at the next meeting. As I see it, we have two alternatives -- either to carry forward your paper on the basis of information available here, or to supplement this with some field work on a sample of selected countries. My feeling is that the latter course will probably not give us much in the way of new conclusions but it would certainly give the Study more credibility and analytical weight. Undoubtedly, it will take more time. I feel, however, that we should decide this issue now, and I am asking Laszlo to flag this for the next meeting of the Steering Group.

As I mentioned, I shall pick up the threads when I get back. In the meanwhile, please send your revised paper to Miss Gillian Butler (my secretary). She will get it into the proper hands. I also want to mention that Bulcha Demeksa is very keen to roll up his sleeves and get to work, especially on the African countries, and I feel that he is likely to be of considerable assistance in that area. Could you plan to allocate some time when you next come down to exploring how he can be most usefully and effectively brought into the work program for the Study.

With best regards,

Yours sincerely,

Moeen A. Qureshi
Vice President

cc: Mr. von Hoffmann

MAQ:gmb

A FEW POINTS ON PROFESSOR MASON'S PAPER

Page 2 - 4:

The link between the relative significance of the private/public sector, and the stage of economic development is a complex one at best. Page 2 tends to present this relationship in terms that appear far too simplistic:

"In general, the relative importance of the private sector decreases and that of the public sector increases with development as measured by increases in per capita incomes".

While Page 3 does bring out some of the complexities, I wonder whether such a link is valid even in general terms?

While it is true that generally agriculture is "privately oriented" and capital infrastructure tends to be dominated by the public sector, I am not sure that similar conclusions can be drawn for the industrial sector as it acquires economies of scale. In other words, the economies of scale in industry are just as likely to be utilized by the private as by the public sector (Brazil, Hong Kong, Taiwan). Also I am not very clear about the progression in the relative importance of new investment in capital infrastructure (whatever that means) at different stages of development. In short, while I do not disagree that the relative importance of the private sector is related to the pattern of investment and production, I feel this issue needs more careful handling.

Page 5 - 6:

"What is private?": In paragraph 2 where you refer to the assets criterion, I suggest you include "cooperatives" as a separate category, one that is both important and growing in many developing countries.

Page 7:

"What is an enterprise?": Please note that the idea of focussing the Study on "enterprises" was a suggestion. I am informed that there is not much unanimity of views on this point. Similarly your reference to "profit making" as an inadequate criterion could be a controversial point. I do not suggest any change here but merely wish to underscore that these are possible areas of discussion.

Page 9 -

The Main Issues: I find your treatment of the main issues both comprehensive and judicious:

(a) Please note on Page 12 that we already have a relationship with UNIDO similar to that with FAO and UNESCO;

(b) I feel you should mention somewhere the point that resource availability and opportunity costs will, or at least should, influence how much more can be done in some of these areas. Serving small industry, developing entrepreneurship, capital markets, etc., all involve a growing component of technical assistance. There is a fundamental question here of how much more it is feasible or desirable to do in these areas in the light of the alternatives that might be foregone. Are more of these activities likely to mean less of what we are doing now -- less public sector?

(c) In several places in the paper you refer to the "Bank" when I think you really mean the Bank Group. I would suggest you use the latter term whenever appropriate. Where necessary you might even wish to flag the question as to which part of the Bank Group would have the responsibility for the particular problem. This would, in any event, have to be picked up later in the section on Bank Group organization.

O.P. Research Private
Sector Dev. Study

Russ Cheetham November 12, 1974

Townsend S. Swayze

Study of the Bank Role in Private Sector Development

1. At the outset -- looking through IBRD glasses -- I am a little uneasy with the principal objective of the study: to study how the Bank can stimulate the development of the private sector. My visceral response is that besides DFC financial help (if capital is a constraint), the Bank does not have a direct role to play beyond what we are already doing naturally through our economic missions and loan program. Given our very limited experience and understanding of such a broad area (the private sector) the attached paper falls short of contributing very much. Furthermore, I have a little trouble with the ease in which we accept the private sector as a concept. In many cases the distinction between public and private sector is not very clear, and I am not sure it is very important that the distinction is clarified. In addition, in the case of Malaysia, the "private sector" has enjoyed great freedom of expansion and I would argue that what the country now needs to do is to develop the public sector.

2. The attached paper suggests the study focus on "private enterprise" as distinct from particular sectoral issues, but this is a very inadequately defined term and does not help us along very far toward an approach for the study.

3. The "well-known"constraints" of private enterprise development are listed: lack of skills, capital, infrastructure, marketing and Government support. The paper cites the critical problem as being how to assess the relative importance of these constraints. My guess would be that for some countries much more important is the identification of the more sophisticated (and, of course, related) constraints that probably lie several layers underneath the major constraints identified in the paper. Also, the catch-all constraint of "inappropriate policy environment" (or lack of Government support) may be an area far more important than the others. Government macro-policies (e.g. fiscal and monetary, trade, industrial development controls such as liscensing etc.) would seem to have an exponentially greater power to influence private development than the other factors listed. If so, effective bank assistance would probably best be packaged in specific in-depth economic studies of the particular issues involved -- that is, if the Government, in fact, wanted to promote further private sector development.

4. The attached paper's preliminary search for guidelines toward a greater Bank strategy seem equally without focus. Financing, capital market development small enterpreneurs, foreign private investment and better government policies ale all mentioned. These proposals pick up some of the identified constraints, but drop others, such as market constraints, lack of skill training and important aspects of the broader question of appropriate technologies. I do not get much sense of direction, and the concept of focussing on "private enterprise" as such still does not fall into place.

5. The short piece on Malaysia undoubtedly can be beefed up considerably, hopefully by using the findings of our current industrial sector mission. However, the discussion does not bring out very clearly a basic and very important policy point that is implied in the discussion; i.e.

> The Malaysian private sector has grown very rapidly with a minimum of Government supervision and control (and minimum Government intervention has been an important factor in this growth). The principal objective of Malaysia's new economic policy is to raise dramatically the currently very low level of Malay economic activity, and to do this the Government (public sector) must play an increasingly greater role in the private sector, acting on behalf of the Malays who on their own will not be able to meet the country's policy objectives. Therefore, our principal task in Malaysia is not so much to stimulate private sector development but of stimulating the proper kind of public sector involvement in the private sector, while at the same time stimulating long range development of the bottom group of private sector income earners.

6. My general impression is that when governments want to support rapid private sector growth, the sector will grow. Bank intervention in this area is best at the policy advisory level and that our current project support of the private sector (e.g. through agriculture research, education) is what we know how to do best and how we can best continue to support the "private sector".

TSSwayze:mw

O.P. Res. Private Sector Dev. Study

Mr. Barend A. de Vries, Chief Economist, LAC November 11, 1974

Guy P. Pfeffermann, Senior Economist, LAC I GP

Comments on a Proposed Study on "Bank Role in Private Sector Development"

1. I should not include Peru in a study of private sector role, because this role has been changing rapidly over time. Furthermore, the issue is politically very sensitive, and this might get in the way of our discussing the report with Peruvian officials. I would go along with Colombia, Bolivia and Ecuador; it might be well, however, to drop one of the two smaller countries in favor of a large country with a developed private sector, such as Brazil, Mexico or Argentina.

2. I agree with you that the main purpose of the study ("explore how indigenous private enterprise can be helped to play a fuller and more productive role in the development process") is more relevant for Africa and Asia than for most of Latin America. Even in Haiti, most industries are run by Haitians; this is in sharp contrast to most of Africa. Once this purpose is toned down, there really isn't much that remains in the proposal, which might be relevant for Latin America. All the proposal talks about is "remedial action in the field of technical and vocational education" and "industrial credit". This is very slim. I find the proposal lacks in focus, and what focus there is does not apply much to Latin American conditions.

3. The section on "nature of the private sector" lists some statistics that might be useful on the public versus the private sector. There again, because there is no focus to begin with, the list of data sounds like a shot in the dark. The implicit issues raised are: growth comparisons (but to be meaningful what matters is not growth but efficiency as measured by the relationship of output to input), and equity considerations (concentration of ownership and income); issues like taxation, the incentives framework, the relationship between private and public sectors (excellent in Mexico, in Brazil, perhaps antagonistic in other cases) are not mentioned.

4. The longest section in the proposal is "constraints on private sector development"; this suggests an a priori approach that the question is "how to help the private sector along?" rather than "how to blend private and public efforts so as to achieve the best development result?". In fact, most of the private sector constraints listed - lack of entrepreneurial, management and technical skills, deficiency of capital, inadequate infrastructure, market constraints - apply to the public as well as to the private sector, and it does not therefore, seem legitimate to single them out, especially in Latin American conditions where (a) these constraints are usually not overwhelming; (b) in most countries the public and the private sector have come to a symbiosis, which makes any separate analysis of general conditions rather devoid of meaning.

5. Conversely, I do think that Bank economic work would gain much by paying more attention to the private sector. I do not think, that a "global" study based on a handful of countries world-wide and fed by a simplistic questionnaire is the best way to improve our knowledge. I think the first step would be to encourage economic missions to spend more time talking to the private sector than they do now. This additional information could then be incorporated into economic reports, and, where a problem arises, the issues could be identified in the regular report/CPP system. This would also bring in the "role of the Bank". Once this has been done in most countries in the region it would be most useful to pull together some of the analysis and to look at things in a regional perspective. We should not, however, support a world-wide effort that can only be superficial, and which seems to be geared to African and Asian conditions, with the a priori notion in mind that the problems of the private sector are all specific to the private sector, rather than national problems, such as the lack of finance or of trained managers.

6. It might also be useful to include something on ADELA. For the last ten years ADELA has been financing private enterprises in Latin America, and giving technical assistance in precisely the areas the proposal is concerned with. More could be gained by spending some time looking at the experience of ADELA than by filling questionnaires of the kind proposed.

7. I fear that the kinds of data the questionnaire asks for cannot be readily obtained, simply because national accounts are not, generally, drawn up so as to distinguish between private and public sectors. "Industry" includes government owned as well as private owned establishments. Furthermore, to get back to the same point as above, the questionnaire focusses on constraints, without distinguishing between those that are specific to the private sector, and those that are general to the economy.

8. In sum, I find the proposed study too thin, lacking in focus and asking questions that cannot be answered in a quantitative, internationally comparable way; if we had the answers to all the questions proposed for the 8 countries (Kenya, Zambia, Ivory Coast, Sri Lanka, Indonesia, Colombia, Ecuador and Bolivia) I fear that not only would we not know much that would be of world-wide or regional applicability, but that even for these eight countries the answers could not be aggregated. In the absence of data that can be aggregated with some legitimacy, I think that the focus should be on a "country by country" basis in the framework of economic reporting, which aims at seizing up development issues at a national level.

9. Finally, in the case of Latin America, I think special attention should be paid to the costs and benefits, long-term and short-term, associated with foreign direct investment. This has already been done to some extent on Brazil (John Holsen) and Mexico (in one of the last reports before the "basic" report). Likewise, the question of capital markets can only be meaningfully examined in a national context: otherwise, who is to say whether an increase in private financing is not simply a reflection of a decline in public financing through taxes or bonds?

cc: Mr. Krieger, Director, LAC I

O.P. Research
Private Sector
Development Study

Chief Economists November 8, 1974

Moeen A. Qureshi, VP, IFC; E. Stern, Director, Development Policy

Study of the Bank Role in Private Sector Development

1. Mr. McNamara has directed that IFC coordinate a study of how the Bank Group can further the development of the private sector in developing countries. The purpose of the study and the proposed scope of work is attached.

2. In preliminary discussions of how the study should be organized, it was suggested that there should be an intensive study of the problem in a sample of countries chosen to represent an adequate spectrum of developing countries' experience and prospects. However, it was agreed that before undertaking any field work, the knowledge and expertise available in the Bank Group on these countries should be fully tapped. The countries tentatively suggested for more detailed study are:

-- Kenya, Zambia and the Ivory Coast in Africa;
-- Sri Lanka and Indonesia in Asia;
-- Colombia, Ecuador and Bolivia in Latin America.

3. As a first step, Mr. Iqbal (IFC) was asked to put together the information which existed in Bank Group files on a sample of countries to test data availability. He has done this for the following countries, which are not entirely the same as those tentatively proposed for more detailed study: Indonesia, Sri Lanka, Malaysia, Colombia, Ecuador, Peru, Zambia and Kenya. The notes on these countries are attached.

4. Mr. Qureshi and I should like to meet with you on Tuesday, November 12, at 2:30 p.m. in Room E-1201 to:

a) Discuss the proposed study and its scope;

b) Discuss the data and information required (see attached questionnaire);

c) Discuss the sample of countries and the extent to which field work is necessary; and

d) Review the preliminary country memoranda and assess how much additional information, both quantitative and qualitative, could be provided by the regional economic staffs.

If the proposed time is not convenient to you, please let my office (extension 5451) know who will attend on your behalf.

cc: Mr. Haq
Ms. Hughes

Attachments

MQureshi/EStern:ls

OP-RESEARCH-PRIVATE SECTOR
DEV. STUDY

Mr. E. Stern November 5, 1974

Moeen A. Qureshi

Private Sector Development Study

Here is a set of documents which we can circulate to the Chief Economists. It includes memoranda by Mr. Iqbal on 8 countries -- an attempt to collate whatever information exists in Bank files and documents. I would suggest that we circulate these and earlier papers on the scope of the Study and the questionnaire, to the Chief Economists, and then have a meeting with them.

I would appreciate it if you would call that meeting since it is appropriate than any instructions to them with regard to further work come from you. I am sending you 8 sets of the papers.

MAQ:gmb

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Liaison

November 1, 1974

Mr. Moeen L. Qureshi
Room D-1332
World Bank
1818 H Street, N.W.
Washington 20433

Dear Moeen:

I am sending you two copies of the first draft of a paper on Bank Group Assistance to the Private Sector. It could undoubtedly be substantially improved by further work and the criticism of you and your colleagues. The question is whether there is enough meat in it to serve as a basis for a profitable discussion by the committee. You will note that on page 29 I have a few observations to make on IFC activities. These observations are clouded by a considerable ignorance of IFC which I hope to be able to overcome with further discussion with you and your colleagues. The section on capital markets is entirely based on the documents I receive from Gill. I shall need the time to talk with people in other parts of the Bank concerned with capital market development.

I think it would be useful to have the observations of economists in the Bank concerned with the countries we propose to study, particularly on the issues set forth in the summary. I will be available to go to Washington any time during the next month except the period November 13 to 15 when I have got to be in Philadelphia.

With best wishes,

Sincerely yours,

Ed.

Edward S. Mason

Enclosure
ESM:w

BANK GROUP ASSISTANCE TO THE PRIVATE SECTOR

As defined by President McNamara this study is intended "to consider what problems are associated with stimulating the development of the private sector in the developing countries and how this institution can better contribute to that end." It should, in his view, embrace not only the operations of the IFC but other parts of the Bank concerned with the development of the private sector. And he adds, "It has a lot to do with the desires of the developing countries and the policies they follow, and it is far more than a question of how to inject capital into their economy."

The development of the private sector can, of course, be stimulated not only by assistance to private enterprise but by investment in infrastructure - transportation and communications facilities, power, port installations and the like - that are normally under public control. Indeed in its early years it was the dominant view in the Bank that adequate investment in infrastructure and access to foreign private investment were the primary requirements to a developing private sector. It is still probably true that the Bank Group contributes more to the growth of private enterprise through financing infrastructure than by investments that directly, or through financial intermediaries, accrue to producing units in the private sector. Nevertheless this study is not concerned with the Bank's infrastructural investment but with various forms of assistance to private enterprise. After a short discussion of the scope of the private sector in developing member countries and an attempt to define the meaning of private enterprise for the purpose of this study, the paper turns to a consideration of the main issues.

The Role of the Private Sector at Various Stages of Development

There is a very wide range of variation in the relationships between the public and private sectors and in the structure of the private sector in the developing member countries of the Bank. Consequently there are large differences among countries in the opportunities open to the Bank for the promotion of private enterprise and the private sector.

There is a demonstrable relationship between per capita income and the structure of production, well brought out in a number of studies, and changes in the structure with rising per capita incomes affect the relationship between the public and private sectors. Agriculture, which is overwhelmingly private declines in relative importance. Up to a certain income level investment in capital instructure, primarily transportation, power and communications, which is overwhelmingly public, increases more rapidly than total investment. With industrialization enterprises increase in average size and the growing size of the domestic market offer opportunities for economies of scale that frequently are taken advantage of by public initiative. In general the relative importance of the private sector decreases and that of the public sector increases with development as measured by increases in per capita incomes. This evolution has been well documented in the economic history of industrial countries and, although the developing world has not been subject to as careful study, there is reason to believe that the trend is fully as strong.

But this relationship is frequently distorted by other influences, among which are orientation of production to foreign markets, the size of the domestic market, and ideology. Most of the African countries south of the Sahara are at a low stage of development with primarily agrarian economies. But a number of them, including Botswana, Zambia and the Congo, with large mineral deposits, host large-scale foreign firms, producing mainly for export.

which are becoming increasingly under public control. The oil-rich countries of the Middle East belong in the same category and there are a number of other low income countries with large export enterprises, public or private, which distort the "normal" relationship between per capita income and structure of production.

The size of the domestic market also influences the scale of producing units and the character of the private sector. The small African countries south of the Sahara which are not export oriented are predominantly agricultural and such industrial enterprises as they possess are usually small scale and in private hands. On the other hand countries with a large domestic market, such as India and, to a less extent, Pakistan and Indonesia, have industrial sectors of considerable size with large-scale enterprises, many of which are in public hands.

Although ideology obviously has some importance in determining the relative size of the public and private sectors it is of less importance than the stage of development and probably of less importance than the other influences mentioned above. Value added in the public sector as a percent of G.N.P. is larger in Korea, e.g., supposedly a private enterprise economy, than in India which is assumed to follow a socialist pattern. It seems probable that ideology has greater economic significance on the character of controls over private enterprise than it does on establishing the relative size of the public and private sectors. In countries whose governments favor imperative types of planning with an emphasis on administrative decision-making as against market determination of outputs and prices, policies impinging on the private sector are apt to be economically more important than policies relating to public ownership.

Taking these considerations into account it is clear that Bank efforts to assist the private sector will need to vary substantially country by country. Nor is any grouping of countries by stage of development likely to lead to a simple criteria applicable to Bank lending policies. Furthermore, the possibilities open to the Bank will depend very much on how favorably member governments view the role of the private sector in their development objectives and what parts of the private sector they would like to see advance. The governments of Indonesia and Malaysia are not particularly anxious to assist Chinese businessmen though both governments seem genuinely anxious to assist private enterprise in "indigenous" hands. In other countries governments are interested in promoting small and medium=scale enterprises but are suspicious of large business concentrations. These and other considerations suggest that Bank efforts to assist private enterprise will need to define feasible target groups carefully.

What is the private sector and what part of it
should be included in this study?

What is Private?

There are two criteria for defining the privateness of a productive undertaking: who owns the assets and who controls the decision-making. Both criteria are complex and neither yields an unambiguous definition.

Using the asset criterion the following classes can be distinguished; Government owned; mixed government and private ownership with government majority; mixed with private majority; private. (The assets of coperatives, which are an increasingly important form of enterprise in developing countries, are usually privately owned though the use of these assets may be subject to a more or less strict public supervision.)

Using the control criterion, it is necessary to distinguish between influences on decision-making external (to the enterprise) and internal influences. External influence may take the form of command decisions (as in a fully planned economy); regulated enterprises; differentially taxed or subsidized enterprises. There are no fully autonomous enterprises in the Walrasian sense of enterprises responding only to market signals.

Internally it is useful to distinguish control via equity ownership from control without equity. In the latter case it may be necessary to distinguish control in the interests of ownership from control in some other interest, eg. management.

For statistical purposes the ownership criterion is the only practical one with arbitrary assumptions needed on share of equity in public or private hands if unambiguous results are to be recorded.

Control of decision-making seems the more important criterion for purposes of this study. But there can be no single "correct" definition of a private enterprise. Rather the test of a definition will lie with its usefulness and this will vary with the purpose of the analysis.

Consider the following cases:

A manufacturing enterprise is owned 100% by a financial institution 51% of whose equity is owned by government. The financial institution relies on the private capital market for the sale of its securities and its own investments are expected to yield a rate of return sufficiently high to maintain its position in the capital market. Consequently its directive to the manufacturing enterprise is to maximize its profits. Within these limits the enterprise has substantial autonomy. Is this a public or private enterprise?

An enterprise 100% privately owned is established to supply fertilizer to small farmers at subsidized prices. 60% of the selling price is covered by government subsidy. Is this a private or public enterprise?

• The majority equity in a power plant is held by private owners. But government regulation governs the rates charged, the reinvestment of earnings permitted, and the extent of the market in which sales are allowed. Is this public or private?

Cases of this sort could be multiplied indefinitely. What they appear to indicate is (a) that the definition of what is public and what is private must, on the control criterion, be somewhat ambiguous; (b) that Bank Group lending and technical assistance policies involving the private sector should presumably emphasize administrative autonomy and orientation toward the market rather than ownership; (c) the departments of the Bank dealing with the private sector should be more concerned with action that will effectively promote development and less concerned with definition.

What is an enterprise?

If the ownership criterion is applied to distinguish public from private production, most of agriculture, small-scale commerce and industry, some part of road transport, some part of construction and some part of finance falls in the private sector. Since these production units are mainly small-scale, internal decision-making is also likely to be private. External controls, however, may substantially modify the process of decision-making.

A very large fraction of these producing units, particularly in agriculture, are one-man or one-family undertakings. A recent Bank estimate is that there are 500-600 million producers in the developing countries with per capita incomes of $50 or less and that 85% of these are in agriculture. It is doubtful whether these units can be called enterprises and it is doubtful whether they should be included in the present study. An enterprise, at a minimum, requires the coordination of various inputs to produce output for sale on the market and the focus of the study, as I understand it, is on how producing units of this sort can be established, how entrepreneurship can be developed, how the various obstacles to the growth of such units can be overcome, and what the Bank Group can contribute to this process. Not all of agriculture should be excluded; commercial farms in general and agri-business undertakings are enterprises and should be included. But very small one-family farms, service and commercial undertakings should have very low or zero priority.

The chief characteristics of an enterprise for purposes of this study are autonomy and the marketability of inputs and outputs. Autonomy is mainly a legal and administrative matter and is, on both counts a question of degree. Marketability of inputs and outputs is a matter of business and economic concern and is also a question of degree. Extensive external controls on inputs or outputs, extensive subsidization or differential taxation can substantially modify the character of an enterprise.

Orientation toward profit-making is an inadequate criterion in judging whether an enterprise is private. Some government enterprises are directed to maximize profits; others are directed to earn "satisfactory" profits. Some very large enterprises, controlled by management, are thought to be operated in the interests of managers rather than owners. In the case of regulated enterprises profit goals are defined by government. More important criteria for the purpose of this study are; how independent is the management from external controls and to what extent is management subject to the discipline of the capital and other markets.

Perhaps a working definition of a private enterprise is a production unit owned/or controlled by management with a considerable degree of autonomy producing a marketable product from purchased inputs under conditions such that external influences on decision-making do not override the importance of market signals. By this definition the study should concentrate on industry (including agribusiness), construction, and some segments of commerce, finance and agriculture.

THE MAIN ISSUES

The major areas of interest in an attempt to improve the Bank Group's assistance to private enterprise would appear to be; (1) ways of increasing assistance to small and medium size firms; (2) assistance in the development of entrepreneurship and managerial skills; (3) government policies detrimental to the growth of private enterprise and what the Bank Group might do to change these policies; (4) the potential contribution of foreign private investment and what the Bank Group can do to help realize this potential; (5) Bank Group assistance in the development of capital markets; (6) possible changes in Bank organization and practice favoring assistance to the private sector.

(1) Assistance to small and medium scale enterprise.

A major line of criticism of IFC operations voiced in the Seminar on IFC Policies and Practices (July 2, 1974) stressed an undue concentration on investments in large-scale enterprise in relatively capital-rich countries with a corresponding neglect of smaller indigenous enterprises. A recent Policy Paper on the World Bank and Development Finance Companies (August 29, 1973) argued in the same vein:

"One of the objectives of reform of existing DFC's is to enhance their capacity to assist underpriveleged borrowers - i.e. small operations, potential entrants into the ranks of entrepreneurs with good ideas but little experience or financial strength and industrialists wishing to set-up facilities in backward regions. Whether or not such attempts to graft social orientation on "old style" DFCs will succeed remains to be seen. Therefore, in considering the establishment of <u>new</u> institutions, the Bank should place this objective at the center of the picture and design the structure accordingly."

If the Bank Group is to increase its assistance to small and medium-size enterprise the following questions seem relevant;

(a) What type of financial intermediaries should be assisted for on-lending to small enterprise?

(b) How can the Bank assist in providing technical assistance to such enterprises?

(c) Should the Bank Group play a more active role in finding and shaping investment projects?

(d) Can the Bank do more in financing infrastructure of use to small scale enterprise.

(a) The Bank, as a matter of fact, has had the question of appropriate financial intermediation under scrutiny for some time. In addition to a number of staff studies on assistance to small-scale industries a recent joint report by Bank staff and consultants and consultants from the Swedish SIDA entitled Financing the Development of Small-Scale Industries gives a comprehensive treatment of the subject. The joint study points out the large share of industrial employment and value added accounted for by firms with less than 50 employees and emphasizes that "small industries serve as an indispensable training ground for indigenous entrepreneurs, managers, and industrial workers." The authors believe that the Bank Group could do much more than it does now in financing small-scale enterprise and suggest that such financing "be channeled through (a) a specialized small industry financing institution; (b) a specialized small industry division in a DFC-type institution; or (c) a small industry promotion fund deposited with a central bank or in another appropriate institution."

Both the IFC and Bank/IDA should be involved in financing appropriate institutions. In fact action has begun in this area. The Bank has financed intermediaries on-lending to small-scale enterprise in the Cameroons, Ivory Coast, India, the Philippines and Columbia. And an evaluation of lending of this type in Mauritius is underway. What is needed is an expansion of these efforts and an evaluation of the results.

The Report mentioned above estimates that lending of this type may require a 5 to 6 point interest spread above rates usually charged to large-scale borrowers. The value and productivity of credit to small-scale enterprises will probably permit a covering of the additional costs by borrowers. If not a government subsidy may well, in certain cases, be justified.

On a recent visit to Korea I was favorably impressed by the operations of the Korean Medium Industry Bank. Medium industry is defined in manufacturing as firms employing from 5 to 200 workers; in mining and transportation from 5 to 300 workers; in construction, commerce and services, from 5 to 20 workers. The Bank has 75 branches throughout the country. Its loanable funds come 60 percent from deposits, 25 percent from government loans, and the remainder from foreign lenders. The government money is generally lent at a subsidized rate to export firms. The bank lends on short, medium and long-term. Medium scale manufactured output increased by 32% in 1973. This bank might serve as a useful model for some other countries and for the Bank.

So far as financing intermediaries for re-lending to small-scale enterprises is concerned the Bank Group seems already to be on the right track and needs only to push ahead more vigorously.

(b) Technical assistance for small-scale industry.

There is no need tobelabor the point that small and even medium-sized enterprises frequently lack knowledge of techniques of financial management, materials handling, purchasing and marketing. This has been documented in numerous small-industry studies including the "Kochav Report" recently undertaken by the Bank. And it is clear that lending to enterprises without adequate managerial or technical experience or access to reputable advice is a chancy business. The revelant question is what can the Bank Group do to assist the provision of managerial technical advice? Three possibilities seem worth exploring:

1. Attaching advisory services to financial intermediaries to which the Bank is lending or is intending to lend. If these intermediaries have been established to finance small-scale enterprise they already have, or should have, the capability of providing advice and Bank lending should reinforce that capability. It seems to me doubtful whether a small-industry section capable of supplying managerial advice can be successfully attached to the DFCs that have traditionally borrowed from the Bank. On the other hand the public DFCs who are recent and current borrowers are more promising. The report mentioned above discusses various alternatives that need further exploration.

2. Providing support for the technical assistance programs of UNIDO and the ILO. These are the two international agencies chiefly concerned with the provision of managerial and technical advice to small-scale enterprise and in this area UNIDO is the more important. Although the Bank Group has recently strengthened its relations with INIDO there is still lacking the cooperative arrangements established with UNESCO and FAO.

3. Supporting government programs of managerial and technical assistance to small-scale enterprise and encouraging governments to establish such programs. There are not many effective government programs but there are a few, notably in Israel and India. Such programs are difficult to man and in many countries

it would probably be wiser to give concentrated attention to a limited class of enterprises than to try to cover the waterfront. Certain of the services needed can best be provided by a functioning capital market, a subject for later discussion.

(c) Should the Bank Group play a more active role in finding and shaping investment projects?

The Bank discovered in its early years that unless it took a hand in the preparation of projects its financial assistance to a number of member countries would be limited. These projects, in the main, tended to involve large investment for infrastructure. If the BG is to play a significant role in financing smaller projects and projects of any size in the least developed member countries it will have to intensify its search for investment opportunities. Some steps have already been taken in this direction.

The IFC established in 1973 an Investment Promotion Division which in the short period of its existence seems to have demonstrated its usefulness. It has been particularly active in Africa and Latin America and it has become clear in the course of its operations that the discovery of new investment opportunities usually requires a visit of some length to a particular country. This activity is not very compatible with the analysis and evaluation undertaken in the investment divisions. What appears to be required is either the assignment of special investment promotion personnel to all the investment divisions of IFC or the establishment of more effective relations between these divisions and an enlarged Investment Promotion Division.

It also seems probable that more could be done to promote investment opportunities by the DFCs financed by the Bank. When the IFC is represented on the Board of a DFC a longer stay in the country by the representative and greater attention to investment promotion could produce results. In other DFCs financed by the BG greater attention might well be given to investment promotion as a condition of Bank lending.

There are possibilities to be exploited in BG technical assistance to other institutions in member countries. In Indonesia, for example, an IDA technical assistance credit finances an expert attached to the Central Bank whose assignment is to promote investment opportunities. It seems likely that similar types of activity could be usefully financed in other countries.

It is a commonplace that many industrial firms in developing countries would benefit by greater access to western technology and managerial expertise and, if they possess an export potential, by improved access to foreign markets. Furthermore there are numerous firms in the western world and Japan that are willing to provide technology and managerial assistance, and others are searching for lower cost sources of finished goods, parts and sub-assemblies for their own production and their own markets. The financial and contractual arrangements through which these reciprocal needs can be satisfied are numerous and frequently complex. My own experience leads me to believe that the opportunities in this area have scarcely been touched. What is needed are people familiar with the needs of western firms and the requirements of enterprises in developing countries. Although these skills are in short supply they are available in a number of firms specializing in this type of promotion. Is it possible that the IFC might make greater use of this expertise and that IFC involvement would, in a number of cases, facilitate desirable arrangements?

In general it needs to be said that the treatment of the private sector and of private enterprise in most of the Bank Economic Reports tends to be relatively weak. This treatment reflects a general indisposition in the Bank to be much concerned with the private sector and its role in a country's development. How this weakness in economic reports can be eliminated is a matter that needs further consideration.

(d) Bank financing of infrastructure servicing smaller enterprises.

Of particular concern is BG financing of industrial estates, free zones and similar service institutions. The Bank has, of course, financed a sizeable number of industrial estates with varying results. It is the view of the "Kochav Reports" that, "On the whole industrial estates have been costly failures in promoting small-scale enterprises." While this may be true of very small enterprises it need not be true of medium-scale firms. What is frequently needed is the provision of more than capital infrastructure such as water, sewage, power and transport facilities. In Korea I was much impressed by the Gumi Industrial Estate which now accommodates 120 firms - established or in process of construction - and which has a designed capacity for 320 firms. Although a couple of firms now in production are relatively large most are of medium size producing mainly for export.

In addition to the usual capital infrastructure, including the latest container packing and shipping facilities, the Estate makes provision for import and export licensing, customs clearance, certification of origin and import and export financing. This decentralization of governmental controls and financial assistance is of enormous advantage to small-scale enterprises who find on the ground services that in other situations would only be available at central or regional government offices. The Bank might well take this example into account in its future financing of industrial estates.

2. Bank Group assistance in the development of entrepreneurship and managerial skills.

The Bank Group is almost inevitably involved in attempts to improve managerial practice in all its project financing. Advice on policies concerning pricing, management of cash flows, accounting and other aspects of business administration is a common feature of project preparation, appraisal and supervision. The question is what can the Bank do to assist the development of entrepreneurship and management in addition to technical assistance on projects?

There is probably some point in making a distinction between Schumpeterian entrepreneurship, meaning the ability to establish a new enterprise or to introduce a significant innovation in an old one, and business management, meaning the ability to run successfully a going concern, though the distinction is not sharp. It is presumably possible to impart managerial skills, or else the thousands of business schools around the world are off on the wrong track. On the other hand it seems doubtful that entrepreneurship lends itself to professional training. Sociological and cultural studies of the sources of N achievement and of the propensity of particular communities, castes and disadvantaged aliens to generate entrepreneurial characteristics may offer useful clues but it is difficult for the Bank to take advantage of them. Perhaps the most the Bank can do in this area is to urge governments to follow policies that make it easy to establish new enterprises and to encourage existing ones to grow.

These policies will differ at different stages of development and will obviously be influenced by what elements in the population governments wish to encourage. In the final stages of colonial rule in East Africa it was noted that colonial predilections for clean streets and neat capital cities kept out of circulation street hawkers and other small vendors who might have developed entrepreneurial ambitions. Whether or not this is so the greater hospitality of West African countries for activities of this sort probably has something to do with the obviously more lively business environment in this part of Africa. It has been noted that small-scale trucking has been a source of entrepreneurs in some countries at early stages of development and it seems probably that ease of entry into almost any type of business activity would have the same effect. At later stages of development on the other hand the expansion of private enterprise may require something more.

The sources of managerial skills are less esoteric than entrepreneurship and it seems likely that the Bank can do more than it has done to assist the development of these skills. The major alternatives would appear to be the financing of formal training in institutions specializing in technology and administration and, on the other hand, encouraging the development of business skills in existing domestic and foreign related enterprises. The Bank has in fact financed a number of institutions preparing students for administrative posts in business and government but I do not know of any systematic attempt to evaluate the results. The institutions with which I am familiar, business schools in Iran, India, the Philippines and Nicaragua, established with the assistance of the Harvard School of Business Administration, have enjoyed a fair measure of success. No doubt there are many other examples of this sort.

A more important source is probably the informal training received by employees in existing business establishments. Joint ventures with foreign enterprises can serve as a vehical not only for the transfer of technology but of managerial expertise particularly if provision is made by a gradual take over of administrative posts by local personnel. It seems possible that the Bank, and particularly the IFC, can do more than it has done to accelerate this process.

Something can be learned concerning the development of entrepreneurship and managerial skills from the experience of Korea and the Republic of China (Taiwan), two countries that have been eminently successful. Both countries started in 1945 at point zero since all the established enterprises of any size were Japanese firms employing local personnel at a position no higher than a clerkship. At present, complex industrial enterprises are successfully managed by native born Chinese and Koreans, new enterprises are easily established, and many grow rapidly to a larger scale. Some of the reasons for this development are clear. The population of both countries are highly literate and they are well provided with institutions offering technical and administrative training. Existing firms train managers who move to newer and smaller enterprises. The Chungju fertilizer plant in Korea was established in 1954 and it is remarkable how many chemical and fertilizer plants are now run by former employees at Chungju. Both countries have been hospitable to foreign private investment and, in Korea, joint ventures, particularly with Japanese firms, have been an important source of management training. Finally, both countries have promoted the private sector and have followed policies conducive to the initiation and expansion of private enterprise.

No doubt the Chinese and Korea experience has only a partial relevance to the problems confronting other developing countries and no doubt a number of governments do not wish to follow this pattern of development. But for those who do, and for the Bank, there is something to be learned in the experience of these countries.

3. Government policies affecting the private sector and possible Bank Group influence on these policies.

The relative roles assigned to the public and private sectors by member country governments is a matter of domestic policy with which the Bank is not properly concerned. Early attempts by the Bank to influence policy in favor of private enterprise were unsuccessful and, on occasion, deeply resented. But it may be possible for the Bank to assist governments to realize their objectives by appropriate policy advice regardless of whether the activities affected are judged to be in the private or public sector.

The direction and level of private activities are mainly determined by incentives and disencentives available to business decision-makers and investors. Incentives can be affected by macro-economic fiscal, monetary and exchange policies, by policies affecting the costs and prices of particular products or groups of products, and by policies directed toward the location, scale or management of particular enterprises. Early in its history the Bank's concern with the effect of government policies on development focused on policies affecting the level of domestic prices and the exchange rate - the "enduring stability of the currency." and "realistic rate of exchange" hallowed by IMF usage, and on conditions governing foreign private investment. Later, attention turned to trade policies, tariff rates, exchange controls, import licensing -

and their effect on the production of particular products and groups of products. The calculation of effective rates of protection suggested the extent to which particular industries were diverted away from positions of comparative advantage. And economic reports and sectoral studies emphasized the effect of price controls, the licensing of enterprises, differential taxes and subsidies and labor policy on business incentives and disincentives.

It was and is recognized that appropriate strategy for the development of the private sector will depend on the stage of development of an economy and on the administrative capacity of government. But the Bank has attempted to encourage in most of its developing countries a movement away from excessive emphasis on import replacement toward a more outward looking strategy. To this end it has tended to emphasize, as stated in the Industry Sector working papers a "policy of moderate protection' "minimum use of direct controls"; "a fiscal policy framework designed to strengthen the competitive position of industry and to encourage resource use in accordance with comparative advantage"; "monetary and credit policies aimed at creating a financial environment conducive to a high rate of savings and the efficient mobilization and allocation of available resources"; and "labor and manpower policies designed to achieve maximum employment."

It is recognized that these are very general precepts which to have applicability to the circumstances in a particular country must be carefully specified. The specification, moreover, must take account of political acceptability and administrative feasibility. The objective the Bank presumably wishes to attain is a change in the system of incentives offered to investors and business decision makers applicable to the private sector in general or to particular groups of savers and decision makers; incentives that are acceptable to government and administratively practicable.

In the absence of sensible policies, costs and prices are "distorted" and yield a system of incentives an disincentives that lessens savings and leads to an allocation of resources away from an effective pattern of growth. To counteract these distortions the Bank has, not very systematically, attempted to calculate "economic" rates of return on proposed investments using international prices for commodity inputs and outputs where feasible and supplementing these calculations by shadow prices of capital, foreign exchange and, occasionally, labor. The difficulties of substituting "equilibrium" prices for market prices are enormous and run the ultimate risk that the use of equilibrium prices for certain rate-of-return calculations when all other investment decisions are based on market prices will worsen rather than improve the structure of incentives. In any case there is general agreement that changes in government policy bringing market costs and prices closer to economic costs and prices, changes applicable to all investment and production decisions including those with which the Bank is directly concerned, offer a superior road to a rational use of resources.

If the Bank is to exert greater influences on policies affecting the growth of the private sector it will be necessary,

(a) to establish some priority ranking of the steps it desires a borrowing member government to undertake; a priority ranking based both on the importance to the development of the private sector of the proposed steps and on their political feasibility;

(b) to decide whether the Bank's efforts will be limited to persuasion or whether conditions are to be attached to lending, and, if conditions are to be attached;

(c) to determine what kind of conditions can and should be attached to what kind of financing.

(a) The establishment of a priority ranking.

The prices of greatest importance to the incentive structure of the private sector are the price of money and the price of foreign exchange. The interest rate and the foreign exchange rate affect nearly all enterprises. Consequently any influence the Bank can exert on these rates will be far-reaching. But because it does reach far and affect many interests any attempt to exert external influence is apt to be strongly resisted. It is unlikely that the Bank can have much influence in exchange rates or interest rates except by persuasion. Attempts to influence foreign exchange policy by attaching conditions to program loans or to a proposed level of lending have occasionally produced results but frequently at the expense of worsened relationships between the Bank and the borrowing country. The Bank has often used the occasion of DFC loans and other types of financing to argue the merits of a policy that would bring interest rates closer to the scarcity value of capital and some partial and limited successes can be recorded. In general, however, it would have to be said that although exchange rates and interest rates are of primary importance to the incentive structure of the private sector and therefore should enjoy a high ranking on the priority list of Bank objectives they occupy an area of concern highly sensitive to external influences. Needless to say this is an area of major concern to the IMF which means that efforts by the Bank to influence policy must take account of IMF activities and objectives.

Trade policy including the level and structure of tariff rates, import licensing and exchange controls, export subsidies, restrictions and differential taxes on particular imports and exports, is a second large area of government intervention affecting the incentive structure of the private sector. In recent years this has also been an area of substantial Bank concern. The Bank's general objective has been to encourage a structure of incentives such that resources would be directed into activities in which a member country had a comparative advantage. To this end the Bank has favored lower and more uniform tariff rates, elimination of quantitative restrictions and exchange controls, and a shift from an exclusive concern with import savings toward a greater emphasis on export earnings. In addition to persuasion, backed up by numerous studies indicating the superior performance of outward oriented economies, the Bank has taken both negative and positive steps to further its objectives. It has increasingly refused to finance projects whose earning prospects depended on a high effective rate of protection and it has had some degree of success in attaching trade-liberalization conditions to import loans and proposed levels of lending. Trade policy must continue to be an area of active Bank interest in any attempt to assist the development of the private sector.

Proceeding from the general to the particular encounters a welter of policies and administrative rules and regulations offering incentives and disincentives to particular industries and enterprises. Occasionally the Bank attempts to exercise influence via sector loans as, eg. the broad agricultural credit loans to Brazil a few years ago which were conditioned on lending at positive real interest rates by agricultural credit agencies amd the elimination to the barriers to export of certain products. Import loans of the late 1960's in India were conditioned on the simplification for particular industries of import licensing and other regulations. Occasionally the financing of a particular enterprise offers opportunities for removing certain disincentives.

Although there has been a continual improvement in the quality of economic reports and in the Bank's sector studies, and although there is continued emphasis on the need in particular countries for coherent industrial strategy, this had not led, so far as I can see, to the devising for country programs of a systematic analysis of the impediments offered by government policy and practice to the development of the private sector and what the Bank might do to induce a change in counterproductive policies and practices. The relation of government to business in any economy is a complex subject not very amenable to quantitative analysis. But the incentives and disincentives that determine the health of the private sector are imbedded in this relationship and unless theycan be sorted out and appraised the Bank will not be well equipped to offer advice on what needs to be done to assist business enterprise.

It is suggested that industrial sector studies, and perhaps economic reports, pay more attention to an analysis of the effects of government policies and administrative arrangements in the direction and volume of private investment and the conduct of industrial enterprises with a view to establishing priorities for Bank attempts to induce policy changes. The Terms of Reference for the Western Africa Regional Mission (Bela Balassa, April 29, 1974) is a good statement of policies to be assessed in terms of their effect on import and export incentives. The proposed study is not limited to the private sector nor does it include policies not related to foreign exchange and earning.

(b) Persuasion versus conditions.

In general it seems to be true that the more general (macroeconomic) are policies affecting business incentives the more sensitive to external influence governments are. The argument for persuasion tends to be strong and for attempts to attach conditions to financing tends to be weak. At the other end of the scale the Bank has had considerable success in attaching conditions to specific project loans whether in the public or the private sector.

The financing of DFCs represents an intermediate position between program and project loans. Changes either in government policy toward DFCs or in DFC investment policies can affect business incentive over a relatively wide area. The Policy Paper on the World Bank and Development Finance Companies has a good discussion of the merits and demerits of persuasion versus controls (conditions) in dealing with government policies governing DFCs and DFC policies toward customers.

(c) What kinds of conditions can and should be attached to what kind of loans?

The Policy Paper mentioned above considers a number of conditions that might be used in DFC financing to improve project design, to expand DFC assistance to underpriviledged borrowers, and to reduce the dependence of DFCs on concessional financing.

Should there be a systematic examination of the possibility of inducing changes in government policy affecting business incentives by persuasion or conditioning in other types of Bank financing? I have the impression that there is a considerable variation in Bank practice in different geographical areas, (perhaps there should be) and that the possibilities have not been carefully studied.

If efforts to persuade governments to undertake policy changes, or if the conditions to be attached to loans, are to be successful, it would be useful if the various divisions and the departments of the Bank concerned with particular areas of policy could see eye to eye in their analysis of what needs to be done, what tactics should be used, and who is to do it. The bringing of influence to bear on a member government to induce a change in economic policies is a matter requiring coordinated Bank action and I have the impression that coordination is frequently lacking. There are, e.g. four parts of the Bank concerned with policy toward industrial enterprises; IFC, the Industrial Projects Department, the DFC Department and the Industry Division of the Economics Department. Establishing a common view sometimes presents difficulties.

4. Foreign Private Investment and the Private Sector

One of the primary purposes of the Bank, stated in its Articles of Agreement, was the promotion of foreign private investment. Indeed it was thought by its founders that the guarantee of foreign private investment could be the Bank's principal function. When, for various reasons, this proved impractical the Bank encouraged private investors to enter into joint financing arrangements in which the Bank evaluated the project and took the longer maturities leaving the shorter, and less risky, maturities to its private partners. The Bank also encouraged foreign investors through the sale of participations in its loans and through sales from portfolio. At its high point, in 1962, these sales and participations amounted to more than $300 million. Such participations have by now nearly disappeared as the result, mainly, of the differences between the terms of Bank lending and the returns available to investors in other securities. Although the private contribution in joint financing and participations was primarily directed, in concert with Bank lending, to infrastructure investment in the public sector, some part of it financed industrial enterprises in the private sector.

Disappointment with the slow revival of foreign private investment after the war was partially responsible for the Bank's decision in 1950 to lend to private enterprise in developing countries through financial intermediaries and, in 1956, to establish the International Finance Corporation. Since then there have become the most important channels of Bank financing of private enterprise. Direct loans for industrial projects now go mainly to public sector enterprises. And the only other source of Bank financing of private enterprise is the share of occasional import loans that are allocated to such enterprises. The IFC encourages private participation in its investment projects and, on occasion, sells its own holdings to private investors. Apart from this the Bank does little to cooperate with foreign private investors nor are its own investments in the private sector large.

The Bank Group could and should do more in both areas. Various possibilities of increased Bank lending to the private sector are touched on in other parts of this paper. Here we are primarily concerned with policy toward foreign private investment. This is likely to be an area of increasing importance to developing countries as official development assistance appears to be declining, at least in real terms. The developing countries are, in fact, turning increasingly to the private capital market. Although the trend of private direct investment is uncertain there has been a substantial increase indeveloping country borrowing from banks on short and intermediate terms. The resources available from the oil producing countries will greatly expand the potential for borrowing.

Unfortunately both direct foreign investment and portfolio investment and Bank lending, go overshelmingly to a few rapidly growing semi-industrialized countries leaving most of the developing world untouched. Furthermore, most private investing and lending are undertaken without very much regard for development priorities in the receiving countries. For this and other reasons a high degree of suspicion, particularly for foreign direct investment, exists in many developing countries. The suspicion of direct investment by multinational corporations is particularly strong in certain quarters.

The Bank in dealing with foreign private investment has two responsibilities toward its member developing countries. The first is to assist them in protecting themselves against low priority investments and investments on unacceptable terms. The second is to encourage foreign private investment that promises to contribute to development.

In foreign investments in which the Bank itself participates the interests of the member country are presumably well protected. If it is a mining investment involving a concessions agreement the terms of this agreement are carefully studied. If the Bank Group participates in other types of investment the potential contribution to development is studiously assessed. The Bank also, frequently in concert with the IMF, advises on terms of borrowing in connection with an examination of a member country's debt structure.

But it seems that the Bank could do more, particularly in advising a member country on the prospective developmental consequences of proposed foreign investment in which it is not a participant. Zambia is said to have a knowledgeable expatriate official who advises the government on all foreign investment proposals. Egypt has recently established an Organization for Arab and International Investment to pass on all foreign investment proposals. Two expatriate advisers are to be attached to this Organization to assist in analyzing such proposals. This would seem to be an area in which the Bank could make a greater contribution than it now does. Its expertise in this area is large and the needs of a number of developing countries are great.

In the exercise of the Bank Groups responsibility of encouraging productive private investment the IFC has a particular role to play. Although the IFC investment has expanded rapidly in recent years it is still a relatively unimportant member of the Bank Group. Are there opportunities for a substantial expansion of its activities? On this subject I lack adequate information and can only ask a number of subsidiary questions.

Outside the Bank the IFC has the reputation of being a cumbersome and slow moving organization at least in comparison with other development banks. Are there ways of simplifying and accelerating its procedures?

I have been told by a senior official in IFC that the factor limiting expansion is the lack of trained business personnel capable of putting investment projects together. If this is so should IFC do more investing via such intermediaries as ADELA? Could it make greater use of outside promotional services as suggested earlier.

The IFC has always been an odd-man-out in the Bank Group, a position some of its staff seem to relish but which seems to me counterproductive. Should the Executive Vice President be also a Vice President of the Bank in close touch with the Bank's work? Should the DFC Department whose work so closely resembles that of the IFC, and which once was part of the IFC, be transferred to the IFC?

Any considerable expansion of IFC activities will require a strengthening of its capital structure. How and when is this to be done?

These are questions for which I, for lack of knowledge, have no strong opinions.

The Bank's potential in encouraging foreign private investment is not, however, limited to the IFC. Early in its history the Bank lessened the risk to joint private investors by guaranteeing repayment. This practice fell into abeyance when it no longer appeared necessary. But perhaps some assumption of risk may be necessary if private investment in those member countries which most need investment is to be encouraged. Charles O. Sethness, the U. S. Director, has offered a suggestion concerning "integrated" Bank-private investment that is worth consideration. The essence of the proposal is embodied in two conditions. (1) There should be a provision for different terms of lending (i.e. rates and maturities) for the private and Bank participation. (2) The inclusion of a "cross-default" clause providing "that in the event of a default to the private lender" or to the Bank, "both loans would be considered in default." It is thought that the unwillingness of the borrower to default on a Bank loan would give added protection to the private lender.

This and other proposals for Bank participation in risk to the private lender need to be studied.

5. The development of capital markets.

Capital markets are here defined broadly to include both short-term and long-term money, the institutions that intermediate lending and investments, the governmental rules and regulations under which they operate, the types of securities offered for purchase and sale, securities markets, and the accounting, auditing, brokerage and advisory services available to participants in money and capital markets. The principal functions of such markets is to generate savings, allocate savings to high priority uses, hopefully at minimum cost.

There are, of course, alternative ways of generating and allocating savings that make little use of a capital market. Governments can and do accumulate savings by taxation, intervention in factor and product markets, the pursuit of inflationary policies, and by other means. Savings thus generated usually, though not necessarily, flow primarily into public investment. Alternatively both the public and private sector can depend on capital markets. And, if the flows of savings and the choice of investments are to be subject to market tests related to the scarcity value and productivity of capital, they need to flow through capital markets.

It seems elementary that the development of a capital market must accompany the development of the private sector though at early stages of development government may be the principal participant in this market. In the process of development there is obviously a relationship of action and reaction between the financial and real characteristics of development. At times changes in the capital market will stimulate savings and their allocation to productive use. At other times potential saving and investment opportunities will call forth the financial instruments and institutions needed to realize these potentialities. Since the financial side accompanies so closely the real side of development of the private sector it follows that any external attempt to assist the expansion of a capital market must be related to the stage of development of the economy as well as to the stage of development of financial institutions and practices.

An effectively functioning capital market may be said to exist when:

The financial institutions in the market fit the stage of development of the economy in the sense that potential savers, investors and capital users, throughout the economy, are offered the range of incentives that the state of development permits. This requires that adequate information be available to make rational choices; that the financial instruments available facilitate these choices; and that intervention from the state or powerful private interests do not seriously distort the incentive structure. Under these circumstances it can be expected that lending and borrowing rates will approximately reflect the scarcity and productivity of capital.

Although, strictly speaking, they are not a part of the capital market, the business enterprises that borrow from and sell their securities on the market, with their accounting and auditing practices and policies concerning release of information, together with the company law and government regulations that affect the operation of these enterprises, influence the character of the institutions that make up the capital market. A thorough study of a capital market must take these influences into account.

In general it would have to be said that the Bank Group has, at least until recently, tended to underestimate the role of capital markets in economic development and, particularly its importance to the development of the private sector. A few financial missions have been sent to visit member countries and, for a short period of time, a capital markets division existed in the Bank. But country economic reports in general have given relatively perfunctory attention to money and capital markets. This has been in keeping with the Bank's primary concern with public sector investment and the attention given to the mobilization of savings through governmental measures and to a government rather than a market determination of investment priorities. A notable exception has been the work of the Bank in the establishment and supervision of development finance companies. But here the concentration has been on one particular type of financial intermediary rather than on a broad program for the development of capital market institutions.

A large step forward was taken in 1971 with the formation of the Capital Markets Department. This Department has already initiated a number of investments in financial intermediaries other than DFCs and has given policy advice and technical assistance to a number of member countries interested in developing their capital markets. But the situation in the Bank is still unsatisfactory. The position of the Department in the IFC limits its activities to the area of IFC responsibility. Although a certain degree of cooperation with other parts of the Bank dealing with capital markets, mainly the DFC Department, the Domestic Finance Division, the Development Services Department, and the Bank's Regional and Industrial Projects Department has been achieved, it so far embraces only an exchange of information. A determination of Bank policy toward the development of capital markets would require more effective means of coordination. The lack of staff in the Capital Markets Department, moreover, has limited action to ad hoc projects undertaken without an examination of a sensible strategy for capital market development.

The formation of such a strategy taking full account of the relations between the financial and physical state of development in a member country would greatly assist the establishment of Bank work priorities, the choice between policy advice, technical assistance and project investments, and the effectiveness of persuasion as against conditions attached to Bank commitments. It is unlikely, however, that this will be possible unless and until the various parts of the Bank can be brought to work together more effectively.

There remains the problem of coordinating more effectively the capital markets activity of the Bank with similar work in other agencies including the IMF, O.E.C.D., IDB and U.S.AID. A conference in Geneva on Financial Markets Development, at which some 24 international lending organizations were represented, accomplished an exchange of information on this question but no positive action.

Over the long run assistance to member countries in their development of money-and-capital markets appears to be one of the most effective ways of assisting the development of the private sector.

6. Suggestions for change in Bank organization and practice favorable to the development of the private sector should be postponed until a later stage in this study.

Summary

The discussion thus far has suggested a number of areas in which the Bank Group might increase its assistance to the private sector. The following seem worth further examination in connection with the proposed study of nine or ten developing member countries.

1. What type of financial intermediary should the Bank encourage and finance for on-lending to small and medium size firms? Should technical advisory services be attached to these intermediaries?

2. Should more be done through the IFC's Investment Promotion Division, the Bank's connections with DFCs, and in other ways to find new investment opportunities in the private sector?

3. What can the Bank do in financing industrial estates and free zones to provide services of use for smaller scale firms?

4. In assisting the development of managerial skills should the Bank emphasize formal training or informal training via established enterprises? Can the Bank attach training schemes to project financing?

5. Is it possible, for a particular country, to establish a priority ranking of government policies adversely affecting the development of the

private sector which the Bank would like to see changed; a ranking based (a) on the extent of the adverse effect, and (b) on the possibility of exerting influence?

If so, what strategy can be devised to bring about the desired changes, and through what channels?

6. Should the Bank offer a broader range of advisory services to member countries concerned with the developmental consequences of foreign private investment proposals?

7. How can the IFC expand its rate of investment in concert with private investors?

8. Are there ways by which the Bank can encourage foreign private investment by various types of risk-sharing?

9. Should the Bank assign a higher priority to capital market development by (a) increasing the staff of the Capital Markets Department, and (b) improving the coordination within the Bank of the various divisions and departments concerned with capital market development?

Private Sector Dev. Study

Members of the Committee on Private Sector Development

October 9, 1974

Moeen A. Qureshi

Private Sector Development Study

/- AUG. 29 1974/

Attached are two draft memoranda for discussion.

The first is an attempt to outline in broad terms the purpose and scope of the Study. This is not a detailed outline, its main purpose is to provide a basis for Professor Mason to prepare a more detailed "think piece" outlining the issues involved, and the areas where further work should be done.

The second is a questionnaire which identifies the type of information and knowledge that would be required for studying the experience and prospects of private sector development in particular countries.

We propose to discuss the organization of work on the Study on the basis of these memoranda on Friday, October 11 at 11.00 a.m. Professor Mason will be here on Friday to participate in the meeting.

Distribution:

Mr. Avramovic
Mr. Bell
Mr. Chaufournier
Mr. Gill
Mr. Goodman
Mr. Gustafson
Mr. Stern

Private Sector Dev. Study 162
9/7

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September 27, 1974

Mr. Moeen L. Qureshi
International Finance Corporation
World Bank
1818 H Street, N.W.
Washington, D. C. 20433

Dear Moeen:

I have nothing to add to the proposed questionnaire. I think it covers everything I had in mind and should be ready to send out to the country economists. I hope they take it seriously.

I liked your piece on the Bank group's role in the development of the private sector but I do have a few comments here.

Page 3, first full paragraph. Add employment to investment and value added in measuring the relative size of the private sector. I agree with you that it would be useful to have an overall view on the importance of the private sector and where it is increasing or decreasing. How are we going to get this? Would it be possible to ask the chief economists in the various area departments to give us a paper on this subject even if their views are only impressionistic?

Page 5, first full paragraph, second sentence. Direct investment can make a contribution to industrial development at any level of development. Consider Botswana where there are heavy foreign investments at one end of the scale and Brazil at the other. It would be better to say what contribution can foreign investment make at different levels of development.

The more I think about this subject, the more illusive it becomes. It is relatively easy to establish rough relationships between per capita income and the structure of production and consumption. Chenery and Houthakker have both made contributions in this field. But when one deals with the results of the public and private sector it is not at all easy to establish relationships between per capita income or the stage of development. This relationship so much depends on natural resource endowments, cultural backgrounds and the ideology. It is a peculiarly "institutional" subject. But despite these difficulties I am perserving.

I expect to be in Washington on the 10th and 11th of October to talk to various people at the Bank. I hope you can set up a meeting of our Advisory Committee on that date.

Sincerely yours,

Ed

Edward S. Mason

ESM:w

Research Studies

Mr. L. von Hoffmann

September 24, 1974

Moeen A. Qureshi

Study on Private Sector Development

I would appreciate your taking a look at these two papers before I distribute them to the members of the Committee and to Edward Mason.

I have written the main note in order to give some ideas with respect to the purpose and scope of the Study and some of the principal issues that should be tackled. It is not intended to be an annotated outline -- that is what I would like Mason to do.

The list of questions (which has been drafted by Weigel) is designed for Ernest Stern. He had said that he could get the Chief Economists to do some work on the sample of countries we had selected. This list of questions should provide the necessary focus for their work.

MAQ:gmb

Attachments

BANK GROUP'S ROLE IN THE DEVELOPMENT OF THE PRIVATE SECTOR

Purpose of the Study

The purpose of the Study is to explore the Bank Group's role in stimulating the development of the private sector. This would suggest that the Study should include an analysis of the problems and prospects of private sector development in different countries at different stages of development, an assessment of the major issues involved, and an identification of the types of assistance which the Bank Group could provide.

Although the Government's role has been expanding rapidly in many developing countries, large segments of the economy remain in private hands. For instance, agriculture, the primary economic activity in the developing world has typically a "private" orientation. This is also generally true of trade and small and medium-sized industry. There is undoubtedly a growing tendency to earmark certain economic activities for the State -- but, except in some "strategic" areas, this generally reflects a dissatisfaction with the slow growth of indigenous private enterprise and a desire to spur economic growth through deliberate State initiative and investment. Even in these cases, private enterprise has not been entirely eliminated and "mixed" enterprises are gaining in popularity. In particular, joint ventures between State enterprises and foreign private investment are becoming more frequent. In short, private enterprise, both local and foreign, continues to be an important element in the development process in the large majority of developing countries.

Its Scope

How should the private sector be defined for the purposes of the Study?

Private enterprise in the developing countries is to be found in virtually every sector -- agriculture, industry, trade, transportation, etc. The Study should not become an investigation into specific sectoral issues -- e.g. problems of rural development or of industrialization. It should rather explore how indigenous private enterprise can be helped to play a fuller and more productive role in the development process.

Some discussion and recognition of particular development problems and sectoral issues is, of course, unavoidable since questions of private sector development must necessarily be viewed against the perspective of the development of the economy as a whole. A useful point of departure might be to focus on problems of developing "private enterprise" rather than particular sectors or activities (e.g. agriculture or rural credit) where private enterprise is prevalent. For example, while agriculture is predominantly a "private" activity in most developing countries, it is conducted typically by private individuals rather than enterprises. Commercial agriculture and agro-businesses are only just beginning to be established in the developing world. Since private enterprises -- small, medium and large -- are to be found typically in trade, industry and construction, these areas would appear to deserve particular attention in the Study. A focus on "private enterprise" as distinct from particular sectoral issues, is also desirable because problems of private sector development and their solutions run across sectoral boundaries. Thus, programs to encourage small and medium-scale enterprises, or to develop skilled industrial labor, may involve remedial action in the field of technical and vocational education. Similarly, difficulties in obtaining industrial financing may result from inadequate institutional development in the financial field. While these problems need to be identified and ranked in priority, the Study should not become a treatise on industrial credit or a full-fledged investigation into the problems of the financial sector.

Nature of the Private Sector

At an early stage of the Study, it would be useful to outline the importance of the private sector in the developing world. What is the relative size of the private sector, as measured by investment or value added, in various groups of countries? Where has the private sector increased or decreased in relative importance?

In selected countries it will be desirable to go into more detail to learn the role of private enterprise in the major economic sectors, and the relative rates of growth in the public and private sectors. In these countries it would also be desirable to know the degree of concentration of ownership and income, the distribution between domestic and foreign ownership, and between the public and private sectors. Information on these aspects is not readily available, but a realistic feel for the current state of the private sector in different types of investor countries is vital for any appreciation of its problems or prospects.

Constraints on Private Sector Development

This would be the main analytical part of the study -- the identification and evaluation of the principal constraints on the development of private enterprises in developing countries. The major difficulties are, of course, well-known:

-- lack of entrepreneurial, management and technical skills.

-- deficiency of capital - both local and foreign exchange.

-- inadequate infrastructure.

-- market constraints.

-- inappropriate policy environment.

It is easy to enumerate the principal constraints on the development of private enterprise; the main difficulty is to assess the relative importance of these constraints in different types of country situations, to identify the contributing factors and to develop paractical approaches to resolving the problems.

Is the development of entrepreneurial and management skills indeed the critical problem in some of the smaller African countries? Should primary emphasis be placed on training and educational programs, or should the first order of priority be the identification and preparation of projects, and the development of "extension" services, through appropriate local institutions created for this purpose? These are obviously not mutually exclusive options but, in view of scarce resources, relative priorities should be clarified.

There are similar issues with respect to the more advanced developing countries. A recurrent theme concerns the need for technology. Is the answer a more active role by the Government to assist the private sector through the development of suitable industrial or technology institutes, or more joint ventures with foreign enterprises, or importing technology on a contractual basis?

The question of importing technology also leads to the broader issue of the role of foreign private direct investment in the development of the private sector. At what level of development can direct investment make a contribution to industrial development? Is foreign investment competitive or complementary to the development of local resources? What policy measures would enable various types of developing countries to get the most out of foreign direct investment?

Foreign investment is sometimes used to circumvert problems of the local capital market. To what extent are capital markets unable to raise and allocate capital to the best uses at a price which reflects its scarcity and the risk involved? What types of financial infrastructure are required to support a growing business and industry? How can the financial requirements of particular groups (agricultural credit, credit for small businessmen) be met?

The lack of physical infrastructure is also, in varying degrees, a common characteristic of most developing countries. In this case, the main question to be considered in the Study is whether steps can be taken to provide facilities which will enable the private sector to mobilize more fully its available skills and potential -- e.g. industrial estates, electrification programs for cottage industries.

The market constraint referred to above does not only have to do with market size but with problems of access to markets, both internally and externally. For example, access to foreign markets may prove difficult for local business and industry without special assistance. Similarly, problems of market access can arise within a country due to the domination of particular groups -- e.g. by foreign companies, or by particular ethnic or regional groups. In many African and Asian countries, these factors have constrained the sound growth of private enterprise.

Finally, the issue of an appropriate policy environment has already been touched upon above. Government regulations and policy towards the private sector vary from country to country -- there are important differences in the attitudes towards private participation in different sectors of the economy, and the encouragement and incentives provided to private enterprise, domestic and foreign. The Study should make an assessment of the attitudes of developing country governments towards the development of private enterprise. The potential role of the Bank Group in this field must inevitably be conditioned by the attitudes and wishes of its members.

Strategies for Private Sector Development
and the Bank Group's Role

It is hoped that a general strategy for private sector development can be derived from the analytical work. The strategy may be designed to deal specifically with the constraints discussed earlier, or with more integrated approaches. In any event it should focus on questions which can be dealt with by the Bank Group. Some possible areas of attention are suggested below.

Providing Finance: Making the necessary finance available is in itself an important contribution in many cases, but it would be useful to arrive at a better definition of those areas where the needs are believed to be greatest. The terms on which financing should be provided also require study. There are a number of other important questions: What should be the relative emphasis between loans and investments on the one hand and indirect financing (through local intermediaries) on the other? Should there be greater concentration on equity as against loan financing, particularly in joint ventures or in extractive investments? Should financing to the private sector be on "market terms" (whatever that means) or is a concessionary element justified in some cases? Answers to these questions can help shape an appropriate role for the Bank Group.

Money and Capital Market Development

For a number of reasons, developing countries are taking increasing interest in programs of money and capital market development. These include: (i) the dwindling importance of foreign assistance and therefore the increased pressure to mobilize domestic resources for development; (ii) the desire to broaden and diversify public ownership of business and industry, and (iii) the need to create a supportive financial infrastructure for the growing industrial and commercial base.

In most developing countries private enterprise is likely to be a major beneficiary from a more developed money and capital market although such development does not, of necessity, have to have a "private" orientation. In this field, it is relevant to ask whether and to what extent, Bank Group assistance should continue to be channelled through traditional DFC type intermediaries? Is there much scope for developing new types of institutions, more responsive to local requirements (e.g. rural development, extension services). Under what conditions is it useful to follow the example of financial markets in more developed coutries (stock exchanges, investment banks, mutual funds, etc.)? Should the Bank Group undertake a major effort in some of the smaller developing countries to build the basic institutions required to mobilize savings (savings banks, postal savings, Savings and Loan associations, etc.) and/or to allocate resources to particular sectors (housing, finance, consumer finance)?

A number of agencies -- both bilateral and multilateral -- are currently active in programs of assistance in the capital market field. The forumulation of a Bank Group role in this sector must be an important element of any overall strategy for stimulating private enterprise in developing countries.

Promotion of small Entrepreneurs

In most developing countries, the expansion in the role of the State in economic activity, has tended to inhibit the growth of large private enterprises. With very few exceptions, developing country governments have generally been anxious, for political and social reasons, to stregthen small scale enterprises. This is, of course, also the group which is the most difficult to assist and the Bank Group's role in this area has been, at best, peripheral in the past. It is important to define more clearly the Bank group's role in the sector. Can more be done to support the small enterprise sector, particularly in the smaller and economically less advanced coutries? How would such an effort be organized, and what demands would this make on available staff?

The Role of Foreign Private Investment

The role of foreign investment, and of multinational corporations, is a very controversial issue in the developing world. Nevertheless, foreign investors are an important source of technology and, to a lesser extent, of capital for the developing countries. In the past, the Bank Group has been associated with only a small part of the total flow of direct foreign private investment, but its contribution as a catalyst and as an intermediary between the investor and the recipient has been important in individual cases.

The foreign private investment scene -- both direct and portfolio -- is changing rapidly and it is important to reconsider in this context the role which the Bank Group can play in this field and to ask whether there is any further scope for the Bank Group to strengthen the flow of foreign capital to the developing countries without seriously compromising its image with either the developing or developed countries. For example, should we undertake a more intensive effort -- through advice, technical assistance, or more direct means (e.g. guarantee) etc. -- to promote a better "climate" for foreign investment? Can we do more to facilitate the transfer and adaptation of foreign technology?

A Better Policy Framework

It is often argued that improvements in the policy enviroment or the regulatory framework in developing countries would be much more important for the development of private enterprise than any form of direct assistance. The problems resulting from either undue restrictions on private sector activity, or from excessive incentives, have already been mentioned above. It will be necessary to review the means currently available to the Bank Group to influence the policy framework for the private sector, the extent to which we have been effective, and the manner in which we should proceed in the future.

Role of IBRD, IDA and IFC

Having charted out a course for the Bank Group, the

Study should then address itself to the question of how the work and responsibilities should be allocated between the various instruments available within the Bank Group: IBRD, IDA and IFC.

DRAFT 2
DWeigel:cgt
August 29, 1974

QUESTIONNAIRE FOR STUDY OF PRIVATE SECTOR DEVELOPMENT

I. Importance of the private sector in the economy.

A. To what extent has gross domestic product been contributed by the public and private sectors during the last 5 years?

B. What has been the share of private investment in total fixed investment in the last 5 years?

C. What is the division of public and private investment and value added in the major sectors:-

1. manufacturing?
2. mining?
3. agriculture?
4. service?

II. Performance of the private sector.

A. What has been the rate of growth of value added in the public and private sectors over the last 10 years?

B. What has been the trend in private investment relative to total investment over the last 10 years?

C. In which sectors of the economy has the private sector been most dynamic?

III. Structure of the private sector.

A. What is the size distribution of private firms in the manufacturing, service and trade sectors. (% of workers, value added and enterprises in firms with 0 - 19, 20 - 49, 50 - 199, and more than 200 workers).

B. To what extent is value added in various industry subsectors concentrated in a few firms?

1. In which subsectors is the concentration greatest?
2. To what extent are concentrated subsectors dominated by:-
   a) foreign investors;
   b) local entrepreneurs;
   c) government enterprises?
3. Are the sectors in which local entrepreneurs predominate more or less concentrated than the other sectors?

C. To what extent is private ownership of industrial, trade and service enterprises concentrated in a few families or industrial groups?

1. To what extent are there conglomerate groups which cross industry lines?
2. To what extent are these groups either controlled by families, small groups of entrepreneurs, or widely held within the country?
3. To what extent do financial institutions control and participate in the management of large scale private enterprises?

IV. Give a general ranking of the factors that have limited expansion of private enterprise. (The most important factor should be given the rank of 1).

Government policies

Infrastructure

Shortage of resources

Lack of entrepreneurial and management skills.

V. The effect of government policies

A. What direct restrictions are placed on the private sector?

1. From what sectors are private investors excluded?

2. To what extent are private investors prevented by government policy from obtaining needed resources? (Capital, foreign exchange, etc.)

B. How have tax policy, price controls and subsidies (including protection) affected private sector development?

1. Have these various policies substantially distorted prices in the economy?

2. Have these distortions fallen more heavily on the private or public sector?

3. In which sectors of the economy have private firms benefitted most, or lost most from price distortions?

C. Has adequate infrastructure been provided by the public sector for the private sector?

1. Have infrastructure investments in power and transportation been timely and in locations that would aid

private investors?

2. Have industrial estates been organized for private firms?

3. Has the educational system been organized to provide some of the manpower required by the private sector?

D. Has public investment tended to pre empt private initiative?

1. To what extent are public supported projects organized in sectors also open to private investors?

2. Do the public projects tend to be organized in anticipation of market growth, before there is private interest?

3. To what extent are these projects subsidized by the government?

VI. Financial markets and the development of the private sector

A. What has been the direction of monetary and financial policies during the last 10 years?

1. Have interest rates been allowed to reflect inflation and provide a real return to savers?

2. Has the government interfered with the allocation of savings?

3. What types of new financial instruments and institutions have been promoted by the government?

B. How have money and capital markets developed in the last 10 years?

1. Has the banking system's role as a financial intermediary been increasing, (i.e. has the real value of

the money supply (currency, demand deposits and time deposits) been increasing relative to real gross national product).

2. Has financial intermediation in general (as measured by the ratio of total financial assets to GNP) increased?

3. Has the banking system's role as a financial intermediary increased or decreased relative to other types of intermediation?

4. Which other types of financial instruments (mortgages, savings and loan deposits, insurance reserves, government bonds, corporate bonds, corporate stock, etc.) have shown the most rapid rate of growth?

C. Please indicate the sources of gross finance for private non-financial enterprise during the last 3 years.

Source	Percentage
1. Earnings and depreciation	
2. Financial sources	
a. Short term debt	
bank borrowing	
trade credit	
other	
b. Long term debt	
bonds	
other	
c. Shares issued	

VII. Foreign capital and technology

A. How important has been private foreign direct investment:-

1. relative to total investment, and to total private investment;

2. in particular sectors of the economy (agriculture, manufacturing, extractive, banking, trade)?

B. What has been the direction of government policies toward foreign direct investment?

1. Encouragement (tax benefits, tariff subsidies, infrastructure, etc.)
2. Restrictions (sector limitations, ownership limitations, repatriation restrictions, etc.)

C. How important is foreign technology for the development of the private sector?

1. What have been the most important methods used to transfer foreign technology to the private sector (direct investment, licenses, equipment purchases)?
2. Are there public institutions or agencies to facilitate technological transfer?

D. Is there any evidence to indicate the extent to which foreign direct investment and technology have contributed to the development of the private sector?

1. Is technology included with direct investment actually transferred to the local private sector?
2. Under what conditions has the cost of foreign technology been too high?
3. Has direct investment been complementary, or competitive with local private investment?

PRIVATE SECTOR DEV. STUDY

AUG. 29, 1974 (APPROX)

BANK GROUP'S ROLE IN THE DEVELOPMENT OF THE PRIVATE SECTOR

Purpose of the Study

[illegible] the Study is to explore the Bank Group's role in stimulating the development of the private sector. This would suggest that the Study should include an analysis of the problems and prospects of private sector development in different countries at different stages of development, an assessment of the major issues involved, and an identification of the types of assistance which the Bank Group could provide.

Although the Government's role has been expanding rapidly in many developing countries, large segments of the economy remain in private hands. For instance, agriculture, the primary economic activity in the developing world has typically a "private" orientation. This is also generally true of trade and small and medium-sized industry. There is undoubtedly a growing tendency to earmark certain economic activities for the State -- but, except in some "strategic" areas, this generally reflects a dissatisfaction with the slow growth of indigenous private enterprise and a desire to spur economic growth through deliberate State initiative and investment. Even in these cases, private enterprise has not been entirely eliminated and "mixed" enterprises are gaining in popularity. In particular, joint ventures between State enterprises and foreign private investment are becoming more frequent. In short, private enterprise, both local and foreign, continues to be an important element in the development process in the large majority of developing countries.

with labour?

Its Scope

How should the private sector be defined for the purposes of the Study?

Private enterprise in the developing countries is to be found in virtually every sector -- agriculture, industry, trade, transportation, etc. The Study should not become an investigation into specific sectoral issues -- e.g. problems of rural development or of industrialization. It should rather explore how indigenous private enterprise can be helped to play a fuller and more productive role in the development process.

Some discussion and recognition of particular development problems and sectoral issues is, of course, unavoidable since questions of private sector development must necessarily be viewed against the perspective of the development of the economy as a whole. A useful point of departure might be to focus on problems of developing "private enterprise" rather than particular sectors or activities (e.g. agriculture or rural credit) where private enterprise is prevalent. For example, while agriculture is predominantly a "private" activity in most developing countries, it is conducted typically by private individuals rather than enterprises. Commercial agriculture and agro-businesses are only just beginning to be established in the developing world. Since private enterprises -- small, medium and large -- are to be found typically in trade, industry and construction, these areas would appear to deserve particular attention in the Study. A focus on "private enterprise" as distinct from particular sectoral issues, is also desirable because problems of private sector development and their solutions run across sectoral boundaries. Thus, programs to encourage small and medium-scale enterprises, or to develop skilled industrial labor, may involve remedial action in the field of technical and vocational education. Similarly, difficulties in obtaining industrial financing may result from inadequate institutional development in the financial field. While these problems need to be identified and ranked in priority, the Study should not become a treatise on industrial credit or a full-fledged investigation into the problems of the financial sector.

Nature of the Private Sector

At an early stage of the Study, it would be useful to outline the importance of the private sector in the developing world. What is the relative size of the private sector, as measured by investment, value added, and employment, in various groups of countries? Where has the private sector increased or decreased in relative importance?

In selected countries it will be desirable to go into more detail to learn the role of private enterprise in the major economic sectors, and the relative rates of growth in the public and private sectors. In these countries it would also be desirable to know the degree of concentration of ownership and income, the distribution between domestic and foreign ownership, and between the public and private sectors. Information on these aspects is not readily available, but a realistic feel for the current state of the private sector in different types of investor countries is vital for any appreciation of its problems or prospects.

Constraints on Private Sector Development

This would be the main analytical part of the study -- the identification and evaluation of the principal constraints on the development of private enterprises in developing countries. The major difficulties are, of course, well-known:

— lack of entrepreneurial, management and technical skills.

-- deficiency of capital - both local and foreign exchange.

-- inadequate infrastructure.

-- market constraints.

-- inappropriate policy environment.

It is easy to enumerate the principal constraints on the development of private enterprise; the main difficulty is to assess the relative importance of these constraints in different types of country situations, to identify the contributing factors and to develop paractical approaches to resolving the problems.

Is the development of entrepreneurial and management skills indeed the critical problem in some of the smaller African countries? Should primary emphasis be placed on training and educational programs, or should the first order of priority be the identification and preparation of projects, and the development of "extension" services, through appropriate local institutions created for this purpose? These are obviously not mutually exclusive options but, in view of scarce resources, relative priorities should be clarified.

There are similar issues with respect to the more advanced developing countries. A recurrent theme concerns the need for technology. Is the answer a more [illegible] for the Government to assist the private sector through the development of suitable industrial or technology institutes, or more joint ventures with foreign enterprises, or importing technology on a contractual basis?

The question of importing technology also leads to the broader issue of the role of foreign private direct investment in the development of the private sector. What contribution can foreign investment make at different levels of economic development? Is foreign investment competitive or complementary to the development of local resources? What policy measures would enable various types of developing countries to get the most out of foreign direct investment?

Foreign investment is sometimes used to circumvert problems of the local capital market. To what extent are capital markets unable to raise and allocate capital to the best uses at a price which reflects its scarcity and the risk involved? What types of financial infrastructure are required to support a growing business and industry? How can the financial requirements of particular groups (agricultural credit, credit for small businessmen) be met?

The lack of physical infrastructure is also, in varying degrees, a common characteristic of most developing countries. In this case, the main question to be considered in the Study is whether steps can be taken to provide facilities which will enable the private sector to mobilize more fully its available skills and potential -- e.g. industrial estates, electrification programs for cottage industries.

The market constraint referred to above does not only have to do with market size but with problems of access to markets, both internally and externally. For example, access to foreign markets may prove difficult for local business and industry without special assistance. Similarly, problems of market access can arise within a country due to the domination of particular groups -- e.g. by foreign companies, or by particular ethnic or regional groups. In many African and Asian countries, these factors have constrained the sound growth of private enterprise.

Finally, the issue of an appropriate policy environment has already been touched upon above. Government regulations and policy towards the private sector vary from country to country -- there are important differences in the attitudes towards private participation in different sectors of the economy, and the encouragement and incentives provided to private enterprise, domestic and foreign. The Study should make an assessment of the attitudes of developing country governments towards the development of private enterprise. The potential role of the Bank Group in this field must inevitably be conditioned by the attitudes and wishes of its members.

<u>Strategies for Private Sector Development and the Bank Group's Role</u>

It is hoped that a general strategy for private sector development can be derived from the analytical work. The strategy may be designed to deal specifically with the constraints discussed earlier, or with more integrated approaches. In any event it should focus on questions which can be dealt with by the Bank Group. Some possible areas of attention are suggested below.

<u>Providing Finance</u>: Making the necessary finance available is in itself an important contribution in many cases, but it would be useful to arrive at a better definition of those areas where the needs are believed to be greatest. The terms on which financing should be provided also require study. There are a number of other important questions: What should be the relative emphasis between loans and investments on the one hand and indirect financing (through local intermediaries) on the other? Should there be greater concentration on equity as against loan financing, particularly in joint ventures or in extractive investments? Should financing to the private sector be on "market terms" (whatever that means) or is a concessionary element justified in some cases? Answers to these questions can help shape an appropriate role for the Bank Group.

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In most developing countries, the expansion in the role of the State in economic activity, has tended to inhibit the growth of large private enterprises. With very few exceptions, developing country governments have generally been anxious, for political and social reasons, to stregthen small scale enterprises. This is, of course, also the group which is the most difficult to assist and the Bank Group's role in this area has been, at best, peripheral in the past. It is important to define more clearly the Bank group's role in the sector. Can more be done to support the small enterprise sector, particularly in the smaller and economically less advanced coutries? How would such an effort be organized, and what demands would this make on available staff?

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A Better Policy Framework

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Role of IBRD, IDA and IFC

Having charted out a course for the Bank Group, the

Study should then address itself to the question of how the work and responsibilities should be allocated between the various instruments available within the Bank Group: IBRD, IDA and IFC.

Guidelines for Chief Economists on the Private Sector Development Study

Mr. McNamara has directed that IFC coordinate a study of how the Bank Group can further the development of the private sector in developing countries. In preliminary discussion of how the Study should be organized there was considerable support for the view that there should be an intensive study of the problem in a sample of countries chosen to represent an adequate spectrum of developing countries' experience and prospects. However, it was agreed that before undertaking any field work the knowledge and expertise available in the Bank Group on these countries should be fully tapped. The countries initially selected for more detailed study are:

-- Kenya, Zambia and the Ivory Coast in Africa

-- Sri Lanka, Indonesia and Malaysia in Asia

-- Colombia, Ecuador and Bolivia in Latin America

The attached questionnaire has been prepared to assist the Chief Economists in providing information on the abovementioned countries. It focuses on those areas of enquiry that seem particularly relevant for the purposes of the Study. The first three parts of the questionnaire concern the importance, performance and structure of the private sector. The fourth part asks for a general assessment of the extent to which several factors have influenced private sector development. The remaining questions go more deeply into some of these general factors such as Government policy, financial markets and foreign investment.

The responses to these questions should be supported by quantitative information wherever possible but the main purpose is to get access to the knowledge which already exists in the area departments of the Bank. Consequently, in many cases where hard data are not available, informed judgement and evaluation may be all that is possible.

PRIVATE SECTOR DEV. STUDY

DRAFT 2
DWeigel:cgt
August 29, 1974

QUESTIONNAIRE FOR STUDY OF PRIVATE SECTOR DEVELOPMENT

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   C. What is the division of public and private investment and value added in the major sectors:-

      1. manufacturing?

      2. mining?

      3. agriculture?

      4. service?

II. Performance of the private sector.

   A. What has been the rate of growth of value added in the public and private sectors over the last 10 years?

   B. What has been the trend in private investment relative to total investment over the last 10 years?

   C. In which sectors of the economy has the private sector been most dynamic?

III. Structure of the private sector.

   A. What is the size distribution of private firms in the manufacturing, service and trade sectors. (% of workers, value added and enterprises in firms with 0 - 19, 20 - 49, 50 - 199, and more than 200 workers).

B. To what extent is value added in various industry subsectors concentrated in a few firms?

1. In which subsectors is the concentration greatest?
2. To what extent are concentrated subsectors dominated by:-
   a) foreign investors;
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3. Are the sectors in which local entrepreneurs predominate more or less concentrated than the other sectors?

C. To what extent is private ownership of industrial, trade and service enterprises concentrated in a few families or industrial groups?

1. To what extent are there conglomerate groups which cross industry lines?
2. To what extent are these groups either controlled by families, small groups of entrepreneurs, or widely held within the country?
3. To what extent do financial institutions control and participate in the management of large scale private enterprises?

IV. Give a general ranking of the factors that have limited expansion of private enterprise. (The most important factor should be given the rank of 1).

Government policies

Infrastructure

Shortage of resources

Lack of entrepreneurial and management skills.

V. The effect of government policies

A. What direct restrictions are placed on the private sector?

1. From what sectors are private investors excluded?

2. To what extent are private investors prevented by government policy from obtaining needed resources? (Capital, foreign exchange, etc.)

B. How have tax policy, price controls and subsidies (including protection) affected private sector development?

1. Have these various policies substantially distorted prices in the economy?

2. Have these distortions fallen more heavily on the private or public sector?

3. In which sectors of the economy have private firms benefitted most, or lost most from price distortions?

C. Has adequate infrastructure been provided by the public sector for the private sector?

1. Have infrastructure investments in power and transportation been timely and in locations that would aid

private investors?

2. Have industrial estates been organized for private firms?

3. Has the educational system been organized to provide some of the manpower required by the private sector?

D. Has public investment tended to pre empt private initiative?

1. To what extent are public supported projects organized in sectors also open to private investors?

2. Do the public projects tend to be organized in anticipation of market growth, before there is private interest?

3. To what extent are these projects subsidized by the government?

VI. Financial markets and the development of the private sector

A. What has been the direction of monetary and financial policies during the last 10 years?

1. Have interest rates been allowed to reflect inflation and provide a real return to savers?

2. Has the government interfered with the allocation of savings?

3. What types of new financial instruments and institutions have been promoted by the government?

B. How have money and capital markets developed in the last 10 years?

1. Has the banking system's role as a financial intermediary been increasing, (i.e. has the real value of

the money supply (currency, demand deposits and time deposits) been increasing relative to real gross national product).

2. Has financial intermediation in general (as measured by the ratio of total financial assets to GNP) increased?

3. Has the banking system's role as a financial intermediary increased or decreased relative to other types of intermediation?

4. Which other types of financial instruments (mortgages, savings and loan deposits, insurance reserves, government bonds, corporate bonds, corporate stock, etc.) have shown the most rapid rate of growth?

C. Please indicate the sources of gross finance for private non-financial enterprise during the last 3 years.

Source	Percentage
1. Earnings and depreciation	
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a. Short term debt	
bank borrowing	
trade credit	
other	
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bonds	
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c. Shares issued	

VII. Foreign capital and technology

A. How important has been private foreign direct investment:-

1. relative to total investment, and to total private investment;

2. in particular sectors of the economy (agriculture, manufacturing, extractive, banking, trade)?

B. What has been the direction of government policies toward foreign direct investment?

1. Encouragement (tax benefits, tariff subsidies, infrastructure, etc.)

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C. How important is foreign technology for the development of the private sector?

1. What have been the most important methods used to transfer foreign technology to the private sector (direct investment, licenses, equipment purchases)?

2. Are there public institutions or agencies to facilitate technological transfer?

D. Is there any evidence to indicate the extent to which foreign direct investment and technology have contributed to the development of the private sector?

1. Is technology included with direct investment actually transferred to the local private sector?

2. Under what conditions has the cost of foreign technology been too high?

3. Has direct investment been complementary, or competitive with local private investment?

WHAT IS PRIVATE ENTERPRISE?

by

Professor Edward Mason

The purpose of this study is to consider how the Bank Group can further assist private enterprise in developing member countries.

it is necessary at the outset to define what is private and what, for the purposes of the study, should be considered to be an enterprise.

What is Private?

There are two criteria for defining the privateness of a productive undertaking: who owns the assets and who controls the decision-making. Both criteria are complex and neither yields an unambiguous definition.

Using the asset criterion the following classes can be distinguished; Government owned; mixed government and private ownership with government majority; mixed with private majority; private.

Using the control criterion, it is necessary to distinguish between influences external (to the enterprise) on decision-making and internal influences. External influence may take the form of command decisions (in a fully planned economy); regulated enterprises; differentially taxed or subsidized enterprises. There are no fully autonomous enterprises in the Walrasian sense of enterprises responding only to market signals.

Internally it is useful to distinguish control via equity ownership from control without equity. In the latter case it may be necessary to distinguish control in the interests of ownership from control in some other interest, eg. management.

For statistical purposes the ownership criterion is the only practical one with arbitrary assumptions needed on share of equity in public or private hands if unambiguous results are to be recorded.

Control of decision-making seems the more important criterion for purposes of this study. But there can be no single "correct" definition of a private enterprise. Rather the test of a definition will lie with its usefulness and this will vary with the purpose of the analysis.

Consider the following cases:

A manufacturing enterprise is owned 100% by a financial institution 51% of whose equity is owned by government. The financial institution relies on the private capital market for the sale of its securities and its own investments are expected to yield a rate of return sufficiently high to maintain its position in the capital market. Consequently its directive to the manufacturing enterprise is to maximize its profits. Within these limits the enterprise has substantial autonomy. Is this a public or private enterprise?

An enterprise 100% privately owned is established to supply fertilizer to small farmers at subsidized prices. 60% of the selling price is covered by government subsidy. Is this a private or public enterprise?

The majority equity in a power plant is held by private owners. But government regulation governs the rates charged, the reinvestment of earnings permitted, and the extent of the market in which sales are allowed. Is this public or private?

Cases of this sort could be multiplied indefinitely. What they appear to indicate is (a) that the definition of what is public and what is private must, on the control criterion, be somewhat ambiguous; (b) that Bank Group lending and technical assistance policies involving the private sector should presumably emphasize administrative autonomy and orientation toward the market rather than ownership; (c) the departments of the Bank dealing with the private sector should be more concerned with action that will effectively promote development and less concerned with definition.

What is an enterprise?

If the ownership criterion is applied to distinguish public from private production, most of agriculture, small-scale commerce and industry, some part of road transport, some part of construction and some part of finance falls in the private sector. Since these production units are mainly small-scale, internal decision-making is also likely to be private. External controls, however, may substantially modify the process of decision-making.

A very large fraction of these producing units, particularly in agriculture, are one-man or one-family undertakings. A recent Bank estimate is that there are 500-600 million producers in the developing countries with per capita incomes of \$50 or less and that 85% of these are in agriculture. It is doubtful whether these units can be called enterprises and it is doubtful whether they should be included in the present study. An enterprise, at a minimum, requires the coordination of various inputs to produce output for sale on the market and the focus of the study, as I understand it, is on how producing units of this sort can be established, how entrepreneurship can be developed, how the various obstacles to the growth of such units can be overcome, and what the Bank Group can contribute to this process. Not all of agriculture should be excluded; commercial farms in general and agri-business undertakings are enterprises and should be included. But very small one-family farms, service and commercial undertakings should have very low or zero priority.

The chief characteristics of an enterprise for purposes of this study are autonomy and the marketability of inputs and outputs. Autonomy is mainly a legal and administrative matter and is, on both counts, a question of degree. Marketability of inputs and outputs is a matter of business and economic concern and is also a question of degree. Extensive external controls on inputs or outputs, extensive subsidization or differential taxation can substantially modify the character of an enterprise.

Perhaps a working definition of a private enterprise is a production unit owned/or controlled by management with a considerable degree of autonomy producing a marketable product from purchased inputs under conditions such that external influences on decision-making do not override the importance of market signals. By this definition the study should concentrate on industry (including agribusiness), construction, and some segments of commerce, finance and agriculture.

Research Studies

Mr. L. von Hoffmann August 21, 1974

Moeen A. Qureshi MQ

Work Program for the Private Sector Development Study

As we discussed earlier, the starting point of the Study must be to consider the issue of private sector development within the context of the problem of overall economic development. To me this means evaluating how the problem of private sector development differs by type of country, stage of development, etc., and identifying the factors that have contributed to differences in the performance of the private sector. In this way we can evaluate the obstacles to development and see new areas for Bank Group action.

Herewith are some possible elements of a work program, which we may discuss on Thursday in connection with the private sector development study.

(1) First on my list is the preparation of a brief memorandum outlining the scope of the Study and the definition of the private sector. At the outset, we should discuss amongst ourselves, and then incorporate in a note, some operating concepts of what it is that we wish to study. What do we mean by the private sector? On which parts of the private sector will the Study be focussed? How far, and in which way, do we want to get into the agricultural sector? Do we merely identify some issues in the field of rural development that have a direct bearing on private sector development, or do we go more broadly into agricultural development? I hope not, but we still need to agree whether, and to what extent, our focus should be on industry and trade? Similarly, how widely do we wish to embrace the concept of "development"? If we can agree on what we should try to cover in the Study, my associate Dale Weigel could prepare this memorandum.

(2) The second step, in my view, should be to do a "think piece" on the main factors and problems related to private sector development. This paper should outline the main issues and hypotheses that should be covered and tested in the Study. There are two ways of approaching this paper which would, in fact, provide the detailed terms of reference for the Study. One is to have different people with specialized interests do individual pieces on the principal elements,-- e.g. capital market development, entrepreneurial development, the role of private foreign investment, employment, technology, etc. -- and then to integrate these into one paper. Another alternative would be to ask Professor Mason, or, if he were not willing, then someone like Gus Ranis, to do a paper covering all these aspects in general terms. This paper would then provide the framework for the more detailed work to be done including some limited research on individual countries.

.../..

(3) We must do some limited work on a sample of countries representing different country types to get a concrete feel for some of the problems and issues that are identified in the general paper mentioned above in (2). There are obviously several ways of getting at a sample group. Dale Weigel has done some work on differentiating countries by income, size and the relative importance of the public and private sectors. (This has been done on the basis of the data contained in the attachment). This yields a tentative list of some eight countries:

(a) Low income, large size, high public sector reliance: India;

(b) As above, but high private sector reliance: Indonesia;

(c) Low income, small size, high private sector reliance: Kenya;

(d) As above, but high public sector reliance: Bolivia;

(e) Higher income, large size, high private sector reliance: Korea or the Philippines;

(f) As above, but high public sector reliance: Iran or Brazil;

(g) Higher income, small-size, high private sector reliance: Malaysia or Ivory Coast;

(h) As above, but high public sector reliance: Dominican Republic.

A number of persons come to mind whom we could ask to do these country studies. These include people in Gus Ranis' group at Yale or in the Harvard Advisory Service, and such persons as Scott and Paul Streeten. On issues of entrepreneurial development and the like, someone like Ken Hansen or de Wilde, or one of the Israeli economists, might be more appropriate. My own preference would be to try to get some local research institutes to participate in the Study -- e.g. the Industrial Research Institute in Singapore. All of this however will take time and will require organization. Professor Mason might agree to direct these studies.

MAQ:gmb

cc: Mr. Gaud
Mr. Stern
Mr. Goodman

AFRICA (SOUTH OF THE SAHARA)

Population, GNP, Total Investment, Private Sector Investment, and Investment in Industry - 1971
(US$ million)

Country	Population (1) '000	GNP at Market Prices (2) Amount 2/	GNP at Market Prices (3) Per Capita (US $)	(4) Total Investment 2/	(5) Net Capital Imports 3/	(6) Investment by the Private Sector 3/	(7) Investment in Industry 1/ 3/
IFC Member Countries	202,575	28,520		5,000	795	3,085	1,275
Above $200 GNP per Capita	31,049	8,060		1,510	310	885	385
Gabon	494	340	700	90	..	65	20
Zambia	4,250	1,620	380	470	30	260	165
Ivory Coast	5,227	1,730	330	350	100	175	70
Mauritius	847	230	280	40	-	20	10
Senegal	4,019	1,020	250	160	55	100	50
Ghana	8,856	2,250	250	270	50	170	50
Liberia	1,570	330	210	60	60	40	10
Sierra Leone	5,786	540	200	70	15	55	10
Below $200 GNP per Capita	171,526	20,460		3,490	485	2,200	890
Swaziland	433	80	190	10	-	5	..
Mauritania	1,190	200	170	40	15	20	10
Kenya	11,670	1,850	160	440	50	260	140
Togo	2,009	300	150	40	5	20	5
Nigeria	56,510	7,840	140	1,200	130	715	300
Malagasy	7,220	1,020	140	140	60	90	25
Uganda	10,148	1,340	130	140	..	80	30
Sudan	16,135	1,900	120	230	40	140	25
Tanzania	13,249	1,470	110	340	35	230	50
Lesotho	941	100	100	10	..	5	..
Zaire	19,326	1,750	90	530	130	380	230
Malawi	4,550	410	90	80	..	40	10
Ethiopia	25,250	1,990	80	260	20	200	60
Somalia	2,895	210	70	30	..	15	5
Other Countries	41,864	4,430		670	245	390	110
Above $200 GNP per Capita	7,546	1,610		300	175	115	45
Congo	1,123	300	270	80	80	15	10
Botswana	637	150	235	70	65	30	10
Cameroon	5,786	1,160	200	150	30	70	25
Below $200 GNP per Capita	34,318	2,820		370	70	275	65
C.A.R.	1,586	240	150	40	..	25	10
Niger	4,132	400	140	60	..	40	10
Dahomey	2,783	280	100	50	5	40	10
Guinea	4,080	380	90	40	..	20	10
Chad	3,716	310	80	40	35	30	5
Upper Volta	5,497	390	70	40	20	30	5
Mali	5,123	370	70	40	5	30	5
Rwanda	3,786	230	60	30	5	30	5
Burundi	3,615	220	60	30	..	30	5

Source: Columns (1)-(3)- World Bank Atla[illegible]73; Columns (4)-(7)- Country Data table[illegible] estmates.

(1) including mining. (2) rounded to the nearest US$10 million (3) rounded to the nearest US$5 million

Population, GNP, Investment in Selected Countries

	Population (000)	GNP at Market Prices Total ($millions)	Per Capita	Total Investment	Net Capital Imports	Private Sector Investment	Investment in Industry
ASIA							
Burma	2958	2430	80	241		65	43 a/
Afghanistan	14586	1140	80	117 b/	24.5	84 b/	15 c/
Sri Lanka	12849	1260	100	380	80	280 d/	60 e/
Nepal	11280	990	90	100 f/	25	50	3 g/
Yemen	5900	480	90	50 f/	27	45	7 e/
LATIN AMERICA							
Haiti	4315	500	120	27	23.8 h/	16	5 i/
Bolivia	5063	950	190	153	55.7	59.5	15 j/
Paraguay	2458	680	280	104	26.2	70.0	20

a/ 21% of public investment plus 10% of private.
b/ 1970/71.
c/ 1/3 public investment is in industry and accounts per 3/4 of total investment.
d/ includes public corporations but not public interprises.
e/ 15% of total investment.
f/ 10% of GNP.
g/ 3% of total investment, equal to proportions of GDP originating in industry.
h/ including net current account transfers of $18.9 million.
i/ 20% of total.
j/ 10% of total, average 1965-71 was 16%, but there was a sharp decline in mining investments in 1971.

Population, GNP, Investment in Selected Countries

Less Developed Countries	Population (000)	GNP at Market Prices Total ($ millions)	Per Capita	Total Investment	Net Capital Imports	Private Sector Investment	Investment In Industry
Yugoslavia	20721	15180	730	4057	417	3823 a/	1214
Turkey	36160	12160	340	2564	324	1407	763
Brazil	95435	44260	460	7224	576	3184	1600 b/
Colombia	22324	8180	370	1652	280	1057	330 c/
Korea	31849	9140	290	2177	728	1651	444
Philippines	37919	9160	240	1640	166	1455	550 d/
Iran	29780	13420	450	2855	908	1225	860 e/
Developed Countries							
Belgium	9710	28710	2960	7229	-	6200	1615
Norway	3900	12220	3130	5553	-	5338 f/	870
Denmark	4960	17020	3430	5302	-	3946	624
Australia	12730	36540	2870	10817	-	9186 g/	2139 h/

a/ Total less reported capital expenditures of Central and Republic Governments.
b/ Estimated by country economist
c/ 20% of total investment.
d/ $520 in manufacturing
e/ $760 million net investment in manufacturing. Assumed 30% of total investment in industry
f/ Central government investment only deducted from total investment
g/ Estimated based on the proportion of private investment to the total in 1969
h/ Estimated based on long run average proportion of investment in industry to GDP.

Research Studies

OFFICE MEMORANDUM

TO: Mr. William S. Gaud

DATE: June 8, 1974

FROM: Moeen A. Qureshi MAQ

SUBJECT: Mr. Tersoglio's Study on Agro-business

I discussed with Mr. Tersoglio today the progress of his study on agro-business in Latin America.

Mr. Tersoglio feels that he has now reviewed most of the material that was available in Washington. He has also been in touch with the Agriculture people in the Bank, and with representatives of some international agencies (FAO) and certain research institutions in the U.S. On the basis of his preliminary work, he has narrowed the scope of his study to 3-4 countries, and a few issues which he considers "researchable" during his six month consultancy period. He is now ready to undertake some field work and his program includes visits to CABEI (to get material on Central America) and possibly two countries in Latin America (he mentioned Colombia and North East Brazil, but is still undecided). The focus of his work will be to define the problems and requirements of agro-business, identify the areas in which an institution such as IFC can be of assistance, and draw some conclusions on how best such assistance should be provided. Hopefully, the study will be of some assistance to IFC in considering how to develop its work in the agro-business area.

I indicated to Mr. Tersoglio that he should try not to concern himself with specific projects in any operational sense. He understands quite clearly that we are looking forward to his study but not to his involvement, directly or indirectly, in our operational work, and agrees quite fully with this approach.

I suggested to him that before he embarks on his visits to countries he should talk to some of my senior colleagues on the operational side as well as in the Engineering Department, and get the benefit of their experience. He will be contacting them soon and will seek their assistance in organizing his visit.

cc: Messrs. Talavera
Paterson
Parmar
Hilton
Eckrich
McClure
Stephansen

MAQ:gmb

Research Studies

Mr. L. von Hoffmann August 14, 1974

Moeen A. Qureshi

Terms of Reference for the Private Sector Development Study

An earlier note of Dale Weigel's gave you some approaches to the Private Sector Development Study.

I agree with the basic thrust of Dale's argument that:

(i) the Study must relate the problem of the private sector to the problem of overall economic development, and

(ii) it must assess how the problem of private sector development differs by type of country, stage of development, etc., and come up with some answers on how different situations should be approached. On this basis one can then try to define the role and possible contribution of the Bank Group and its component elements.

To begin with, one has to be clear as to what is meant by the "private sector" and its development. In other words, we shall have to develop some operating concepts of what it is that we wish to study.

Second, the constraints on the development of the private sector in different countries and in different situations will have to be analyzed. What is it that is lacking: entrepreneurial and management skills, capital, markets, an appropriate policy environment, supportive institutions, infrastructure ?

These constraints or deficiencies obviously vary from country to country both in their nature and intensity, and I believe it would be useful to study in some depth a sample of countries representing different country types -- including both the so-called "success stories" and those that are economically inert -- to identify the problems as well as the possibilities of resolving them. Thereafter, one can proceed to see what the Bank and IFC respectively can do to assist.

As the first order of business, I propose to get someone (I have in fact such a person, who knows the Bank well, has been working on a Bank study and happens to be available for a month or so) to go through everything that is available in the Bank Group on this subject: country data and information, the analysis of private sector performance in particular developing countries, and so forth. There is likely to be more in the Bank Group files from which we could learn about this subject than in the published literature.

.../..

Second, we should proceed now to set up a formal group which can meet periodically to review progress. Let us discuss amongst ourselves and with Professor Mason, the names of some appropriate persons on the Bank Group staff and then propose the list to Mr. McNamara. Some possibilities from the Bank are Ernest Stern, Ray Goodman, Ravi Gulhati and Bill Diamond. Gustafson has already been suggested by Mr. McNamara. From IFC I would suggest Jud Parmar. and David Gill.

Third, we should ask Professor Mason to outline a detailed program of work. I feel we shall need to study a few prototype countries in depth. We might get two consultants from the outside who might take, say 3 countries each, and work on predefined areas and issues of private sector development. Visits to the countries concerned will be necessary. We should ask Professor Mason whether he would agree to direct the overall research effort. I shall certainly be prepared to provide whatever assistance and coordination is necessary within the Bank Group.

cc: Mr. Gaud

MAQ:gmb

Research studies

Research Committee May 28, 1974

Moeen A. Qureshi

Review of two Research Proposals

Mr. Turnham and I reviewed the following proposals for the forthcoming meeting of the Research Committee. Our reactions are as follows:

(i) Employment and Income Distribution in Malaysia

The project has two components: (a) a study of income distribution in Malaysia from Census data, and (b) a Simulation Model on the employment implications of alternative growth patterns.

The work on the Model has been delayed because of the unavailability of the Input-Output table from Malaysia. The researchers now believe that the table will be available within the next few months. In the meantime, two papers have been prepared -- one utilizing the data from the census to examine the size distribution of income in Malaysia, and the other dealing with the estimates of labor input coefficients by skill and wage levels for various sectors to be used in the Simulation Model.

The paper on Malaysian income distribution examines distribution patterns by race, region, sector, etc., and comes up with some interesting results which have a bearing on development policy alternatives in Malaysia. The paper is extremely well written, and this alone has justified, in our view, the resources allocated to this project. A sequel to this paper will examine the relationship between income levels and education for wage earners. The data have already been processed and the results are now being written up.

The paper on sectoral employment data is a less finished document; it basically identifies the problems involved in estimating the labor input coefficients.

The proposed work plan for next year will involve the production of the Simulation Model and its use within the framework of the Malaysian Five-Year Plan to examine employment implications of alternative demand patterns. It is also planned, in this connection, to use some of the income distribution data to examine questions relating to the impact of changes in the structure of production on income distribution.

We believe that the research work already done, particularly on income distribution, will be very useful for the Bank's future operational work in Malaysia. It should also help to shed some light on certain policy issues that are likely to be raised in terms of economic planning in Malaysia, and similar other countries. The ability

.../..

of the researchers to carry this particular project forward next year depends critically on the availability of the input-output data. We recommend approval of the amounts that have been requested bearing in mind, however, that there could be further delays in the progress of this project (stemming from the input-output figures) and therefore in the funding requirements for fiscal year 1975.

(ii) Urbanization Standards for Sites and Services Projects

The project essentially involves the preparation of a Manual for operational work in the field of sites and services. The research sponsors have indicated that the Manual will involve not only the compilation of currently available knowledge and methodology but also, to some degree, the development of new analytical approaches to the evaluation of sites and services projects.

Close cooperation between the Urban Settlement Design Group headed by Professor Horacio Caminos of MIT and the Transportation and Urban Projects Department of the Bank is expected in the preparation of the Manual. The Transportation and Urban Projects Department of the Bank has already prepared a monograph which reviews the Bank's own, relatively limited, experience so far. The Caminos Group will extend this into a more comprehensive and global review. The Caminos Group is expected to focus on the analysis of the physical and technical aspects of sites and services projects while the Bank Staff expect to make a contribution on questions of economic methodology.

In essence, the purpose of this research proposal is to buy into the expertise of an outside group and integrate it with our own in-house experience. The Bank Staff's contribution to this project will have to be much more than the "monitoring" to which reference is made in the proposal; it will have to involve fairly significant inputs, particularly on the economic side. As the proposal is presently written up, it leans heavily towards physical and technical aspects of project evaluation rather than towards economic evaluation. We have been assured, however, that the study is likely to cover both economic and technical aspects in a more balanced fashion than is now implied in the proposal.

There is little question about the usefulness for the Bank's operational work of having such a Manual in the emerging field of sites and services. On the assumption that such studies are a legitimate claim on the Research Budget (rather than departmental budgets), we support the proposal. The total project cost of $74,660, of which $50,000 is budgeted for FY75, appeared somewhat large at first glance, but we are pursuaded that the approximately 5 man-years of work for which funding is requested will, in fact, be required.

MAQureshi:gmb

Distribution:

Mr. Chenery	Mr. Gulhati	Mr. Ahluwalia
Mr. Stern	Mr. Karaosmanoglu	Mr. Beier
Mr. Adler	Mr. Schulmann	Mr. Turnham
Mr. Avramovic	Mr. van der Tak	Mr. Swayze
Mr. Balassa	Mr. D.C. Rao	Mr. Harral
Mr. Baneth	Mr. Yudelman	Mr. Patel

Research Studies

Mr. D. C. Rao   May 24, 1974

Moeen A. Qureshi

Research Proposals: World Commodity Models

I wish to record my strong support, in principle, for Mr. Stoutjesdijk's research proposal. I feel, however, that the proposal needs to be more clearly defined, and cut to more manageable proportions.

There is little question in my mind that this is potentially an area of great importance for the Bank Group's policy and operations. The scope and objectives of the research program which Mr. Stoutjesdijk has in mind are -- quite correctly -- much broader than is commonly denoted by the phrase "commodity models". As I see it, the research proposal breaks up into three phases or segments:

(i) analytical work on issues of topical importance and urgency in the energy field, including "OTPOP";

(ii) methodology for examining trade-offs -- from the standpoint of developing country producers -- between alternative investment, production and trade patterns for certain major minerals;

(iii) development of world optimal production and trade models for selected natural resource based industries.

Considering the emerging political and economic issues in the field of natural resources, the proposed area of research clearly touches on matters of great importance for developing as well as developed countries. But what is being proposed in concept, and what is undoubtedly needed, is a major research program. The particular aspects and issues on which research will be done have to be more precisely defined, indicating in the process the extent to which the methodology and analytical techniques to be developed will relate to specific policy and operational issues.

While I agree and give my support to the project concept, I suggest approval at this stage only for the first phase which relates to certain specific issues in the energy field. Even these, with the exception of "OTPOP", need more definitive formulation.

MAQ:gmb

cc: Mr. Stoutjesdijk

Research Studies

Mr. Moeen A. Qureshi January 11, 1974

Joris J.C. Voorhoeve J.V.

The Nutrition Situation by Regions

1. Food Requirements

Definitions

The energy requirement of a person is the daily energy intake which is adequate to meet the physiological energy need of an average healthy person. The protein requirement used below is the daily intake of protein which is a minimum to meet physiological needs and maintain the health of the average healthy person, plus a safety margin of 30% which is deemed sufficient to cover the variation in requirements among individuals. Per capita requirements are weighted averages of the population of the group concerned.

Levels

Specified by regions, energy and calorie requirements per capita are as follows:

	Calorie requirements per capita per day	Protein requirements per capita per day in grams
LDC's excluding Socialist Asia	2284	38.4
Africa	2335	41.5
Latin America	2383	37.7
Near East	2456	45.5
Asia and the Far East	2223	36.6

Source: FAO, Agricultural Commodity Projections 1970-1980 (Rome: FAO, 1971), p. 47.

2. Food Supplies

In 1970, the actual daily intake of calories and proteins as a percentage of requirements was as follows:

	Calories	Proteins
LDC's excluding Socialist Asia	96	147
Africa	93	141
Latin America	106	172
Near East	97	147
Asia and the Far East	93	141

Source: FAO, The State of Food and Agriculture 1972 (Rome: FAO, 1972), p.24

Food consumption surveys show that the distribution of food intake per capita is very uneven among nations, national regions, socio-economic groups, seasons, and even among members of the same family. Maldistribution is particularly serious in the case of protein. Therefore, the figures in the table above do not warrant the conclusion that undernourishment or malnutrition are not very grave.

cc: Mr. Hartigan

JV:cm

Research Studies

Mr. L. von Hoffmann

November 8, 1973

Moeen A. Qureshi MAQ

I have three interrelated points:

1) The current Nigerian consumption of fertilizers is insignificant, barely 12,000 tons per annum. By 1980, maximum projected consumption is likely to be 60,000-100,000 tons. This will not support even a small facility to produce a nitrogenous end product (or other complex fertilizers).

2) I feel therefore that we should not define our proposal in terms only of ammonia facilities. Keeping in view potential market and prices, an ammonia-cum-urea facility would appear to be more attractive. A small part of the urea would be domestically absorbed, but there is likely to be an enormous urea market in Brazil and I feel potentially also in the United States. Hence it seems to me that a "jumbo-sized" ammonia plant of 2,000 tons with two separate 1,000 ton streams may prove to be attractive, and it could be coupled with a 1,000 ton urea plant.

3) I would suggest some reformulation of the conditions you have outlined, in order mainly to make them look a little less formidable. If domestic consumption is so small, we can afford to tread softly on the question of domestic distribution.

As I said the idea of a mini steel plant seems excellent if the market can support it. I am sure the Liberians will get hot under the collar, but so what!

MAQ:gmb

AIDE MEMOIRE

The International Finance Corporation has been examining for some time the opportunity for creating additional nitrogenous fertilizer capacities in the developing world for domestic consumption and for export to other developing and developed countries.

IFC's studies indicate that there appears to be an excellent opportunity to create such a project on an international basis in Nigeria using the natural gas available. While such a project would include an effort for a vigorous expansion of the domestic fertilizer market, it would be export-oriented, mainly towards Europe and South America. IFC has discussed the concept of such a project with the Government and industry in Brazil and has received an expression of interest in principle to participate in an effort to develop such a project in cooperation with IFC and others. Equally, IFC has received strong indications from the fertilizer industry in Europe that they would be prepared to join such a project. It is IFC's view that in addition to participation of these two groups, a substantial participation of the Nigerian Government or of its agencies would be essential.

As an indication of the order of magnitude involved, a project of this nature designed to produce, say, 2000 TPD of ammonia and 1000 TPD of urea would take about 4 years to realize, would involve a capital investment of about $100 million, a gas consumption of about 65 MCFD and would generate exports in a range of $50 to $60 million per year, depending on export prices assumed.

If the Government of Nigeria would welcome an effort by IFC to promote a nitrogenous project on such a basis, IFC would be prepared to take the lead in formulating such a project and to explore the possibility of obtaining foreign participation in financing, marketing and management. For such an effort to be successful, certain basic premises would have to be acceptable to GON. These include:

1. Project's access to natural gas at a reasonable price under a long-term contract;
2. Acceptance of substantial foreign equity investment in the project;
3. Assurance of autonomous management of the project and freedom in organizing distribution of output.

If the Government of Nigeria's reaction to this suggestion were positive, IFC as a first step would arrange for a visit by one of its senior officers to discuss the matter in detail with the Nigerian authorities.

The Steel Industry

The involvement of Brazilian interests in the above project presents a valuable opportunity to advance the development of the steel industry in Nigeria. After many years of research various technologies appear to be available for the reduction of iron ore by the use of natural gas. These technologies make feasible the economic production of primary steel for relatively small markets, which do not justify the large capacities necessary for blast furnace operations. Such a project if established in Nigeria, could be supplied with iron ore from Brazil, obtained in exchange for nitrogen, and IFC could assist in obtaining the most suitable technology on the basis of its experience with similar projects in other countries.

Research Studies

Mr. William S. Gaud

October 15, 1973

Moeen A. Qureshi MAQ

Conversation with Mr. Stern

1. Ernie Stern has asked me to participate in a Group consisting of himself, Mahbub ul Haq and Wouter Tims, which is being formed in the Bank to provide assistance and advice to a Sub-Committee of the Group of Twenty on the transfer of resources to LDC's. Mr. Frimpong-Ansah, Vice-Chairman of the Group of Twenty, is Chairman of the Sub-Committee. He has asked Bank assistance in the work of this Committee.

The Group of Twenty has established four sub-committees, one of which will deal with the problem of resource transfer to LDC's, which will include issues such as, for example, "the Link". (The other sub-committees are on the Adjustment Process, Liquidity, etc.)

The next meeting of this Sub-Committee is scheduled for October 26 and Mr. Frimpong-Ansah will soon circulate an issues paper which might form the work program of the Sub-Committee in the coming months.

I told Mr. Stern that I would be glad to assist subject, of course, to your approval.

2. Mr. Stern also mentioned to me that following his meeting with Mr. Moshe Sanbar of Israel, Mr. McNamara again told him that he was anxious to have a study which would indicate more precisely the magnitude and urgency of the problem of financing LDC exports of capital goods so that he might reach a decision on whether or not the Bank should play a role in this area. Stern will provide one person from the Development Policy Staff (probably Swaminathan) who will be working full time for the next three to four months on this issue. We have agreed that it would be desirable, in addition, to hire a consultant from the outside who could work with Swaminathan on the study. Field trips to several countries will be necessary. Stern and I will have the responsibility of seeing that it is completed over the next three to four months.

MAQ:gmb

cc: Mr. von Hoffmann

Research Studies

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Moeen A. Qureshi

DATE: September 13, 1973

FROM: Roger Sullivan RW

SUBJECT: IFC's Impact on the Flow of Direct Private Foreign Investment (excluding Petroleum) to Developing Countries in FY 73: Some Observations

1. Preliminary information indicates that the flow of direct private foreign investment (DPFI), excluding petroleum, from DAC countries to developing countries was probably between \$1.8-\$2.0 billion in FY 73. The amount that IFC and associated foreign investors contributed to this flow is roughly \$126 million. This is calculated as follows:

	$ million
Total project cost of IFC's financial investments in FY 73	480.7
(less) Local investment	(175.2)
and	305.5
(less) Suppliers' credits	(59.5)
(equals) Direct Foreign Investment (IFC plus associated foreign investors)	246.0
(times) Rate of Disbursements to commitments	.6
(equals) Gross flow of DPFI (disbursement)	147.6
(less) Repayments of loans to IFC	(21.2)
(equals) Net flow of DPFI (IFC plus associated foreign investors)	\$126.4 million

2. To determine the flow of DPFI, deductions are made from total project costs to account for the local investment component and supplier's credits. In discussing the flow of funds, disbursement figures are used, and this can be expressed as a percent of the commitment level. Historically, IFC's disbursements in any fiscal year have averaged 60% of commitments. Since it is not known how much the foreign investors associated in IFC's investments disburse each year, the same percent is applied to their commitments in order to obtain a general net disbursement level. From this amount is deducted the repayments made on IFC's loans. Thus, based on a range of DPFI between \$1.8 - \$2.0 billion in FY 73, IFC and associated investors accounted for 6.3%-7.0% on a disbursement basis and 12.3%-13.6% on a commitment basis.

../2

3. The attached chart provides a picture of the shifting proportions that IFC, associated foreign investors (including suppliers' credits) and local sponsors contributed to total project costs from FY 65 to FY 73. In examining the FY 73 figures in comparison with those of previous years, IFC's catalytic role, if defined as the amount contributed to total project costs by associated foreign and local investors, has diminished. For each $1.00 IFC invested in the last six years, IFC's other partners have contributed the following:

FY 68	FY 69	FY 70	FY 71	FY 72*	FY73
$4.35	$4.18	$3.42	$3.30	$4.99	$2.27

*3.41 excluding Marinduque.

In FY 72 IFC made a $15 million loan in the $247 million Marinduque nickel mining project in the Philippines. Excluding this investment, the catalytic effects of IFC's other projects in FY 72 was $3.41 of associated investor funds per IFC dollar.

4. In the last six years, the level of associated investment accompanying IFC's participation has decreased from approximately $4.00 per IFC dollar in the late Sixties to just over $2.00 in FY 73. Several factors can account for this development but they all reflect a greater diversity in IFC's operations. First, a part of this reduction can be allocated to IFC's increasing activity in capital market investments and related operations. In projects of this nature, IFC has often been the major investor. Second, in FY 73 there were several cases of major participation in IFC's investments as opposed to direct project investment. This tended to inflate IFC's total exposure in those projects.

5. In addition to the changing catalytic effect, a second and more recent development deserves mentioning. This is the relationship of suppliers' credits to total project costs. Suppliers' credits averaged 16.3% of project costs in FY 70 - 72. In FY 73 they were only 12.3%. This reduction can be attributed to the increasing availability of the Euro-currency market to developing countries.

6. A third development, which we should watch, is the apparent leveling off of IFC's net disbursements to developing countries. As you know,

this has been a much discussed problem also on the Bank's side. Given the fact that net repayments are inevitably rising, a question can be raised about the net transfers of resources which IFC makes possible. While total disbursements in FY 73 were an IFC record, the net transfer of financial resources by the IFC has not been rising. As shown below, this is a result of increasing loan repayments.

(US $ million)

	FY 70	FY 71	FY 72	FY 73
IFC Gross Disbursements	85.3	72.0	60.8	88.1
(Repayments of loans to IFC)	(5.7)	(6.1)	(7.3)	(21.2)
IFC Net Disbursements	79.6	65.9	53.5	66.9

7. A final point is that in FY 73 the average project in which IFC invested cost $17.1 million -- lower than in any of the five previous years. As IFC pursues a policy of sponsoring investments in the poorer developing countries, particularly in Africa, average project cost could decline even further. This fact is obviously not to be lamented but we should be aware of what such a trend implies for IFC's costs (financial & manpower) per dollar of business done.


CUMULATIVE CHART OF IFC INVESTMENTS FY65-FY73, Total Project Costs broken into IFC component, Foreign component (other foreign investors and suppliers' credits), and local investment component.
(US $ Millions)
LOCAL
OTHER FOREIGN
IFC
1000
900
800
700
600
500
400
300
200
100
0
FY65
66
67
68
69
70
71
72
73

Research Studies

Messrs. Qureshi, Hartigan, Benvenisti, Weigel, and Sullivan

September 11, 1973

J. Fuenzalida

Standard table for the economic rate of return computation

The following is a proposition for a standard table to show in the IC and Board Reports the economic rate of return computation.

The first part compares the economic with the financial flow, as suggested by Moeen. These flows produces the project's financial and economic rates of return.

The second part considers the foreign capital flow to compute the economic return of the project to the country.

These tables have to be considered only as basic ones. One may add columns as each specific project may require. For example, if there are infrastructure investments financed by the government, one may add a column nearby "Investment costs-Economic Values." Or if there are "surplus" benefits to the consumer because of a reduction in the selling price, one may add a column next to "Output - Economic Values." The same thing applies if foreigners are obtaining other benefits than dividends or are paying other than withholding taxes.

JF:cm

INTERNAL RATES OF RETURN

Project's Return

Investment Costs		Output		Current Costs		Net Flow	
Financial Values	Economic Values	Financial Values	Economic Values	Financial Values	Economic Values	Financial Values (-1+3-5)	Economic Values (-2+4-6)
1	2	3	4	5	6	7	8

Project's Internal Rates of Return ______% ______%

Country's Return

Project's Net Flow (Economic Values)	Foreign Capital Flow						Net Flow to the Country
	Inflow of Foreign Capital (Equity and Loans)	Repayment of Foreign Capital (Equity and Loans)	Interest to be paid abroad	Assumed dividends to be paid to foreigners	Withholding tax (on payments to foreigners)	Total Flow (9-10-11 -12+13)	8-14
8	9	10	11	12	13	14	15

Internal Economic Rate of Return to the country ______%

Research Studies

Mr. Moeen A. Qureshi September 4, 1973

J. Fuenzalida

The income distribution goal and IFC activities

IFC must clarify its role on promoting income distribution through the financing of projects in its area of activities. There is no doubt that the "income distribution" consideration is becoming perhaps the most important policy preoccupation for the World Bank Group. Because IFC deals exclusively in the private sector field, the income distribution objective presents an important and difficult challenge to ourselves, a challenge we cannot and should not avoid.

At least two papers that have been circulating in draft in the Bank lately are of utmost importance: "Economic Analysis of Projects" and "Redistribution with Growth." The first paper, "Economic Analysis of Projects," has been written by Mr. van der Tak's group. This paper aims at providing guidelines to the Bank Group's economists to evaluate projects. The paper starts from the point that all countries, but particularly the developing ones, are faced with the basic economic problem of allocating limited resources, such as labor, management capacity, capital, natural resources, and foreign exchange, to many different uses, such as consumer goods, public services or investment in infrastructure, industry, agriculture or education. But, the paper adds, that "these different uses of resources are not the final aim of the allocative process; rather they are the means by which an economy can marshall its resources in the pursuit of more fundamental objectives such as the removal of poverty, the promotion of growth and the reduction of income inequalities."

Accordingly, the paper suggests that the income distribution consideration must be added to the evaluation process. A project should be evaluated in three stages. The first evaluation stage would correspond to the financial appraisal of the project. The second stage would correspond to the present practice in the Bank: the evaluation at "efficiency prices" 1/ - i.e. correcting the distortions in factor and product markets (the economic rate of return). Since the paper argues that the economic contribution of a project does not depend only on the benefits generated by the project, it adds a third evaluation stage which looks at the effects of the project on the income of different groups in society: the distribution effect.

When the paper talks about "income distribution," it includes two concepts: 1) the "interpersonal" distribution, or the benefits

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1/ This is a new terminology. "Shadow prices" terminology is reserved to those prices that include the evaluation of the income distribution impact.

for different classes of income recipients (or regions); and 2) the "intertemporal" distribution, or the evaluation of tomorrow's consumption versus today's consumption (or saving versus consumption).

IFC would have to begin evaluating its projects in accordance with these three stages as soon as the country economists of the Bank are able to provide us with some basic information: value judgments of the government to determine the weight to be given to future consumption relative to present consumption, i.e., to growth (savings) versus consumption; to benefits for different classes of income recipients (or regions); to future employment relative to present employment; and to other possible objectives such as national independence and modernization. The Bank should try to arrive at some common understanding with the government concerning the social/economic goals pursued in the country's development policy. However, in extreme cases of discord, for example with respect to the desirable distribution of gains from development, the paper suggests that the Bank might prefer to cease operations in that country.

The second draft paper - Redistribution with Growth: An Approach to Policy - has been written and edited by a group including Mr. Chenery.1/ The editors indicate that "in the poor countries the main concern is the fact that historically high rates of growth over the past decade have brought little benefit to the poor in large parts of the Third World. While there is still a promise that continued growth will produce greater benefits for all in the future, the growing inequality of income distribution is a more immediate problem. The first evidence of this problem was the rising level of unemployment and underemployment in many countries. Further analysis has shown that many of the employed are not better off, and emphasis has shifted to the failure of rapid growth to affect poverty levels of large segments of the population. It is a matter of speculation whether pursuit of this objective, this redistribution of the benefits of growth towards the poor, will involve significant trade-off in terms of a slower rate of aggregate economic growth."

The paper adds, however, "that formulating a dynamic strategy of income distribution is not a matter of choosing between growth and income distribution but of generating a desired pattern of income growth with special emphasis upon the growth of income of the poverty group. What is needed is not merely growth of GNP in the aggregate but broad based growth in which the benefits of growths are distributed to

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1/ This paper was prepared by Messrs. Chenery, Duloy, Jolly, Ahluwalia, and Bell on the basis of the discussion and papers presented at a workshop convened at the Rockefeller Foundation Conference Center in Bellagio, Italy, in April 1973.

all sections of the population. Development strategies defined in these terms may be described as seeking redistribution through growth, a useful reminder that growth cannot really be ignored given the very low per capita income."

This approach means shifting from the traditional measure of performance - the growth rate of GNP - to a summary measure which reconciles growth and distributional objective. This is equivalent to passing from the second step on project appraisal to the third step suggested in the van der Tak paper.

If we accept giving a higher weight to income received by the low income groups and a low weight to that received by the high income groups, we should then be willing to accept a lower growth of GNP (a non weighted index) provided the weighted index of GNP is improved.

There is no doubt that this kind of consideration will be a common practice in the Bank Group projects appraisal very soon. What are the implications for IFC's operations? What can we do to improve our contribution to income distribution? How can we identify those projects that make a contribution from this angle?

Let me summarize in one phrase what should be the new IFC objective for each member country: to obtain growth (economic rate of return) and better income distribution through investments in the private sector (which requires an adequate financial return).

Since IFC receives projects almost always at the final stage of preparation and we have very little room to maneuver, we should be prepared to recognize and promote those projects that have the best chance to pass the three tests. IFC already knows how to reach the first objective (growth) and how to be useful to the private sector. I will concentrate on the income distribution objective.

Any policy action in this area, whether for the Bank or IFC, is obviously limited by the lack of reliable information on the profile of poverty of each country in which we operate, specially in the poorest ones. Even general statistics on the level of income and on its distribution are scarce, doubtful and often inexistent. However, the Chenery paper suggests that we can follow some general norms that can be applied more or less effectively according to the level of the knowledge we have of each country.

Let us analyze the lowest income level of the population, which we could call the "target," in order to establish what policies are more relevant. These income groups are to be found in both rural and urban areas. In the rural areas these "target" groups are 1) landless unskilled labourers; 2) small farmers relying on a combination of family labour and small amounts of land; and 3) self-employed craftsmen, artisans, and those engaged in services in the villages. In the urban areas the "target" group includes 1) both unskilled and semi-skilled workers and 2) the large body of under-employed labour force currently engaged in low productivity self-employment in the so-called "informal sector"; generally this sector is not a marginal or temporary phenomenon; it includes large proportion of the work force engaged in a wide variety of production activities which are economically efficient and profit-making though small in scale and limited by simple technologies, little capital and lack of links with the other "formal" sector. (It has been estimated i.e. that this "informal" sector provides about 25-30% of total urban employment in Kenya).

This description shows that the poor section of the population are formed by two large groups of people: 1) those who live predominantly on a salary; and 2) those who live predominantly on the income from their own assets. Accordingly a policy oriented towards improving distributional patterns requires action on these two fronts: it should operate on the functional distribution of income in favor of the lower income group, and it should attempt to alter over time the underlying pattern of concentration of both physical and human capital.

In the first case, IFC should prefer projects which promote directly higher income to the "target" population:

- Any labor intensive project in countries with under or unemployment most probably will produce a positive impact. However since labor mobilization is not always smooth and perfect, the project location is important. Obviously a major impact is produced by projects located directly or near the zones where the unemployment or underemployment exists. Labor intensive activities that employ unskilled labor are classically in the construction and the agriculture sectors.

- Projects that stimulate the production of mass consumption goods. These projects, if well conceived, might push prices downward and help to maintain higher real incomes at the consumer level.

- Projects which produce a backward linkage effect on labor intensive activities. Many industrial projects in the agriculture sector have this impact: a canned food industry may produce higher income for the small suppliers of agricultural projects. Another clear case is represented by the Babacu project in Brazil which may employ directly 800 persons, and between 10,000 to 20,000 families in an underdeveloped area are expected to nearly triple their cash income from nut harvesting activities (this effect could be jeopardized, however, if the new industry deals only with big landowners).

- Projects which contemplate labor participation in profits over and above their present level of salaries, or any project that presents the prospect of an increase in the wage share. We may include in the first group cooperatives, workers' industries, and even corporations with a very wide distribution of shares.

The second area of action would be to try to alter over time the present pattern of concentration of assets. The limitation on expanding labour absorption makes it inevitable that a strategy for raising incomes at lower income levels must rely in large part on raising productivity and income within the self employed sector. What can IFC do on this front?

- To organize or support projects which provide access to the capital market to small scale enterprises, including small shops and small farmers.1/ There are many private oriented organizations around the world that provide this kind of service, although normally at a very modest level. Many of these organizations are non profit oriented. In Latin America, for example, the Panamerican Development Foundation has organized institutions in more than fifteen countries to help finance the activities of small businesses. There are many institutions to promote the availability of houses for the poorest sector of the population. Most probably the main problem for IFC to enter effectively in this field would be the cost of its loans; I wonder if IFC could make a case to obtain IDA funds for this purpose, or to provide a softer window for certain clearly identifiable purposes.

- Organize projects that distribute ownership. If we try to promote distribution, any project which adds to the concentration of ownership would have a negative feature, especially in countries where assets are already highly

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1/ One could argue that the promotion of small business means promoting activities with lower productivity than large ones. However, since we have decided to give a higher weight to the income of the poor than of the rich, the final result is to obtain a higher value in the productivity of capital invested in small business than in large ones if these last businesses do not benefit the poor people and the former do.

concentrated (and this will be reflected in lower economic rates of return for the project on the new weighted basis). We have to recognize that many IFC projects fall in this category.

Each country and each project will require a different approach to find small equity participants, and imagination and flexibility will be required to find workable solutions. In some cases, IFC can require an enterprise to "open" its capital; in other cases it may assist this process through a stand-by agreement for underwritings. In yet others there should be a much greater willingness on IFC's part to take a much larger equity status.

There could be situations in which IFC may have to play a more active role, for example, by promoting sales organizations sponsored by the same company in which IFC is investing, to sell the stocks widely and over time on an installment basis. There may also be possibilities for IFC to finance the prospective stock buyers through organizations or trusts formed on an ad hoc basis: these buyers could be the worker's organization, or other communities of buyers formed exclusively to acquire certain packages of stocks.

cc: Messrs. Gaud
von Hoffmann
Richards
IFC Economists
Circulation

JF:cm

Research studies

August 29, 1973

Mr. H. E. Robison
Senior Director - International
Stanford Research Institute
Menlo Park, California 94025

Dear Mr. Robison:

I am sorry that my absence from Washington has prevented me from replying sooner to your letter of August 1 about the project in which you are seeking to identify guidelines for shareholders in venture banking operations.

I am not entirely clear whether you are asking if IFC is prepared to become one of the sponsors of the project, or one of the institutions which the project will study, or both.

Frankly, I do not feel that IFC should become a sponsor of the study. Our interest in development banks and similar organizations is primarily in their impact on the local economy rather than in the objectives outlined in your paper. Nor am I at all sure that IFC is a suitable guinea pig for you to study. Our members (i.e. stockholders) are countries, they neither expect nor receive dividends from our activities, and although we try to invest only in enterprises which will earn a profit we are as much interested in economic development as in profits. All of which makes me doubt that you would gain the kind of insights that you want from studying IFC.

As you say, I will be in San Francisco attending the International Industrial Conference and will be glad to talk to you at that time if you wish. I will be staying at the Fairmont Hotel but will have to leave the Conference on the evening of September 19 to keep a prior engagement.

Sincerely yours,

(signed) William S. Gaud

William S. Gaud
Executive Vice President

cc - Mr. von Hoffmann
Mr. Qureshi

WSGaud:dbs

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Research studies

OFFICE MEMORANDUM

TO: Mr. William S. Gaud

DATE: August 28, 1973

FROM: Moeen A. Qureshi MAQ

SUBJECT: Stanford Research Institute study on Venture Banking Organizations

I do not feel it would be useful to participate as a sponsor in this Study. Its focus is not quite our's, and there are two studies in progress within the Bank on DFC's. Mr. Davenport and his colleagues may benefit from looking at some of the results of the Bank's study on DFC's.

MAQ:gmb

I have looked at this again after having talked with you on the telephone. You were right; this research proposal does involve guidelines basically for shareholders in venture banking corporations. Indeed, the point which Fuenzalida makes (whom I had asked to look into this research project) is precisely that it concerns itself with the financial success of the institution rather than with its impact on the economy. My temperature in regard to any active IFC participation or association with this research remains very low.

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Research Studies

OFFICE MEMORANDUM

TO: Mr. Moeen A. Qureshi

DATE: August 15, 1973

FROM: J. Fuenzalida

SUBJECT: Stanford Research Institute study on Venture Banking Organizations.

After reading the preliminary draft proposal, I feel this study is of only limited interest to IFC, because:

1) As you say, there are two studies already on the way in the Bank related to this subject. In addition, you may remember that the present research being done by the DFC Department is only the beginning of a series of studies on the DFC's performance. Mr. Gaud may ask the opinion of the DFC Department on this proposal.

2) The proposed research seems to center its analysis on the venture banking's institution itself and not on its impact to the economy. By analyzing financial structure, performance, the principal elements of cost, etc. the research is not pointing to the target, at least the IFC development target. IFC can be more interested i.e. in financing an institution with lower profits and higher costs that promotes the social and economic welfare than one with good profits and low costs that invests no matter on what industry.

Research Studies

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara (through Mr. E. Stern)

DATE: August 13, 1973

FROM: Mahbub ul Haq

SUBJECT: Note on Ocean Resources

1. I am sending you the attached note, which may be of interest. It has been prepared by Mr. Varon in the Policy Planning Division.

2. The use of ocean resources, particularly for seabed mining, has been receiving increasing attention in the last year. The interest stems in part from the impending UN Law of the Sea Conference to be held in Santiago, Chile, in April 1974, but more importantly from the realization in the United States and other industrialized countries that seabed mineral resources (consisting primarily of manganese, copper, cobalt and nickel) are enormous. This interest has been reinforced by fears of long-term shortages of industrial raw materials (inspired by the Club of Rome book) and also by talk of OPEC-type actions in other strategic materials besides oil.

3. The major facts on seabed mining are the following:

(a) The major areas with"nodules" (the ball-shaped concentrations where the four minerals are found together) are in the Pacific, at depths of 15,000 to 20,000 feet. These areas are well beyond the 200-mile territorial waters claimed by some countries, notably Chile, Ecuador and Peru. So far, no mining of nodules has occurred at these depths, but experiments by a subsidiary of Tenneco at about 3,000 feet off the East Coast of the United States and by Japanese firms have shown that it is possible to develop a viable technology for mining at the required depths.

(b) The economics of seabed mining is very uncertain. The uncertainty is partly the result of the unusual combination of minerals found in most nodules: the proportions of the minerals found in deep-sea nodules are 25 to 30 percent manganese, 1 to 1.5 percent nickel, 0.5 to 1 percent copper and 0.25 percent cobalt. The remainder is made up of silica, other minerals and water. These proportions - compared to the present pattern of consumption - imply a large surplus of manganese, nickel and cobalt. Once seabed mining gets started on even a fairly modest scale, the prices of these three metals would probably fall sharply. This would have serious implications for some of our member developing countries.

(c) There are only speculative estimates at present as to the potential of seabed mining that can be realized over the next decade or two. One of the proposals is that an international fund be formed - several have suggested that the Bank manage the fund - to channel the royalties from seabed mining into development assistance. The developing countries are naturally interested in staking out a major claim on royalties from the exploitation of the common property resources of mankind.

(d) There are many legal questions about who has the right to mine the seabed and under what conditions. A possible international regime has been discussed in the UN and the debate will continue in Santiago. In the meantime, a bill sponsored by Senator Metcalf of Montana is before the US Congress which would establish an interim regime to permit US firms to begin seabed mining operations. The bill has been attacked within the US and by developing countries as a unilateral action, and it is uncertain whether the bill will be approved.

4. Many outsiders see a large role for the Bank, as possible financier of seabed mining ventures and as administrator of an international fund. Inquiries have been received in recent months about the Bank's views on the subject of seabed mining from a number of agencies, including the Brookings Institution, Resources for the Future, Inc., The Overseas Development Council, the Law of the Sea Institute, the Rockefeller Foundation, the National Science Foundation, ECLA, the UN Environmental Program, and private industry. A few weeks ago, the US Executive Director's office inquired at the request of Senator Tunney of California if the Bank had prepared a paper on seabed mining issues. Some enthusiasts, like Professor Roger Revelle, have submitted a paper (July 1971) on The World Bank as an Agent for an Interim Deep Sea Regime visualizing an ambitious - and perhaps unrealistic - role for the Bank.

5. We plan to continue keeping ourselves informed, together with the Industrial Projects Department, of developments in this new field. This should be helpful in developing the position that the Bank may take in the UN Law of the Sea Conference in April 1974 which it would be invited to attend.

Copies for information:

President's Council
Department Directors, IBRD
Economic Adviser, IFC

MHaq:pa

THE OCEANS DEBATE AND THE BANK - A BACKGROUND NOTE

Table of Contents

Bension Varon
Policy Planning and Program Review Department
August 13, 1973

THE OCEAN DEBATE AND THE BANK - A BACKGROUND NOTE

I. Introduction

1. The ongoing debate about the oceans concerns essentially the regulation of the uses and the sharing of the wealth of the oceans, which comprise roughly 70 percent of the globe's surface. The wealth of the oceans now under contention covers fisheries, energy resources, and mineral resources, particularly those found beyond the limits of national jurisdiction. The issues involved are complex for economic, legal and political reasons.

2. The debate on jurisdiction over ocean resources has gained momentum since it began a few years ago. The planned UN Law of the Sea Conference scheduled to open early next year is likely to further the discussion. Moreover, there have recently been an increasing number of references to the potential role of international organizations, including the Bank; the US Congress is considering legislation on seabed mining and several articles have appeared on this subject in the press. It is, therefore, appropriate for the Bank to become more familiar with the subject.

II. Main Technical Developments

The Resource

3. At least thirty common minerals are known to exist in the sea, either in the sea-water itself, as sediments on the ocean floor, or within bedrock. World production of these marine minerals totalled over $7 billion in 1969, of which $6.1 billion consisted of oil and gas (Annex Table 1). Among the as yet untapped resources, those that hold the greatest promise from the economic standpoint and are nearest to commercial exploitation

are the so-called manganese nodules. Nodules are metallic objects ranging in size between a pea and a baseball, found scattered over large areas of the ocean floor at depths from 3,000 to 20,000 feet. The metallic composition of the nodules varies depending on where they are. A typical deposit of commercial interest contains 25-30 percent manganese, 1.0-1.5 percent nickel, 0.5-1.0 percent copper, 0.25 percent cobalt, as well as small quantities of several other metals. The remainder of the nodule is made up of water and silica. While all oceans are known to have nodules, the Pacific Ocean appears to be particularly rick in high-grade nodular material.

4. Although the existence of nodules has been known for 100 years, widespread interest in them is recent and is in part a by-product of growing concern over the possible exhaustion of high grade conventional (land-based) resources. At the same time, there has been rapid progress in the technology of nodule mining and utilization. The enormous size of the resource is another important factor which has generated interest in its development. (See the estimates about the resources of the Pacific Ocean alone in Annex Table 2.) To illustrate, meeting the world's current needs for manganese and cobalt exclusively from ocean nodules would require mining an area of about 1,100 square miles and 240 square miles, respectively, equivalent to only 0.0008 percent and 0.00017 percent of the ocean bottom. Furthermore, nodules are "renewable", i.e., self-regenerating, albeit at a slow pace[1/]

1/ Though a great deal remains to be discovered about the genesis of the nodules, it is advanced that nodules are formed and continuously enlarged by precipitation of elements at a rate of 0.01-1.0 mm per 1,000 years in the abyssal ocean floor, but probably much faster in continental slope areas. While the average rate of formation is undoubtedly slow, the vastness of the resource base leads to the contention that many metals in the manganese nodules, e.g. manganese and cobalt in particular, are accumulating several times faster than they are being consumed by man.

5. A peculiar characteristic of the nodules which merits attention at the outset is that the ratio of their metallic constituents does not resemble the current consumption pattern of the metals in question. For example, the ratio of copper, nickel and cobalt currently in use is 266:27:1 compared to a ratio of 3:4:1 in nodules of average composition. This complicates greatly the assessment of the economics and the potential market impact of nodule mining, as will be illustrated later. It suffices to note here that mining nodules sufficient to meet the world's 1967 needs for cobalt will yield simultaneously manganese, copper and nickel in amounts equivalent to 22 percent, 0.7 percent and 13 percent of their respective world requirements. If, on the other hand, the world's entire need for copper were supplied from this source, there would be made available at the same time nearly 25 times as much manganese, 15 times as much nickel and 113 times as much cobalt as the market could absorb (Annex Tables 3a and 3b).

The Technology

6. Since, as noted, nodules are essentially surface deposits lying in cobblestone-like heavy concentrations (1-5 lbs. per sq. ft.) on the ocean floor, developing a technology for mining or harvesting them has not proved to be an insuperable task. In fact, recent advances resulting from over $100 million of investment and nearly 10 years of research and development, mostly by US firms, have led the United Nations Secretariat to conclude in a recent document: "For deep ocean mining of manganese nodules, the major problem is no longer a technical one but foremost legal and political." 1/

1/ UN "Projections of Natural Resources Reserves, Supply and Future Demand", E/C.7/40/Add.2, December 5, 1972.

This claim was supported by a leading US firm, Deepsea Ventures Inc., a subsidiary of Tenneco, Inc., in a three-hour presentation (arranged by the Industrial Projects Department) which included the showing of two films on May 8, 1973 at the Bank. Technological breakthroughs have been achieved not only on the lifting of the nodules, e.g., through a hydraulic air suction system or a so-called continuous line bucket system, but also in winning the metals from the nodules. Much of the requisite prototype equipment has already been designed, patented, built and tested.[1/]

The Economics

7. Less is certain about the economic viability of nodule mining, however. The facts are a closely-guarded secret; besides, there is no commercial exploitation at present. The cost/benefit estimates available differ widely and lead to a variety of views ranging from the assertion that the operation would be totally uneconomic, or at best marginal, to the claim that it would constitute a highly profitable undertaking. (Some very general estimates are given in Annex Tables 4a to 4c).

8. On the cost side, little disagreement seems to exist on operating costs, which can be said to be relatively low. However, there is greater uncertainty about capital costs, clearly the dominant factor in the operation. Furthermore, the estimation of revenues is a highly complex task in this case. To illustrate, the lack of parallelism between the mineral composition of the nodules and the current world consumption pattern of the metals in

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1/ However, a potential source of residual difficulty may arise from the fact that most of the tests so far (by the US, for example) have been conducted at depths of 3,000 feet, whereas most deposits of commercial interest are found at 12,000-18,000 feet. In addition to imposing greater demands on the equipment, this implies a greater need to optimize on the physical conditions (shape of the terrain, underwater currents, surface conditions, etc.). However, the proponents of the technology advance as a mitigating factor that the abundance of the resource increases the chances of locating numerous mining sites where all necessary conditions can be optimized.

question means that there will not be a market at present prices for all the metals in the nodules. In other words, expected revenue cannot be calculated simply by adding up the value of the individual metals per ton of nodule. Numerous additional complications arise from uncertainties about the marketability of some of the products, particularly manganese,[1/] the substitutability and joint-product nature of some of the metals produced on land, and the possible reaction of existing land-based producers.

9. The capital requirements for a typical operation harvesting one million tons of nodules per year are reported to be in the order of $150-200 million; annual operating costs are estimated at $40-70 million; gross revenue at $90-135 million; and net return on investment at 12-30 percent. In each case, the higher costs and revenues seem to be more consistent with the latest technical and market-price information.[2/] If even the upper limit of the profitability range does not seem as high as had been claimed earlier, it is because: (a) these estimates refer to the initial operations of the first firm; there are significant opportunities for economies of scale (depending on the amount of nodules lifted per day, which can be up to twice as much as assumed so far, the number of days a year the mining ship remains at sea, etc.); (b) the estimates are heavily influenced by US-developed technology; the Japanese-developed mining system is reported to be lower cost even on a smaller scale of operation; (c) nearly $40 million out of the capital cost of $200 million are for research and development.

1/ The marginal costs of obtaining (isolating) the manganese in a marketable form are very high.

2/ The calculations in Annex Table 4c are based on the 1970 prices of the four metals. Each of these has risen considerably since then: copper and cobalt prices by about 35 percent, nickel and manganese prices by 15 percent.

Main Firms and their Plans

10. That nodules no longer represent merely an oceanographic curiosity is demonstrated by the fact that today about 30 companies in the US, Japan and Western Europe are actively engaged in exploration, development and equipment construction. These include, in addition to Deepsea Ventures, Inc., the Hughes Tool Co., Kennecott Copper Co., International Nickel Co., Lockheed and Global Marine, Snexo-Societe Le Nickel (French group), Metallegesellschaft/ Preussag (German group), Nippon Steel, Sumitomo, Mitsubishi, and Mitsui. The Soviet Union, too, appears to be keenly interested in this resource: it is reported to have set up a Comecon International Coordinating Center for Marine Exploration to undertake joint expeditions to select suitable mineral exploitation sites. While one or two firms have withdrawn or shelved plans for further investment, it is clear that the majority of the enterprises intend to pursue their research and development.

11. The plans of Deepsea Ventures, Inc., the farthest ahead in the field, as expressed to a congressional committee in April 1972, call for capacity to mine a million tons of nodules per year beginning in 1975 and to have processed metals on the market in 1976.[1/] This entails one or two years of further development work - some of it already under way - estimated to require $16 million (on top of the $20 million which the company has already invested in research and development), followed by two to three years of mining-equipment and processing-plant construction involving nearly $150 million. Deepsea Ventures has already identified several potential mining sites, built a pilot processing plant (near Norfolk, Va.) and mined 60,000 tons of nodules for testing (from

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1/ US Congress, Senate Committee on Foreign Affairs, Law of the Sea and Peaceful Uses of the Seabeds, Hearings, 92:2, April 10 and 11, 1972.

The Blake Plateau, off the coast of Florida). Activation of the plans is awaiting the completion of legal, financial and business arrangements. Next in line is a consortium of Japanese, American and European firms which has already tested twice a Japanese-developed mining system. Among the newer entrants into the field the most powerful is the Hughes Tool Co. This company launched a mining support vessel in January 1972 and a mining ship in November 1972 and is reported to have invested about $250 million in developing a seabed mining system.[1/] Japan's Ministry of Trade and Industry is in the process of forming a semi-public venture, which would hopefully start ocean mining in 1977. Thus, it is quite possible that there will be at least four rigs in operation by 1980, each harvesting about a million tons of nodules per year; the number may be as high as 10 by 1985.[2/] The potential market impact of these operations is discussed below in paragraph 21.

III. Legal and Ownership Questions

The Controversy

12. The debate about the oceans pivots around the question "For whose benefit are the ocean's resources to be exploited?" in view of the widely accepted but operationally vague notion that the oceans are "the common heritage of mankind". In the case of mineral resources, the question is

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1/ The Washington Post, August 6, 1973, p.1.

2/ While the commercialization of nodules may be delayed somewhat beyond the above dates due to legal uncertainties, we may turn out to be pessimistic about the eventual size of the operations. For example, a paper by Mr. Leigh S. Ratiner, Director for Ocean Resources, Department of the Interior, postulates that of the three US firms which may be in nodule mining by 1978, two firms would mine 3 million tons of nodules per annum (we have assumed one million).

of some importance now since various conflicting attempts are afoot to proceed unilaterally or multilaterally, as explained below.

13. In December 1969, the UN General Assembly adopted a resolution declaring a "moratorium" on all exploitation of deep seabed resources pending the establishment of an international deepsea regime, i.e, a multilateral convention. Progress toward drawing up such a convention has been slow despite earnest attempts by several key countries, including the United States. In August 1970, for example, the United States presented to the UN Seabed Committee a draft treaty of 78 articles providing for the administration of the seabed's resources beyond the limits of national jurisdiction. Though received with much admiration by some countries, the draft treaty came under strong criticism on the grounds that it gave far too much to the coastal states and far too little to the international community. There were strong objections to the US proposal for the establishment of a Seabed Council of 24 members, of which 6 would come from the most industrially advanced nations, three of the six holding veto power over all Council decisions.

14. In November 1971, responding to the case put forward by the American Mining Congress, Senator Lee Metcalf of Montana introduced a bill (S.2081, also known as the Metcalf Bill) designed "to provide an interim basis for deep ocean mining by US nationals until a treaty can be agreed upon, ratified and entered into force." (A bill identical to S.2081 has been re-introduced in the House in this session of Congress as H.R.9.) Briefly, the Bill authorizes the Secretary of the Interior to issue licenses for the mining of the deep seabed to US nationals and to foreign individuals or corporations acting through companies incorporated in the US or any other

country with comparable legislation. The proposed law, which disregards the 1969 UN moratorim resolution, would enable the US mining industry to proceed with the exploitation of nodules by creating an interim regime based on parallel (reciprocating) national legislation among industrialized countries.

15. The Metcalf Bill has been opposed widely both in the US and abroad. Spokesmen for developing countries complain that the so-called interim regime will very probably become a permanent regime serving the club of rich countries. Supporters of the Bill deny that the Bill discriminates against LDC's; they insist that the Bill is necessary as a vehicle for introducing a modicum of order into the field, since it would take a long time to draw up an international convention and they point out that the legislation, like nearly all proposals to date, provides for contributions - of unspecified size - to a central international pool, the proceeds of which would eventually be transferred to LDC's through a new or an existing international organization.

The Interests of the Leading Industrialized Countries

16. Testimony before Congressional committees and other public statements by the sponsors of the Metcalf Bill makes it clear that the competition among rich countries to harvest the mineral wealth of the seabed is spurred by considerations such as the following:

(a) The importance of the nodules' metals. Manganese, copper, nickel, and cobalt are important industrial raw materials, some of them indispensable for steelmaking. World production of these four metals mostly for the needs of the industrialized countries, totalled \$6 billion in 1969 as shown in Annex Table 5.

(b) Balance of payments considerations. Most of the developed countries are deficient in these metals and rely on imports for the bulk of their requirements. (Data for the US in Annex Table 6.)

(c) A desire to develop a nonpolitical source of supply which cannot spring OPEC-type surprises. This has been made quite explicit though it is based on a questionable premise: as concluded in a recent Bank paper, OPEC-type cartels are feasible in at best one or two nonfuel minerals.1/

(d) The desire of countries to improve or maintain their overall competitive position in metal-intensive exports of manufactures viz-a-viz other industrialized countries.2/

(e) Cost considerations. It is possible that, due to the apparent abundance of nodules, the cost of extraction of sea-based minerals will not rise in the same proportion as does the cost for land-based minerals. This is due to the fact that new areas of sea-bed can easily be mined by moving the mining ship, whereas a land-based mine is confined to one place.

The Interests of the LDC's

17. Developing countries are key, active parties in the debate first of all because many of them are large suppliers of the minerals found in the oceans and feel threatened. LDC exports of copper, nickel, manganese and

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1/ B. Varon, "What are the Opportunities for Raising LDC's Earnings from Exports of Non-Fuel Minerals through OPEC-type Cooperation," Economic Analysis and Projections Department, February 11, 1972.

2/ See statement by B. Varon in Lewis M. Alexander, Editor, The Law of the Sea: Needs and Interests of Developing Countries, Proceedings of the Seventh Annual Conference of the Law of the Sea Institute, University of Rhode Island, February 1973, pp. 42-46.

cobalt are about $2 billion. Some developing countries are large exporters of two or more of these metals and are heavily dependent on them for their export earnings (Annex Table 7). Several LDC's have large and in some cases newly discovered reserves of these metals and, particularly the least developed, have been counting on them to move forward. They fear that large-scale seabed mining might lead to revenue lost as well as revenue foregone.

18. There is also a more general interest of the developing countries in the benefit they receive from the exploitation of the common property resources of mankind like the ocean beds. If such exploitation becomes a sizeable source of revenue, as some estimates suggest, the developing countries are likely to stake out a claim that they are entitled to a major portion of these revenues as they constitute the majority of mankind.

The UN Law of the Sea Conference

19. The debate will move shortly to the United Nations' Conference on the Law of the Sea. The Conference will open in April 1974 in Santiago, following a preparatory meeting in November 1973 in New York. It is likely that several draft treaties, including the 1970 US draft, will be introduced there. While the Conference may break the UNCTAD record in size, duration, and disappointment, one cannot rule out the possibility that it may give birth to an international convention by 1975. The Bank will be invited to the Conference.

IV. The Role of the Bank

20. A recent report by the Secretary-General of the United Nations suggests repeatedly that national marine management and optimum utilization of seabed resources require a closely coordinated and interdisciplinary approach by the whole United Nations system.[1/] Beyond this, there are a

1/ United Nations, ECOSOC, Fifty-fifth session, "Marine Cooperation", Report of the Secretary-General, E.5332, May 11, 1973.

number of reasons why the Bank should keep itself informed of developments about ocean resources: (a) The Bank Group has an investment program in mining involving some of the metals found in the oceans. It financed four nickel projects in the last five years, for instance: the manganese output of Gabon, the largest producer among market-economy countries, comes from a Bank-financed project; (b) The effect of ocean mining on the prices of some minerals could seriously disrupt the economies of various member countries, especially copper exporters; (c) The proposed collection of royalties might provide a source of development capital of interest to the Bank, whether these funds are distributed through the Bank or through another agency; and (d) Ocean mining may provide new areas for investment.

International Economic Implications of Seabed Mining

21. If a significant output can be generated by seabed mining, it is likely to exert a strong downward pressure on the prices of some minerals. The question of compensation to the affected land-based producers then arises. For this purpose, some sort of international fund might be established. Another reason why such a fund has been suggested is the international nature of most seabed resources.

22. It is not possible to quantify the possible size of an international fund at the present stage. First, there is the difficulty of forecasting the future level of nodule output, costs and prices; second, a possible royalty would be determined largely by international bargaining. The royalty rate contemplated or hypothesized in recent studies ranges from 10 percent to 30 percent of gross revenue (although the formula need not be

based on this concept).[1/] Assuming, for illustrative purposes, a nodule output per rig of one million tons a year valued at today's prices, or \$125-135 million annually, 4 rigs (the expected number by the mid or late seventies) could produce \$500-540 million of metals. By the mid-eighties, total output mined from nodules could be \$1.7-1.9 billion. These conjectural forecasts give a very general idea of the possible base for royalty revenues. Since allowance has to be made for the potential price depressing effects of nodule mining, discussed below, output would probably have to reach at least 35 million tons in order to yield an international revenue of \$1 billion at a tax rate of 30 percent. However, this sort of estimate remains highly conjectural.

23. The price effects of nodule mining are just as difficult to gauge. Most experts agree, however, that cobalt prices would be affected first and most (by as much as 50 percent downward) in the next 10-15 years because of the relatively small size of the market, and copper prices last and least (by 3-5 percent downward, if at all) because of its minor occurrence in the nodules compared to the large size of its market. Manganese prices, about which there is less agreement, could fall by as much as 40 percent if the vast amount available could be marketed.[2/] The profitability of nodule mining will depend heavily on the production of nickel, the price of which might fall by 10-20 percent. It is significant to note that the prices of cobalt and possibly manganese could be affected immediately, by even a single nodule-

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1/ See Raul Branco, Ocean Economics and Technology Branch, United Nations, "The Tax Revenue Potential of Manganese Nodules", February 1973, draft, and UNCTAD, "Mineral Production from the Area of the Seabed Beyond National Jurisdiction: Issues of International Commodity Policy", TD/113/Supp. 4, March 7, 1972.

2/ The major producers of cobalt among the LDCs are Zaire, Zambia and Morocco; the major producers of manganese are Gabon, India and Brazil.

mining venture. On the basis of the above figures and assuming a growth rate in world demand for these metals of 5-6 percent per annum, annual export earnings of developing countries from these commodities in 1980-85 could be $300-400 million lower than the normal projection without sea-bed mining. The royalties collected at a rate of 10 percent of gross earnings would be insufficient to offset LDC's losses in revenues, unless an international fund also obtained similar royalties from deepsea oil and gas operations or the developing countries themselves have a stake in seabed mining operations. However, both conditions are unlikely to occur: oil and gas resources are generally too close to shore to be susceptible of internationalization, and the capital requirements for nodule-mining are beyond the financial means of most developing countries. On balance, therefore, there is some basis for the fears of a number of developing countries that seabed mining could disrupt their export earnings.

24. For the time being, our role should be to keep informed of developments and to prepare ourselves for the Law of the Sea Conference. However, we should be aware of the fact that outsiders in some cases see a large role for the Bank, as possible financier of seabed mining ventures and as administrator of an international fund. A number of agencies have in recent months inquired about the Bank's views on the subject of ocean mining. Such inquiries have been made by the Brookings Institution, Resources for the Future, Inc., the Overseas Development Council, the Law of the Sea Institute, the Rockefeller Foundation, the National Science Foundation, ECLA, the UN Environmental Program, and private industry. A few weeks ago, the US Executive Director's office inquired at the request of Senator Tunney of California if the Bank had prepared a paper on seabed mining issues.

Professor Roger Revelle, now at Harvard, submitted a working paper at the Pacem in Maribus-2 Conference held in Malta in July 1971 on The World Bank as an Agent for an Interim Deep Sea Regime visualizing an ambitious - and perhaps unrealistic - role for the Bank. The Conference simply took note of it without much discussion or passing any resolution; Revelle, however, seems eager to pursue the subject. This background suggests that the Bank will be asked to express its views on various issues and new proposals at the Law of the Sea Conference by early 1974.

Table 1: ESTIMATED WORLD PRODUCTION OF MINERALS FROM THE SEA IN 1969

(Millions of US dollars)

From sea water	
Salt	173
Magnesium metal	75
Fresh water	51
Bromine	45
Magnesium compounds	41
Heavy water	27
Others (potassium, calcium salts, sodium sulphate)	1
Total value from sea water	412
From sea floor (surface deposits)	
Sand and gravel	100
Shell	30
Tin	24
Heavy mineral sands (ilmenite, rutile, zircon, garnets etc.)	13
Diamonds	9
Iron sands	4
Total value of surficial deposits	180
From sea floor (sub-surface deposits)	
Oil and gas	6,100
Sulphur	26
Coal	335
Iron ore	17
Total value of sub-surface deposits	6,478
TOTAL	7,070

Source: UN, Mineral Resources of the Sea, E/4973, April 26, 1971.

Table 2: RESERVES OF METALS IN MANGANESE NODULES OF THE PACIFIC OCEAN

Element	Amount of element in nodules (billions of tons)[1]	Reserves in nodules at consumption rate of 1960 (years)[2]	Approximate world land reserves of element (years)[3]	Ratio of reserves in nodules/reserves on land	U.S. rate of consumption of element in 1960 (millions of tons per year)[4]	Rate of accumulation of element in nodules (millions of tons per year)	Ratio of rate of accumulation rate/ of U.S. consumption	Ratio of world consumption/ U.S. consumption
Magnesium	25.0	600,000	[5] L	....	0.04	0.18	4.5	2.5
Aluminum	43.0	20,000	100	200	2.0	.30	.15	2.0
Titanium	9.9	2,000,000	L	....	.30	.069	.23	4.0
Vanadium	.8	400,000	L	....	.002	.0056	2.8	4.0
Manganese	358.0	400,000	100	4,000	.8	2.5	3.0	8.0
Iron	207.0	2,000	[6] 500	4	100.0	1.4	.01	2.5
Cobalt	5.2	200,000	40	5,000	.008	.036	4.5	2.0
Nickel	14.7	150,000	100	1,500	.11	.102	1.0	3.0
Copper	7.9	6,000	40	150	1.2	.055	.05	4.0
Zinc	.7	1,000	100	10	.9	.0048	.005	3.5
Gallium	.015	150,000	....	....	.0001	.0001	1.0	....
Zircon	.93	100,000	100	1,000	.0013	.0065	5.0	....
Molybdenum	.77	30,000	500	60	.025	.0054	.2	2.0
Silver	.001	100	100	1	.006	.00003	.005	....
Lead	1.3	1,000	40	50	1.0	.009	.0009	2.5

[1] All tonnages in metric units.
[2] Amount available in the nodules divided by the consumption rate.
[3] Calculated as the element in metric tons. (U.S. Bureau of Mines, Staff, 1956.)
[4] Calculated as the element in metric tons.
[5] Present reserves so large as to be essentially unlimited at present rates of consumption.
[6] Including deposits of iron that are at present considered marginal.

Source: Estimates by John Mero given in George Doumani, Exploiting the Resources of the Seabed (Prepared for the Subcommittee on National Security Policy and Scientific Developments), Washington, D.C., 1971.

Table 3a: SIMULTANEOUS AVAILABLITY OF FOUR ASSOCIATED METALS IN MANGANESE NODULES FOR ALTERNATIVE HYPOTHESIS OF SUPPLYING THE ENTIRE 1967 WORLD PRODUCTION OF EACH METAL

	1967 World Production	lbs./ton of nodules 1/	Percentage of 1967 world production of associated metals that would be made available simultaneously			
			Manganese	Copper	Nickel	Cobalt
Manganese	18,650,000 short tons ore	-	100 (%)	4 (%)	59 (%)	453 (%)
Copper	11,184,377,000 pounds	15	2,502	100	1,479	11,335
Nickel	1,007,943,000 pounds	20	169	8	100	766
Cobalt	32,890,000 pounds	5	22	.9	13	100

1/ Based on nodules containing 25 percent manganese, 1 percent nickel, 75 percent copper, and 25 percent cobalt.

Table 3b: TONS OF NODULES AND BOTTOM AREAS TO BE HARVESTED EACH YEAR TO YIELD METALS AT THE 1967 LEVEL OF PRODUCTION FROM LAND SOURCES

	1967 World Production	lbs./ton of nodules 1/	Short tons of noduels required 2/	Area to be harvested sq.miles	Fraction of total deep ocean bottom area 3/
Manganese	18,650,000 short tons ore	-	29,800,000 4/	1,089	0.0008 (%)
Copper	11,184,377,000 pounds	15	745,625,100	26,746	0.0192
Nickel	1,007,943,000 pounds	20	50,397,150	1,808	0.0013
Cobalt	32,890,000 pounds	5	6,578,000	236	0.00017

1/ Based on nodules contining 25 percent manganese, 1 percent nickel, 75 percent copper, and 25 percent cobalt.

2/ Based on nodule density of 2 lbs. per sq. ft. of ocean bottom or 27,878 tons per sq. mile.

3/ Estimated to be 139.5 million sq. mi. (361 x 10^6 sq. km.)

4/ Increase due to lower manganese content of nodules (26 percent) as compared with 40 percent in land based ores.

Source: F.L. LaQue, "Deep Ocean Mining: Prospects and Anticipated Short-Term Benefits," Pacem in Maribus, The Center for the Study of Democratic Institution, Occasional Paper, Vol. 11, No. 4 June 1970.

Table 4a: ESTIMATED COSTS OF PRODUCING METALS FROM THE DEEP SEA MANGANESE NODULES ($/TON)

Cost Item	Kauffman 1/	Smith 2/
Exploration	$ .70	$ .70
Lease Acquisition	2.50	-------
Mining Cost	5.00	4.00
Transportation to Shore	1.00	1.00
Unloading	1.00	1.00
Benefication	2.00	2.00
Processing	20.00	20.00
Waste Disposal (Environmental Protection)	5.00	5.00
Overhead	4.00	4.00
Cost of Operation	$41.20	$37.70

Table 4b: TOTAL COSTS OF PRODUCING MANGANESE NODULES ($/TON)

Cost Item	Kauffman 1/	Smith 2/		
		4 year Writeoff	6 year Writeoff	8 year Writeoff
Return on Capital Investment	$ 6.00	$ 30.00	$ 30.00	$ 30.00
Taxes	6.00	30.00	30.00	30.00
Depreciation	----	50.00	33.33	25.00
Cost of Capital	$12.00	$110.00	$ 93.33	$ 85.00
Cost of Operation (From Table II)	41.20	37.70	37.70	37.70
Total Cost of Production	$53.20	$147.70	$131.03	$122.70

Table 4c: RECOVERABLE VALUE OF METALS FROM DEEP SEA MANGANESE NODULES ($/TON)

Metal	High Content Value	Low Content Value
Nickel	$ 41.00	$30.50
Copper	19.30	14.40
Cobalt	18.50	7.40
Total Recoverable Value Without Manganese	$ 78.80	$52.30
Managanese Considered As a 50% Mn. Content Ore Equivalent	$ 13.25	$10.60
Recoverable Value of Other Metals	78.80	52.30
Total Recoverable Value	$ 92.05	$62.90
Manganese Considered As a Ferromanganese Equivalent	$ 47.50	$38.00
Recoverable Value of Other Minerals	78.80	52.30
Total Recoverable Value	$126.30	$90.30

1/ Alvin Kaufman, "The Economics of Ocean Mining," Marine Technology Society Journal, July-August 1970.

2/ See source.

Source: Wayne J. Smith, "International Control of Deep Sea Mineral Resource," Naval War College Review, June 1971.

Table 5: WORLD PRODUCTION OF COPPER, NICKEL, MANGANESE AND COBALT IN 1969 AND SHARE OF LDCs

	Value of Production		Volume of Production		LDCs' Share of:		
	World	LDCs	World	LDCs	Output	Consumption	Reserves
	(... $M ......)		(..1,000 M.T...)		(......... percent ....)		
Copper	4,965	2,143	5,473	2,212	40	3.1	47
Nickel	661	95	549	162	30	2.0	22
Manganese	351	147	7,700	2,760	36	1.4	23
Cobalt	37	26	20	14	70	0.7	48
Total	6,014	2,411					

Source: U.S. Congress, Senate Committee on Interior & Insular Affairs, Development of Hard Mineral Resources of the Deep Seabed , Hearings, Wash, June 1972.

Table 6: IMPORT DEPENDENCE OF THE U.S. IN COPPER, NICKEL, COBALT AND MANGANESE

	1970 U.S. consumption short tons	1970 U.S. short tons imported	1970 dollar value of imports
Copper	1,600,000	400,000	$400,000,000
Nickel	160,000	150,000	390,000,000
Cobalt	6,000	6,000	27,000,000
Manganese	1,000,000	1,000,000	69,000,000
Total	2,766,000	1,556,000	886,000,000

Source: U.S. Congress, Senate Committee on Interior & Insular Affairs, Development of Hard Mineral Resources of the Deep Seabed, Hearings, Wash. June 1972.

Table 7: MAJOR LDC EXPORTERS OF MANGANESE, COBALT AND COPPER, 1967-69 AVERAGE

	Manganese	Cobalt	Copper
	A. Share of World Exports 1/ (percent)		
Brazil	10.3		
Chile			18.7
Gabon	16.3		
Ghana	5.0		
India	14.7		
Morocco		7.8	
Peru			5.8
Philippines			3.1
Zaire	3.1	51.8	9.8
Zambia		7.8	19.6
Total above	49.4	67.4	57.0
	B. Share of Country's Total Exports (percent)		
Brazil	0.9		
Chile			77.0
Gabon	22.7		
Ghana	3.2		
India	0.9		
Morocco		0.6	
Peru			24.1
Philippines			10.4
Zaire	0.6	4.8	65.0
Zambia		0.8	95.0

1/ Except for cobalt which is share of world production.

Sources: U.N. Yearbook of International Trade Statistics, 1969; U.K. Geological Sciences, Statistical Summary of the Mineral Industry 1964-69; Morocco, Office de Charges, Statistiques du Commerce Exterieur du Maroc.

Research Studies

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. J. Fuenzalida
Mr. D. Weigel

DATE: August 7, 1973

FROM: Moeen A. Qureshi MAQ

SUBJECT:

Aug 1/73

Please take a look at this proposal. We have two studies currently in progress, one being carried out by the P and B Department and the other by the DFC Department on a detailed appraisal of the economic impact of DFC's. In view of the studies that are already in progress, do you think we should go into yet another one conducted by S.R.I.?

MAQ:gmb

Research Studies

OFFICE MEMORANDUM

TO: Mr. L. von Hoffmann

DATE: August 1, 1973

FROM: Moeen A. Qureshi MAQ

SUBJECT: Export Credit Refinancing

Frank Vibert from Haq's shop visited three large banks in New York to get a feel as to what a World Bank guarantee could contribute to improving the terms and conditions of a scheme for export credit refinancing. He also raised with them the question of an IFC consortium (see attached). July 27/73

I have subsequently had a meeting with Haq. While the Bank staff would like the Bank to extend a guarantee, I believe this is out. I told Haq that we had not explored with the financial community possibilities whereby IFC might be of some real assistance in improving the access of LDC's to the international capital market and one could not say much, one way or the other, before this was done. The persons Vibert talked to were second or third level people in these institutions. I felt there might be more interest in European-based institutions with close contacts with the Euro-dollar market.

Haq would like to put some alternative proposals in a memorandum to Mr. McNamara so that Mr. McNamara has something for the Annual Meetings. Do you think we should do a little exploring on our own with selected financial institutions before the Annual Meetings?

The possibility of a meeting on this problem with interested institutions during the Annual Meetings should also be kept in mind. Haq is in favor of trying to organize a special meeting which would include Regional Development Banks. But I have a feeling that we need to do some of our own homework and talk to some institutions before we get very far with any proposal.

Could we talk about this at your convenience?

2748

1. Mr. v H.
2. Mr. Gaud

STANFORD RESEARCH INSTITUTE
MENLO PARK, CALIFORNIA 94025
(415) 326-6200

1624

August 1, 1973

cc: Mr. Qureshi

Research Studies

Mr. William S. Gaud
Executive Vice President
International Finance Corporation
1818 H Street, N.W.
Washington, D.C. 20433

Dear Mr. Gaud:

Finance specialists from the staff of Stanford Research Institute have been following experimentation with various types of venture banking operations for more than a decade. It has been their observation that venture banking techniques, for most organizations, are developed through expensive and time consuming trial and error processes. At the same time, the ability to conduct some form of venture banking operation, both domestically and internationally, is becoming increasingly important to most major banks and multinational corporations.

We believe that these banks and corporations would benefit considerably from a systematic international comparative evaluation of venture banking operations. Such an analysis would provide concerned executives with a clearly articulated and synthesized summary of the intuitive knowledge that some of the more experienced and successful venture bank managers now possess. It would also provide an objective comparative assessment of a variety of operating methods, and of the lessons derived from them.

A preliminary draft proposal for such a study is enclosed. After you have had an opportunity to review it, one of our leading specialists in this subject who will lead the project, Dr. Robert Davenport, would appreciate an opportunity to discuss the proposal with you and other appropriate members of your organization. His purpose is to ascertain the specific questions and subjects that you would particularly like to have covered, and to explore your potential interest in participating in the study.

I understand you will be attending the International Industrial Conference in San Francisco next September. At that time Dr. Davenport and I will be available for individual discussions on this matter with those interested. We will appreciate your prior indication of interest in order that necessary arrangements can be made.

RECEIVED

1973 AUG -4 AM 10:52

COMMUNICATIONS SECTION

August 1, 1973

We have already been advised that the important ADELA Investment Company will cooperate with us in the project, and are now seeking suggestions of other venture banking organizations that should be included in the analysis. Meanwhile, we are making preliminary preparations in order that the project can be initiated at an early date.

Sincerely yours,

H. E. Robison

H. E. Robison
Senior Director - International

HER:mmc
Enclosure

STANFORD RESEARCH INSTITUTE
Menlo Park, California 94025 · U.S.A.

July 1973

GUIDELINES FOR SHAREHOLDERS IN VENTURE BANKING OPERATIONS

A Multiclient Research Proposal for
A Comparative Analysis of Methods and Achievements
of Venture Banking Organizations

(Draft for Discussion Purposes)

By Robert W. Davenport

INTRODUCTION

An increasing number of private development banks and other similar venture banking organizations have been formed in recent years, reflecting the rising needs for the types of functions these organizations are intended to serve. Attempts to employ venture banking principles are increasingly being made not only in less developed countries where private development bank experiments are best known but also in the United States and other industrialized countries where venture banking is becoming prominent in other forms. Although the general concept of venture banking is not new, relatively little organized information exists on the best methods for conducting these operations under present day conditions, particularly where international transactions are an important element. As a result, not all of the venture banks that have been formed are producing the kind and level of results which many of their sponsors anticipated.

Need for Evaluation

The overall performance of venture banks has so far not been sufficiently disappointing or apparent to prevent continued formation of venture banks often patterned along organizational operational lines of existing institutions. This is not evidence in itself that sound operating principles are known and being applied since few of these organizations have operated long enough for their overall results to be apparent on the basis of the obvious evidence of past results. A number of venture bank managers are, however, developing a good intuitive knowledge of the relative usefulness of different methods at least for the particular operations for which they have been responsible. Thus, there is becoming available in the collective knowledge of these individuals and in five to ten years of detailed operational records of existing venture banks the essential raw material which if objectively analyzed could provide guidelines for the most practical methods of operating this type of an organization. An analysis of this information to provide such guidelines is needed to facilitate meeting the future requirements for sound venture banking organizations. The exceptional staff capabilities required and the large amounts of long-term capital risk per staff member makes learning through trial and error a highly costly procedure. Moreover, the demands of daily operations provide few opportunities for timely and in-perspective reflection or interchange of experience by those managing venture banking operations. Thus the lessons of experience need to be supplemented by objective comparative analysis before they can be given precise and clearly articulated form. It is to meet these needs that the research outlined below is proposed.

The accumulated experience in these various operations currently is sufficient to enable an accurate assessment of what are the specific requirements for successful venture banking operations; what operational methods have proven most effective; what are the distinctive advantages and risks of such organizations; how well particular venture banks have served the objectives of sponsors; and in view of findings on the foregoing, what steps sponsors might take to expand, contract or modify the operations of particular banks or their participation in these institutions. An evaluation is needed so that policies on participating in venture banking in developing countries can be formulated on the basis of a concise knowledge of the lessons of past experimentation. The evaluation will have the further value of providing guidance to the growing and potentially more important use of venture banking techniques in the United States, Europe and other industrially advanced areas.

OBJECTIVES

The study has two central objectives:

(1) To identify factors that significantly contribute to the success or failure of venture banking activities and to formulate on the basis of these findings guidelines on methods for organizing the operating venture banks appropriate to particular situations and objectives. For this purpose a comprehensive and comparative analysis will be made of venture banking experience including an analysis of trends in financial structure and performance, major elements of cost, management and staffing, operating policies and procedures, and character and influence of shareholder objectives and priorities on operating results.

(2) To analyze specific venture banks in the context of the general findings and to make recommendations appropriate to the interests of shareholders for expanding, contracting, or modifying the activities of individual venture banks or the role of participants in these activities.

SCOPE AND METHOD OF APPROACH

Following a review of background information, the study will make complementary use of three main analytical methods: (1) in depth field investigation and analyses by venture banking specialists of a few venture banking operations selected for the probable importance of the derivable lessons of experience; (2) the creation of a computer data bank using readily available time series data on basic operational characteristics of a large number of venture banks and the use of correlation and regression techniques to test hypotheses on factors affecting various relationships related to performance; and (3) a survey of shareholders and other major suppliers of capital to venture banking operations on their views on the objectives and performance of particular venture banks.

The review of background information will include a study of significant previous investigations of venture banking operations in all regions of the world in addition to those previously conducted by the present investigators. Periodic evaluations of venture banks have been made by international lending agencies in cases where the latter have been sources of loan or equity capital. Foreign shareholders have also in some cases made evaluations. University and applied economists have carried out investigations of particular institutions. A review and integration of all relevant information available from these sources will provide the basic framework of the study.

Case Studies

In-depth field investigations will focus on five or six organizations. These will be selected on the basis of the interests of sponsors of the study and other indicators of the probable value of information to be gained from including an organization among those to be studied in-depth.

One organization that especially merits detailed study because of the extent and diversity of its experience is ADELA (The Atlantic Community Development Group for Latin America). During its eight years of operating experience, it has tested a variety of new concepts in conducting venture operations while making more than 100 investments in a diverse range of enterprises in twenty-one countries. An objective analysis of ADELA's operational history to ascertain the degree to which various methods have been successful and to identify the principle explanations of achievements or failures could provide much instructive information on appropriate methods of managing particular aspects of venture operations in various situations.

Of similar interest is PICA (The Private Investment Company of Asia), which has been patterned along the general organization lines of ADELA. Because its operations focus on the very different venture environment of the countries in Asia and because it has differed substantially from ADELA in its detailed operational methods, careful comparisons of its operations with those of ADELA could provide valuable insights into principle determinants of operational results.

Several additional case studies will provide useful comparative data and perspective on the varying situations and environments in which venture operations may need to be conducted. The kind of detailed information on a venture bank's current and previous operations required for such an analysis is most readily available for the 36 private development banks established with World Bank assistance. Particularly relevant comparative information might be provided by a number of these such as:

National Investment Bank for Industrial Development, S.A. (NIBID), Greece

Banco del Desarrollo Economico Espanol, S.A.

The Industrial Credit and Investment Corporation of India (ICICI)

The Development Bank of Singapore (DBS)

Industrial and Mining Development Bank of Iran (IMDBI)

C. A. Venezolana de Desarrollo Sociedad Financiera (CAVENDES)

Another type of perspective can be provided by an analysis of venture operations that are relatively unrestricted by national development objectives. Venture banks of this type are of increasing importance in countries such as Australia, Brazil and Mexico. Although each venture bank particularly in this group tends to have its own distinctive characteristics, selected, detailed studies together with a broad review of basic information on other organizations will provide insight into the requirements and achievements of these operations.

The case studies will be further enriched by drawing on comparative information on selected aspects of operations from a variety of well known organizations that are relatively unique but have in varying degrees relevant experience. Of particular importance in this group are the International Finance Corporation of the World Bank Group, International Basic Economy Corporation, Commonwealth Finance Corporation and Industrial and Commercial Finance Corporation.

Quantitative Studies

The quantitative analysis will focus on data reflecting the experiences of 20 to 30 venture banks over the past 5 to 10 years, in terms of major variables characterizing capital structure, investments, costs, income, basic policies and procedures, management and staffing, and the evolution and interrelationships of such variables over time.

The first step will be to assemble the data in computer-readable form. With such a set of data available, computer correlations and regressions can be used to set up and test a variety of model forms. It is the intent of this proposal to keep the analysis simple, to work primarily with the data that are readily available, and to develop model forms that are easy to understand. This approach would keep the magnitude of the research effort within bounds while displaying the merits of the method.

Where data are available, statistical analyses will be used in search of correlations, e.g., how the operating costs vary with the volume or characteristics of investments or particular operating policies. Plausible relationships suggested by case studies and other investigations by the research team will be tested where possible to see if such hypotheses can be substantiated or refuted. Models will be used to project identified patterns into the future as a means of forecasting where these patterns lead. In addition, alternative changes in identified patterns can be tested to appraise the impact of such changes on future performance.

Although many aspects of venture banking operations cannot be included, the most readily quantifiable factors and those for which data are most readily available can be incorporated. This will provide a cross-check on judgments based on the experience and intuitive knowledge of venture bank managers and specialists. It will also broaden and deepen comparisons and summarizations of the detailed case studies.

Analysis of Shareholders Experience

The survey of shareholders and other major suppliers of capital to venture banking operations on their views on the objectives and performance of particular venture banks will be carried out through mail questionnaires, interviews, group seminars and other appropriate means.

Each of the selected venture banks will be analyzed in terms of the objectives of sponsors, how well actual operations have served their objectives, and how methods and achievements compare with those employed by other organizations in the study. The analysis will be supported by comparative data on capital, pattern of shareholding, sources and terms of other capital, government assistance and other relationships with governments and international agencies, organizational structure and managerial and professional staffing, operational methods, types and terms of financing and other services extended, cost structure, and profitability of operations.

The major research tasks are summarized below:

- Organization and digestion of basic information, reports, and previous analyses of venture banking organizations.

- Survey of major shareholders on their conceptions of objectives, operations, and achievements.

- Formulation of standards for evaluating achievements and preliminary testing against assembled data.

- Initiate quantitative study by
  -Identifying factors believed to affect the costs and profitability, including capital losses and gains of venture banks.

  -Assemble data for incorporation into the computer

  -Identify the computer system to be used for this study

- Make preliminary quantitative analyses:
  -Convert the data into a computer-usable file compatible with the selected computer system

  -Run correlations and regressions testing for the relationships identified in discussion and search for patterns among the data elements.

- Field survey of selected venture banks checking the validity and implications of information and filling gaps in information essential to assess environments, trends, prospects, and other aspects of comparative performance.

- Presentation of interim report to sponsors and special advisers, and assessment of potential implications and importance of preliminary findings in terms of courses of action sponsors might wish to take.

- Field survey of remaining selected venture banks.

- Retest the quantitative model. The corrected, adjusted, or enlarged set of data will be used to test the hypotheses that now appear to be most appropriate. The data gathering, testing, reviewing, and regenerating of hypotheses may require several iterations, and two such iterations have been scheduled.

- Integration and comparative analysis of research results on individual banks, and evaluation of the possibilities and consequences of alternative courses of action that sponsors might wish to adopt.

- Preparation of oral presentation of findings and of final written report.

RESEARCH MANAGEMENT AND STAFFING

The research will be conducted under the leadership of Dr. Robert Davenport, Director of SRI's International Development Center, whose extensive experience in directing studies on the design or operational improvement of development finance and venture capital organizations in both developed and developing countries is summarized in a biodata sheet attached. He will be assisted by a project team of SRI specialists who are well qualified in the fields of international and business finance, banking, management sciences, and the economic and business environments of developing economies. The quantitative portion of the study will be under the direction of Dr. George Klein who has specialized training and experience in the types of quantitative analyses being proposed for this study. He is currently supervising research on model development for long-term credit evaluation for a major Japanese bank.

The SRI staff will draw on the assistance of consultants with specialized knowledge of investment banking and banking law in particular countries where research in these areas are important to case studies. The research team will also be assisted by an advisory council of six to eight including representatives of banks and industrial corporations that have been major shareholders in venture banks and of international lending agencies that have been closely associated with their operations through loans or other assistance. The council will meet with the research team every third month to bring their experience to bear upon the conduct of the research through discussions on findings, sources, and alternative lines of inquiry and through suggestions and guidance to the research team.

Estimated Time and Cost

It is estimated that the research could be completed within a period of fourteen to sixteen months. It will involve the skills throughout most of this period of four professionals specialized in various aspects of international banking as well as other staff and consultants for shorter periods. It is anticipated that widespread interest in participating in the study on a multiclient basis will make it possible for the cost to be no more than $10,000 to $15,000 per client.

Proprietary Handling

The specific interests and objectives of sponsoring clients will be handled on a confidential basis. Market or technical information of a proprietary nature obtained from sponsoring companies or from other companies interviewed during the research will not be individually disclosed; such information will be used only for deriving aggregate information. To facilitate data collection, the Institute reserves the right to provide the companies interviewed with a brief summary of the findings pertinent to their particular contributions. Such disclosures will be limited, however, and will not negate the value of the detailed research to the sponsoring organizations.

Since the results of the study will be proprietary, it is understood that the Institute and each sponsor will use the results in a manner consistent with the best interests of all sponsors. All reports of findings are issued for the sole and confidential use of the sponsors and their majority-owned subsidiaries. Each sponsor will take reasonable precautions to protect the confidential nature of the reports supplied them under this program.

QUALIFICATIONS

Stanford Research Institute is an independent, nonprofit organization that provides specialized research services to industry and government. Included within its scope are activities in industrial and development economics, physical and life sciences, engineering, management sciences, and combinations of disciplines within these fields.

SRI is an international institution. In addition to offices and laboratories in several locations within the United States, it maintains operating bases in London, Zurich, and Tokyo, and resident representatives in a number of other cities including Paris, Milan, Madrid, Bangkok, Manila, and Sydney. A significant portion of SRI projects conducted overseas are located in Southeast Asia, Latin America and elsewhere in developing countries. At any given time about 200 of its 1700 professional staff are engaged in projects abroad located in about 30 countries.

SRI's international research on banking institutions has included:

- A development finance corporation for the Middle East
- A review of the causes of failure of the Middle East Industrial Projects Corporation (MIDEC)
- An evaluation of the operating methods and procedures of the Industrial Bank of Turkey
- A feasibility study of a Caribbean regional development bank
- Advisory assistance in the design and negotiation of the Caribbean Development Bank

- A plan for the reorganization of the National Development Bank of Honduras

- An analysis to improve the operations of the Bank of Northeast Brazil

- A regional program for channeling development financing to small and medium industry in Peru

- Sources of capital investment funds for Argentine industrial development

- A survey of industrial credit requirements and financial services in Colombia and a recommended program and procedures for the Banco Popular

- An analysis of Puerto Rico's experience with special industrial financing programs.

- Instituciones Estatales de Creditos en El Paraguay--Un Plan Para su Reorganization

- A survey of the organization and operation of the private development corporations in Central America

- A study of two government lending institutions in Central America: INFONAC in Nicaragua and INFOP in Guatemala

- An analysis of the operations and experience of the Fundo de Garantia y Fomento in Mexico

- Rural industry, commerce, and credit in Nyasaland

- Agricultural credit program for Ethiopia

- Japanese financial institutions--a field survey of industrial lending policies and procedures and credit requirements

- Indian financial institutions--a field survey of industrial lending policies and procedures and credit requirements

- A survey of selected European financial institutions with special programs for the small manufacturer: the Industriekreditbank A.G. of Germany, the Middenstandsbank of the Netherlands, and the Finansieringsinstituttet for Industri og Handvaerk in Denmark

- An analysis of the industrial financing procedures and experience of two Canadian institutions: the Industrial Bank of Canada and the Manitoba Development Fund

- Development of private industry through public aid--an analysis of alternative methods

- Private U.S. venture capital in newly developing countries.

In addition, SRI conducts studies on domestic banking issues such as the selection of branch bank locations, market analyses for banking services, diversification opportunities, investment analyses, and financial trends.

A special group in SRI's Management Systems Division is devoted to research on the more effective use by banks of computer and management science techniques. Three other SRI divisions--Information Science and Engineering, Electronics and Radio Sciences, and Engineering Systems--engage in the development of equipment and engineering systems specially adapted to the requirements of financial institutions.

The Corporate Strategy group within SRI's Economics Division devotes special attention to training seminars as well as to research on bank planning strategy. The Long Range Planning Service reports periodically on such topics as "World Capital Markets," "Commercial Banking," "Flow of Funds," and "Leasing in Western Europe," as well as economic and technical trends in other sectors of general interest to bank executives. Reports in preparation or recently issued include "Trends in Investment Banking," "Stock Trading," and "Banking in Europe."

Other international research activities of SRI relevant to this study are its projects in the field of international investments. Representative projects include:

- The role of U.S. private investment in the economic development of Spain

- Factors affecting the flow of private foreign investments

- Investments in newly developing countries

- Attracting private foreign investment in Argentina

- Advisory services in establishing the Indian Investment Center

- The motivation and flow of private foreign investment

- Industrial investment climate in Ethiopia

- Factors affecting foreign investments in Brazil

- International private investment - A guide to prospectus preparation

In addition to research in international finance, Stanford Research Institute has taken an active part in bringing together leaders of world business interested in investment opportunities and officials of countries in need of foreign investment to finance economic development. These meetings give the participants an opportunity to exchange views and become acquainted with each other on a highly personal and informal basis. During the past six years, SRI has sponsored nineteen international meetings in fourteen countries.

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Correspondents / Participants

Subject / Title
CVs of Robert Davenport, George Klein, Philip Huyck

Exception(s)
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Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

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Research Studies

July 30, 1973

Mr. Ashish Mitra
Mahindra-Ugine Steel Company
Shree Niketan, Shiv Sagar Estate
Dr. Annie Besant Road
Bombay 18, (WB) India

Dear Mr. Mitra,

I have now returned from my trip through Africa and South Asia and will shortly leave for Latin America to complete the site visits of the firms included in the study. I wish to thank you, for your very warm hospitality and your very helpful cooperation in providing the data for my study.

As it is necessary for me to advance somewhat the timetable for the completion of my study, I would appreciate your sending the accounts and information which Mr. Syed is compiling at your earliest convenience. If you have already done so, I will carry out an initial analysis with these data of the employment effects, foreign exchange savings, etc. as soon as I return from my Latin American trip, and then send it to you for your comments.

Thank you again for your interest and assistance in this undertaking. I am sending to you, under separate cover, copies of the OECD and UNIDO guidelines on project evaluation. I will look forward to your comments on my "first draft" evaluation of MUSCO's economic impact.

Sincerely yours,

SG.
Stephen Guisinger
IFC Consultant

Research Studies

Files

July 27, 1973

Frank Vibert

Israeli Export Credit Guarantee Proposal -
Comments of New York Financial Institutions

1. This note records the main points made to me by the financial institutions (Morgan Guarantee, Manufacturers Hanover Bank, First National City Bank) I visited in New York on the afternoon of July 24 and on July 25.

Use of IBRD Guarantee Authority

2. The market for medium to long term credit instruments between developing countries depends on the particular transaction and particular countries involved. A Bank guarantee on the paper could make the market much more like the short-term trade financing market in Bankers acceptances where what is important for the marketability of the instrument is the presence of a prime signature.

3. However, the general feeling was that the capital goods exporting countries which would be affected by the Israeli proposal are the more creditworthy developing countries which can borrow as much as they want directly in the market and certainly against any expected export proceeds. In present conditions the market is extremely competitive and a margin of 2% over the cost of funds would be considered a very good margin even for an LDC borrower. The effect of an IBRD guarantee might be to reduce the margin by say 1% (to which would have to be added any guarantee charges).1/

4. If the Bank were to guarantee export credit paper it would be important to keep the instrument simple. Multiple guarantees beyond say the guarantee of the Central Bank of the importing country and IBRD itself could impede marketability. There was a general feeling that a guarantee by a Regional Development Bank and the exporting country would be unnecessary. It would also be important that the coverage of IBRD's guarantee be very clear, preferably covering both political and commercial risks. A partial guarantee, say to cover only political risks, would invite legal questioning, and a discounting Bank would have to look beyond the IBRD guarantee in order to assess the commercial risks. Both factors would weaken the effect of the guarantee.

1/ Manufacturers Hanover Bank pointed out that there would be a very heavy administrative burden in operating a guarantee scheme. Quite apart from project appraisal and country creditworthiness analysis there would be the whole question of the class of goods being financed and the terms being offered which in practice involved a very considerable burden. This would be an important consideration if a guarantee fee were related to administrative costs.

5. Of the institutions I talked to, Morgan Guarantee was the most positive about the usefulness of the guarantee. First National City Bank was sympathetic and Manufacturers Hanover Bank was very skeptical. Both of these latter two institutions thought that under current market conditions where developing countries have direct access to the market under very competitive conditions, the Bank would have to consider carefully whether direct lending to facilitate exports would not be more useful than using the guarantee authority.

6. Neither Morgan Guarantee nor First National City Bank seemed to think that guaranteed obligations of the Bank would have any side effects on the Bank's direct obligations. On the other hand, Manufacturers Hanover thought that there definitely could be an adverse impact unless the Bank, possibly acting through IFC, took steps to ensure orderly marketing of the guaranteed instruments, supporting the market if necessary.

7. It was clear from my conversations that these institutions are very much influenced by the current situation of abundant global liquidity. A tight Euro-market could both affect the access of developing countries to the market and increase the cost margin between prime borrowers (say Exxon) and developing countries. The effectiveness of the Bank's guarantee would be correspondingly much greater both in reducing costs and improving the availability of finance. All of the institutions assumed that they would be using Euro funds for these credits.

IFC Consortium

8. I sounded out how these institutions reacted to the idea of an IFC organized consortium of Banks. Morgan Guarantee felt IFC participation could be useful in providing a multilateral umbrella for private investors. However, both Manufacturers Hanover Bank and the First National City Bank reacted negatively to the idea. They felt that the IFC would not provide an umbrella since sophisticated private institutions would be relying on their own judgements about the creditworthiness of a country and some countries for example, Chile, seemed keener to preserve their standing vis-a-vis private creditors thanthey were against official. In general, there was much less interest in the IFC scheme than in the idea of the Bank using its guarantee power since they did not see what improvement IFC could possibly bring to the market.

cc: Messrs. Stern
Haq
Qureshi
Kuczynski
Hulley
Swaminathan

FVibert:ms

Research studies

Mr. Moeen A. Qureshi

July 3, 1973

J. Fuenzalida

The work of an IFC Economist

In my opinion the economic analysis of projects in IFC has definitely improved. Certain traditional tools of analysis like the level of protection and the foreign exchange savings, have receded to their true level of importance, and other measures like the economic rate of return and the cost of foreign exchange savings have acquired more importance as a more meaningful way to focus, through a single measure, on the economic impact of IFC projects.

However, our analysis is still limited; it lacks breadth and depth. Any desk appraisal, as ours, tends to be formalistic and somewhat mechanical and repetitive. It has to be limited to the information we have available; and what we have available on the project itself is only a little more than a by-product of the data obtained by the investment officer or the engineer in their missions. To relate a single project to its economic environment, we have to use the information provided by the reports written by the economic missions of the Bank, and this information is always also limited because these reports are prepared following the Bank's own objectives, and meet the objectives of our analysis only partially.

When the investment officer and the engineer ask us sometimes (for normally we try to seek them out), before a mission trip, what data we need for our report, we face two alternatives: first, to give a detailed list of all the project aspects we would like to be looked into, and the data we should like to get. For this we must stretch our imagination, and envisage all possible alternatives. If we do this, the list becomes several pages long, and one can be sure that nobody in the Mission would be able to follow the list, or to look into the various alternatives to be explored - for these depend in turn upon the answers one gets (for example, if an output is for import substitution, then we like to know if it will be internationally competitive; however if it happens to replace some local production, we would like to know, in addition, the economic cost of closing down present plants).

The second alternative is to give the investment officer or the engineer a very simple and relatively short list of the minimum information we require, knowing that they have their own work to do and a limited time to do it. With this alternative - which we generally practice - our analysis necessarily tends to be limited and somewhat superficial.

What then is the solution? The obvious answer, it seems to me, is that the economist should have as deep a knowledge and understanding of a project from an economic standpoint as that possessed by the engineer or the investment officer in their own respective fields. Obviously, since we have a limited staff of economists, we should be selective in the extent and depth of our appraisals. What I propose is the following:

1. The economist should receive from the very beginning copies of all the information available for each project: letters, memoranda, reports, etc. This is something which, in principle, is expected to be done even now and there has been a distinct improvement in this regard more recently, but even now the directives are not fully followed, and we are often uninformed about important issues.

2. The economist should be invited to every meeting related to the project: with the sponsors, with management where substantive project issues are discussed, etc. It is not enough to give to a third person a list of questions to be asked in a meeting; certain answers lead to, and require, new questions. Similarly, the discussion between the investment officer (and/or the engineer) and the sponsor unfolds new aspects of a project not anticipated at the beginning. Since our staff is small, we should not expect to attend all or even most of the meetings. Of course, when we are not present, the economist should be allowed to solicit the information he needs, or the questions he wishes to raise through the investment officer or the engineer who attends the meeting.

3. The economist should be entitled to go on every mission. The Office of the Economic Adviser should decide if it is worthwhile to participate in certain missions or not, and whether the staff is available for this purpose. Evidently, this should be checked with management as is done by other departments. The question as to what the economist expects to get out from the mission - which he cannot get in Washington or through the engineer or the investment officer - is, I venture to say, not very pertinent. We don't always know in advance. By visiting the country, and talking to the sponsors and the government, the economist will get a much clearer understanding of the general economic characteristics of the country than by reading the World Bank's economic report. He is also like to have a clearer picture of the indirect economic costs and benefits of the project. He will be able to assess what additional information should be obtained, or what new questions should be asked, in addition to those he has put together in Washington. He can get a first hand impression of how the government looks at the project in the context of a country's own economic development strategy.

With this background, the economist might in fact become a supporter of a project which, apriori from Washington and on the basis of limited information, might have looked rather uneconomic. In short, by going on the Mission the economist will obtain the same type of information which the investment officer and the engineer are getting - the information which it is not possible to obtain through a questionnaire or a report, or even by telephone, namely the personal evaluation and understanding one gets from informal talks, from detailed discussions and from face-to-face meetings.

Another reason to be on the missions - at least for the more important projects - is that a mission normally reaches a certain kind of informal understanding with the sponsors even though, admittedly, everything is subject to further consideration and review by Management at Washington. If a project does not look good from the economic viewpoint, the most obvious and appropriate time to consider whether any informal understanding should, or should not be reached, is during the course of the mission. In such cases, there might also be practical ways of improving the project from an economic viewpoint, assuming there is some flexibility in this regard. The Mission is the right time to explore this. Needless to say, the mission work should continue to be conducted as a "team", as at present.

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Research studies

OFFICE MEMORANDUM

TO: Mr. William S. Gaud

DATE: June 21,1973

FROM: Moeen A. Qureshi

SUBJECT: Refinancing Exports of Capital Goods

Messrs. Mahbub ul-Haq, Kuczynski, and some of their colleagues from the Development Policy staff of the Bank came today to discuss the work they are doing on a scheme for financing exports of capital goods from developing countries.

Mr. Haq said that Mr. McNamara had expressed interest in the Israeli scheme which asked the Bank (and Regional Development Banks) to provide a guarantee to enable the developing countries to raise funds at reasonable costs to finance their exports of manufactured goods. Apparently, Mr. McNamara had addressed letters to the heads of the Regional Development Banks asking them to give serious consideration to the Israeli proposal. A good deal of work had been done by the Bank staff to analyze the Israeli proposal, but they have now concluded that a guarantee mechanism was not feasible for the Bank. They now wished to discuss whether IFC could assist in this area.

I said that a guarantee mechanism raised the same problems for IFC as for the Bank. Sometime ago, we had given some thought to the export financing problem. It struck us that one possibility might be to put together an international consortium which would refinance export paper from selected developing countries on the basis of certain agreed criteria. IFC might be in a position to help put together such a consortium, which would provide financing at the going market rate.

We discussed the implication of an approach along these lines. I said that I could not say whether such a scheme would prove attractive to the international financial community at this time. Nevertheless, if the Bank Group felt that this would be a worthwhile initiative and IFC should do something about it, we could sound out a few institutions. Mr. Haq requested that we should write out a tentative proposal, which they would include in a paper to be presented to Mr. McNamara on the subject of export financing. He and his colleagues thought that there was merit in the approach I had suggested, it appeared practical and could prove to be a useful first step.

Messrs. Haq and Kuczynski are going to send me the material they have been working on. I propose to put something in writing by next week, which I shall clear with you before sending it over.

MAQ:gmb

Research Studies

Mr. William S. Gaud June 21,1973

Moeen A. Qureshi

Refinancing Exports of Capital Goods

Messrs. Mahbub ul-Haq, Kuczynski, and some of their colleagues from the Development Policy staff of the Bank came today to discuss the work they are doing on a scheme for financing exports of capital goods from developing countries.

Mr. Haq said that Mr. McNamara had expressed interest in the Israeli scheme which asked the Bank (and Regional Development Banks) to provide a guarantee to enable the developing countries to raise funds at reasonable costs to finance their exports of manufactured goods. Apparently, Mr. McNamara had addressed letters to the heads of the Regional Development Banks asking them to give serious consideration to the Israeli proposal. A good deal of work had been done by the Bank staff to analyze the Israeli proposal, but they have now concluded that a guarantee mechanism was not feasible for the Bank. They now wished to discuss whether IFC could assist in this area.

I said that a guarantee mechanism raised the same problems for IFC as for the Bank. Sometime ago, we had given some thought to the export financing problem. It struck us that one possibility might be to put together an international consortium which would refinance export paper from selected developing countries on the basis of certain agreed criteria. IFC might be in a position to help put together such a consortium, which would provide financing at the going market rate.

We discussed the implication of an approach along these lines. I said that I could not say whether such a scheme would prove attractive to the international financial community at this time. Nevertheless, if the Bank Group felt that this would be a worthwhile initiative and IFC should do something about it, we could sound out a few institutions. Mr. Haq requested that we should write out a tentative proposal, which they would include in a paper to be presented to Mr. McNamara on the subject of export financing. He and his colleagues thought that there was merit in the approach I had suggested, it appeared practical and could prove to be a useful first step.

Messrs. Haq and Kuczynski are going to send me the material they have been working on. I propose to put something in writing by next week, which I shall clear with you before sending it over.

MAQ:gmb

Research studies

Mr. Hans Fuchs

June 20, 1973

William S. Gaud (Signed) William S. Gaud

<u>Expanded Bank Role in Mineral Sector</u>

June 20/73

Attached is a memorandum prepared by Moeen Qureshi on the above subject on the basis of his and my discussion of your June 1 paper which you sent me under cover of your memorandum of June 11. I agree with Moeen's paper. It seems to me that we are getting ahead of ourselves in preparing an action program before we have had a chance to discuss the basic propositions.

cc - Messrs. Baum
Chenery
Qureshi

WSGaud:dbs

Research Studies

Mr. Hans Fuchs June 20, 1973

Moeen A. Qureshi

Action Program for an expanding role in the mineral sector

It would be difficult to find fault with the work program which has been outlined for the Bank in the mineral sector if one were to accept all the policy recommendations and other assumptions which underlie it. I have considerable difficulty in doing so.

One can readily agree that the Bank Group should do more in the mining field than it has done in the past. The main justification for this is that the investment climate in developing countries has changed, there is much greater need than before for a multinational approach -- and perhaps for an "international presence" -- in mining projects, and the capital requirements of mining projects have increased dramatically for technological and other reasons. There is also obvious justification for the Bank Group to make a special effort in those developing countries where the exploitation of minerals offers important growth possibilities, and there is not much else in the way of potential resources.

All this is true, but it still does not mean that the Bank should take on the wide variety of things that are outlined in Mr. Demuth's memorandum. Specifically, I question the advisability for the Bank to :

(a) support the creation of an International Exploration Fund (even with the qualifications that have been made);

(b) provide, on an exceptional basis, finance for government purchases in equity mining ventures;

(c) be prepared to support small scale mining through lines of credit to national mining development banks and/or other suitable financing intermediaries;

(d) help governments to obtain advice -- or in exceptional circumstances, provide direct assistance -- in the conduct of negotiations with private mining companies seeking to engage in mineral exploration and/or development.

Insofar as (a) is concerned, there is a good case for Bank Group assistance on a selective basis at the exploration stage. But why cannot this be done within the framework of our existing procedures? You will recall that at the recently held Bank Mining Seminar, the reaction of the representatives of some of the larger developing countries (e.g. Nigeria, Iran) to obtaining assistance in the field of

.../..

exploration was, to say the least, very lukewarm. Moreover, I have reservations about the practicability of associating the Bank too closely with the present U.N. scheme for an International Exploration Fund which is bogged down in serious political problems and does not even elicit the enthusiasm of many important developing countries. I have also doubts from a practical standpoint as to whether general Bank support for a policy of establishing national exploration funds is the best stance for the Bank Group to take. How shall we distinguish between large and small countries, and between countries that look like having potential for mineral development and those that do not? Why not evaluate this question on a country by country basis. We are not precluded from supporting such funds at present.

As regards (b) it does not seem to me either a sound or worthwhile approach to encourage governments to obtain Bank loans for the purpose of financing their equity in mining ventures. It is now the increasing practice in the mining field for governments of developing countries to obtain equity on the strength of their ownership of mineral assets, or their expected share of future earnings. We ought to encourage this approach. When additional equity is needed, it can be provided by IFC.

As far as small scale mining is concerned (item c), this is somewhat of a red herring in the case of the mining sector. Support to national mining development banks, or other suitable financing intermediaries would be justified irrespective of whether the projects are small or large. But the exploitation of mineral resources is primarily a large scale operation, and is not feasible on a small scale basis except in minor cases. The pattern of mining development which took place in some of the developed countries in the 19th and early 20th century is probably not very suitable, and almost certainly is not likely to be acceptable, in most developing countries.

Finally, the direct involvement of the Bank in the conduct of negotiations with interested private parties (item d) involves risks which do not seem commensurate with the potential gains. As you mentioned, the Bank and IFC have provided assistance of this nature in the past upon request. We can do more of this in cases where we feel we can be helpful without compromising our position with either party. But I question the advisability of our putting ourselves forward to perform this role, and of hiring people exclusively for this purpose.

In short, I agree there is scope for doing more in these areas than we have done in the past and we ought to discuss the justification for it, and the relative priority and urgency of doing certain things as against others. It had been my impression that the recommendations made by Mr. Demuth were to be considered by Management in the context of the Mining Sector Program Paper. I had also hoped that there would be some prior discussion of these policy issues amongst the various units concerned, and before the Policy Review Committee. I still feel that this would be desirable.

I would certainly favor the preparation of the policy papers that are mentioned in the Work Program (e.g. on the International Exploration Fund, the National Exploration Funds, and the Bank Role in Providing Advisory Services for Mineral Policy). These papers will throw more light on the feasibility of these proposals and will provide a basis for discussion within the Bank Group of the various issues involved. They should also provide an important input into the Mineral Sector Program Paper. In my view, the operational work program for the Bank should be the outcome, and not the forerunner, of such analysis and discussion.

In considering the prospects of an expanded work program in the mining field, I am also somewhat concerned about what the division of work and responsibility will be between IFC, DPS and IPD. The very same factors that have contributed to an increase in the Bank's interest in mining projects are stimulating an increased interest for IFC's financial assistance in this area. In this respect, the problem is not very different from that of industry.

MAQ:gph

cc Mr. W. S. Gaud
Mr. H. B. Chenery
Mr. Warren C. Baum

Research Studies

Mr. Moeen A. Qureshi (Economic Adviser, IFC) June 15, 1973

CArlos Sanchez-Marco

Preliminary 1972 Figures on the Flow of Resources to LDC's.

1. I was in touch this morning with Mr. Stein (OECD, Development Assistance Directorate, Paris) over the telephone. I called him to obtain information on the 1972 flow of resources to developing countries. An OECD-DAC press meeting is scheduled for July 4, 1973 and on that occasion the following figures are to be announced:

	(billion US$) (*)		
	1971	1972	% increase (decrease)
1. Official Development Assistance	7,708	8,610	11.7
II. Other Official Flows	1,271	1,450	14.1
III. Private Flows	8,230	8,140	(1.1)
of which:			
Direct Investment	3,875	3,790	(2.2)
Bilateral Portfolio Investment	775	1,680	116.8
Multilateral Portfolio Investment	770	640	(16.9)
Private Export Credits	2,810	2,030	(27.8)
IV. Grants by Private Voluntary Agencies	913	1,050	15.0
TOTAL	18,122	19,250	6.2

(*) preliminary

2. The above figures are expressed in current dollars at 1972 exchange rates. Using 1971 exchange rates, the above figures for 1972 would be approximately 5 percent lower.

3. Mr. Stein offered the following comments:

(a) Although total flows have increased by approximately 6 percent, GNP expansion in donor countries has been more vigorous than that, with the result that total development assistance as a percent of GNP has decreased from 0.82 in 1971 to 0.76 in 1972. Official development assistance has decreased only from 0.35% in 1971 to 0.34% in 1972. Consequently, the sluggines$ of private flows has been the principal factor accounting for the deterioration of aid performance (in relation to GNP) in 1972.

(b) Private direct investment remained in 1972 at similar levels than in 1971. A 2% decrease is small, and given the complexities in statistical reporting, may not be meaningful. Mr. Stein did not see relevant changes in investment climate in LDC's or Government measures in donor countriesthat may have accounted for the lack of renewed dynamism of private flows in 1972. Uncertainties in the international monetary scene were however even greater than in 1971.

(c) Bilateral Portfolio investment increased substantially in 1972. DAC feels this may have been accounted by real state purchases in LDC's following monetary instability in the world.

(d) Private export credits showed a sharp decrease, and is even more significant when compared with the strong upward trend experienced during the last few years.

4. A DAC report (DAC (72) 28) dated May 23, 1972 recognized that a striking development occurred in 1971 when private bank lending of eurocurrencies to developing countries increased sharply to a level of $1.1 - 1.3 billion (May 1971 to April 1972). Mr. Stein suggested that a revised estimate of about $2.0 billion may be more accurate for 1971. Flows of private bank lending to LDC's continue to be excluded from DAC statistics due to the difficulties involved in establishing a reliable reporting system. During the last 12 months, it is estimated that this category has increased to a level of approximately $5.0 billion. It has become now so important that something has to be done urgently to develop a good reporting system. Mr. Stein requested help from every quarter. IFC's contacts with private financial institutions in capital exporting countries could be helpful, and Mr. Stain expressed a desire to see us digging into the matter.

CL
CS-M/wb

Cc.: Messrs. Macdonald
Saxe
Miss Yudin

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INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Distribution as listed below

DATE: June 11, 1973

FROM: H. Fuchs

SUBJECT: Expanded Bank Role in Mineral Sector

June 1/73

1. Mr. Warren C. Baum has asked me to request your comments on the attached memorandum on "Action Program for Expanded Bank Role in the Mineral Sector".

2. It is intended to subsequently send the "Program" to Mr. McNamara and I would very much appreciate receiving any comments you may have by June 20.

cc: Messrs. Gaud, Qureshi (IFC)
Messrs. Kirmani, Knox, Thalwitz, Wapenhans, Weiner
Mrs. Hughes, Mrs. Boskey
Messrs. Hoffman, Franco, Gustafson
Messrs. Cash, Bosson (o/r) for information.

Research studies

OFFICE MEMORANDUM

TO: Mr. Warren C. Baum, Vice President, Projects DATE: June 1, 1973

FROM: Hans Fuchs, Director, Industrial Projects

SUBJECT: Action Program for Expanded Bank Role in the Mineral Sector

A. Introduction

1. This memorandum outlines a tentative action program for expansion of the role of the Bank in support of the mineral sector. It is proposed that the additional staff resources required be placed in the Industrial Projects Department, which is responsible for present Bank operations in the sector. In addition, support from other Departments and the Regional Offices will be necessary. The action program is translated into a work program and budget for the fiscal years 1974 and 1975.

2. This program assumes that the policy recommendations contained in Mr. Demuth's memorandum to Mr. McNamara of March 5, 1973 - The Role of the Bank in the Non-Fuel Mineral Sector - and subsequently discussed at the Operational Vice-President's meetings of March 19 and April 9, 1973, are accepted in principle by the management. These are briefly that the Bank Group should:

a) play a much larger role in the mineral sector than it has in the past, and substantially increase financing for mining development projects over the next few years;

b) support the creation of an International Exploration Fund, as proposed by the UN, primarily for the benefit of the least developed countries, on the condition that provision is made for its effective administration;

c) be prepared to finance national exploration funds;

d) take steps to become involved in mining projects at a much earlier stage than in the past, principally through an increase in sector studies;

e) provide, on an exceptional basis, finance for government purchases of equity in mining ventures;

f) be prepared to support small scale mining through lines of credit to national mining development banks and/or other suitable financial intermediaries;

g) encourage, in appropriate cases, establishment of mineral processing facilities in the developing countries;

h) offer more actively advice to governments on mineral policy and legislation and on the requisite institutional framework; and

i) help governments to obtain advice - or in exceptional circumstances, provide direct assistance - in the conduct of negotiations with private mining companies seeking to engage in mineral exploration and/or development.

B. Launching of the Program

3. We propose that a program for attaining the above objectives be launched during FY 1974 - using that as a year of preparation - and be put into active execution during FY 1975. The first step would be to prepare a Mineral Sector Program Paper, which would consist essentially of the recommendations, and their rationale, on Bank Group Policy, along the lines of Mr. DeMuth's paper of March 5, 1973. This would be supported by the detailed background paper on the mineral sector, properly updated and edited, prepared by the Industrial Projects Department and presented to the mid-January (1973) mining seminar. We propose that the Mineral Sector Program Paper be completed for review by the President in September 1973 and Board presentation in October/November 1973.

4. Concurrently with preparation of the Mineral Sector Program Paper, the proposals for Bank support of national and international exploration funds, and increased Bank involvement in providing advice on mineral policy, legislation and negotiations would be explored in depth. Discussions would be initiated with the UN to determine whether or not Bank involvement - administrative and/or financial - in the proposed UN sponsored International Exploration Fund would be desirable or whether the Bank ought to initiate a fund of its own. At the same time the possibility of establishing a joint advisory group on mineral policies, legislation and negotiations would also be discussed with the UN. Preliminary results and conclusions of these discussions would be incorporated into the Mineral Sector Program Paper.

5. Policy papers would be prepared on the proposed national and international exploration funds and on advisory services to developing countries. We would plan to complete these papers by December 1973, so that the results can be taken into account when preparing the FY 1975 work program in February 1974. For our discussions with the UN and the preparation of these policy papers, we would require cooperation of the staff of the International Relations and Legal Departments, and we would also need the assistance of a broad-based mining consultant, such as Sir Ronald Prain, who played an outstanding role during the mining seminar.

C. Work Programs for FY 1974 and FY 1975

6. Taking into account projects now under active consideration and the objectives as summarized above, work programs for the mineral sector for the next two fiscal years are presented in Annexes 1 and 2 and briefly summarized below:

Work Program for Mineral Sector (FY74 and FY75) 1/

		FY74 Present Program		FY74 Expanded Program		FY75 Present Program		FY75 Expanded Program	
		Manweeks (number of tasks in parentheses)							
1.	Economic Mission Support	24	(4)	24	(4)	24	(4)	30	(5)
2.	Sector Mission	28	(2)	36	(4)	56	(4)	70	(5)
3.	Project Identification and Preappraisal	124	(11)	166	(14)	133	(12)	179	(15)
4.	Project Appraisal	211	(8)	195	(7) 2/	173	(6)	223	(8)
5.	Negotiation and Board Presentation	24	(3)	32	(3)	77	(6)	89	(7)
6.	Project Supervision	42	(10)	44	(11)	73	(12)	81	(13)
7.	Support for Other Departments (DFC, Infrastructure)			5		7		13	
8.	Technical Assistance	3		8		4		12	
	Sub-total-Traditional Activities	456		510		547		697	
9.	Research and Policy Papers	130		198		145		161	
10.	International Exploration Fund	-		-		-		8	
11.	Advisory Activities-Mineral Policies, Legislation and Negotiations	-		-		-		76	
12.	Sub-total-All Direct Output Activities	586		708		692		942	
12.	Overhead and Administration	95		125		122		180	
	GROSS TOTAL MANWEEKS REQUIRED	681		833		814		1,122	
	of which								
	Professional Staff in Industrial Projects Department	390		505		515		766	
	Consultants	82		91		112		145	
	Professional Staff From Other Departments	209		237		187		211	

1/ Does not include IFC activity.
2/ One project (Kudremukh Iron Ore in India) originally scheduled has been removed in view of recent events.

7. The above table summarizes for FY74 the present work program based on the previously approved budget, and an expanded program considered necessary if the Bank is to start carrying out the policy recommendations indicated above. Similarly for FY75 a comparison is made between continution of the present program involving only traditional types of activities, and an expanded program including both traditional and new types of activities. The work programs can be divided into three major groupings: Traditional Operational

Activities (items 1-8), Research and Policy Papers (item 9), and New Activities (items 10-11).

1. TRADITIONAL OPERATIONAL ACTIVITIES (Items 1-8)

8. The Expanded FY1974 Program proposes a 12% increase in manpower requirements over the approved FY74 program. The major increases in activity would be in sector missions and project identification and preappraisal. The increase in mineral sector work in the past few years has along with the increasing trend to national development of mineral resources already led to an increasing number of projects coming to the Bank. A further increase in sector work is necessary to:

a) become involved in mining projects at an earlier stage than in the past;

b) increase Bank support for small scale mining;

c) identify suitable DFC type operations in the sector;

d) assist in establishing national exploration funds; and

e) generally to expand the Bank's knowledge of, and future activity in, the sector.

9. As the Bank has become more involved in the mineral sector, it has become apparent that in many instances projects can be advanced to a stage suitable for Bank financing only with substantial inputs by Bank staff for project preparation and preappraisal. Apart from those projects with which the large international and sophisticated mining companies are associated, considerable assistance not only on the financial side but also for the technical and commercial aspects is required. This is increasingly absorbing staff time but is very necessary if the Bank is to increase its financial assistance to the sector. Hence, the expanded FY1974 program proposes a significant increase in project identification and preappraisal work.

10. The "Present Program" for FY75 has been prepared on the basis of projects now under active consideration by the Bank. Even this minimal program will require an increase in manpower of about 15%. While economic mission support would be at about the same level as in FY74, the sector work should increase. Increases will occur in negotiation and Board presentation and in project supervision as a result of appraisal work in the approved FY74 program. Project identification and preappraisal is projected at the minimal level required to support the financing of five to six projects per year.

11. The Expanded FY75 Program is a natural follow-up of the expanded FY74 program, assuming the Bank's intent to expand its role in the mineral sector. We anticipate supporting up to five economic missions per year to countries in which mining is a major element. The sector work can have an important effect on attracting other sources of finance to the mining sector in the LDC's and should therefore be expanded. For the Bank to make any

significant increase of its role in the sector, the level of project identification, preappraisal and appraisal work must be raised. With the increasing number of mineral projects coming to the Bank, there will be no shortage of projects. Increased technical assistance is also envisaged, along with an increasing number of infrastructure projects serving mineral facilities and DFC mining credits which require inputs from the Industrial Projects Department. The expanded FY75 program increases manpower requirements by 45% over the present FY74 program and 30% over the expanded FY74 program.

2. RESEARCH AND POLICY PAPERS (Item 9)

12. The Expanded FY74 Program proposes that in addition to the mineral commodity studies (120 manweeks) conducted by theEconomic Analysis and Projections Department and the Mineral Sector Program Paper (10 manweeks) included in the Present FY74 Program, policy papers would be prepared on: the International Exploration Fund and national exploration funds (25 manweeks); and the future role of the Bank in providing advisory services for mineral policy, legislation and negotiations (28 manweeks). It is also proposed that some time be spent on sector research and planning (15 manweeks).

13. The FY75 Programs allow for a small increase in the Mineral Commodity Studies (to 145 manweeks) with a nominal provision of 16 manweeks for sector research and planning and miscellaneous policy papers.

a) International Exploration Fund

14. The creation of an International Exploration Fund for minerals as well as water and energy resources as proposed by the Department of Transport and Natural Resources of the UN was approved in principle by ECOSOC on May 18, 1973, though with considerable reservations 1/ A recent cursory review by the Bank indicated that as yet the proposal is of a very preliminary nature and would require substantial work before it could be considered an operational proposition. This would include defining the objectives of the Fund; laying down ground rules for selection of projects; establishing operational and administrative procedures and scope of work to be done by the Fund; determining schedules for implementation and staffing; establishing the financial assistance required, and designing a system for repayment which will over time result in a revolving Fund. Success of the Fund will depend upon adequacy of its structure and administration. If the Bank were to become involved, this will require a thorough "in-house" review of the existing proposal. In drawing up the work program, we assume that Bank staff time assigned to the project would be the minimum required to inject the Bank's thinking into the formulation of the Fund and to prepare a paper proposing the terms and conditions for Bank support of the Fund (if any), or possibly recommending that the Bank not support the Fund. Staff requirements: 21 manweeks. Completed December 1973.

1/ The vote was 17 for, none against, and 9 abstentions (Brazil, Finland, Hungary, Mali, Mongolia, Poland, U.S., U.S.S.R., and U.K.

b) National Exploration Funds

15. From our sector work and the limited experience with national exploration funds in Bolivia and Iran, it is apparent that the Bank should increase its knowledge in this field particularly if we intend to promote the establishing of these funds. A brief paper listing the national exploration funds in active operation throughout the world will be compiled and a brief analysis made of the objectives, structure and success of each. Staff requirements: 4 manweeks. Completed: June 1974.

c) Advisory Services: Mineral Policy, Legislation and Negotiations

16. To follow up on the recommendations that the Bank should provide an advisory service to governments on mineral policy and legislation, and also assist LDC's in their negotiations with mining companies, a policy paper on this issue will be prepared. To a limited extent the Bank has already been offering advice on mineral policy, legislation and administrative arrangements as a part of its work in the sector. The proposal is, therefore, to expand these services substantially, and in addition to assist in negotiations of mineral exploration and exploitation concession agreements, and possibly to establish a joint advisory group with the UN. It is proposed that the first steps be to open discussions with the UN to explore the possibility and desirability of setting up a joint service. While it is assumed that the responsibility for these discussions will be vested in the Industrial Projects Department, the participation of both the Legal and International Relations Departments will be essential. At the same time, it will be necessary to research the availability of such services in other agencies, companies and consultant groups and to identify terms under which these services can be obtained by the LDC's. The demand for such services should also be reviewed. The results of these activities would then be presented in a policy-cum-action paper which would recommend a) whether or not the Bank Group should provide such services over and above those now provided as part of sector studies; and, if so, b) whether the Bank Group should form a joint advisory group with the UN or with any other agencies, or proceed on its own; c) what would be the objectives of such a group; d) what number and type of people would be required to provide the services, etc. Staff requirements: 28 manweeks. Completed: December 1973.

d) Sector Research and Planning

17. From the sector work and the work done for the preparation of the background paper on the Non-Fuel Mineral Sector, it is apparent that the Bank needs to improve substantially its knowledge of the mineral sector of member countries. It is proposed that this be achieved by: a) collating all mineral sector data now available within the Bank (sector and economic reports, consultants' reports); b) reviewing sector work done by other agencies and consultants (US Bureau of Mines, US Geological Survey, German Geological Survey, Canadian International Development Agencies, etc.): and c) preparing systematic accounts of the knowledge of mineral sectors by country for each member LDC of the Bank. This would provide a basis for formulating programs of sector studies and operational activities. This would be a continuing exercise, with a major initial input in FY74. Periodic updating would be required thereafter. Staff requirements in FY74: 15 manweeks and FY75 4 manweeks.

e) Mineral Sector Program Paper

18. As mentioned above, the Mineral Sector Program Paper will be prepared during FY74. Staff requirements: 10 manweeks. Completed: September 1973.

f) Mineral Commodity Papers

19. Preparation of commodity reports for the major minerals (aluminum, buaxite, coal, iron ore, lead, manganese, nickel, tin, zinc) is a continuing exercise carried out by the Commodity and Export Projections Division of the Economic Analysis and Projections Department. In the present FY74 program, approximately three man-years are allocated to mineral commodity reports, of which between 30-40% is directly attributable to projects work. The remaining 60-70% is for country economic work and preparation of policy papers. Only minor increases in this activity need accompany the expanded role of the Bank in the mineral sector. Staff required for FY74: 120 man-weeks; for FY75: 145 manweeks.

g) Miscellaneous Research and Policy Papers

20. The mineral sector is going through a period of rapid changes on technological, financial, commercial, political and ecological grounds. To continue to contribute effectively to the sector, the Bank must keep abreast of these changes, and this will require research and possibly preparation of policy papers. Some of the areas requiring early attention are: exploitation of deep sea mineral reserves - the technology, financing, commercialization, and political jurisdictions; and coordination regional mineral exploration through the use of the Earth Resources Technology Satellite Program (ERTS). Staff required for FY75: 12 manweeks.

3. NEW ACTIVITIES (Items 10-11)

21. The extent to which the Bank gets involved in new activities will, of course, depend upon the conclusions reached in the policy papers described above. Their effect on the FY74 work program is reflected merely in the additional work required for research and preparing the policy papers. The actual carrying out of the new activities would start in FY75. The FY75 program has been prepared on two premises: the "present program" assumes that the Bank will continue its present types of activities, whereas the expanded program assumes that the Bank will as a result of the policy papers prepared in FY74 a) agree to support and participate in an International Exploration Fund managed by the UN should it come into being ; and b) agree to proceed with a gradual upgrading of its activities for providing advice on mineral policies, legislation and negotiations.

a) International Exploration Fund

22. Obviously Bank support for the Fund will be provided only if the Fund is structured and managed essentially on a basis deemed satisfactory by the Bank. Many of the conditions included as part of the ECOSOC recommendation

that the General Assembly decide to establish the Fund raise questions as to its viability 1/ These relate inter alia to: allocation of the Fund's resources among countries; whether or not exploration should be restricted to non-fuel minerals or also include exploration for energy and water resources; the administrative arrangements, which are now proposed to fall under the Governing Council and Administrator of the UNDP; and the bases for financial support and repayments to the Fund. Support from the Part I countries at this point appears limited. Nevertheless, the expanded FY75 program assumes that the Bank would agree to provide the Fund with support, though the nature of that support is now quite unclear. The 8 manweeks allocated for this is considered an absolute minimum and could increase to at least 30-40 manweeks.

b) Advisory Activities

23. If the Bank decides to expand its advisory services, then regardless of whether it proposes to support a joint Bank/UN advisory group or establish a separate "in-Bank" service, it will be necessary to assign initially from the beginning of FY75 a minimum of one expert full time to these activities. Even if such "in-Bank" service involves primarily helping applicants to obtain outside assistance, it would be provided on a task force basis and hence require in addition substantial backing from the technicians, financial analysts and economists within the Department. It is considered important that the advisory services be closely related to the operational activities of the Bank. Advice on mineral policy and legislation should be closely linked to country sector mission activity. On the other hand, advice to governments on negotiations with mining companies may have to be kept separated from sector or projects work, but will in any case require substantial inputs from the Department's technical and financial people. The work program assumes a gradual advance into this field, using the same staff to provide advice both on policies and for negotiations.

D. Personnel

24. The expanded work program would require a buildup of staff of the existing Division II (Mining and Mechanical Industry Projects) of the Industrial Projects Department during FY 1974, and necessitates the formation of a new Mining Division in the Industrial Projects Department. Professional personnel requirements within the Industrial Projects Department for each alternative, present program and expanded program, are summarized below:

1/ See the Memorandum from Mr. Ernesto Franco-Holguin to Files "U.N. Revolving Fund on Natural Resources Exploration", May 25, 1973.

Staff Classification	FY 74 Present Program	FY 74 Expanded Program	FY 75 Present Program	FY 75 Expanded Program
Engineers 1/	2.0	3.0	3.0	4.0
Economists/Financial Analysts	5.0	5.0	6.0	7.0
Minerals Economist	-	-	-	1.0
Mining Lawyer	-	1.0	-	1.0
Management	0.5	0.7	1.0	1.0
	7.5	9.7	10.0	14.0

1/ Includes engineers in mining, metallurgy and geology.

25. We recommend as a minimum that the Bank proceed with the preparation of the policy papers on exploration funds, and on the increase in advisory activities, and with research to improve planning for the sector. These tasks will require engaging in FY74 two additional staff, which would be required anyway for continuing with the present program in FY75. Taking into account the difficulties of recruiting adequately qualified people 1/ for the mining sector, we propose that a minimum program be pursued with the following staff complement:

Staff Classification	FY74	FY75
Engineers	3.0	3.0
Economists/Financial Analysts	5.0	5.0
Minerals Economist	-	1.0
Mining Lawyer	1.0	1.0
Management	0.7	1.0
	9.7	11.0

E. Budget

26. Approximate budgetary implications of these work programs are summarized in the following table:

Budget Allocated to Mining Sector Work

Cost Items	FY 74 Present Program	FY 74 Expanded Program	FY 75 Present Program	FY 75 Expanded Program	FY 75 Proposed Minimum Program
	$000				
Personnel Services of Industrial Projects Department 1/	300	390	400	560	440
Consultant Fees	82	90	100	125	110
Operational Travel 2/	80	90	100	150	120
Personnel Services of Other Depts and Regional Offices 3/	275	310	250	275	260
Total Direct Charges for the Mining Sector	737	880	850	930	1110

1/Assume total personnel costs including Special and General Services Staff of $40,000/yr per professional staff member(average for total Industrial Projects Department in FY74 budget).

2/Includes travel only associated with NDP staff and consultants. Average travel cost of $12,000/yr per professional staff member and consultant less staff assigned to management and research.

3/Assume cost of $53,000 per professional manyear assigned by other departments to the mineral sector, including travel (calculated as the average cost per professional from the FY74 budget).

1/ There is at present a worldwide shortage of mining and metallurgical engineers and the Bank has experienced considerable problems in its recent efforts to recruit suitably qualified mining personnel. Even greater problems are expected in finding a suitably qualified minerals economist.

RLB:er

cc: Messrs. Kalmanoff, Cash, Moore, Bosson

Industrial Projects Department
June 1, 1973

WORK PROGRAM SUMMARY
FY 1974

	Number of Activities or Tasks	Average Man-Weeks per Task	FY Total Man-Weeks	Man-Weeks By Source: Profes-sional Staff	Consul-tants	Other Depts.
1. ECONOMIC MISSIONS:			24	6	18	-
Thailand	1	6	6	}6	}18	-
Three African Countries	3	6	18			-
2. SECTOR MISSIONS:			36	12	24	-
*Caribbean Bauxite Survey	1	4	4	4	-	-
Colombia - Coal	1	8	8	-	8	-
*Peru - Identification	1	4	4	4	-	-
Thailand	1	20	20	4	16	-
3. PRE-APPRAISAL			166	90	21	55
Brazil - Carajas Iron Ore	1	30	30	10	-	20
Burma - Tin/Tungsten	1	4	4	4	-	-
India - Kudremukh	1	10	10	6	-	4
India - Rajasthan	1	12	12	12	-	-
Iran - Mining Exploration Fund	1	2	2	2	-	-
Ivory Coast - Iron Ore	1	8	8	2	4	2
*Swaziland - Coal	1	20	20	12	6	2
*Turkey - Iron Ore Mines (Hassan/Cellebi/Divirgi)	1	12	12	3	3	6
*Turkey - Zonguldak Coal	1	10	10	8	-	2
Tunisia - Phosphate	1	6	6	6	-	-
Yugoslavia - Kosovo Nickel	1	6	6	6	-	-
Zaire - Copper	1	26	26	4	8	14
Other			20	15	-	5
4. APPRAISAL			195	126	28	41
(i) Initiation of Appraisal						
Brazil - Carajas Iron Ore	1	20	20	6	-	14
Zaire - Copper	1	30	30	14	10	6
(ii) Full Appraisal						
Burma - Tin/Tungsten	1	32	32	27	-	5
Colombia - Cerro Matoso Nickel	1	50	50	34	8	8
Iran - Mining Exploration	1	12	12	4	-	8
Peru - Mining	1	16	16	16	-	-
Tunisia - Phosphate	1	35	35	25	10	-
5. NEGOTIATION AND BOARD			32	32	-	-
Iran - Mining Exploration Fund	1	8	8	8	-	-
Peru - Mining	1	12	12	12	-	-
Tunisia - Phosphate	1	12	12	12	-	-
6. PROJECT SUPERVISION			44	44	-	-
Botswana - Copper and Nickel	1	6	6	6	-	-
Brazil - Alcominas	1	4	4	4	-	-
Brazil - MBR	1	6	6	6	-	-
Chile - Lota Schwager	1	2	2	2	-	-
Congo - Potash	1	6	6	6	-	-
Dominican Republic - Falconbridge	1	3	3	3		
Guinea - Boke	1	3	3	3		
India - IISCO Coal	1	2	2	2		
Iran - Mining Exploration	1	4	4	4	-	-
*Mauritania - MIFERMA	1	2	2	2		
Peru - Mining	1	6	6	6	-	-
7. SUPPORT OF OTHER DEPARTMENTS			5	5	-	-
*Bolivia - Mining Credit I (Appraisal)	1	3	3	3	-	-
*Unidentified (Appraisal)	1	2	2	2	-	-
8. TECHNICAL ASSISTANCE			8	8	-	-
*Bolivia Survey of Small Mines	1	2	2	2	-	-
*Unidentified (Appraisal)	2	3	6	6	-	-
9. RESEARCH AND POLICY PAPERS			198	57	-	41
. Mineral Sector Program Paper	1	10	10	10	-	-
b) Mineral Commodity Reports 1/			120	5	-	15
*c) UN Exploration Fund, -Initial Discussion	1	6	6	4	-	2
-Policy Paper	1	15	15	10	-	5
*d) Advisory Group: Policy, Legislation & Negotiation -Initial Contact with UN	1	8	8	4	-	4
-Policy Paper	1	20	20	10	-	10
*e) Sector Planning	1	15	15	10	-	5
*f) National Exploration Funds	1	4	4	4	-	-
10. OVERHEAD			125	125	-	-
** Management			30	30	-	-
General			55	55	-	-
Leave			40	40	-	-
GROSS TOTAL MAN-WEEKS REQUIRED			833	505	91	137
(Man-Year Equivalent)			17.34	9.67	1.75	5.93
GROSS TOTAL MAN-WEEKS PROGRAMMED FY 1974 BUDGET			681	390	82	209
(Man-Year Equivalent)			14.30	7.50	1.58	5.22

*Projects or Work not included in the FY 1974 Work Program submitted to P & B.

1/ Most of this work is done by Economic Analysis and Projections Department, of which 40% can be attributed directly to mining projects and 60% to General Commodity review and assistance to the Regional Offices.

Industrial Projects Department
June 1, 1973

WORK PROGRAM SUMMARY
FY 1975

	Number of Activities or Tasks	Average Man-Weeks per Task	FY Total Man-Weeks	Man-Weeks by Source: Prof. Staff	N. D. F. Consultants	Other Depts.
1. ECONOMIC MISSIONS			30	10	20	-
*Unidentified	5	6	30	10	20	-
2. SECTOR MISSIONS			70	25	15	-
*Unidentified) Various African Iron Ore)	5	14	70	25	45	-
3. PRE-APPRAISAL			179	108	34	37
Algeria - Gara Djebilet	1	10	10	6	-	4
*Bolivia - Mineral Development	1	6	6	4	-	2
Burma - Bawdin Pb/Zn	1	20	20	12	8	-
Colombia - Coal	1	18	18	10	6	2
*Costa Rica - Aluminum	1	8	20	10	-	10
Guinea - Iron Ore/Bauxite Ident.	1		5	5	-	-
India - Kudremukh Iron Ore	1	8	8	8	-	-
Jordan - Phosphate	1	8	8	6	-	2
Madagascar - Bauxite Infrastructure	1	10	10	3	-	7
Mauritania - Guelb	1	3	3	3	-	-
Thailand - Mining	1	6	6	6	-	-
Yugoslavia - Kosovo Nickel	1	15	15	10	5	-
*Others - Unidentified	5	10	50	25	15	10
4. APPRAISAL			223	135	46	42
Brazil - Carajas Iron Ore	1	10	20	15	-	5
Burma - Bawdin Pb/Zin	1	33	33	20	8	5
India - Rajasthan Phosphate	1	30	30	20	8	2
*Ivory Coast - Iron Ore	1	30	30	25	-	5
Swaziland - Coal	1	30	30	15	5	10
*Turkey - Coal	1	20	20	10	10	-
Turkey - Iron Ore	1	30	30	20	5	5
Zaire - Copper	1	30	30	10	10	10
5. NEGOTIATION AND BOARD			89	89	-	-
Brazil - Carajas Iron Ore	1	20	20	20	-	-
Burma - Tin/Tungsten	1	10	10	10	-	-
Colombia - Cerro Matoso Nickel	1	15	15	15	-	-
Swaziland	1	12	12	12	-	-
*Ivory Coast - Iron Ore	1	12	12	12	-	-
Turkey - Iron Ore	1	8	8	8	-	-
Zaire - Copper	1	12	12	12	-	-
6. PROJECT SUPERVISION			81	81	-	-
Botswana - Copper/Nickel	1		4	4	-	-
Brazil - Alcominas	1		4	4	-	-
Brazil - MBR	1		4	4	-	-
Burma - Tin/Tungsten	1		6	6	-	-
Colombia - Cerro Matoso Nickel	1		10	10	-	-
Congo - Potash	1		6	6	-	-
Dominican Republic - Nickel	1		3	3	-	-
Guinea - Boke Bauxite	1		3	3	-	-
Iran - Exploration Fund	1		3	3	-	-
*Ivory Coast - Iron Ore	1		8	8	-	-
Mauritania - Miferma	1		2	2	-	-
Peru - Mining	1		10	10	-	-
Tunisia - Phosphate	1		10	10	-	-
Zaire - Copper	1		8	8	-	-
7. SUPPORT OF OTHER DEPARTMENTS			13	13	-	-
Bolivia - Mining Credit I (Supervision)	1		3	3	-	-
- Mining Credit II (Appraisal)	1		4	4	-	-
*Unidentified-DFC Appraisal) -Infrastructure) -Project Appraisal)	1		4	4	-	-
8. TECHNICAL ASSISTANCE			12	12		
Unidentified (Follow up from Sector Missions)	3	4	12	12		
9. RESEARCH AND POLICY PAPERS			161	31	-	130
*a) Sector Planning			4	4	-	-
b) Commodity Reports - Unidentified			120	5	-	115
Iron Ore Report (for Carajas)			25	10	-	15
c) Unidentified	2	6	12	12	-	-
10. ADVISORY ACTIVITIES: MINERAL POLICIES, LEGISLATION AND NEGOTIATIONS			76	76	-	-
*-Initial staffing (1 man)			46	46	-	-
*-Backup financial and technical staff						
* - Mineral Policy			10	10	-	-
* - Negotiations			20	20	-	-
11. UN EXPLORATION FUND			8	6	-	2
*-Administration, programming and control			8	6	-	2
12. OVERHEAD			180	180	-	-
*Management			40	40	-	-
General			80	80	-	-
Leave			60	60	-	-
GROSS TOTAL MANWEEKS REQUIRED			1122	766	145	211
(Man-Years Equivalent)			22.2	14.7	2.8	5.3
GROSS TOTAL MANWEEKS REQUIRED (CONSTRAINED)			814	515	112	187
(Man-years Equivalent)			16.8	9.9	2.2	4.7

* Projects not included in "present" work program; the project program assumes only 4 of each of Economic and Sector Missions, and 25 Manweeks Project Identification (unidentified).

Industrial Projects Dept. June 1, 1973

Research Studies

Mr. Pedro-Pablo Kuczynski June 1, 1973

David Gill

June Issue of Policy Paper Inventory

This is in response to Mr. Haq's memorandum of May 30 on the above.

My only comment with reference to Item A6 - Financial Sector Paper - in the draft of the June issue of the Inventory, is as follows.

It seems to me the proposed description of the subject "Financial Sector Paper (including capital markets)" is a little confusing. That is, the parenthesized reference to including capital markets could imply excluding money markets. We are quite relaxed as to the title so long as it appropriately describes the subject matter which should be included, which is the role of finance in development and, more specifically, the role the Bank Group should play in developing the financial systems of LDCs. This covers money markets and capital markets, and should embrace all of the institutions, instruments, governmental policies and infrastructure involved.

By way of explanation, in earlier discussions on this paper there was much debate as to an appropriate title. In the same vein, there is a tendency for the expression "capital markets" to mean different things to different people, depending on their degree of interest in, and knowledge of, the subject. In practice, it is impossible, and also undesirable, to make an arbitrary distinction between capital markets and money markets, or even to settle in a definitive way limited definitions of capital markets. For this reason, we think the simple term "financial sector paper" covers the intent of the overall concept that Development Policy staff and we, ourselves, have in mind.

DG/rty

cc: Mr. Stern

Research Studies

May 29, 1973

Mr. Alvaro Concha M.
Financial Manager
ENKA de Colombia
Apartado Aereo 52-33
Medellin, Colombia

Dear Mr. Concha:

Thank you very much for your cooperation in the study of IFC's past investments. The purpose of the study is to examine the contribution made by IFC's investments to the economic development of their host countries. As Mr. Eckrich indicated in his letter to you, I have already reviewed the available financial and technical information on your firm. The principal objective during my visit with you will be to check this data and to gather additional information on the economic effects of your firm. There are several categories of effects on which it would be particularly important to gather quantitative indices. These include:

1. Employment

   a. The annual levels of employment generated directly and indirectly by your firm.

   b. The economic value of the skills acquired by your employees through on-the-job training or specific training program.

2. Foreign Exchange Savings

   a. The value of the foreign exchange saved, directly or indirectly, through import replacement.

   b. The value of foreign exchange used directly or indirectly by your firm.

3. Technical improvements and production resulting from new investments or operational decisions.

4. Indirect benefits

   a. Indirect productive effects on your suppliers and on your clients.

b. Other beneficial indirect effects, such as your firm's contribution to the regional development of the country.

During my visit, I will seek other specific data on each of these effects for every year since IFC's initial investment. Any assistance you can provide in helping me compile this data will be greatly appreciated.

I plan to arrive in Medellin on August 5, 1973, and the Bank has made arrangements for me to stay at the Intercontinental Hotel. I will contact you soon after arrival to arrange an appointment at your earliest convenience. I look forward to meeting with you and thank you once again for your very kind cooperation in this endeavor.

Sincerely yours,

S. Guisinger By: C. Wouters

Stephen Guisinger
Consultant

cc: Mr. Eckrich

SG:cm

Research Studies

Mr. J. Parmar

April 26, 1973

Moeen A. Qureshi

Research on Public Enterprises

Herewith for your information a copy of the note from Fred Moore to Ernest Stern regarding Walstedt's work on public-private enterprises. This is in line with some recommendations made by Professor Mason regarding the need for defining Bank Group experience and policy in regard to public sector industrial projects. One of the ideas is that we should compare the performance of public and private sector industrial enterprises. At some stage I am sure they will want our collaboration with respect to the two Indian fertilizer projects, which I hope we can provide.

MAQ:gmb

cc: Circulation

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Ernest Stern, Senior Adviser, Development Policy, Office - VP., Development Policy

DATE: April 10, 1973

FROM: Frederick T. Moore, Industrial Projects FTM

SUBJECT: Research on Public Enterprises

As agreed on the telephone the other day, we will undertake to direct the work of two graduate students who will be hired as research assistants for the summer. They will undertake two tasks identified in Professor Mason's research proposal concerning public enterprise. One of them will review Bank reports systematically to determine whether and to what extent there is substantive information concerning any of the problems that Professor Mason has identified. Presumably this will mean a review of economic and sector mission reports. The second research assistant will undertake a preliminary review of the status and the comparative performance of the three public sector fertilizer plants and the two private sector plants in India. The basic material will be the appraisal reports, supervision reports, and background information that has been collected by the analysts. We will need the cooperation of Mr. Qureshi in obtaining the files on the two private sector plants. As I recall, he volunteered to make this information available. In addition, Mr. Walstedt will be available to work with them prior to leaving on his sabbatical. You have agreed to transfer $5,000 to us to pay the salaries of the two research assistants. Since I now have files of several candidates for summer work, I will choose two who are competent to undertake this work.

cc: Mr. Qureshi
Mr. Fuchs
Mr. Kalmanoff.

Jill

Research Studies

SOUTHERN METHODIST UNIVERSITY

DEPARTMENT OF ECONOMICS
DALLAS, TEXAS 75222

March 26, 1973

Mr. M. A. Qureshi
Economic Adviser
International Finance Corporation
1818 H. Street, N.W.
Washington, D. C. 20433

Dear Moeen:

Enclosed is a tentative itinerary for the first leg of this summer's site visits. I have set a minimum of three full working days at each project, and have planned this first leg on the basis of this minimum time. If you feel that it would be desirable for me to stay somewhat longer in one or more projects, that can be easily arranged. The trip does seem to flow in a logical sequence, but the point at which I start is somewhat arbitrary. I have planned to begin with Arewa in hopes of making contact with a DFC mission which will be leaving Nigeria at the end of May. It is usually possible to travel from one project to the next in one day, and I have allotted myself the minimum travel time in planning the itinerary. I have, however, set aside three extra days in the middle of the trip to absorb any skippage from travel delays.

If you would like for me to come to Washington to discuss the itinerary or to meet with any of the investment officers responsible for these projects, April 17-20 would be the most convenient time for me, although I could come at any other time that would be more convenient for you.

Sincerely yours,

Steve

Stephen Guisinger
Associate Professor

SG:jhs

Enclosure

Itinerary

Firm	Place	Dates
Arewa Textiles, Ltd.	Kaduna	May 23-25
Khartoum Spinning Mills, Ltd.	Khartoum	May 28-30
Cotton Company of Ethiopia, S.C. (plant)	Dire Dawa	June 1-2
H.V.A.-Metahara (estate and refinery)	Metahara	June 4-5
Cotton Company of Ethiopia and H.V.A.-Metahara -- head offices	Addis Ababa	June 6-7
Precision Bearings, India, Ltd.	Baroda	June 11-13
Lakshmi Machine Works, Ltd.	Coimbatore	June 15-18
Packages, Ltd.	Lahore	June 22-26
Sherkate Sahami Aliaf		June 28-30

Research Studies

Mr. William S. Gaud February 28, 1973

Moeen A. Qureshi

Meeting on Mining

Mr. Demuth had a meeting today to discuss the draft note to Mr. McNamara on the Bank Group's role of the non-fuel and mining sector. This is the last assignment that he wishes to complete; he leaves on February 28.

I said at the meeting that I was troubled by the memorandum because it suggested that the Bank Group should do a wide variety of things in the mining field without clearly indicating the justification for them and without assigning any priority or urgency to one against the other. I also had doubts about the advisability of the Bank's entering into some of the proposed areas.

The paper indicated that the Bank should (i) support exploration in the larger developing countries through the establishment of exploration funds; (ii) support and finance the U.N. proposal for the creation of an international mineral resources exploration fund primarily for the benefit of the less developed countries; (iii) double its financing at the exploitation stage; (iv) undertake mining sector surveys and act as advisor to governments; (v) be prepared exceptionally to finance the government's purchase of that part of the share of the equity which must be paid for in cash; (vi) be prepared to support small scale mining through lines of credit through mining banks; (vii) encourage the establishment of mineral processing facilities in less developed countries; (viii) equip itself to offer advice to governments on mineral policy and legislation, and equip itself to advise governments in the conduct of negotiations with private mining companies.

I pointed out that the mining seminar had not revealed much enthusiasm on the part of the larger countries for external assistance at the stage of exploration. It seemed pretty risky to me to get involved in a U.N. proposed fund, if at the same time the Bank wished to finance national exploration funds. The U.N. Proposal would have to be substantially revised in order to meet the Bank's recommendations, the scheme would not work unless the Bank administered it, and it seemed like a lot of headache for very little gain.

I agreed that the Bank/IDA/IFC should do more in mining and the main justification for this was that the investment climate had changed, and there was much greater need than before for an "international presence", and for capital. I had serious misgivings as to whether the Bank should establish a separate advisory service in mining and, in particular, whether it should regularly provide staff to participate in the conduct of negotiations with private mining companies.

.../..

I fear that Mr. Demuth did not agree with most of what I daid. He did agree that the presentation should be improved and greater justification should be provided for the proposals.

I sincerely regretted being so negative and critical but I felt I could be most useful by being frank.

MAQ:gmb

Research Studies

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Moeen A. Qureshi

DATE: February 5, 1973

FROM: Jaime Fuenzalida

SUBJECT: Ownership and income distribution. Possible use of Mr. Kelso's ideas in IFC investments.

1. Louis Kelso is a San Francisco lawyer and General Counsel of Bangert and Company, a firm of San Francisco investment bankers. For some years Mr. Kelso has been expounding a theory of planned ownership calling for the liberal use of credit to enable employees of corporations to purchase equity securities on a "self-liquidating" basis - just as corporations normally acquire capital on a self-liquidating basis. A number of U.S. companies have applied his plan with some success; his associate, Mr. Kurland, is seeking to adopt these ideas to the uses of American Indians and Eskimos.

2. Mr. Kelso is very interested the World Bank adopts his ideas and is seeking a meeting with Mr. McNamara. Last week a group of the Bank's staff (Messrs. Merriam, King, Hawkins, Jennings and myself) heard Mr. Kelso's presentation at lunch time.

3. As I have informed you, despite the fact I think Mr. Kelso's ideas fall far short of his pretention of having invented a new economic theory ("Two Factor Economics"), they can be used in practice to spread ownership in some IFC investments. Even though the plan can be applied to acquire ownership by any group of low income people, it is best applicable to the employees of a certain enterprise. Since employee's ownership is a very controversial subject in many societies, any use of Kelso's plan by IFC must be on a very selective basis. The following is a schematic explanation of the system. Attached is a diagram provided by Mr. Kelso.

4. An enterprise asks IFC for a $1 million, 10 years, 9% loan for an expansion project. Instead of making the loan to the enterprise, IFC provides it to an "employee trust." With this money, the "employee trust" buys an issue of shares from the enterprise. At the same time, the enterprise guarantee IFC that it will make annual dividend payments to the "employee trust" equal to the service of the loan (amortization plus interest). Thus under this scheme:

- The enterprise receives the money it needs, and during the terms of the loan has to pay as dividends the same amounts it would have paid if the transaction were a straight loan. After the repayment of the loan - in this case 10 years - the enterprise will have to pay normal dividend on the common stock (a way to do this would be to issue preferred stock, convertible into common stocks by the 10th year).

- The employees acquire ownership without any cost to them. Their annual payments to IFC will be financed by the dividend payments, and this will be guaranteed by the enterprise.

- IFC will make a straight loan that would have two purposes: 1) to finance a specific project and 2) to spread ownership.

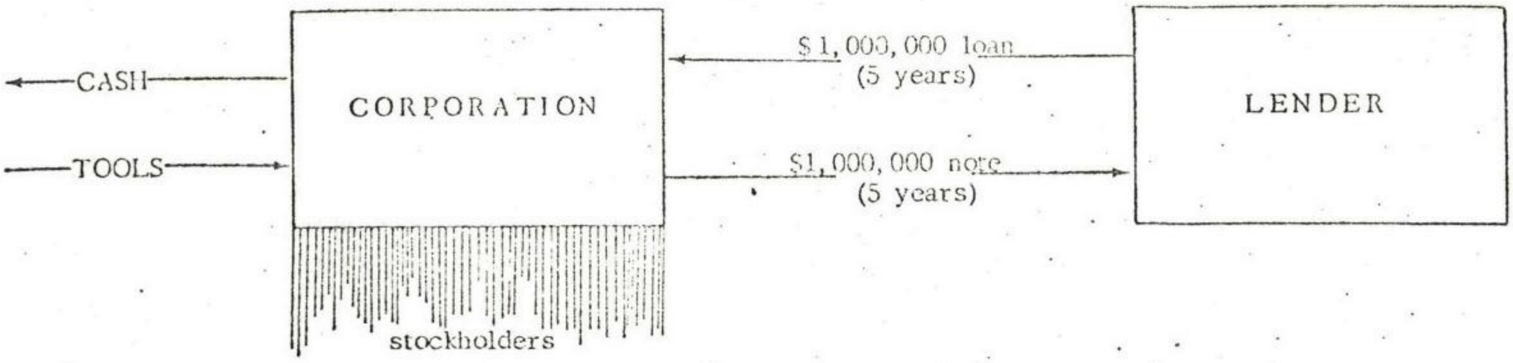
5. Evidently, the situation is not quite as simple as described above. We have to find an enterprise willing to 1) accept equity instead of loan financing, 2) accept the employee participation plan, 3) accept a more expensive deal than a straight loan - both because normally tax treatment on interests is more favorable than that on dividends, and because the enterprise will continue paying dividends after the loan is repaid. Only a very socially-minded enterprise would be inclined to accept this method of financing. However governments with this type of social inclination might be willing to create some tax incentives to alleviate the costs to the enterprises.

6. The physical distribution of stocks as between the employees is a technical problem which is not difficult to solve. Kelso has several solutions for it.

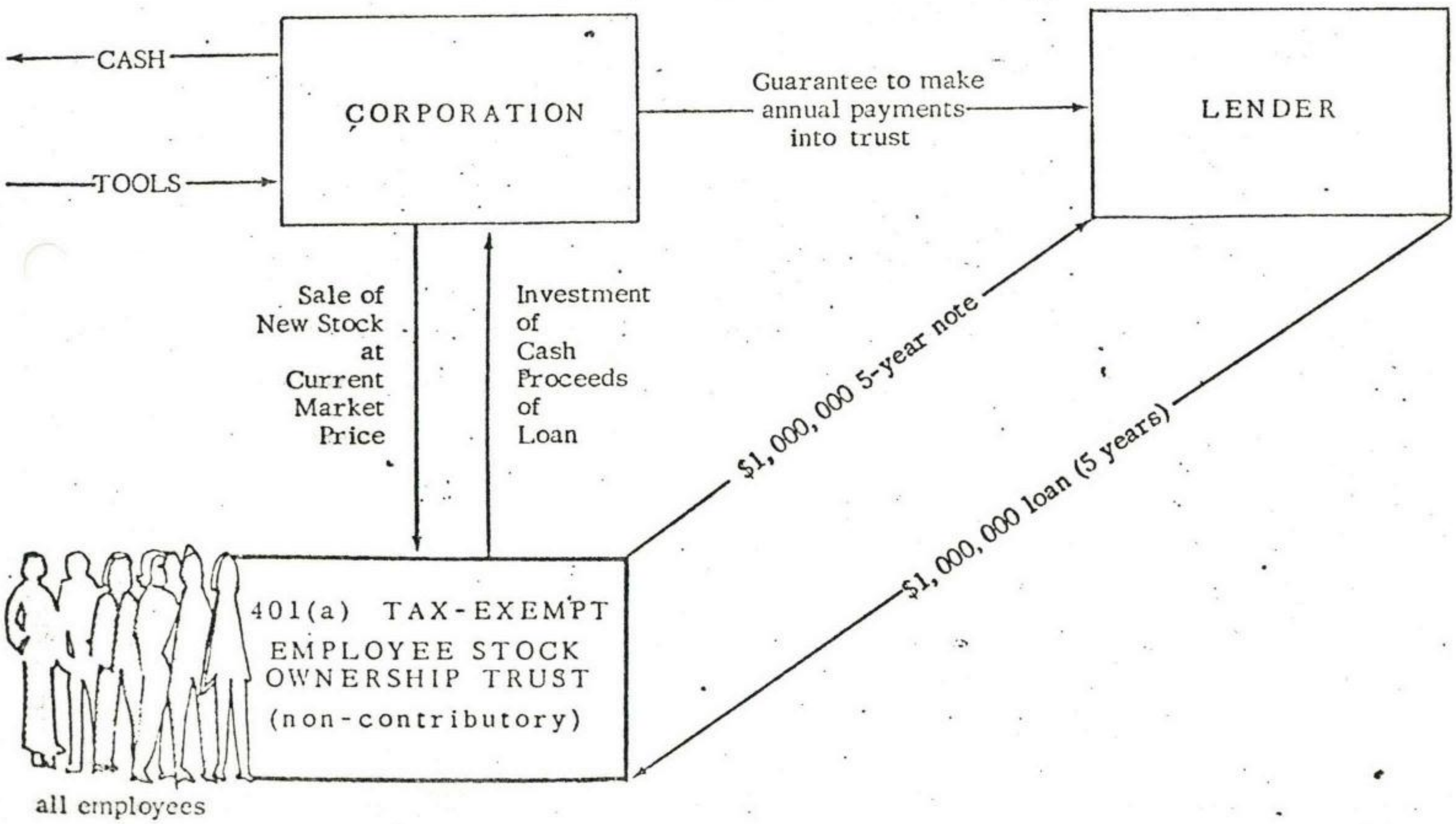
7. IFC could consider this proposal or a variation of this system in those cases in which it is difficult to find local partners particularly in African countries or other small countries (e.g. Bata Shoe in Zambia? Finap in Paraguay?).

cc: Messrs. Gaud
von Hoffmann
Richards
Circulation

MODEL I
CONVENTIONAL CORPORATE FINANCE



MODEL II
EMPLOYEE STOCK OWNERSHIP FINANCING



Research studies

Mr. M.A. Qureshi (Through Mr. Cherif Hassan) February 1, 1973

J.J. Deveaud MM

EEC study of export-oriented textile industries in associated countries

I am sending you a two volume study made by Professor J. De Bandt for the EEC on export-oriented textile industries in associated countries, and also a summary from the Commission on the subject.

These documents, which I have just received from Mr. Durieux, complement the preliminary surveys on the other industrial sectors which he sent me last year and which I passed on to you.

Please also find attached, for your clearance, copy of my letter to Mr. Durieux. I think this is a field in which we could cooperate with the EEC.

Attachments

JJDeveaud:em

Research Studies

See distribution below. January 22, 1973

Moeen A. Qureshi

Mr. Guisinger's Report

Professor Guisinger has now completed Part I of his Report on Protection in a sample of twelve IFC investments. His Report applies different measures of protection to IFC's investments and includes detailed explanation of the concepts and the methodology used.

Profession Guisinger is now ready to proceed to the second part of his study. This will involve (i) broadening of the sample to, say 20 to 24 projects, and (ii) field visits to some of the projects in order to identify the reasons which contribute to the need for protection.

You might recall that the position of IFC's Economic Staff has been that a high degree of protection should not, by itself, be an automatic reason for rejecting a project. The need for such protection could arise from a variety of reasons, e.g. the "learning process" involved or certain aspects of the project (e.g. high raw material costs or project defficiencies), or domestic policies pursued by the Government. It is important, therefore, in each case to try to identify the reasons for the protection needed for an economic assessment.

Attached is a tentative list of possible projects to which site visits might be contemplated by Professor Guisinger. (Attachment A). I would like very much to have your reactions to this list. We would not wish to do anything that would impair IFC's relations with these investments. On the other hand, Professor Guisinger is an experienced individual, with a great deal of tact, and with personal knowledge of most of the countries in this list. He will not be asking ~~significantly~~ much more than a normal investment officer would during a follow-up visit, and would obviously abide by any ground rules we set for such visits. Obviously, also, your close cooperation and prior communication with these projects will be required to ensure that Mr. Guisinger's visit is productive.

Attachment B provides a tentative list of the possible projects for the extended sample which will be covered in Professor Guisinger's study. Please let me have your reactions, and especially if you feel that, for one reason or another, some particular project would not be illuminating for the purposes of this study. We do intend to reduce the list somewhat.

After you have read Professor Guisinger's basic report, I am sure you will have various reactions, questions and criticisms. Mr. Gaud has agreed to have a special meeting to discuss the report with Mr. Guisinger on Monday, January 29, at 3.30 p.m. You are invited to this meeting at which time you can raise any point you like about the Report, or suggest such modifications as you deem necessary.

.../..

Once this is done, it is our intention to have the study printed and to give it wider circulation.

MAQ:gmb

cc: Mr. von Hoffmann
Mr. Richards
Mr. Hilton
Mr. Paterson
Mr. Hassan
Mr. Talavera
Mr. Parmar

cc: Mr DuPre
Mr Marthenon
Mr Guisinger

Research Studies

Mr. William S. Gaud   January 19, 1973

Moeen A. Qureshi

Guisinger's Report on Protection

We now have Guisinger's final version of his Report on Protection in a sample of IFC industrial projects.

He has deliberately kept his conclusions rather tentative at this stage. The plan is that he should now proceed to the second stage of his study which requires identification of the reasons why protection is high in some of IFC's past projects - whether this has to do with project aspects or the policy environment - and what specific operational lessons can be drawn by IFC from it.

It is quite unnecessary for you to look through the whole Report. I suggest you read pages 1 to 4 and pages 31 to 39. These are appropriately marked for your convenience in the attached folder.

I am circulating Guisinger's Report to my colleagues in IFC. If you agree, I would like to arrange a meeting on Guisinger's Report in which we can have a frank exchange of views with him as to what he has already learnt about IFC's past projects and what he proposes to do next. My Investment Department colleagues can raise any questions or level any criticism of this Report that they might wish at that time. Following such a meeting, and subject to any modifications that you or others suggest, I would plan to go ahead and have the Report printed.

In our Protection paper for the Board, we indicated that Guisinger's Report would be circulated towards the end of the year. You may wish to consider whether it should be circulated to the Board in connection with the forthcoming discussions of IFC Policies. There may be some merit in deluging them with documentation - and this Report has an ample exposé of protection theory and concepts.

MAQ:gmb

Research ~~Projects~~ Studies

Mr. Ernest Stern M.A.Q. January 16, 1973

Moeen A. Qureshi

Rural and Urban Public Works Program - Research Proposal

It is about time we did something to initiate or support some investigations (I hesitate to call them research) into these new heresies without worrying excessively whether all the rites have been observed.

I have considerable sympathy with what has been said by some of my colleagues. The project does suffer from an excessive desire to overview everything; it is weak on the 'nuts and bolds,' and admittedly these nuts and bolts have multi-disciplinary traits. But we have to recognize that our state of knowledge in this general area is such that it is truly difficult to formulate precisely the critical problems, obstacles and alternatives in this field.

We are assured in this project of having a good research team and we can expect to get a great deal more of factual and comparative information on country experience in this area through this study. I therefore support it, although the project could be somewhat amended. Section H (a model of an economy with the public works program) is more than even my enthusiasm for these programs can take.

cc: Members of Research Committee

Research studies

Mr. Vinod Prakash January 3, 1973

Moeen A. Qureshi

Mrs. Hughes' note on work on industry

Herewith a somewhat more detailed explanation of the type of work done on policy issues:

Work on policy issues takes a variety of forms. They are, first, papers which are destined for the Board or the President. As in the past, IFC's Economic Staff expects to be involved in 1973 in the work connected with the preparation of Industry and Mining sector papers. Other examples in this category are the two papers - "IFC's Policy on Protection" and "IFC Business Promotion Activities" which were recently circulated to the Board as appendices to the paper "IFC Operating Policies". Similar requests for papers on policy issues can be anticipated in 1973.

Aside from these, a number of internal papers and memoranda are prepared in connection with emerging issues related to operational work. Examples of these are two recent papers on the "Measurement and Treatment of Inflation in Project Appraisal" and the "Pulp and Paper Sector in Brazil". Similar papers and internal memoranda on the priorities to be followed in IFC's operational work, and on industry and sectoral priorities in particular countries can be expected in 1973.

MAQ:gmb

Research Studies

Mrs. Helen Hughes December 6, 1972

Moeen A. Qureshi

Policy formulation, guidelines and research in industry

In connection with the preparation of your paper on "Policy Formulation, Guidelines and Research in Industry" you asked me what work was being done in IFC in this general area. The simple answer is not enough - certainly much less than is needed in the context of the emerging problems and issues in the field of industrial development, and especially policies affecting the private sector.

The day-to-day work of economic appraisal of IFC investments - new and old - takes at least two-thirds of the time of IFC's Economic Staff. Some 250 investment proposals are presented to IFC in an average year and most receive some form of economic review, ranging from a very quick screening to an in-depth project appraisal. A certain degree of sector and country economic work is also invariably associated with any serious project analysis. In these circumstances, the time devoted by the Economists to other matters - policy papers, the development of analytical tools, guidelines for operational work - is more a function of the urgency of the problem and the availability of staff time rather than a measure of requirements.

Policy Issues:

Aside from project analysis, papers and memoranda on policy and operational issues take the major share of the remaining staff time available. These can be formal papers destined for the Board, such as such as the Industrial Sector Paper (1972) or the paper on "IFC Policy on Protection (1972)". More frequently, they are papers and memoranda for internal consumption, e.g. "The measurement and treatment of inflation in project appraisal", "Fertilizer development in Pakistan", "Pulp and Paper Industry in Brazil", etc.

This aspect of the Economic Staff's work is likely to become more important in the future as some of the more routine project appraisal work becomes mechanized, and moderate increases in staff permit somewhat greater flexibility to work on matters other than individual investment appraisals.

Development of Analytical Tools:

This is being done largely as a part of the operational work on project appraisal. Given the large number of investment proposals that are presented to IFC, there is considerable scope for testing different approaches, determining the differences in results, and the adaptability of the alternative approaches to short cuts and the time constraints of operational work. IFC has been using alternative techniques, i.e. Little-mirrlees, "Effective Protection", the Bruno Ratio in its various projects.

.../..

Data and Monitoring Systems:

IFC's Economic Staff is now engaged in preparing a project information system for standardizing data collection, retrieval and analysis which will greatly facilitate a computation of various economic appraisal indicators for projects including their foreign exchange impact, reliance on protection and the economic rate of return.

IFC is also participating on a continuing basis in a UNIDO information system involving simple project information relating to the investment of a large number of participating international and national financial institutions operating in the developing countries.

Research:

IFC's Economic Staff does no real research. We have initiated certain detailed investigations on issues relating to IFC's operations. The most significant of these is a study, initiated early last year, to measure and evaluate the level of protection in a selected group of IFC's industrial projects. The study discusses the implications of the measured level of protection for project evaluation procedures, the policy guidelines to be adopted for future projects and the further research which should be done to improve the accuracy and relevance of the data used in computing social profitability. It is being carried out by Professor Stephen Guisinger a consultant. Part I of the study will be available this month. Thereafter Guisinger will begin work on the second phase of the study which will involve a broadening of the project sample and more precise identification of the reasons for the required amount of protection in individual projects. Part II of this study should be available sometime in the latter part of 1973.

Another study, also focussing on a sample of IFC's investments, is being initiated to examine the choice of different technologies and the possibilities of labor capital substitution. The study will take IFC projects in one or two major industries, (e.g. textiles) and will study the range of technologies being used in these projects, as well as in local industry, analyse the differences in the labor capital ratios, identify the reasons for the differences and the possibilities for labor capital substitution. The study should throw light on the extent to which IFC can make a constructive contribution through appropriate reformulation and modification of projects in the project appraisal stage. It will also provide empirical evidence in an area where there is much theorizing but relatively little practical application.

It is very hard to fill the blanks in your Table 1 - but I have tried assuming no change in existing economic staff. The table below does not include the work of consultants - I expect about 3 man-months of consultants' time during November 1972-June 30, 1973 and possibly 4.1/2 man-months during 1974 assuming no addition to the two studies mentioned above.

.../..

IFC Professional Economic Staff

	FY 1973 (Nov.1,1972 - June 30,1973) (man-weeks)	FY 1974
Policy Papers, Guidelines and Standards	15	36
Data and Monitoring Systems	8	8
Analytical Tools	4	12
Research (Supervision)	1	4
	28	60

MAQureshi:gmb

cc: Mr. Gaud

Research Studies

Mr. William S. Gaud

November 29, 1972

Moeen A. Qureshi

The material on Pacific Basin Economic Council

I have read the material which Mr. Grant sent you. (Incidentally I attended a meeting on "International Economic Order" at the Overseas Development Council some three weeks ago, at which some of the same subjects were discussed.)

First, with regard to the problem of appropriate methodology, which is mentioned both in the study of Louis Wells and in Harold Malmgren's book Pacific Basin Development sent to you by Grant. I agree with everything they have to say on the possibilities of substituting labor intensive technology but there is nothing much here that is new. Wells' article provides some interesting empirical evidence. I am sending you my notes for the speech which I recently made to the Association of Chemical Industries; they sing the same refrain.

Some work is being done in the Development Research Centre in the Bank. One research project on the choice of techniques in the mechanical engineering sector in Korea is underway. Some further work is also planned in connection with programming models in the manufacturing sector. You recently received some material from Gus Ranis on the findings of research done at his Centre; there is some very interesting material on "appropriate technology". You will see from my notes that there are a number of other institutions which are active in this field.

IFC provides in my view very fertile ground for studying this aspect in greater depth. I have had in mind a research project (to be done by an outside consultant) to determine the different technologies being used in a sample of IFC's projects, and the scope for labor-capital substitution in them. The approach would be similar to the study on "Protection" which Stephen Guisinger has done for us and which should be available within a few days.

I wish very much we could do what Grant suggests in his letter: "...time is ripe for IFC under your leadership to do some pace-setting for the international private sector." But this means that we must deliberately try to develop a role for IFC in the area of policy advice on matters relating to the private sector, especially industry. You know my feelings on this subject. But realistically IFC can undertake this role only if we have more economists specifically for this purpose. Alternatively, we could do this in conjunction with the Bank provided we had greater control and say in organizing the work done there in the industrial field.

.../..

As I mentioned to you, there is scope within IFC for doing much more than we are doing now in exploring the possibilities of substituting more labor intensive technology in industrial projects which we finance, provided the engineers and the economists work collectively and devote the time and effort that would be required to look at practical, and financially viable, opportunities for such substitution. If you agree I shall expedite the above-mentioned research project on the possibilities of choosing labor intensive technology in a selected sample of IFC projects, and will try to get Hilton involved so that we might get some engineering inputs into it.

Apart from all this, I share your feeling that the Pacific Basin Economic Council appears to be a vigorous and representative body and we should try to get closer to it. A speech from you to the forthcoming session in Washington would certainly be a useful method of initiating contacts. If you consider it useful, I shall be glad to assist Norman Macdonald in developing some ideas for such a speech.

MAQureshi:gmb

Research Studies

Mr. William S. Gaud November 24, 1972

Moeen A. Qureshi MAQ

Industry - Present and future work plans

Mrs. Helen Hughes called me yesterday to say that she was preparing a paper for Mr. McNamara which would describe the work being done, and proposed to be done in 1973 and 1974, in the industrial sector in the area of "policy formulation, guidelines and research," and that she would appreciate some inputs from me regarding work being done in IFC.

She explained that at a meeting with Messrs. Chenery and Baum, Mr. McNamara had requested this information for all sectors. I inquired if Mr. McNamara's request applied to IFC. Helen Hughes said that she had checked with Hollis and that it was his understanding that it did.

As you know we have not done too much in this area in the past but if you agree I shall send information on whatever little we have done to Helen Hughes. I am more concerned about what to say with respect to the future. Mrs. Hughes has sent me a copy of the programs that Gustafson and Fuchs have drawn up; these are ambitious.

MAQ:cm

Research Studies

Mr. Moeen A. Qureshi November 21, 1972

Carlos Sanchez-Marco

The Flow of Private Bank Lending to LCDs

1. At your request I have contacted staff members of the Bank and of the OECD in Paris to obtain information on the flow of private bank lending to LCDs. The information available is very limited, but there is a growing concern about getting to know more on this subject.

2. A DAC report [DAC (72) 28] dated May 23, 1972 recognizes that a striking development in the last year has seen the increase in private bank lending of euro-currencies to developing countries. These represent bank credits financed jointly by a group of banks from several DAC countries. The report suggests that, given the increasing importance of these transactions, the DAC Group on Statistical Problems should consider how estimates could be arrived to obtain sufficiently reliable statistics to be included in DAC flows. I have been told by OECD staff members that a meeting took place recently in Paris to consider the above DAC request. Unfortunately, because of the difficulties involved in establishing a reliable reporting system to determine private bank lending to LCDs, the group decided to continue excluding those private flows from the overall DAC statistics.

3. The Bank is also interested in this subject and Mr. Saxe is making efforts to take the lead here. He has promised to send us a report in a few weeks' time, covering this topic. However, the Bank is not yet in a position to report quantitative estimates.

4. For the time being, the only estimate available is contained in DAC's report of May 1972. It is stated there " . . . it may be estimated that net flows of euro-currency bank lending to developing countries in the year from May 1971 to April 1972 may have been in the region of some US $1.1 - 1.3 billion. Little information is published about the interest rates in these loans, but it appears that in most cases they are floating at 3/4 - 1 1/2 percent above the six months euro-dollar deposit rates depending on the credit standing of the borrower 1/(. 1 .). Since the transactions are commercial ones, the

1/ "During recent years these rates have varied considerably as it appears from the following list:"

Euro-dollars six months deposit rate (%)

	Maximum	Minimum
1965	4.56	5.31
1966	5.44	7.44
1967	4.81	6.56
1968	5.88	7.31
1969	7.56	11.38
1970	6.75	9.56
1971	5.81	8.75

costs of the credits to the borrowers are obviously rather high. Due to their floating nature, it is difficult however, to estimate the average interest rat es over the lifetime of these loans."

5. As mentioned above, there are no comprehensive statistics on these flows. The OECD has assembled a list of individual transactions taken mainly from advertisements in the press. They are shown in the attached table. Though incomplete, this gives an illustration of the extent to which a limited number of developing countries have been able to tap the euro-currency market.

6. As for bonds, the DAC has reported that preliminary statistics for 1971 show that bonds were issued by developing countries to an amount of US$ 441.5 million, an increase of 17 percent over 1970. International development institutions in 1971 issued bonds for US$ 1,697.5 million, or some 37 percent more than the year before. Of the total of US$ 2.1 billion, "international issues" (euro-bonds) accounted for US$ 652.2 million or nearly one-third, the remaining two-thirds being traditional "foreign issues".

CSM/mdc

Attachment (1)

ANNEX

LIST OF EURO-DOLLAR BANK LENDING

Month	borrowing country	amount million U.S.$	provided by banks from	maturity	sector	remarks
May 71	Venezuela	70.0	U.S., Japan, Canada, U.K.	7 years	Petroleum	Host government guarantee
June 71	Brazil	10.0	U.K. and others	..	Telephone Co.	
June 71	Brazil	50.0	U.S. and Europe	6 years	Electricity	
June 71	Iran	50.0	U.S.,U.K.,Canada,Sweden,Japan	..	..	
July 71	Brazil	40.0	..	..	Railroads	
July 71	Brazil	20.0	Japan,U.S.,Austria,Canada(Brazil)	7 years	Airport	
July 71	Spain	30.0	U.K.,U.S.,Japan,Netherlands,Canada, Austria,Sweden (Spain)	7 years	Telephone Co.	
July 71	Algeria	20.0	U.K.,France,Italy,Germany,(Luxembourg, U.S.S.R.,Arab countries)	5 years	Petroleum	
Aug. 71	Zaire	30.0	U.S.,France,Japan,Italy,Belgium (Arab countries)	7 years	Government	
Sept.71	Iran	31.0	U.S.,Japan,Canada, U.K.	6 years	Central Bank	
Oct. 71	Algeria	30.0	U.S.	5 years	Petroleum	Interest rate indexed to 6 mos euro-dollar rate
Oct. 71	Greece	17.0	U.S.,France,U.K.,Switzerland,Italy,Canada	..	Roads	Host government guarantee
Oct. 71	Brazil	4.0	U.S.,U.K.,Canada,France,Italy	4 years	State Bank	
Nov. 71	Brazil	50.0	U.S.,Canada,U.K.,Japan,Belgium,Italy, (Brazil)	6 years	Electricity	
Nov. 71	Mexico	20.0	U.K.,U.S.,Netherlands(Mexico,U.S.S.R.)	..	Development Bank	
[illegible]. 71	Brazil	24.8	U.S.,Canada,France(Arab countries)	7 years	Shipping	Host government guarantee; loan denominated in DM
Dec. 71	Argentina	35.0	(Bahamas)	..	Development Ministry	
Dec. 71	Venezuela	9.0	Canada,U.S.,Switzerland(Bahamas)	5 years	Chemical Industry	
Dec. 71	Brazil	18.0	U.K.,Canada,Japan, U.S.	..	Electricity	
Dec. 71	Malaysia	26.1	U.K.,U.S.,Canada (Hong Kong)	5 years	Government	Multicurrency loan denominated in £.interest rate based on London Interbank rate
Dec. 71	P.I.C.A.	(10.0)	France,U.S.,Netherlands,Australia,Japan, U.K.,Canada(Singapore)	4 years	Private Inv.Co.	Asia-dollar loan
Dec. 71	Mexico	120.0	U.S.,France,Canada,Japan,Switzerland (Bahamas)	10 years	Development/Petroleum/electricity	
Jan. 72	Brazil	16.0	U.K.,Japan Belgium,Canada,U.S.,Italy Brazil	6 years	State government	
Jan. 72	Algeria	20.0	France(Arab countries)	5 years	Petroleum	
Jan. 72	Greece	30.0	U.S.,U.K.,Canada,Japan	10 years	Central Bank	
Feb. 72	ADELA	(30.0)	Canada,U.S.,Netherlands,U.K.,Switzerland, France,Germany,Japan(Luxembourg,Arab Countries)	5 years	Private Inv.Co.	
Feb. 72	Iran	8.0	U.S.,U.K.,Japan	6 years	Government	
[illegible]b. 72	Mexico	80.0	U.S.,U.K.,(Mexico,Spain)	10 years	Steel	
[illegible]b. 72	Zambia	25.0	U.K.,Canada,Japan	3 years	Copper mine	Variable interest rate
Mar.72	Iran	21.4	U.S.,Japan,Canada,Germany(Luxembourg)	6 years	Government	
Mar. 72	Yugoslavia	100.0	U.S.,France,Germany,Italy,Japan,U.K. (Luxembourg)	5 years	Government -	(Interest rate (1 1/2% above 6 mos (euro-dollar rate
Mar. 72	Venezuela	10.0	U.K.,U.S.,Canada	..	Housing	
Mar. 72	Iran	20.0	France,Austria,Germany,U.K.,Belgium	5 years	Development Bank	
Apr. 72	Brazil	21.0	France,U.S.,Japan,Belgium,Canada (Brazil,Luxembourg)	..	Electricity	
Apr. 72	Algeria	7.0	France, U.S.,Italy,Germany(Arab countries)	5 years	Housing	(SIFIDA participation in loan)
Apr. 72	Iran	20.0	France,Netherlands,Belgium,Germany,Italy, Austria,U.K.(Luxembourg)	5 years	Development Bank	
Apr. 72	Iran	40.0	U.S.,France,U.K.,Canada,Japan,Belgium, Switzerland,(U.S.S.R.)	7 years	Government	
Apr. 72	Greece	40.0	U.S.,Canada,Japan, U.K.	7 years	Electricity	Interest rate 1% above six month euro-dollar rate

Total May 71 - Apr. 72 1163.3 (excluding private investment companies)

Research Studies

November 16, 1972

Mr. Norman G. Kurland
Executive Director
Institute for the Study of Economic Systems
2027 Massachusetts Avenue, N.W.
Washington D.C. 20036

Dear Mr. Kurland:

Before proceeding on a visit to Europe, Mr. Gaud passed your letter to me.

It is true that a major issue of our times is that the mere production of wealth is not sufficient. We have also to consider its distribution and social impact. I was therefore very interested in the article on 'Uprooting World Poverty' which you sent me as well as the material on the practical experiment initiated by the Government of Puerto Rico. I am sure there is much to be learned from that experience.

Whether there is scope for applying these ideas to individual investments undertaken by IFC is of course another matter. However some of my colleagues in the Economic Staff and I would welcome an exchange of views with you on this general subject. My office will be in touch with you to arrange a mutually convenient time.

Yours sincerely,

Moeen A. Qureshi
Economic Adviser

MQureshi:gmb

cc: Mr. Gaud

Research Studies

Mr. Moeen Qureshi November 10, 1972

Martin Hartigan [signature]

Wider Distribution of Ownership: Louis Kelso's Scheme for Greater Participation in Economic Ownership.

The following summarizes my main thoughts on the papers sent to Mr. Gaud by Norman Kurland of the Institute for Study of Economic Systems. My principal conclusion is that the scheme described in those papers is of general interest to IFC and, if feasible, might be tried on a pilot basis in connection with divestment of our existing holdings of shares.

Principal Features of the Scheme

In general, the Kelso scheme is presented as a method of achieving a greater degree of labour force participation in the benefits of economic development, without any significant departure from capitalistic ideals and using only existing financial techniques and mechanisms.

The central principle in the scheme is the use of future earnings on share capital to enable the current financing of stock purchases on behalf of labour or, more generally, those productive elements of society that otherwise would not share adequately in the fruits of economic development. In effect, normal banking system credit is extended in an unconventional use.

The Kelso scheme is claimed to embody capitalist ideals as a "worker participation" scheme involving no actual redistribution of already existing wealth; only newly-generated wealth will ultimately be shared by its participants. Usually, loanable funds for productive enterprises provided by the banking system would be available only to owners of capital, thereby "levering up" their rates of return. Under Kelso's scheme, other groups of society would also be enabled to share in the use of these funds and the benefits of their leverage.

The exact mechanics of the scheme - its scope, the choice of financial mechanisms and participants, etc., - could be varied greatly according to the needs of a situation, but in general they would be as follows:

> Stock in one or more corporations is purchased by a trust fund on behalf of certain already-found participants in the scheme, using loan funds obtained through the banking system. This is done either at the time of a new issue or through an agreed placement of existing stock. Guarantees of repayment of these loans may come directly or indirectly from the corporate or government organizers of the scheme, and the share scrip might be held by the banks as security on their loans. Rediscounting possibilities with Development Banks or the Central Bank might be introduced at this point if care is taken to avoid the inflationary effects of monetary expansion. On behalf of its individual shareholders, the trust fund will then, over time, defray the interest and principal costs of these loans using the returns (dividends, etc.)

from the shares and other payments as required (e.g. pre-tax payroll contributions of corporations, direct payments by the participants themselves, or payments of the guarantors). Given the soundness of the stock chosen under the scheme and a sufficient stream of dividends, the participants can ultimately become its owners with little additional payments during the gradual process of acquisition.

The scheme's advocates maintain it is already being tried in a variety of forms within the U.S., chiefly by individual corporations on behalf of their employees but even in a most comprehensive mutual fund form by Puerto Rico' on behalf of its labour force. When used in conjunction with new share issues the scheme is said to be attractive to corporations as an inexpensive way of both raising new capital and gaining the benefits of greater worker participation. Practices similar to the Kelso scheme have been tried elsewhere in the world, notably by one of Japan's leading electronics corporations which primarily attributes its remarkable post-war success to an employee participation scheme.

Relevance to IFC's Operations

Proponents of Kelso's scheme envision great potential benefits from its use in solving not only the problems of the developing world but of the capitalist system itself. Much of this comment smacks of sheer rhetoric, seemingly uninformed by an awareness of practical limitations on resource flows - both between the developed and developing worlds and within nations themselves.

However, if practicable, careful applications of the scheme could have substantial benefits in promoting development of capital markets, wider distribution of ownership, higher labour productivities and social senses of awareness and involvement in the development process, and greater efficiencies in resource use. Since the corresponding costs should be low, careful attention by IFC is merited.

Conceptually there are three ways in which IFC might become involved in applications of the scheme, although from a practical viewpoint perhaps only one of these merits any serious consideration at this time. IFC could in theory:

(a) apply the scheme when making new investments in productive enterprises;
(b) apply it in divesting its portfolio in existing corporations with established records of performance; or
(c) provide financial or other support to an application of the scheme, whether mounted by IFC or not.

The first alternative is likely to be impractical even in ventures involving corporations with established records of performance. The more sound a new or expansion venture is expected to be, the more interested participants, banks, etc., are likely to be; and the less interested the sponsors will be in sharing their ownership. However, the scheme retains some interest to IFC for those new investment situations combining a strong

IFC bargaining position and either a lack of local sponsors or IFC's unwillingness to provide equity for other than project reasons. IFC's interest in this alternative would presumably be greatest in those countries where industrial wealth is most heavily concentrated and capital markets least developed.

The second alternative might be worthy of pilot testing, perhaps even on a mutual fund basis and combining IFC's holdings along with other leading stocks. Possibilities of this type deserve further consideration, especially in those countries where capital markets are least developed and hence domestic divestment difficult.

The third alternative raises a range of possibilities not just for IFC but for the Bank Group as a whole, although such special supportive efforts would be very difficult to mount and administer satisfactorily. Examples could arise in the areas of: provision of loan funds to finance the domestic ownership re-distribution; provision of loan guarantees or risk reinsurance; and related institution-building areas. Once the success of applications of the scheme such as the Puerto Rican one could be demonstrated, there would be strong argument for Bank Group consideration of a role of this type. In the meantime, further consideration of the third alternative by IFC might not be appropriate except in connection with potential uses of the first and second alternatives.

MH/wb

Circulation: 111

Research Studies

OFFICE MEMORANDUM

TO: IFC Files

DATE: June 23, 1972

FROM: Claus A. Westmeier CAW

SUBJECT: The Development of the Tanker Market: Impact on Shipbuilding Industry and Aspects of Investment Analysis

Current Trend of Seatrade

1. At the end of the 1960's, world seaborne trade in ton-miles grew at 9 percent per annum (p.a.). In 1971, the growth rate dropped to 4.5 percent, and it is expected to reach about 5 percent in 1972 and perhaps 6 percent in 1972. On the other hand, new ship deliveries are reported to come in at a 10 percent expansion level. As one source put it,1/ as fast as vessels go into lay-up,2/ their places will be taken by newcomers. In short, the current seatrade market is characterized by sluggish world trade conditions, declining freight rates and over-supply of ships (see Table 1). The structure of seaborne world trade is illustrated in Table 2. Crude oil accounts for more than half of world trade ton-miles, and there is no evidence of any relevant change in crude's predominant role in the years to come, say, until 1980.

Table 1: Seatrade, Ship Completions and Lay-ups

End of Quarter		Seatrade Index	Ships Completed	Ships Laid-up
1969	I	100	100	100
	II	86	106	80
	III	94	110	77
	IV	118	135	66
1970	I	113	115	61
	II	150	108	54
	III	181	128	50
	IV	196	142	100/1
1971	I	132	127	133
	II	88	145	172
	III	74	157	436
	IV	82	147	484
1972	I	68	154	545

/1 New Series Commenced.
SOURCE: Seatrade, May 1972.

1/ Seatrade, May 1972.

2/ The most spectacular recent lay-up struck the Norwegian Very Large Crude Carrier (VLCC) "Hadrian", 220,000 deadweight tons (dwt), which immediately after delivery went into lay-up. With regard to dry cargo, at present about 60 percent of all new tonnage enter service without commitment.

Table 2: Seaborne World Trade in 1968/1969 by Commodity Groups

Commodity	1,000 Million Ton-Miles	Percent
Crude Oil	4,850	52.4
Iron Ore and Coal	1,364	14.8
General Cargo	607	6.5
Other Bulk	2,430	26.3
TOTAL	9,251	100.0

SOURCE: Maritime Transport Research, Japanese Economic Growth and its Effect on Demand for Sea Transport, London, February 1971.

The Tanker Market

2. The tanker market is an eminent example of present seatrade conditions. Following the boom of 1970/1971, a fall in freight rates came at no surprise taking account of the historical working of the freight rate cycle. Generally, rapidly rising rates are caused by an unpredictable growth of demand for tanker tonnage, e.g., through the closure of the Suez Canal. In such event, new orders are placed and laid-up vessels re-enter service. Rates continue to rise until new capacity and/or market expectations cause a downturn. Consequently, new orders slow down, and in turn, lay-ups begin to increase as shipowners find it uneconomic to continue less competitive tanker operations. On the other hand, in time additional new tonnage ordered during the boom would be absorbed by growing demand, i.e., the increase in world trade. As a result, tankers come out of lay-up, and freight rates start to rise again to "normal" levels.1/ At present, apparently the point has been reached at which (i) freight rates decline resulting from supply of additional tonnage, and (ii) more vessels go into lay-up as rates generate sufficient revenues but for most competitive tankers.

3. Historical analyses do not allow for more precision in forecasting the "timing" of future cycles.2/ However, there are various indicators pointing in the direction of a delay of market recovery for several years:

1/ Counter-cyclical forces, e.g., ordering of new tonnage during low rate periods in anticipation of rate recovery, do "distort" market patterns without reversing the cycle.

2/ For example, the period between the peaks of the two recent freight rate cycles has been as short as three years (1967-1970) and as long as eleven years (1956-1967).

(i) The 1970/1971 tanker market boom triggered off an excessive ordering of new tonnage. In addition, the world fleet of combined carriers 1/ will more than treble during 1970-1974.

(ii) When present order books finish, i.e., by 1974/1975, the world shipbuilding industry will be large enough to increase its output by about 11 percent p.a. (assuming maximum capacity utilization). The corresponding growth of the world fleet would be of the order of 50 million dwt per annum.2/

(iii) Oil consumption in the world's two largest oil importing areas, Western Europe and Japan, is expected to rise at lower growth rates as (a) Japan's long-term economic growth appears to moderate, and (b) oil will slow down the expansion of its share in European energy markets. Also, Western Europe will curb the increase in crude oil imports as North Sea oil production gets underway.

(iv) Changes in trading patterns and distances, such as the growth of Indonesian exports to Japan and the opening of important new pipelines may lead to depress the increase in future tanker demand.

On the other hand, two arguments are being advanced in favor of an "early" recovery:

- There is plenty of leeway for a mass scrapping policy worldwide.3/ Scrapping and lay-ups may well reach unprecedent high levels as older, smaller and less efficient tankers meet increasingly stiffer competition from VLCCs.

- The reported U.S. "energy crisis", i.e., the expected shortfall in indigenous oil and gas production, may entail an early stabilization of the future growth of tanker demand through increasing U.S. imports of crude, largely from the Middle East.

1/ Combination carriers, i.e., Ore/Oil carriers (OO) and Ore/Bulk/Oil carriers (OBO), mostly behave like tankers making occasional excursions into the coal and iron ore trade.

2/ Seatrade, May 1972. European shipbuilders recently forecasted that even if no new yards were constructed after 1974, there would be 12 percent excess capacity (total industry) for the next five years. See The Economist, June 3, 1972.

3/ As of June 1972, more than 13 percent of the world's total fleet of over 2,000 gross registered tons (grt) is in the age range of 20 years or more.

4. Presently, there is no agreement on future demand for seaborne oil transportation. However, all of four recent projections anticipate a surplus of tonnage in 1975, overtonnaging increasing through 1980 if shipyards would sustain maximum output (see Table 3).

Table 3: Forecasts of Tanker Tonnage Demand and Supply
(million dwt)

Forecasts/1	1975			1980/4		
	Demand	Supply/3	Surplus/3	Demand	Supply/3	Surplus/3
A/2	203-222	232 (272)	10-29(50-69)	267-316	350 (400)	34-83(84-133)
B	211	232 (272)	21(61)	318	350 (400)	32(82)
C	210	232 (272)	22(62)	300	350 (400)	50(100)
D	190	232 (272)	42(82)	281	350 (400)	69(119)

/1 Two forecasts have been produced by consultants, one by a shipbuilding association and one by a shipbroker firm.
/2 Higher estimates assume "higher" level of US crude oil imports.
/3 Higher estimates (figures in brackets) include combination carrier fleet.
/4 Estimates assume maximum output of shipyards during 1975-1980.

SOURCE: Seatrade, May 1972.

The key element of uncertainty is the future level of U.S. crude oil imports. Even the highest 1980 estimate (Forecast A) of 460 million tons is substantially below the 600-700 million tons projected by some observers of the U.S. energy scene as import requirements by 1980. If the latter assumption proves accurate the tanker market would absorb perhaps additional 10-20 million and 30-50 million dwt by 1975 and 1980, respectively. On the supply side, much will depend on the scrappage rate. Beyond 1975, the contracting of new ships as key variable bearing on supply of additional tonnage appears to depend partly on the dry bulk market with its demand for combination carriers. The latters' increasing employment in the tanker market would only raise over-tonnaging, and on the other hand, would imply more severe corrective measures in the form of accelerated scrappage of older tonnage. Western experts seem to agree that facts and projections indicate hard times until at least 1975. Accordingly, low freight rates will encourage the withdrawal of sufficient tanker tonnage and lead to a "reasonable" balance between supply and demand by the mid-seventies. Thereafter, rates would have to rise so as to encourage the building of new tonnage to meet growing world trade demand. Rates and additional tanker tonnage will depend critically on U.S. energy import policy, and to a lesser extent, on future North Sea and Alaska supplies.

Impact on Tanker Shipyards

5. As mentioned above, recent projections of tanker demand and supply anticipate rising surplus of tonnage until 1975 and further increasing over-tonnage through 1980 if yards would work at maximum capacity utilization. On the other hand, while shipyards total orderbooks are full for two years or so ahead, the current general contracting trend for new buildings is declining and back where it was two years ago (see Table 4).

Table 4: World's Shipyards - Orderbook and Contracting Trend

Period/1	Orderbook		New Contracts	
	Million grt	Index	Million grt	Index
Dec. 31, 1969	59.8	100	29.5	100
March 31, 1970	59.9	100	25.8	87
June 30, 1970	64.5	108	29.0	98
Sept. 30, 1970	69.7	117	33.8	115
Dec. 31, 1970	78.5	131	39.0	132
March 31, 1971	82.4	138	43.3	147
June 30, 1971	83.7	140	41.6	141
Sept. 30, 1971	84.1	141	37.7	128
Dec. 31, 1971	83.7	140	28.6	97
March 31, 1972	83.2	139	25.3	86

/1 For Orderbook: Total as of date indicated. For New Contracts: 12 months ended as of dated indicated.

SOURCE: Seatrade, May 1972

VLCCs account for well over half of all shipbuilding completions. Although the general opinion is that there is still a market for VLCCs (as well as for product carriers), shipbuilders themselves apparently do not trust the future market mechanism. Most recently, the Council of Builders of Large Ships (CBLS), an organization of twelve yards in Western Europe, and the Shipbuilders Association of Japan have held a series of joint meetings aimed at the "the sound development of the shipbuilding industry of both Western Europe and Japan".1/ The two groups are nearing an accord on sharing development of the supertanker market in their respective areas through (i) supply restrictions, and (ii) absorbing proportionately any deterioration in demand

1/ A joint announcement has stated, inter alia, "As a result of the exchange of opinion on the future demand for VLCCs, both parties have agreed on the view that compared to the last few years, demand would decrease for the time being for the new building of VLCCs to be delivered around 1975." (See the Journal of Commerce, June 2, 1972).

for VLCCs. According to the CBLS, at present the world shipbuilding industry has a capacity to deliver 150 tankers of 200,000 dwt. The demand during 1972-1975, however, is expected to drop to 80-100 VLCCs all of whom capacity-wise could be built by Japan alone.1/ In any event, the future accord's effectiveness will depend on voluntary restrictions on the part of the ship-builders concerned.

6. It is recognized that virtually unrestricted expansion of existing and construction of new building facilities has gone ahead unchecked. However, there is no clear-cut responsibility as to who has moved the industry in this direction. In many cases, it is the ship operators rather than the builders whose planning policy has resulted in more and bigger yards. Furthermore, governments around the world are pumping direct and indirect subsidies into the shipbuilding industry on social and development policy grounds. Such subsidies are a major cause of the emerging capacity surplus which in turn tends to (i) depress prices of new tonnage and hence the profitability of shipbuilding, and (ii) discourage labor-saving investment in those yards which would improve their competitive position, particularly vis-a-vis high-investment Japanese yards and low-wage yards in developing countries and in Southern Europe. It has to be seen whether suppliers' accords on output restriction such as the above-referred agreement would alter the tanker market development even if various governments would curb subsidies to ailing shipyards.

Aspects of Tanker Building Investment Analysis

7. Taking into consideration the above referred tanker market development, market analysis emerges as parmount for evaluating future investments in the tanker building industry. It appears that such analysis primarily would have to focus on forecasting:

(i) Demand for Tanker Tonnage: (a) World seaborne trade by commodity groups (crude oil, iron ore and coal, general cargo and other bulk), (b) world merchant fleet tonnage by types and sizes of ships, and (c) new building requirements taking account of replacement needs.

(ii) Competition and Structure of Industry: (a) Concentration/dispersion of world tanker building industry, (b) share of enterprise concerned in market of reference, and (c) comparative analysis of main competitors' costs, prices, product quality and customer service.

1/ So far, of 200 VLCCs, 120 have been built in Japan and 80 in Europe. 140 tankers are operating from the Persian Gulf to Europe and 60 from the Persian Gulf to Japan (Europe's crude oil consumption is three times that of Japan).

(iii) Profile of Clientele: (a) shipowners' choice of trading patterns (charter terms, etc.), flags and methods of finance, and (b) owners' attitude towards risk, particularly as regards VLCCs.

(iv) Environment: (a) Disparities in governments' subsidizing shipbuilders and protectionist measures linking national import requirements with maritime transportation in home-built tankers, and (b) international anti-pollution regulations possibly affecting the development of larger tanker sizes.

8. However formidable the task of forecasting new building tanker tonnage (=new tonnage + replacements) may appear, the individual shipbuilding enterprise must afford it if it is to operate successfully in an increasingly complex and competitive world market threatened with rising excess capacity.1/ Ingenious market research efforts are necessary to establish micro-economic business objectives and strategies. With regard to demand projections, for the shipbuilder concerned it does not suffice to adopt merely global surveys. Rather, he has to use reasonably precise conversions ton-miles/dwt/number of ships which cannot be done on a global basis but rather for particular routes and/or individual commodities, and perhaps only be shipowners or builders from personal knowledge of the trades involved.2/ The conversion of seaborne trade projections into merchant fleet tonnage poses some problems even if only oil and dry cargoes are considered because the rapid growth of combination carriers produces additional "headaches to the maritime forecasters".3/ In addition, forecasting the demand for tanker tonnage particularly with regard to individual maritime routes, implies certain assumptions on future changes in trading patterns and distances. For example, future oil production in the North Sea continental shelf is estimated to account for 5 percent in 1975 and 8 percent in 1980, respectively, of total crude oil supplies for Western Europe's markets. As a result, the substitution of North Sea oil probably for Middle East oil would reduce considerably the demand for crude transportation by 1980.

1/ The interdependence between individual enterprise and world market, of course, varies with the shipbuilders' export business policy.

2/ Global demand forecasts expressed in dwt or grt vary too widely to be used by entrepreneurs. Ton-miles are the only universal basic measure of demand for sea transport, and the usual method to correlate ton-miles/dwt/number of ships is to divide the total ton-miles by the total deadweight to produce a ton-mile per dwt p.a. efficiency factor. Differences in efficiency factors between different types of ships are due to differences in time spent (i) in port, and (ii) travelling in ballast.

3/ See Dobler, J. P., "Comparison of Some Recent Forecasts of World Maritime Economy", Paper presented at International Symposium on Middleterm and Longterm Forecasting for Shipbuilding and Shipping, The Hague, June 1970.

9. Having established tonnage forecasts by commodities/routes, the investor would have to quantify market segments in terms of kinds of ships and vessel sizes in order to specify new building requirements as to the shipyard's actual or planned product mix. Tanker size has been increasing, and will continue to increase, because larger ships produce lower per-unit costs of transport.1/ Increases in size have been encouraged by rising trade volumes and by improvements in ship design and shipbuilding technology. Currently, facilities to permit building tankers up to 1,000,000 dwt are being prepared.2/ However, the future selection of tanker size may be made on some basis other than technical feasibility. The shipbuilder must define his marketing policy on the basis of the economics of tanker size in order not to blind himself to the increasing danger of building excess capacity. Investment appraisal on the basis of the economics of tankers implies carrying out tanker cost analyses from owner's/operator's angle taking into account quantitative and qualitative decision factors. Normally, the per-unit transport cost/tanker size function decreases with increasing ship size, though showing diminishing economies of scale. However, this function merely represents factors favoring larger sizes, but does not reflect the impact of variables inhibiting size.3/ Chiefly, such factors are:

- Draft of harbors and sea routes.
- Availability of terminal and repair facilities.
- Liability in case of breakdown or accident.4/
- Subsidiary risks of operation related to pollution.
- Tied-up capital in case of lay-up.
- Rising prices for VLCCs.5/

The investor has to reach judgment as to the impact of qualitative decision factors in order to forecast trends in ship sizes.

1/ The major items of per-unit operating costs for a typical crude oil tanker are acquisition and manning costs. It is in these areas that the greatest economies of scale are obtained.

2/ Construction of the 477,000 dwt "Globtik Tokyo", currently the world's largest tanker size, began in Japan in April, 1972.

3/ See Litton Systems, Inc., "Oceanborne Shipping: Demand and Technology Forecast - Part 2", Culver City, California, June 1968.

4/ Reflected in progressive insurance premiums.

5/ During 1967-1970, the construction cost of a 250,000 dwt tanker doubled from US$ 18.0 million to US$ 36.0 million. See UNCTAD, "Review of Maritime Transport, 1971 - Review of Current and Long-term Aspects of Maritime Transport", 1972.

10. The study of competition including the comparative analysis of main competitors' performance and strategy is a crucial part of market analysis, particularly because of (i) worldwide competition increasing with the emergence of excess capacity, and (ii) the prominent role in ship construction of bought-in steel, machinery and equipment. As much as 60 percent of the cost of construction may be "bought-in". That is to say, shipbuilders do not control a substantial part of production cost and therefore are vulnerable to cost inflation pressures. On the other hand, the value added by shipyards, i.e., chiefly the cost of labor, may be even more important for the overall competitiveness, subject to disparities in national wage levels. For example, disparities in the cost of labor and labor-related problems is one of the driving forces behind the shifting of shipbuilding facilities from highly industrialized into (low-wage) developing countries.1/ Such moves, designed to improve the position of the enterprises concerned, in fact may substantially change the international scene of competition. Furthermore, in determining a shipbuilders' future competitiveness it appears increasingly important to study the supply structure of world shipbuilding industry as certain groups of yards move to "share" market developments.

11. The analysis of the clientele's profile would appear to supplement the assessment of future trends in ship sizes on the basis of the economics of tanker size. Although each case in regard to the acquisition of new tonnage is different, the shipbuilder must appreciate that it is ultimately a certain package of finance, flag and trading which governs shipowner's/operator's rationale of acquisition. For example, a recent study by a U.K. owner showed that to build in the U.S., operate under American flag and use of American sources of funds produced a better cash flow to him than building in Europe, operating under Liberian flag, and using U.K. funds.2/ Shipowning being highly capital intensive, particularly with the advent of VLCCs and LNG carriers,3/ the methods of finance available to the owner are often crucial for his acquisition policy. As current world-wide ship finance requires owners to apply for long term finance (15 to 20 years), shipbuilders must study the impact of disparities in financing conditions in different countries, on acquisition patterns.4/

1/ One important recent step in this direction is the decision of Japanese shipbuilders to construct a 500,000 dwt repair dock in Iran that could be converted into a major tanker yard.

2/ See Slater, Paul, "Raising the Capital for New Vessels", Seatrade, May 1972.

3/ Liquefied Natural Gas Carries. At present a VLCC may cost about US$ 40 million, and a LNG carrier about US$ 80 million.

4/ For example, at present the only source of low fixed interest financing (long term) is the U.S., whereas Western Europe's finance institutions offer but high interest rate long term funds or variable interest rate funds for owners taking the risk of rate changes, and even then only on the security of a charter.

Evidently, this consideration is linked to the assessment of what might be termed "environment", i.e., essentially governments' subsidizing the shipbuilding industry (e.g., in the form of investment tax credits, cash grants or interest subsidies) and protectionist measures linking respective national import requirements with maritime transportation in home-built ships.1/ Environmental forces affecting market conditions also would include moves such as the plan of the Intergovernmental Maritime Organization (IMCO) to regulate the capacity of tanker cargo tankers in order to limit pollution in case of accident. Such regulations would increase the number of tankers in oil vessels and therefore result in more steelwork, i.e., in higher cost, thus particularly affecting the construction of VLCCs.

1/ Current example: Japan.

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cc. Mr. H. G. Hilton
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IFC Circulation (3)