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OFFICE OF THE PRESIDENT

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT  
WASHINGTON, D. C. 20433, U.S.A.

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**MAY 22 2013**

**WBG ARCHIVES**

CONFIDENTIAL

June 17, 1970

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 13 Concerning Plans  
for Reaching Official Aid Target

Recommendation

"All member nations of the Development Assistance Committee should prepare plans for reaching the 0.70 per cent target, and the President of the World Bank should place discussion of these plans on the agenda of the 1971 meeting of the Board of Governors. The national plans should be submitted for publication to the Chairman of the DAC by January 1, 1971."1/

Comment

The reference to the 0.70 per cent target relates to the immediately preceding recommendation that "Each developed country should increase its commitments of official development assistance to the level necessary for net disbursements to reach 0.70 per cent of its Gross National Product by 1975 or shortly thereafter, but in no case later than 1980."2/

Underlying the recommendation to which this memorandum is addressed is the thought that, assuming that the aid-giving countries agree to accept a target for official development assistance and a timetable for reaching that target, plans for implementing the agreement ought to be discussed in a forum in which both donors and recipients are present. I am sympathetic to that point of view. However, aid targets and timetables are already under consideration in various United Nations bodies (including the U.N. Conference on Trade and Development) as aspects of the strategy for the Second Development Decade (DD II), a process in which both developed and developing countries are participating. It may be assumed that some mechanism will be created for a continuing evaluation, including evaluation by United Nations bodies, of the goals and of progress made toward reaching them.

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1/ Report, page 152.

2/ Ibid.



Nevertheless, if prior to the 1971 meeting of the Boards of Governors the members of the World Bank Group should indicate a desire to discuss aid targets at the Annual Meeting, I shall make the necessary arrangements.

*Robert S. McNamara*

August 6, 1970

Recommendation No. 13: Plans for Reaching Official Aid Target

1. Directors who asked for discussion: 4

Ali, Hattori, Plescoff, van Campenhout

2. The following information on the position of DAC members with respect to a supplementary target for official development assistance is provided as background for the Committee of the Whole discussions:

The most recent DAC paper summarizes the present positions of DAC members as follows: "Some can accept 0.7% or 0.75% of GNP by 1972 and more can accept 0.7% by 1975; one country can accept 0.7% but without a precise date. It has also been proposed that DAC members should accept a target of 0.6% or more to be reached by 1973. Some countries do not expect to be able to accept any target of this kind or at least not with a level and date which could be acceptable to the less developed countries".

Individual country positions are indicated in the DAC document as follows:

Australia: Sees virtue in a separate ODA target and might support one, but has reservations about aid targets per se. (It has stated that any commitment to a date for the 1% target is inapplicable to it.)

Austria: Has not committed itself to a precise date for a separate ODA target. (or for the 1%).

Belgium: Favors adoption of an ODA target of 0.7% by 1975. Would support 0.6% if a majority of donors, comprising the major donors, would subscribe.



- Canada: Has stated that it intends to move toward the internationally accepted targets and will try to increase each year the percentage of national income allocated to ODA.
- Denmark: Supports the establishment of an ODA target. A government commission has recommended that Danish ODA should reach 0.7% by 1975/76 and approach 1% by 1980.
- France: Has proposed an ODA target of 0.6% or more, depending on the structure of the particular donor's program, to be reached in 1973.
- Germany: Will try to reach a 0.7% target, without specifying a date.
- Italy: Has taken no definite position on an ODA target.
- Japan: Sees difficulties in adopting an ODA target by a specific date, in view of the rapid growth of its GNP and the present level of its ODA. It intends to increase the proportion of ODA.
- Netherlands: Favors adoption of 0.75% ODA target by 1972.
- Norway: Plans to increase ODA appropriations to reach 0.75% in 1974.
- Portugal: No definite position on an ODA target.

Sweden: Supports 0.75% for ODA, to be reached by 1975.

Switzerland: Could not consider accepting an ODA target for itself, although it would not stand in the way of adoption of the target if the majority of other countries favored it, and is itself considering a substantial increase in the ODA element of its total flow.

U.K.: Is examining its policy on targets.

U.S.: Has not accepted the concept of an ODA target although it is willing to endorse the need for larger volume of assistance.







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April 28, 1970

MEMORANDUM TO THE EXECUTIVE DIRECTORS

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

Recommendation

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

Background

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

While the Commission believed that debt relief should not be provided "irrespective of the policy performance of debtor governments" and that debt relief is not justified "[i]f a debt crisis is patently the result of mismanagement and there is no reasonable hope for a change of policy," it also stressed that "[t]he accumulation of excessive debt is usually the combined result of errors of borrower governments and of their foreign creditors."<sup>3/</sup>

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<sup>1/</sup> Report, page 157.

<sup>2/</sup> Ibid., page 157.

<sup>3/</sup> Ibid., page 156.



The Commission found that, in several instances, debt had been rescheduled on the basis of short-run accommodation which failed to ensure an orderly resumption of normal financial relations and had to be followed soon thereafter by further rescheduling operations. This "short leash" approach, in the Commission's view, creates undesirable uncertainty and hampers the efforts of the debtor to formulate the long-term plans and policies necessary to ensure renewed growth of the economy. The Commission concluded, therefore, that, when debt relief is justified, it should be given for "an adequate period to avoid a rapid succession of debt relief negotiations." It added that debt problems should, preferably, be considered in "consortia or consultative groups where the accent of the discussion is placed on developmental problems and policies."<sup>1/</sup>

#### Analysis

In the last ten years, the Bank has attended the discussions for all but one debt relief operation for its member countries. In all these discussions, Bank staff, together with staff of the IMF, has provided technical information and advice on the economic condition and prospects of the debtor country. The Bank has been particularly concerned to stress the implications for long-term growth in the debtor country of alternative solutions to the immediate debt problem.

I share the Commission's view that "t<sup>h</sup>ere is a close connection between debt difficulties and the need for future foreign assistance."<sup>2/</sup> I therefore agree that the Bank -- in close cooperation with the Fund -- should actively participate in the discussions between the creditor countries and a debtor country which is experiencing a debt crisis; and that, in such discussions, the Bank staff should continue to pay particular attention to the probable effects of any proposed relief on the future development of the debtor.

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

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<sup>1/</sup> Report, page 157.

<sup>2/</sup> Report, page 157.

Conclusion

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

*Robert S. McNamara*







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December 11, 1969

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 15 Concerning Assistance to Development Banks, Industrial Parks and Agricultural Cooperative Credit Institutions

Recommendation

". . . we recommend greater help to development banks and similar institutions in developing countries. In addition, assistance should be provided to such promising activities as industrial parks and agricultural cooperative credit institutions, designed to promote financing of the domestic private sector."1/

Background

In the context of its discussion of ways to make aid more effective, the Commission notes that "Smaller investment projects may also require support, and there is then a case for the assistance of national development banks and similar institutions, public and private."2/ These institutions, particularly the development banks, the Commission says, "are especially important because they can reach the small investor, their administrations are generally more decentralized and fast moving than larger enterprises, and they result in such important institution-building as the strengthening of local capital markets."3/ In its historical review of the last two decades, the Commission also notes the role of development banks in facilitating savings and investment,4/ and elsewhere in the report stresses the importance of the role of financial intermediary.5/

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1/ Report, page 179.

2/ Ibid., page 179.

3/ Ibid., page 179.

4/ Ibid., page 31.

5/ Ibid., pages 64-65.

There is no mention or discussion of industrial parks per se in the Commission's report, beyond the statement in the recommendation that they constitute a promising activity. The closest reference occurs in the discussion, earlier in the report, of the problems of the private sector, where mention is made particularly of financial institutions to accommodate small entrepreneurs, and there is a passing reference to the need for legal and accounting facilities, suitable land tenure and management training as well.<sup>1/</sup> All of these considerations arise in connection with industrial parks. There is no extended discussion of agricultural credit institutions, although it is noted elsewhere in the report that increasing agricultural production raises a demand for more farm credit.<sup>2/</sup>

For convenience, each of the three types of facilities mentioned in the recommendation -- development banks, industrial parks and agricultural cooperative credit institutions -- will be analyzed separately.

### Analysis

#### A. Development Banks <sup>3/</sup>

The Bank's involvement with development banks dates from 1950 when it assisted in the establishment of the Industrial Development Bank of Turkey and the Development Bank of Ethiopia. Ever since, the Bank Group has been heavily engaged in promoting, financing and extending technical assistance to such institutions. A few indications of this activity are cited below:<sup>4/</sup>

- a. The Bank Group has helped to promote 12 development banks and to reorganize another six.

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<sup>1/</sup> Report, page 65.

<sup>2/</sup> Ibid., page 61.

<sup>3/</sup> In view of the characteristics cited by the Commission (quoted in the text, above) to illustrate the importance of "development banks", it appears that the Commission had in mind the kind of institution known in Bank Group parlance as a "development finance company", in contrast to such institutions as e.g., the Japan Development Bank which is the government's agency for borrowing abroad and which serves as a conduit for funds to private industry, or the Corporacion de Fomento de la Produccion of Chile, created to devise and give effect to a plan to promote production in all sectors of the economy and to borrow abroad. Accordingly, the following description of the Bank's experience with "development banks" concerns institutions of the former type, devoted primarily to stimulating medium-sized and smaller enterprises in the private sector of the economy.

<sup>4/</sup> The data includes companies in Austria and Finland although these countries fall outside the category of "developing countries". Both are Part I IDA countries.



- b. The Bank Group has assisted in recruiting key personnel for a number of development banks. IFC is represented on the board of 13.
- c. Fifty-five officials of development banks which have been financed by the Bank Group have received training in the Bank's Economic Development Institute; sixty-one have received training under special programs.
- d. Gross commitments to development banks up to the end of September 1969 amounted to \$954 million. This financing was extended to 28 companies in 24 countries and included Bank loans (93%), IDA credits (4%), and IFC investments (3%). These figures reflect a recent rapid acceleration of commitments. Until the end of fiscal 1963, commitments amounted to only \$229 million; in the next five-year period they totalled \$497 million. In fiscal 1969 alone, commitments reached almost \$195 million. About 61% of gross commitments had been disbursed up to the end of September 1969. Allowing for repayments and redemptions of about \$149 million, the disbursed amount outstanding was \$430 million.

Bank Group policies towards development banks have been reviewed periodically, most recently by the Executive Directors in November 1968. Several significant changes have recently taken place. For example, in June 1968, the Bank, whose policy once prohibited lending to government-controlled development banks, decided it would be prepared to lend to such institutions provided their management was sound and autonomous in day-to-day decision making. Another policy departure, accepted in November 1968, involved the scope of operations of institutions financed by the Bank Group. Formerly they were eligible only if they were devoted primarily to manufacturing industry. Now they may be multi-purpose companies, financing not only industry but also tourism, housing, and other productive activities. Moreover, in the past year IFC has sponsored and helped bring into existence two companies which are primarily devoted to promoting new enterprise and to providing investment services, rather than finance.<sup>1/</sup> These developments, all indicative of increased flexibility on the part of the Bank Group, reflect the importance which the Group attributes to institutions which can mobilize capital, allocate it for productive purposes, promote investment and generally act as intermediaries in the investment process.<sup>2/</sup>

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<sup>1/</sup> These companies, and IFC's investment in them, are not included in the figures cited in the previous paragraph.

<sup>2/</sup> As noted in the memorandum concerned with IFC's preinvestment promotion work, IFC intends also to work with, support and help to finance such institutions as the Atlantic Development Community Group for Latin America (ADELA), the Private Investment Company for Asia (PICA) and other comparable organizations (including the investment company proposed for Africa), if these institutions need help, are well managed and are carrying on investment programs that will assist the development of the countries in which they operate.



The 28 development banks presently associated with the Bank Group are now committing the equivalent of about \$430 million per annum in loans, investments, etc. These in turn contribute to a total investment estimated at about \$900 million. The vast bulk of these investments assist the manufacturing sector. Judging by the size of the operations, it is fair to say that development banks are financing primarily medium-scale enterprises and, to some extent, small enterprises. If it did not work through such intermediary institutions, the Bank Group would be unable to reach a very significant part of the manufacturing sector of developing countries.

The principal objective of the Bank Group, however, is not simply to find retail outlets for dispensing external finance and technical assistance, but to help build effective investment institutions in developing countries. Hence, the Group encourages development banks to be active in mobilizing domestic capital, underwriting securities, subscribing to equities, selling from their portfolios in order to broaden ownership of enterprises, identifying and promoting investment opportunities and assisting entrepreneurs in formulating and carrying out investment proposals. While some progress has been made on these lines, a great deal remains to be done. Most development banks have not acquired much capability as mobilizers of financial resources and remain dependent on government funds, or on international institutions or on foreign aid. Furthermore, development banks, in the main, still respond to investment opportunities presented to them by their clients and only rarely do they do much in the way of identifying and promoting projects on their own initiative.

I fully accept the recommendation of the Pearson Commission that the Bank Group should provide more help to development banks.

The Bank's Five-Year Program already reflects this view. The plan for gross Bank and IDA commitments to development banks in the period 1969-73 is around \$1,500 million, compared with \$483 million in the preceding five-year period. As noted above, in fiscal 1969, the first year of the period, \$193 million was committed. Although there is not yet a projection for IFC operations in this field, I have little doubt that IFC, too, will expand its role in financing development banks.

To achieve the objective of the Five-Year Program, the number of development banks associated with the Group will grow to perhaps twice the current number of 28.

The proposed expansion in the number of institutions, as well as in the volume of operations, is closely related to the recent changes of policy already mentioned, which make possible a significant expansion of activity in Africa and in Latin America. In particular, it is probable that three or four loans will be made to government-controlled development banks in the current fiscal year. We have begun a systematic exploration of existing small development banks in Africa and of the possibilities of financing such institutions.



This expansion of activity, in exploration, in appraisal of companies, and in actual lending, has placed an unusual strain on staff. In fiscal 1969 the number of professional staff in the Bank's Development Finance Companies Department increased by 50%, from 20 to 30; another 25% increase is expected in the current year.

As noted above, Bank Group policies towards development banks have in the past been periodically reviewed in the light of experience and as new problems emerged. I shall continue to bring to the Executive Directors proposals for further changes as and when they appear desirable.

#### B. Industrial Parks

Industrial parks, sometimes referred to as industrial estates, essentially consist of tracts of land provided with services and public utilities for the establishment and operation of a group of industrial enterprises. First employed in industrialized countries as a device for the planned location or relocation of industries, they have been widely used in developing countries since the 1950's primarily as a tool to foster small-scale and medium-sized industrial enterprises.<sup>1/</sup> Experience has been widespread and interest is growing, but the results have been uneven.

Fundamentally, the industrial estate provides developed sites for the construction of factories, to be built by the entrepreneur or to be offered for sale or lease by the estate management authority. The resulting clustering of enterprises may facilitate working arrangements between enterprises and provide a focal point for other assistance needed by smaller industries. This assistance may take the form of financing; contracts with government regulatory agencies; training; advisory services; research; subsidies; testing facilities; common industrial, purchasing, or marketing services; or labor relations services. Thus industrial estates can serve to create external economies of scale, to make available serviced industrial land at reasonable cost, to produce a desirable pattern of location of industry, and to serve as a means of centralizing official assistance to industry.

In addition to the general-purpose industrial estate, a variety of other forms has evolved in developing countries. Some are large estates for both heavy, large industries and smaller, light industries, and may include major transport facilities such as ports or railway yards.<sup>2/</sup> A newer type for particularly small industries is the estate consisting of "flatted" factories or lofts, for relocating squatter workshops or others covered by urban renewal programs,<sup>3/</sup> or for attracting foreign investment to labor-intensive activities such as electronic assembly.<sup>4/</sup> There are "functional" estates specializing in one type of industry, e.g., metal working. "Satellite" estates have been

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<sup>1/</sup> Industrial estates are found in such diverse countries as Ireland, in Europe; Puerto Rico, Mexico and Brazil, in the Western Hemisphere; India, Pakistan, Malaysia, Singapore and Taiwan in Asia; Ghana and Nigeria in Africa.

<sup>2/</sup> e.g., Jurong near Singapore with a potential area of 17,000 acres; Aratu near Salvador in Brazil with 110,000 acres.

<sup>3/</sup> e.g., Hong Kong, Singapore.

<sup>4/</sup> e.g., Singapore.



created for sub-contractors of larger industries. There are also estates set up in thickly populated rural areas to tap a new work force and decentralize industrial concentrations.<sup>1/</sup> Some countries have created export-oriented estates with customs-free bonding arrangements.

The ownership of industrial estates may be private or governmental, in the latter case at the local, regional or national level. In developing countries ownership must usually be public, although the hope is sometimes that the governmental initiative may induce similar operations by private entrepreneurs. Given public ownership at one or another level of government, the question arises, in relation to the Commission's recommendation, as to what kind of external assistance governments need and what role there can be for the Bank Group. Technical assistance, which can be used to good advantage for preinvestment studies and planning of industrial estates as well as for their operation, is available from the U.N. Industrial Development Organization (UNIDO) with financing from the United Nations Development Programme, and from bilateral sources, both public and private, such as USAID and the Ford Foundation. Finance is required for land acquisition, the provision of infrastructure, factory buildings and equipment, and for various kinds of services.

The Bank Group's potential role is obviously primarily one of providing finance. Our experience with industrial estates is limited to one IDA credit of \$6.5 million, extended to Pakistan in 1962 to help develop two industrial estates. This particular project ran into difficulties, partly because the estates were not well sited and partly because the financing arrangements for the prospective tenants were inappropriate. Nevertheless, I believe that we should, consistent with the Commission's recommendation, be prepared to give assistance to appropriate projects involving the establishment of industrial estates. A follow-up of the Pakistan project is in fact in an advanced state of preparation and should come forward to the Board early in 1970.

As the Executive Directors know, we keep searching for ways in which the Bank Group of institutions, centrally organized as they are, can effectively help the small entrepreneur. The Commission is, in my judgment, entirely correct in pointing to industrial estates as a promising vehicle for such assistance. Of course, in each case we would need to weigh the relative merits and costs, social as well as economic, of helping to establish an industrial estate as against other possible ways of promoting the particular small industries concerned.

In the single instance in which we have thus far provided financing for an industrial estate, our funds were used primarily for importation of capital equipment for private factories located on the estates. The financing requirements for other cases may well be primarily for the public sector infrastructure. Each case will have to be judged on its merits. In most instances, it is likely to be desirable to associate our financing with technical assistance from other sources. We should also, I believe, be prepared to help in the planning of industrial estates projects for which Bank Group financing is contemplated. This might be done, in appropriate cases, in association with UNIDO.

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<sup>1/</sup> e.g., Taiwan.



### C. Agricultural Credit Cooperatives

The Commission noted that increasing agricultural production in the developing countries has increased the demand for farm credit. It was particularly concerned about the needs of small farmers, who characteristically have difficulty in finding funds with which to buy imported seed, fertilizer, pesticides and implements and to improve the productivity of their property. In framing its recommendations, the Commission singled out for support, among the other various kinds of agricultural credit institutions, the credit cooperatives. The analysis which follows is, accordingly, similarly limited, although cooperatives are of course only one of several vehicles through which agricultural credit may be extended.<sup>1/</sup>

Agricultural credit cooperatives specializing in investment lending are rare in developing countries. More frequently multi-purpose cooperatives are found which extend credit in the form of seasonal inputs and collect payment through marketing the crops. There are also various forms of farmer associations, for example in Taiwan, Pakistan and West Africa, which are not cooperatives in a strict sense but which perform many of the same functions effectively. Even where specialized agricultural credit cooperatives do exist, the apex organization is usually not a cooperative, as is the case in Western Europe and North America, but a public agency or specialized banking institution designed to exercise control over the cooperatives and to channel government subsidies to them. In addition, agricultural credit cooperatives often deal mainly or only in short-term credit and, because of lack of experience and appraisal staff, find it difficult to provide longer term credit. That kind of credit is, instead, provided through specialized public agricultural credit institutions.

Within these limitations, the Bank Group has used both agricultural cooperative credit institutions and multi-purpose cooperatives as a channel for making funds available to their members, the ultimate beneficiaries. In some cases, these cooperatives have played an important role in the project as a whole by providing needed services rather than funds.

Experience with these projects has been mixed: some have been successful, others not. The critical factor has been the quality of the management of the cooperatives; if it is weak, as it often is, the project has not been fully effective. In one case, the management of a cooperative group which was expected to act as the channel for Bank funds was so weak that a proposed financing operation had to be postponed indefinitely.

Experience suggests that, in most cases, working through cooperatives imposes a sizeable workload on the Bank, in that substantial guidance and supervision appear to be required. I believe, nevertheless, that our use of

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<sup>1/</sup> A sizeable portion of the Bank Group's total financing of the agricultural sector has, over the years, been extended to agricultural credit institutions, to which we have also provided considerable technical assistance. Bank and IDA financing for agricultural credit aggregated \$285.2 million as of June 30, 1969.



cooperatives has been worthwhile and that they are an important tool in carrying out our agricultural programs and particularly in reaching individual farmers and ranchers. They are not the only tool, however, and therefore the Bank Group must in each case choose the institutional vehicle most suited for carrying out its financing objectives.

When the Bank Group lends for projects which make use of agricultural cooperatives to provide credit and other services for farmers, provision normally has to be made for substantial technical assistance to supplement the provision of finance and to make it more effective. A recent example is the loan and credit of \$9.5 million equivalent made to Senegal in February 1969 to provide (a) credit to farmers, through existing cooperatives, for various agricultural inputs; (b) management services to reorganize the cooperatives' supply and marketing organization and train local staff for its future operations; and (c) extension services to the farmers.<sup>1/</sup> Several agricultural credit projects in India are under consideration now, all of which include the use of specialized credit cooperatives as channels of funds and some of which involve substantial inputs of technical assistance.

I believe, however, that we could do more in this field by way of assistance in project preparation, perhaps most effectively in association with the international cooperative movement which has been active in helping cooperatives in the developing countries. I have therefore directed the staff to consider ways in which the Bank Group might support that movement by relating it more closely to Bank operations, and to come forward with proposals to that end.

#### Conclusion

I am in full agreement with the recommendation of the Commission that more should be done by way of support to the indicated types of intermediary institutions and facilities. Substantially increased assistance to development banks is already provided for in the Bank Group's program for the next five years. Assistance for industrial estates and agricultural cooperative credit institutions must necessarily proceed at a slower pace, for the reasons indicated. However, we are mindful of the potential in these areas. We shall be prepared not only to provide finance in support of industrial estate projects but to assist in the planning of projects of that character for which Bank Group financial support would be appropriate. We shall also be exploring the possibilities of helping to improve the management of agricultural credit cooperatives and of assisting governments in preparing agricultural credit projects involving the use of cooperatives, where appropriate, for Bank Group financing.

No action by the Executive Directors is now required.



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<sup>1/</sup> Loan No. 584 SE; Credit No. 140 SE.







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WASHINGTON, D. C. 20433, U.S.A.

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**MAY 22 2013**

**WBG ARCHIVES**

CONFIDENTIAL

December 11, 1969

MEMORANDUM TO THE EXECUTIVE DIRECTORS

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

Recommendation

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

Analysis

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

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

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



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

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

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

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

If, however, only a few countries are prepared to participate, it may be necessary to restrict bidding to these countries. While even some

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

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



competition is better than none, the full contribution of joint financing in untying tied aid can be achieved only by a broad participation by equipment-supplying countries.

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

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

#### Conclusion

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

*Robert S. McNamara*



JOINT FINANCING OPERATIONS BY YEAR OF SIGNATURE OF  
LOAN OR CREDIT

Year	No. of Projects	Total Cost	Foreign Exchange Cost <u>1/</u>	Bank/IDA Contri- bution	Co-lender amount <u>2/</u>	% Total Cost	
						Bank/IDA	Co-lenders
<u>Primarily</u>							
<u>development</u>							
<u>finance:</u>							
			----- \$ million -----				
1955	1	26.6	18.0	18.0	2.6	67.6	9.7
1956	1	226.0	200.0	30.0	128.8	35.3	57.0
1957	2	54.0	32.3	20.1	16.5	37.2	30.5
1958	2	61.7	41.1	41.1	6.4	66.6	10.3
1959	3	195.6	160.4	60.2	32.3	30.7	16.6
1960	7	279.7	230.2	113.0	56.3	40.4	20.1
1961	5	283.4	151.6	75.1	63.7	25.4	22.5
1962	1	196.0	118.0	47.0	51.0	23.9	26.0
1963	3	97.6	64.6	43.6	22.9	44.6	23.5
1964	8	445.4	284.5	145.6	99.5	33.2	22.3
1965	2	37.8	25.1	15.7	17.1	41.5	45.2
1966	1	39.0	24.0	19.2	4.8	49.2	12.3
1967	4	125.0	94.3	53.2	18.0	52.5	14.4
1968	9	586.4	264.8	145.9	150.3	25.2	25.7
1969 thru Oct. 15	10	577.8	242.4	153.4	101.8	26.5	17.6
Total	59	3,232.0	1,951.3	1,031.1	772.0	31.9	20.8
<u>Indus</u>							
<u>Basin <u>3/</u></u>							
<u>and</u>							
<u>Tarbela</u>							
	2	1,626.0	1,030.0	173.4	1,191.5	10.7	73.3
Total	61	4,858.0	2,981.3	1,204.5	1,963.5	24.7	40.2
<u>Export</u>							
<u>Finance</u>							
1968	5	536.6	320.7	250.0	51.4 <u>4/</u>	46.5	9.6
1969	1	247.4	80.0	60.0	19.7	24.3	7.9
Total	67	5,642.0	3,382.0	1,514.5	2,034.6	26.8	36.0

1/ Includes some estimates.

2/ Excluding public issues but including private placement through banks.

3/ The saving of \$324 million in the Indus Basin Fund has been deducted from both the total cost and the co-lenders' amount and pro rata, 60% from the foreign exchange cost.

4/ Amounts likely to be utilized following pattern of award of contracts.

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
INTERNATIONAL DEVELOPMENT ASSOCIATION

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R70-234

FROM: The Secretary

December 15, 1970

Pearson Commission Recommendations

Following the procedure indicated in the President's Memorandum dated October 10, 1969 (SecM69-472), there is attached hereto an analytical memorandum dealing jointly with Recommendations Nos. 17 and 18. This completes the memoranda on all 33 items listed in the attachment to the above-mentioned President's Memorandum of October 10, 1969.

Distribution:

Executive Directors and Alternates  
President  
President's Council  
Executive Vice President, IFC  
Vice President, IFC  
Department Heads, Bank and IFC





OFFICE OF THE PRESIDENT

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
INTERNATIONAL DEVELOPMENT ASSOCIATION  
WASHINGTON, D. C. 20433, U.S.A.



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December 15, 1970

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendations Concerning the Financing of Local Currency Expenditures and Program Lending

"Pearson" Recommendations

- (1) "We recommend that aid-givers remove regulations which limit or prevent contributions to the local costs of projects".
- (2) "Aid-givers should adapt the forms of aid to the needs and level of development of the receiving country and recognize the great value, in many cases, of more program aid".

BACKGROUND

1. Both these recommendations of the Commission are contained in Chapter 9 of the Report, which considers ways in which aid might be made more effective. The Commission recognized the advantages of project aid, and the reasons - including the wording of the Articles of Agreement of the Bank and IDA - which might cause donors to favor it. It was concerned, however, that the effectiveness of official development assistance is often reduced by too exclusive an emphasis on financing the foreign exchange costs of projects. In particular, the Commission took the view that

- (1) where only foreign exchange costs were financed, this led to "an uneconomic bias towards capital intensive projects with a large foreign exchange component": hence the first of the recommendations considered here; and
- (2) the advantages of program aid, which the Commission describes in summary form, were insufficiently recognized, with the result that "current aid funds would be more effectively used if a larger share were supplied in the more flexible form of program aid": hence the second of the recommendations considered here.

2. In connection with program aid, the Commission specifically endorsed the view that multilateral financial assistance should have a large non-project option. It went on to point out that "in the consortia headed by the World Bank, member countries are enjoined to provide program aid"; and drew the inference from this that it is anomalous that the Bank Group should not itself supply it more freely.

3. These recommendations are I think clearly related. They may be regarded as different and in certain cases alternative methods of achieving the same objectives, namely to provide to recipient countries external assistance over and above what they could expect to receive by way of the direct foreign exchange costs of particular approved projects, and to improve the effectiveness of a given amount of such assistance. Thus the case for program lending depends in part, though only in part, on the extent to which it may not be readily possible to finance local expenditures in connection with project aid. It is for these reasons that both of the recommendations are here treated together in a single memorandum.

#### ANALYSIS

##### A. Provisions of the Articles

4. With respect to the financing of local expenditures, Article IV, Section 3(c) of the Bank's Articles of Agreement provides that

"The Bank, if the project gives rise indirectly to an increased need for foreign exchange by the member in whose territories the project is located, may in exceptional circumstances provide the borrower as part of the loan with an appropriate amount of gold or foreign exchange not in excess of the borrower's local expenditure in connection with the purposes of the loan".

Article V, Section 2(e) of IDA's Articles of Agreement permits local expenditure financing in "special cases".

5. With respect to the purposes for which Bank loans or IDA credits may be extended, Article III, Section 4(vii) of the Bank's Articles of Agreement provides that

"loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development".

Article V, Section 1(b) of IDA's Articles of Agreement contains a similar provision.

6. The interpretation of the provisions relating to the purpose of loans or credits was recently considered in a memorandum prepared by the General Counsel, and circulated for the information of the Executive Directors on March 20, 1970 (Sec M70-120).



B. Recent Consideration of These Issues

7. In relation to local expenditure financing, the policies to be pursued by the Bank and IDA were the subject of a review by the Executive Directors in June 1964, on the basis of a staff paper entitled "Foreign Exchange Loans for Local Expenditure" (FPC. 64-4 dated May 1, 1964), and again in September 1968, on the basis of a staff paper entitled "Foreign Exchange Loans for Local Currency Expenditures" which I transmitted under a covering memorandum dated July 30, 1968. From the discussion on the latter occasion, it was apparent that the Executive Directors were in general though not unanimous agreement that in certain defined circumstances the Bank and IDA must be prepared to finance local currency expenditures if they are to carry out effectively their basic functions as development finance agencies. At the same time, however, some Executive Directors raised doubts concerning the extent to which local cost financing could be undertaken consistently with the wording of the relevant Articles of Agreement. At the request of the Directors, the General Counsel circulated a memorandum on November 19, 1968 (Sec M68-436) which considers the question how far and in what form local expenditure financing is authorised under the provisions of the Articles of the Bank and IDA.

8. The present policies of the Bank and IDA reflect the general position taken by the Executive Directors in 1964 and 1968 and are consistent with the views expressed by the General Counsel.<sup>1/</sup> As the Executive

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<sup>1/</sup> These policies have been summarized in one of the operational memoranda issued as a guide to the staff in the conduct of Bank and IDA business, as follows:

In principle, the Bank is prepared to consider loans for projects involving local expenditure if the following conditions are met:

(a) The borrowing country has a suitable development program and is making an adequate development effort.

and

(b) This development program requires funds in excess of the savings that can be raised locally and the capital, public and private, that can be obtained from other external sources.

and

(c) These funds cannot reasonably be provided to the country in adequate amounts by financing foreign exchange expenditure on development projects (i.e. there are insufficient investment opportunities of this kind).

or

(d) Although there are sufficient investment opportunities of this kind, the Bank could have a greater beneficial influence on the country's development if it directed its financing toward other projects of key importance requiring some local expenditure financing.

(Operational Memorandum No. 2.03, dated June 9, 1969)



Directors are aware, in recommending any loan or credit which incorporates local expenditure financing, I take care to present the facts of the case and to describe the exceptional circumstances which in my judgment justify the action proposed.

9. With reference to program lending by the Bank and IDA, I submitted to the Executive Directors in November 1968, together with a covering memorandum, a staff paper entitled "Program Lending" (R68-206). In the course of the discussion which followed, widely varying views were expressed concerning both the case for program lending in general and the extent to which it might be proper or desirable for the Bank and IDA to engage in it. The Executive Directors reached broad agreement that "program lending could be appropriate for the Bank and IDA in special circumstances where this form of lending would best accomplish the objectives of the Bank Group". However, it was further concluded by the Executive Directors that it was not possible at that stage to lay down specific criteria for the determination of special circumstances, and that "this determination should be made in connection with particular lending proposals".

10. Our present policies and procedures reflect the views expressed and the decisions taken two years ago, together with the opinions set out in the memorandum prepared by the General Counsel (Sec M70-120) to which I have referred above.

11. Although the main themes of these two recommendations of the Pearson Commission have been considered extensively by the Executive Directors in 1968, the Commission's recommendations now provide us with a useful opportunity to review again the lending policies of the Bank Group, and to consider whether any change might be desirable. In the course of my Closing Statement at this year's Annual Meeting in Copenhagen, I noted the importance attached by many Governors to greater flexibility in the lending policies of the World Bank Group, and stated that "the time has clearly come for a full re-examination of both program lending and local expenditure financing".

12. Since these are complex and in some respects controversial matters, which raise very basic questions concerning the role of the Bank Group, there seems to be a good case for a detailed and deliberate review, in which full account is taken of the experience with different modes of lending which has been acquired by the Bank and by other lenders. A summary review of this experience is set out in Annex I attached to this memorandum.

13. Before turning to the general issues which arise in connection with lending policies and techniques, I think it may be helpful if I consider some questions of terminology and interpretation, which have sometimes given rise to difficulties or misunderstandings in the past.



C. The Characteristics of Project and Program Lending

14. The Pearson Commission's analysis makes a general distinction between project aid and program aid. This is a familiar and useful dichotomy, and I do not propose to depart from it. But since the terms are broad ones, and the boundary line between the two types of lending is unclear and sometimes disputed, it may be useful if I state my own understanding of the issues which the Commission has raised.

15. It is generally recognized that a spectrum of lending possibilities exists, with what may be termed the purest forms of project lending or program lending at the two extremes. On the one hand, there is the case of a loan which is specifically made in order to finance the foreign exchange content of the capital expenditures associated with a particular physical undertaking, such as a new road or a power station, the case for which, and the design and execution of which, have been fully reviewed and appraised. This is the pure project loan. At the other extreme, a lender may make foreign exchange available to a recipient country in general support of its development program, with little or no attempt to specify the purpose which the loan is to serve. This is the pure program loan. But it is possible and indeed frequent for intermediate cases to arise, by which project loans acquire some of the characteristics or effects of program loans, and vice versa. For our purpose I think it is useful to look at some of these intermediate categories, and to consider the relation in which each of them may stand to the recommendation of the Pearson Commission.

16. First, to an increasing extent, the individual project forms part of a sector investment program which is appraised as a whole, with Bank financing attached to particular items or groups of items for which it is most appropriate. This is typically the case in telecommunications, water supply and railways, and to a lesser extent in education and power. Highway lending in a number of countries is also being based on a review of investment priorities for the sector as a whole, usually done as part of a comprehensive sector survey, with a number of individual roads of high priority financed under a single project. Agriculture is the sector which, because of its size, is most difficult to embrace in single projects; this is done to some extent, however, in agricultural credit projects, and will become increasingly possible as more Bank/FAO agricultural sector reviews are carried out. Thus in the current practice of the Bank Group, project and sector lending are increasingly becoming coterminous.

17. Although the focus of lending policies has thus shifted from the individual project to a broader setting, it is my view that what may be described as sector lending at any rate in the forms which it has been given or is likely to be given within the Bank Group, should be regarded as falling under the broad heading of what the Pearson Commission refers to as project aid. The essential characteristic in virtue of which this



may be said is that the disbursements are linked to approved capital expenditures carried out in designated fields within the recipient country; funds are not made available in general support of the country's development program.

18. However, even though sector lending of this kind is best thought of for our purposes as a form of project aid, the extent to which the Bank Group is able and willing to engage in it may have a bearing on the case for program lending by the Bank and IDA. The more flexible and varied are the forms for which we are able to provide project assistance, the fewer may be the special circumstances in which we should consider lending for purposes other than that of financing projects.

19. Second, project aid, including even the financing of highly specific individual projects, can have what might be termed a "program aspect" in so far as it incorporates the provision of foreign exchange to finance expenditures in local currency. In such cases, disbursement of the foreign currency is conditional on the execution of approved projects, yet it is common practice for the recipient country not to be tied in respect of the use to which the foreign currency is put. Thus the effect of the loan is not simply to further a particular project but also to furnish the recipient country with free foreign exchange, in much the same way that might have resulted from an extra infusion of aid that was unrelated to project financing.

20. In many cases of so-called program lending, the situation is the reverse of that which I have just described: the foreign exchange is made available for the purchase only of certain specified imports, while no restriction is placed on the use of the counterpart funds that arise from the sale of the foreign exchange which the loan provides. In so far as the uses of the foreign exchange are thus prescribed, so-called program lending may acquire something of a "project aspect"; and if the use of the counterpart funds is tied to local expenditures arising from projects that have been fully appraised, the loan may acquire what can be thought of as the prime characteristic of project aid.

21. Nevertheless, the broad distinction which the Pearson Commission has made remains I think a useful one in relation to the policies of the Bank Group. It has not in fact been our normal practice, in making what may be termed "import loans" or "program loans", to place restrictions on the use of counterpart funds. It is true that in a number of circumstances, as can be seen from Annex I attached to this memorandum, the permissible use of the foreign exchange provided have been specified in some detail, so that in a broad sense this form of financing could be said to have a project aspect. Yet in general the funds thus provided have not been made available specifically and exclusively for financing particular agreed forms of capital expenditure by particular agencies, and hence fall into the broad category of program rather than project aid. I interpret the Pearson Commission as



holding that the Bank ought to be readier than it is at present to provide assistance of this kind.

D. General Analysis and Review

(1) The Context

22. The questions of lending policy that confront us have to be looked at in the context of a number of considerations, which I think it may be helpful to state at this point. There are four considerations in particular which I hope we might all agree should be taken into account.

23. First, the prime object of our policies must be to ensure that the developing countries which borrow from us should benefit to the greatest possible extent from the loans and credits that we are able to extend to them. Forms or techniques of lending are merely the instruments for this purpose; they are not ends in themselves. Thus we should not engage in what may be termed program lending merely for its own sake, or in order to disarm possible critics; but we should be ready to adapt our methods, without undue concern for the terms or nomenclature which may be given to them, in whatever way may seem best suited to the needs of our borrowing countries. Similarly, to use the words of the Pearson Commission, we "should not adhere to project aid as a matter of orthodoxy". The fact that in many situations the distinction between project and program lending may become blurred, as I have noted above, is an additional though subsidiary reason for not becoming too preoccupied with labels.

24. Second, the choice of policies must be seen in relation to a continuing increase in lending commitments by the Bank Group. As the Executive Directors are aware, commitments by the Bank and IDA taken together reached in the fiscal year 1968 a total of about \$1.0 billion. The corresponding figure projected for the fiscal year 1973 is approximately \$3.0 billion, an increase of some 200 percent. Loans and credits from the Bank Group have been increasing not only in absolute terms, but also in relation to the total amount of official development assistance - i.e., in relation to the amounts provided by the bilateral donors.

25. Third, there can be no question but that the greater part of the lending undertaken by the Bank Group will continue to take the form of financing of foreign exchange costs of specific approved projects or sets of projects. It is neither necessary nor desirable for us to change this state of affairs, or to depart in this respect from our established policies and procedures.

26. Fourth, the choice of how we can best carry out our role cannot be made without regard to the policies pursued by the other main providers of aid, and particularly the leading bilateral donors. This does not and



should not imply that our function is to be merely an auxiliary or residual lender, reacting to the decisions taken by other agencies. On the contrary, the Bank Group has and will continue to have its own independent set of policies and criteria. But in order to maximize the likely effectiveness of our aid over any given period we have to take account of what is being done by the other principal sources of external finance.

27. With these preliminary observations, I turn to what seems to me the main substance of the issues which the Pearson Commission has raised.

(2) The case for a broad approach to lending

28. I have already remarked that these two recommendations of the Pearson Commission cited at the outset of this paper are closely linked. In particular, the clear implication of both is that lenders should not limit external assistance to covering only the foreign exchange component of capital expenditures on projects. I believe this view would receive unanimous endorsement from the Executive Directors. If concessional external finance is restricted in this way, a clear bias is introduced against projects with a high content of local expenditure, irrespective of what may be the true priorities in the country and situation that are concerned. In particular, important sectors such as education and agriculture may be unduly neglected. Further, such a restriction may, in certain cases, lead developing countries to buy abroad when the cost to the economy of local procurement would be lower. Thus the choice of projects is no longer made in accordance with an appropriate system of priorities, and in the execution of projects there may be unnecessary waste and increase in cost.

29. A restriction of this kind is in fact a harmful and undesirable form of aid-tying. Though its results may often be less serious than those of the form of tying that is more commonly discussed, by which the proceeds of overseas grants or loans are restricted to the purchase of goods or services from the donor country, both forms share the essential characteristic that recipient countries may lose but cannot benefit from their imposition.

30. The case against tying loans to the foreign exchange component of projects can also be viewed from another standpoint. As the Executive Directors are aware, the Bank Group, when determining the basis of its prospective lending program in a particular country, normally starts out from an appraisal of the total external assistance that is likely to be needed in order to ensure a satisfactory rate of development, taking account of export prospects, the extent to which the funds required for development can and should be financed from domestic sources, and the borrowing capacity of the country. There is no reason to suppose that these estimates of external financing needs will bear any close or predictable relationship to the amounts that would be forthcoming from project assistance that was restricted to the foreign exchange component. For all bilateral and multi-lateral donors to concentrate on this particular form of aid would therefore be incompatible with the aim of securing an efficient and equitable allocation of official development assistance among recipient countries.



31. For these reasons, the case against this narrow form of project assistance, and in favor of a broader and more flexible approach to lending, is a very strong one; and it applies to the Bank Group in common with other sources of financial assistance. Indeed, in view of our special concern and involvement with project lending, it is particularly important for us to ensure that we are able to engage in local expenditure financing whenever it seems appropriate and to the full extent that the individual circumstances may warrant. As the Executive Directors are aware, and as the evidence set out in the first Annex to this memorandum makes clear, the Bank Group has been willing and able in the past to undertake the financing of local expenditures in a variety of cases: here as elsewhere, our policies have been flexible and have been adjusted to changing conditions. What has now to be considered is whether and how far we would benefit from a degree of flexibility with respect to local cost financing which exceeds that which can be attained under our present policies and procedures.

32. On the whole, I incline to the view that for the present at least no basic change is called for. In this connection, however, the interdependence of these two issues of lending policy raised by the Pearson Commission, to which I have referred above, may have to be borne in mind. I have remarked that the strength of the argument for non-project lending by the Bank and IDA depends in part on how broadly we are prepared to interpret the notion of project assistance. The reverse may also be true. Thus it might be held that the need for ensuring a higher degree of flexibility with respect to local cost financing will be affected by the extent of our willingness to recognize special circumstances in which we would be prepared to make loans or credits available in non-project form. I therefore turn now to consider, with special reference to the Bank and IDA, the question of whether and to what extent non-project or program lending may be a useful form of development assistance.

### (3) The possible uses of program lending

33. It may be helpful here to separate the general argument for non-project lending, which applies to all lending agencies considered together as a collective, from the particular case of the Bank Group. What is valid for the whole may not be equally applicable to each individual member of it. Thus even granted that a significant proportion of total foreign assistance ought normally to be made available in the form of program lending, it would not necessarily follow that the Bank and IDA should engage in such lending to the same extent as other donors, or even that they should engage in it at all. Accordingly it is convenient to look first at the wider picture, and only then to consider the question of what policies may be appropriate for the Bank Group.

34. If we consider the total volume of official development assistance, as distinct from what is provided by particular lenders, it would I think be generally agreed that the forms in which this assistance is made available



should not be confined to the financing of projects. The reasons for this are set out in the second of the Annexes attached to this memorandum, and it is convenient to refer to them briefly at this point.

35. One way of viewing the matter is in relation to the estimates that are made within the Bank, and which I referred to above, of the prospective external financing needs of individual developing countries. Although such estimates are necessarily rough, so that any particular figure arrived at represents no more than an order of magnitude, it would I think be generally agreed that this form of analysis constitutes a useful and indeed indispensable approach to the task of designing an external assistance program. I have already made the point that there may be a wide discrepancy between the amount of aid that we believe a country can put to effective use and the amount that would become available to it in the form of the foreign exchange component of capital expenditure on specific projects. There is no doubt that such discrepancies could be narrowed, or even in favorable circumstances eliminated, by suitable provision for financing local currency expenditures. But as is clear from Annex II attached to this memorandum, pages 46 to 47, the extent of the contribution that can be made by local cost financing will vary with circumstances, so that for some countries there might still remain a serious gap both in time and in amount. Thus there may be cases in which the need for freely available foreign exchange cannot be met by external assistance that is linked to projects.

36. Although it is perhaps risky to generalize about such cases, I think that it is possible to specify certain broad groups or categories into which they are likely to fall. One such group comprises countries which are faced with a major and urgent task of reconstruction or rehabilitation of their economic system. In such situations there is typically an immediate need for free foreign exchange, which can be used to finance the imports that are required in order to increase or even maintain the existing rates of production, and also in order to build up essential inventories to an adequate level. In these cases it is almost inevitable that there should be limited scope for project assistance: expansion of infrastructure and production capacity has a lesser priority than full utilization of existing capacity; moreover, a stock of projects that have been properly appraised and are ready for implementation does not exist or is at best extremely inadequate. In so far as the initial emergency needs are met, the case for expeditious program lending becomes less strong; and in so far as an inventory of suitable projects is built up, it may become increasingly possible and appropriate for the balance of external assistance to shift from non-project to project form. But for a substantial period there is likely to be a clear case for providing free foreign exchange independently of the financing of projects, since the need cannot be fully met by a readiness to engage in local expenditure financing.



37. The case for non-project lending of this kind was clearly recognized by the Bank in its early years, during the period of reconstruction which followed the Second World War. As was noted in our Fifth Annual Report, covering the year 1949-50, the reconstruction loans that were made at this time to France, Denmark, and the Netherlands "were designed to meet emergency needs of these countries for foreign funds to finance a large variety of imports essential to the continued running of their industries". Certain more recent instances of non-project lending, both by the Bank Group and by other lenders, would appear to fall under this heading.

38. It is, however, generally accepted that a case for program lending may exist in situations other than that of reconstruction or rehabilitation; and the analysis set out in Annex II lends support to such a view. It is true that for any given country at a particular time the extent to which this case applies, and the amount of non-project assistance which it would be desirable to provide, will inevitably be matters of opinion. We are dealing here not with an exact science, but with difficult and complex issues of practical judgment. At the same time, it is possible to outline the circumstances which may give rise to a need for external assistance in non-project form.

39. A necessary though not a sufficient condition for this need to arise is that the country concerned should be critically dependent on an adequate supply of free foreign exchange, in order to maintain a satisfactory rate of growth or even to avoid an actual decline in production, while at the same time it is faced with a chronic difficulty in obtaining such a supply. A situation of this kind may arise where one or more of the following conditions is present:

- (a) Because of underutilization of existing capacity, particularly in the industrial sector, a country may have greater need for a flow of imports to support existing production than of imports to finance investments that would expand capacity.
- (b) For reasons that lie beyond the country's control, receipts from traditional lines of exports are stagnant or falling and have to be replaced over a period by other products.
- (c) Development has reached a stage where the country is able to produce internally a high proportion of the capital goods, materials and services necessary for new investment, while an increasing volume of other imports is needed in order to sustain economic growth.
- (d) The country concerned is faced with substantial and inescapable claims on freely available foreign exchange, such as arise from debt service payments.



Past experience has shown that it is by no means uncommon for these conditions to be simultaneously realized.

40. The existence of such a situation does not in itself establish a case for program lending. As I have noted above, it is possible for lenders to make available free foreign exchange through project assistance, provided that they are willing to finance local currency expenditures. Yet even with a broad interpretation of project lending, and given a general readiness to make provision for local expenditure financing, this form of lending may not suffice to meet the needs of every situation. Thus it may become necessary for lenders to provide assistance in non-project form in order to ensure that an adequate transfer of resources is effected. Moreover, apart from the question of the amount of assistance, there is also the matter of timing. In the case of project as compared with non-project assistance, the time-pattern of disbursements is both less predictable and more extended. Hence where special needs for disbursements have arisen, it may not be appropriate to allow the extent to which these needs are met to depend on what can be spent on a particular set of projects in a particular time-period.

41. This aspect of timeliness and assurance of assistance has also a bearing on the degree to which external lending can help to bring about improvements in general economic policies. Recent cases have demonstrated that in a situation where a critical shortage of foreign exchange has arisen as a result of factors which are not merely accidental and temporary, countries have often found themselves obliged to resort to forms of restriction and intervention with respect to foreign trade and payments which, while possibly justified as an emergency measure, may have harmful effects on growth and efficiency over the longer period. There have been a number of such cases where the assurance of external assistance, in timely and freely available form, has enabled countries to embark on policy measures which, though they were greatly needed in the interests of economic development, could not have been introduced in the absence of such support. This aspect of the matter has been noted by the Chairman of the Development Assistance Committee in his most recent Report, where he points out that

"Non-project assistance has helped countries such as India, Pakistan, Korea, Turkey and others to introduce more liberal import regimes which have greatly added to efficient resource use by reducing cumbersome administrative controls and increasing reliance on market forces as a means of improving resource allocation."

42. In view of these circumstances, it is not surprising that a need has sometimes become apparent for non-project assistance, a need which could



not have been fully met even with generous provision for local expenditure financing. As the Executive Directors are aware, the Bank staff has on a number of occasions, both in economic reports and at meetings of consortia and consultative groups, taken the view in the case of particular countries that a greater emphasis on this form of lending was very much needed.

43. None of this in any way undermines or conflicts with the case for project assistance, which is familiar and in my view a very strong one. The argument is only that there appear to be situations in which to insist that external assistance should be made available through this medium alone would make it difficult or impossible to achieve important development objectives.

44. Before leaving this general question of the case for program lending, I would like to refer briefly to a number of arguments that have been advanced both for and against such lending, and which in my view can be given too much weight.

45. One such argument is that program lending is increasingly more appropriate for recipient countries as their stage of development becomes more advanced. Although as I have noted above there is something in this point, I do not think that it is right to assume that any simple and automatic relationship does or should exist. Many other factors have to be taken into account; and the situation in which a country has built up a viable capital goods sector, so that its dependence on imported equipment is reduced, is precisely one in which a readiness to engage in local expenditure financing may be an equally effective and appropriate course of action for lenders.

46. Another possibly questionable argument for program aid is that it enables the lender to exert a greater degree of influence and control over the general economic policies, as distinct from the conduct of projects, within the recipient country. There are some who would reject this argument on the ground that it is no business of external lenders to try to exercise leverage with respect to a borrowing country's general economic policies. But even to those it may be apparent that program lending may enable countries to introduce desired changes which could not be made without it. This point is admirably illustrated by the statement which I quoted above by the Chairman of the Development Assistance Committee.

47. On the opposite side of the coin, non-project lending is sometimes regarded with suspicion because of a fear that it will diminish the degree of influence exerted by the lender, enable borrowing countries to introduce or to persist with policies which are unsatisfactory, and result in wasteful use of the funds provided by the loan. In addition, it may be felt that countries which are in receipt of program aid may as a consequence put a lesser priority on project preparation. But the objection thus raised is



not to the principle of such lending but to a deficiency in the way that this principle is carried into effect - a deficiency which lenders in general, and the Bank Group in particular, are in my judgment both ready and able to guard against. Non-project lending need not and should not be a "soft option". Lenders should only be ready to engage in this form of lending, even in the situations to which I have referred above, when it is clear that the country concerned is capable of effective economic management, including the design and execution of a satisfactory development program and the taking of all necessary steps to prepare and execute projects properly. Thus there must be a reasonable assurance that the funds provided will be put to productive use, without adverse effect on the capacity to make use of project assistance.

48. Finally, I would like to refer to an argument that is sometimes brought against the use of program lending, which is that it is not appropriate to use long-term development financing to deal with problems which are or should be of a short-term character, and for which temporary financial assistance is available from the International Monetary Fund. There can be no quarrel with the general principle that different agencies should recognize and respect each other's functions, and that overseas development assistance should serve the purposes that it is intended to serve. It is however a matter of opinion whether the situations in which program aid has been provided either could or should have been dealt with by the provision of short-term financing alone; and the analysis set out in the Annexes strongly suggests that this was not in general the case. There may be, and in my view there actually have been and will continue to be, circumstances where both forms of assistance are required. In any case the simple distinction between short-term and long-term problems may often be a very debatable and uncertain guide to action in the complex situations with which we actually have to deal. Rather than trying to apply a simple mechanical formula, the Fund and the Bank will I hope continue to follow their present procedure of working together to devise for each individual case the set of measures and of modes of assistance which seems appropriate to the circumstances.

49. I turn now to the question of whether, granted that program lending is called for in some circumstances, the Bank and IDA should be ready to join in providing it. In considering this, we should recognize that the Bank has a well-established role and a strong comparative advantage in the provision of project finance, and that it should therefore emphasize this form of lending in the absence of clearly preferable alternatives.

50. At the same time, the most useful and appropriate role for the Bank Group in any given situation cannot in my view be determined entirely independently, but will necessarily depend on the policies that are followed by other sources of official development assistance. In general, it may be said that if a clear case has in our view been established for program lending, if a reasonable estimate of the amount of such lending has been arrived



at, and if it is clear that other lending agencies cannot be persuaded to supply something like this amount, then a prima facie case exists for non-project lending on the part of the Bank or IDA.

51. The view is sometimes expressed that if the Bank Group were to show a greater readiness to undertake non-project lending, this would have an unfavorable effect on the readiness of the Part I countries to contribute to the financing of IDA, or on our reputation and hence our ability to borrow in the capital markets of the world. In my view this should not prove serious if we make judicious use of this form of lending. Almost all the Part I countries themselves engage in program lending, and several of them have expressed their concern that the Bank is not readier to do so. As to international capital markets, it is clear to my mind, from the response to other innovations in our policies, that their confidence in the Bank rests not on a narrow view of what forms of lending are proper for us to engage in, but on the extent to which our policies are seen to be directed towards sound long-run development, on which the creditworthiness of the developing countries primarily depends.

52. Finally, I would like to refer to the relationship between the forms of our lending and the nature and extent of our influence on the economic policies of the countries which we lend to. This again has been a matter of controversy. On the one side, it has sometimes been suggested that by a readiness to engage in program lending the Bank would acquire a greater degree of influence, which would enable us to make a more effective contribution to the development process. On the other side, it has been argued that we ought not to be drawn into passing judgment on the general economic policies of the developing countries, and that one of the dangers arising from non-project lending is that we may be tempted or even compelled to do this.

53. Here again, I find it difficult to sympathize fully with either of these divergent points of view. Whatever may be the forms of Bank Group lending, and even if we were to concentrate exclusively on the financing of specific projects, we are bound to analyze and appraise the general economic policies of the governments that we lend to. Such a broad review of policies has long been recognized as essential even in our own individual interest, in order to ensure a better and more informed choice of projects for which we can lend. It is also a corollary of our present role and functions in relation to the other lending agencies with which we are associated in consortia and consultative groups; and I believe that it is welcomed by the great majority of the countries to which our economic missions are sent. We cannot escape the responsibility of forming judgments concerning economic performance, and where necessary of offering advice.

54. At the same time, I agree with the view expressed by one Executive Director in the course of our discussion of these matters two years ago, when he said that the Bank ought not to assume in any country the role of a



"super-ministry". Our influence should always be exercised, as it now is, through the medium of a continuous dialogue rather than through formal machinery; and we should not regard a particular act of non-project lending as an instrument for extending it - nor on the other hand, as I have emphasized above, should we in any way reduce the extent of our concern with good project performance as a consequence of extending loans or credits in non-project form. With or without such lending, the nature, scope and purpose of the influence that we bring to bear on general economic policy should be substantially the same. No doubt the path is a narrow one between ineffectuality on the one side and unacceptable interference on the other; but we have no choice but to seek this path and to try to keep to it.

#### CONCLUSIONS AND RECOMMENDATIONS

55. The Pearson Commission has rightly emphasized that the forms in which foreign aid is provided should reflect the needs and circumstances of the recipient countries; that aid should not be confined to the direct foreign exchange costs of projects; that lenders should be ready in appropriate cases to finance part of the local costs of projects; and that program lending may in some situations have a valuable role.

56. With respect to the policies and procedures of the Bank and IDA, I conclude that:

- (1) No change is required in our Articles to enable us to provide loans and credits in the forms and proportions that would make the most effective contribution to the economic development of our member countries.
- (2) The Bank has a well-established role and a strong comparative advantage in the provision of project finance, and should therefore emphasize this form of lending in the absence of clearly preferable alternatives.
- (3) In practice the bulk of the assistance provided by the Bank and IDA can take the form of financing the foreign exchange component of investment projects without invoking the special circumstances required to justify the financing of local expenditures or program lending.
- (4) As regards local expenditure financing, the present guidelines seem adequate, and no further decision by the Executive Directors seems necessary at this time.
- (5) With respect to program lending, I believe it has been generally accepted by the Executive Directors that the Bank Group should engage in such lending in special cir-



cumstances where this appears necessary to increase the effectiveness of our lending and to ensure an adequate and timely transfer of resources in support of the development programs of member countries. I should now like to request the Executive Directors to agree in principle, subject to specific demonstration on each occasion when I recommend a program loan or credit for approval, that special circumstances may arise when:

- (a) A borrowing country presents a development program, with supporting economic and financial policies, which is judged to provide a satisfactory basis for external assistance in a given amount.
- (b) The needed transfer of resources from external lenders in support of the development program cannot be achieved effectively and expeditiously by the financing of investment projects, including justifiable local currency expenditures in connection therewith.
- (c) Other external lenders are not prepared to fill this gap by non-project lending.

57. If this last recommendation is accepted the effects on the composition of lending by the Bank and IDA are not easy to estimate with precision. I would, however, envisage that on average in each of the fiscal years 1972 and 1973 we might find it appropriate to extend program loans or credits to perhaps four or five countries, and that this form of assistance might amount to some 7 to 10 per cent of our total lending commitments.

*Robert S. McNamara*

December 15, 1970

EXPERIENCE WITH DEVELOPMENT LENDING

1. Over the past twenty years the annual flow of official resources to developing countries has risen from less than two to more than seven billion dollars. The number of governments and institutions from which these resources come has also increased greatly. Almost every one of the sixteen member countries of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) has established one or more official agencies to administer its development assistance. Multilateral development institutions have also increased greatly in number and importance.<sup>1/</sup>

2 As the amount of assistance and the number of sources has grown, the character of the flow has become increasingly complex. Development assistance is now provided for a variety of purposes. Old techniques have been adapted in the light of experience and new techniques devised to meet the varied needs of the growing number of recipients. These techniques and the extent of their use are discussed in the following paragraphs.

Characteristics of Lending Techniques

3. Lending techniques can be classified into two main categories: program and project assistance.<sup>2/</sup> These differ with respect to their objectives, the ways in which resources are transferred, and the bases for disbursement and control. Although the details of lending practices have come to vary considerably, the principal differences to be discussed apply equally to bilateral and multilateral lending agencies.

4. From an economic standpoint, the principal differences between project and program lending lie in:

- (i) whether the emphasis is placed on the need to increase investment or the need to increase imports;
- (ii) whether the focus is on individual projects or on the requirements of the economy as a whole; and
- (iii) the forms in which resources are transferred.

Lending techniques also differ in their indirect objectives and the basis for disbursing the loan.

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<sup>1/</sup> The UN agencies and the World Bank were almost alone in this category in the early 1950's. By the end of the 1960's, there were eight development institutions included in DAC reports in addition to the UN family and the World Bank Group.

<sup>2/</sup> Neither financial techniques nor terms of assistance are considered here, nor is technical assistance.



5. These differences are illustrated schematically in the accompanying table, which shows the principal characteristics of four common techniques of development lending, ranging from the normal project loan extended by the Bank (case A) to the program loan typically made in the framework of a consortium or consultative group (case D). Two intermediate techniques are described: (B) loans to finance groups of relatively small investments, which may either be in the private sector (by lending to an intermediate financial institution) or in the public sector (by supplying equipment or other inputs to a government agency), and (C) project or sector lending with a significant component used to finance local costs.

6. Assuming a given level of domestic savings, under effective development policies a loan of \$10 million will support an increase in investment of \$10 million in each case. From an economic point of view, therefore, the major differences among the four techniques lie in the types of imports that can be purchased with the loan and their rate of procurement. In cases A and B these are restricted to capital goods and other inputs needed to carry out the investment. In case C the financing of local costs provides an additional amount of free foreign exchange to cover part of the imports needed to carry out the development program. In case D, the resource transfer consists of whatever commodities are needed to support the increase in production and investment, with no necessary component of investment goods. Its timing is related to the need for these imported goods.

7. Program Loans. The direct objectives of program assistance (case D) to a country are formulated in the context of its development plans and policies.<sup>1/</sup> Ordinarily, the first objective of program assistance is to provide imports needed to increase production or to extend productive capacity. Other closely related objectives are to enable the recipient to utilize domestic resources more fully and to improve the allocation of resources within the economy. Support for measures of monetary stabilization and trade liberalization also come under this heading.

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<sup>1/</sup> The functions of program assistance were described by the Chairman of the DAC as follows:

"Experience has, however, shown that the proper implementation of specific projects does not replace the need for an overall development strategy, which has to be based on the total of resources available regardless of whether they originate abroad or in the less-developed country itself. Furthermore, projects create a continuing demand for raw materials and spare parts which often must be imported. If one only assists in the initial construction of plant, it may not operate at full capacity because one of these other import requirements is the bottle-neck. Finally, development may be hampered by a lack of local resources in the hands of the government, and the sale of aid-financed imports in the country may provide funds for local developmental requirements." OECD, Development Assistance Efforts and Policies, 1967 Review (OECD, Paris, 1967), p. 126.



Characteristics of Techniques of Development Lending

Principal Characteristics	(A) <u>Project Loan</u>	(B) <u>Sector Loan</u>	(C) <u>Project or Sector Loan with Local Cost Finance</u>	(D) <u>Program (commodity) Loan</u>
1. <u>Direct Objective</u>	Execute single investment	Execute group of investments	Same as A or B	Supply imports needed to increase production or extend existing capacity
2. <u>Other Objectives</u>	(1) Improve project conception and design (2) Sector reforms	(1) Develop intermediate financial institutions (2) Sectoral reforms	(1) Same as A or B (2) Provide local currency to borrower (3) Supply free foreign exchange to economy	(1) Improve resource mobilization and allocation policies (2) Strengthen policy and planning institutions (3) Provide local currency to borrower
3. <u>Form of Resource Transfer</u>	Goods required to execute investment	Same as A	(1) Goods required to execute investment (2) Unspecified commodities purchased with free foreign exchange	Specified by type or use of commodities
4. <u>Basis for Disbursement and Control</u>	Expenditure on investment or import of required goods and services	Same as A	Same as A or B	(1) Import of specified commodities (2) Specified development expenditures (optional) (3) Periodic review of country performance



8. In the great majority of program loans, resources are transferred in the form of imports of specified commodities. Limitations on the kind of imports depend on the particular purpose to be served. When the primary objective is to increase production, the imports may be raw materials, components, or spare parts for industry or inputs to agriculture, such as fertilizer or pesticides. When the objective is to restore or extend capacity which has deteriorated or been damaged, the imports may be equipment and supplies for rebuilding ports, highways, and railroads as well as a variety of commodities needed to replenish inventories.

9. Imports are usually specified in fairly broad categories. Since the basis for disbursement of program assistance by the lender is the import of the specified commodities, this permits flexible and rapid use of the loan to meet needs which arise over broad areas of the economy. Often goods are procured and distributed through private channels in order to increase the efficiency of allocation by using the mechanism of the market. In most cases, the goods are sold within the recipient country and the local currency proceeds accrue to its government. These resources in domestic currency are sometimes earmarked to finance programs of development or reconstruction or the portions of those programs which are related to the objectives of the loan.<sup>1/</sup> This has not been the practice with Bank or IDA loans, however.

10. Specification of goods and services to be imported helps to ensure their proper use, since the nature of the goods largely determines their end use. However, measures may also be taken to confirm that imports have been used for agreed purposes. Lenders may also make arrangements to review the progress of the borrower towards the objectives of the loan, often in the context of a coordinating group. In these cases, they examine the general situation and prospects of the borrower's economy as well as more specific questions related to the objectives of the loan.

11. Project Assistance. The direct objective of project assistance in case A is the financing of some part of a single tangible investment. An additional objective is to establish or improve the institutions required to administer or manage the project, for example, an electric power company

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<sup>1/</sup> These arrangements had their origin in the European Recovery Program. The basis of the Program was a four-year plan for achieving consumption, production and export targets drawn up by the recipients and approved by them and the donors. From it were derived estimates of requirements for food, fertilizer, fuel, industrial raw materials and equipment. Requirements which could not be met from domestic production were furnished largely by the United States and mostly through private commercial channels. The proceeds of sales of the imported goods were used to finance investment in some countries. In the ERP and related programs for the development of overseas territories, emphasis was very largely on overall objectives.



or a port authority. Attention is also given to the policies and procedures of these institutions on such matters as setting tariffs or rates, accounting, maintenance and repair and so on. These and other sector reforms are appraised in detail by the lender, and in the case of the Bank form an important part of the project loan procedure.

12. In case A, the principal form of project lending, assistance is limited in amount to the cost of imported goods and services required to execute the investment. Resources are transferred to the borrower as work on the investment progresses in the form of those goods and services, which in the case of the Bank/IDA loans may include a variety of commodities (fuel, cement, etc.) in addition to capital goods.

13. Over time as projects have come to be more broadly defined, sector loans which are conceptually part way between program and project assistance have evolved. Under this technique (case B in the Table) assistance is given to execute several investment projects within a given sector of the economy. For example, agricultural improvement may be supported by lending to finance the foreign exchange cost of imported agricultural machinery along with the foreign exchange required to buy fertilizer and pesticides. Sector loans may be implemented by lending to intermediaries such as agricultural or industrial development banks in the borrowing country. In this way, international lenders can indirectly provide assistance to a larger number of smaller investors, and at the same time foster the development of these intermediaries.

14. Many developing countries find it difficult or impossible to raise the local resources required to complete and, in some instances, to operate the projects for which the foreign exchange component is provided. Where this happens, lenders at times undertake to provide resources for some part of the local costs of constructing the projects, and in certain cases, for recurrent costs as well; this is case C in the accompanying table. They do so by providing an amount of foreign exchange equivalent to these local costs. Because this foreign exchange is freely at the disposal of the borrowing country, financing local expenditure for projects may, in some measure, serve some of the purposes of program loans.

15. The several methods of disbursement and control are designed to satisfy the lender that the loan is being used for the purposes specified. In cases A and C, disbursement is based on the rate of completion of single projects. The resource transfer often takes place over a period as long as six years from the time the loan commitment is made; a typical pattern being annual disbursements of 15%, 20%, 20%, 20%, 15% and 10% of the value of the loan. Case B is similar except that the basis for disbursement is the rate of investment in a lending program or group of projects which may be financed through an intermediary. In case D, disbursement is related to the importation of specified commodities or sometimes to the execution of development programs.



16. More generally, each case differs in the conditions that the lender can most readily attach: the conditions directly related to the objective of the loan. Clearly, as understanding of and experience with the development process has grown, the techniques and objectives of lending have accordingly broadened. Thus it has been possible for lenders to focus not only on the design and execution of projects but also on the broader conditions necessary to make the use of resources more efficient. Since the justification for program lending depends heavily on the effectiveness of the country's overall development program, there is usually a provision for a periodic review of the borrower's performance in the framework of an aid consortium or other consultative arrangement.

17. Bilateral Assistance. Official records of the flows of financial resources to developing countries reveal the amounts of assistance in various forms. As can be seen from the figures shown below, somewhat less than one half of official bilateral flows in recent years was in non-project form. It has been estimated that about \$1.7 billion of the \$3.7 billion

Official Bilateral Commitments by Purpose  
Annual Average, 1967/1969

(US\$ billions)

	<u>Amount</u>	<u>Percent</u>
Capital Projects	2.5	30.5
Technical Assistance	1.7	20.7
Non-project Assistance	3.7	45.1
Other	<u>0.3</u>	<u>3.7</u>
TOTAL	<u>8.2</u>	<u>100.0</u>

in non-project assistance, i.e., some 20 per cent of total commitments, was in the form of program assistance of the kind described above as case D. The remainder was largely composed of food aid (approximately \$1.4 billion), of loans for general balance of payments or budgetary support (on the order of \$0.4 billion) or of loans to consolidate or refinance debt (on the order of \$0.2 billion). To a considerable extent, program assistance as it is defined here and the other forms of non-project assistance are substitutes in that the proceeds are in some measure available to finance commodity imports. Details of the objectives and arrangements for various forms of assistance by country of origin are given in Attachment 3 to this Annex.

18. Multilateral Assistance. Multilateral lending institutions have not been a major source of program assistance. The experience of the World Bank Group is described in Attachment 1 to this Annex. In its early years



it made program loans: first for reconstruction, and later to support "general development plans" or for the purchase of imports required for development. IDA credits have been given to finance "industrial imports" in India and Pakistan. These credits, which are the only assistance given by the Bank Group in this form since 1962, totalled a little less than \$0.7 billion.

19. As shown in Attachment 2, the Bank Group has provided appreciable amounts for the financing of local expenditures on projects. Some other multilateral development institutions, as described in Attachment 3, act similarly in this respect, although they provide assistance almost exclusively in project form.

20. Program lending by most countries is very largely concentrated in countries for which there are international arrangements for coordinating assistance. Aid coordinating arrangements have been formed for some 19 countries.<sup>1/</sup> The Bank sponsors fourteen coordinating arrangements for sixteen countries and the East African Community. One important function of these groups is to ensure that assistance from different sources in various forms is combined so as to meet the needs of the recipients. The Consortia for India and Pakistan are sponsored by the Bank and the one for Turkey by the OECD. In these and other cases, the balance between project and non-project assistance has been a subject of considerable importance. Program assistance has gone to a large number of countries, including not only India, Pakistan, Turkey, Colombia, Ghana, Indonesia, for which details are shown in Attachment 4, but also Ceylon, Chile, Korea, Morocco, Tunisia, Nigeria and others.

21. Among the sources of program assistance, the United States is unique by reason of the large amount of its total program lending and the substantial amounts lent to individual countries. The other countries which provide large amounts of non-project assistance are the United Kingdom, Germany, Japan, Italy, Australia, Canada, and the Netherlands. France too provides appreciable amounts, largely in the form of general support for countries with which France has particularly close relationships. But France also provides non-project assistance elsewhere, notably in the consortia for India and Pakistan. The policies of these bilateral lenders are summarized in Attachment 3 to this Annex.

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<sup>1/</sup> In addition, there are arrangements for reviewing the economic situation of member countries of CIAP.



ANNEX I: ATTACHMENT 1

Program Lending - The Bank Group's Practice<sup>1/</sup>

1. The majority of Bank loans and IDA credits have been made for specific investment projects in the sense that each loan or credit operation was made to assist in the financing of some clearly defined amount of capital expenditure for a project or sector being executed by some government, government agency or enterprise which was either the borrower or the beneficiary of the loan or credit.
2. There have also been a small number of operations (approximately 26) which do not fall within this pattern. In five cases this was because they were made to finance "general development plans" rather than specific projects. But the majority of the exceptions were loans made to provide governments with foreign exchange to enable them to import some agreed amount and kind of imports. In these cases the foreign exchange was sold to agencies and enterprises who wished to purchase the kind of imports for which the loan was made. These agencies and enterprises thus became the users and owners of the equipment financed by the Bank but they were not borrowers, either directly or indirectly, of the loan or credit since they derived no additional capital from it, although they benefited from the loan through getting access to imported goods. Details of these operations are set out in the table at the end of this Attachment.

Loans for "General Development Plans"

3. Two loans, each of \$10 million, were made to Italy in 1951 and 1953. The purpose of the loans was described as being to assist "in promoting the economic and social development of Southern Italy by supplying part of the foreign exchange requirements resulting directly and indirectly from the carrying out of the initial stages of the Plan and by making available for the Supplementary Projects the lira equivalent of the Loan." The loans were disbursed proportionately with expenditure on the Plan. An attempt was made to allocate the lira equivalent of the loan to specific projects in the Plan.
4. A loan to Iran of \$75 million in 1957 was described as being "to provide temporary financing required by the Plan Organization to carry out, during the early years of the Plan, programs and projects which would otherwise be delayed in whole or in part solely because the necessary funds therefore would not be available to the Plan Organization until later in the seven year period provided for the carrying out of the Plan." The reason why such funds would not be available was that the oil revenues, which were to finance the Plan, would be fairly small during the first years but would increase rapidly during the later years of the Plan. This loan was for a term of six

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<sup>1/</sup> This is a revised version of Annex B to the paper entitled "Program Lending" (R68-206), dated November 5, 1968.



years; it constituted in effect a medium-term advance against expected revenues.

5. A loan of \$30 million was made to Belgium simultaneously with a loan of \$40 million to the former Belgian Congo in 1951. The purpose of both loans was described as being to assist the two governments to meet "the foreign exchange needs resulting directly and indirectly from the carrying out of" a general program of investment in the Congo. The proceeds of the Congo loan were applied to financing a three-year tranche of the Otraco Project which constituted a substantial and integrated part of the Congo's Ten-Year Development Plan. The Belgian franc counterpart of the Belgian loan was also applied to financing the cost of this Project.

#### Loans to Norway

6. Two loans, each of \$25 million, were made to Norway in 1954 and 1955. Both these loans provided foreign exchange for the purchase of ships. However, the shipping companies were in a strong financial position and did not need capital. The foreign exchange was sold to the shipping companies and the government used the counterpart for investment. The President's Report on the 1954 loan said, "The general purpose of the loan would be to assist Norway in maintaining productive investment in 1954. Specifically, it would provide foreign exchange to enable Norway to pay for ships ordered in foreign shipyards." The report on the 1955 loan referred to Norway's need to import capital and said, "Since, however, the need for capital, though long-term is an immediate one, it could not be appropriately met by a loan for a particular project which would have to be disbursed over a relatively long period. The proposed operation is designed to meet the requirements of this particular situation." It also said that, "as a matter of administrative convenience disbursement would be made against payments for ships." In essence, in these two loans the "project" was simply "maintaining productive investment".

#### Loans for the Purchase of Imports

7. The first three loans made by the Bank (in 1947), the so-called "reconstruction loans" to France (\$250 million), the Netherlands (\$195 million) and Denmark (\$40 million), were for the purchase of imports.

8. There were five loans made to Australia between 1950 and 1956 totaling some \$308.5 million. They were made to enable Australia to import equipment from the dollar area at a time when the sterling area was very short of dollars. Apart from the first, each loan included, as Schedule 2, a "Description of the Programs" which described in general terms the various



sectors of development for which the imported equipment would be used. For some of the loans there was a report which described in some detail the investment which was being carried out in each sector. However, all the counterpart funds accrued to the Commonwealth Government so that the additional import of capital did not accrue to any of the ultimate users of the Bank-financed equipment. In some cases the ultimate users of the Bank-financed equipment were known; in others they were not known. No specific projects were appraised in detail; there was only a general economic appraisal of the various "programs".

9. In August 1961, a "Private Sector Coal Production Project" loan of \$35 million was made to India. The proceeds of this loan were to be "applied exclusively to the provision of foreign exchange required for the cost of goods needed to carry out" the project. The project was described as a program for the maintenance and expansion of coal production by the private sector in India. Although there was a Screening Committee to examine the various enterprises which were to use the equipment purchased under the loan and these enterprises were to be approved by the Bank, the enterprises did not obtain any direct financial benefit from the loan; they only obtained access to foreign exchange.

10. The first "industrial imports project" IDA credit to India was made in 1964. There have been a total of six such credits to India (totaling \$605 million) and two similar IDA credits to Pakistan in 1966, each of \$25 million, one for industrial imports and one for commercial road vehicles.

11. The situation which underlay the Bank Group lending of this kind in India was that the Indian economy had reached a stage in which it could produce domestically a significant proportion of the capital equipment it required for investment projects but it had to spend substantial amounts of foreign exchange for the import of components, spare parts and raw materials for its industrial sector. This meant that the direct foreign exchange requirements of projects tended to be low so that if credits were limited to foreign exchange requirements a large number of loans would be needed to make available to India any considerable amount of capital. Hence, the choice was either to make a number of project credits financing substantial amounts of local expenditure so as to provide foreign exchange which could be used for imports or to finance the needed imports directly. The latter course was chosen, partly because it would make possible the injection of external capital at a more rapid rate but largely because we felt that by providing money directly for the imports we could ensure that the foreign exchange would be used for the benefit of key industries (very largely in the field of capital goods production) in which production had been held back by shortages of imported materials, components and spares.



12. The form of all the industrial import credits, both to India and Pakistan, followed the pattern of previous program loans of this type in that the foreign exchange was sold by the government to the enterprises purchasing the imported equipment and materials and the counterpart funds accrued to the government. The first credit to India was confined to three principal industrial sectors in which there were about 80 firms potentially eligible to use the credit. Almost all of these had been visited, at least briefly, by an appraisal mission and a report was prepared which dealt in some detail with the economic situation of the various industrial sectors. For all but the most recent credit, the number of eligible enterprises also increased very substantially. The sectors to benefit from the Sixth Industrial Imports Credit were chosen from among the considerably larger number of sectors financed in its predecessor. For all these credits, appraisal relied more on a general economic examination of the sectors rather than on an attempt to examine each individual enterprise which was to use the imports.

13. The two program credits made to Pakistan, one for commercial vehicles and one for industrial imports, originated from considerations similar to those which led to the industrial imports credits to India. As in India, industrial capacity in Pakistan was not being fully utilized because of shortage of foreign exchange. The commercial vehicles credit was intended to ease the shortage of foreign exchange since it was expected to be disbursed rapidly but there was also a strong sector element in that the credit was intended to relieve a bottleneck in the road transport system. The industrial imports credit was, of course, aimed at increasing industrial production by enabling industry to utilize more of its capacity but it was also justified by reference to furthering the policy of import liberalization in Pakistan.

14. In most of the program loans and credits mentioned above, formal international competitive bidding procedures were not required. As the commodities financed were purchased by autonomous enterprises using their own funds, normal commercial incentives were considered sufficient to ensure economic use of the money. It was also pointed out, for example:

"Insistence on specific procurement procedures and control of procurement does not appear to be practical. To the extent practicable, the government requires that the recipient of a free foreign exchange license produce evidence of procurement from the most optimal source of supply. Capital equipment to be imported would consist mainly of individual items of machinery and equipment to be brought in by manufacturers of capital goods to balance existing facilities or by construction firms; to some extent, this already limits the source of supply. Components for



the manufacture of capital goods must frequently be procured in specific countries, often from foreign collaborators. However, the foreign collaborators come from so many different countries that a wide distribution of the credit seems assured. The sources of imported spare parts are also limited although not to the same extent as those of components. Assurance that the lowest cost source will be used in the case of spare parts for construction equipment -- the most important class of spare parts -- is provided by so-called rate contracts between the government (the largest user of construction equipment) and the dealers; these contracts fix the upper price limits of spare parts."

Appraisal Report - First Industrial Imports Credit  
(TO-4114a, dated May 28, 1964), paragraph 109(d), page 31.

In the Indian Coal Production loan, however, it was agreed that major equipment needed to carry out mining projects for the opening of new mines would be acquired "on the basis of international competitive bidding and having regard to sound engineering, mining and financial considerations and practices." (Letter of Indian Government to the Bank, August 9, 1961.)

## IBRD AND IDA PROGRAM LOANS AND CREDITS THROUGH OCTOBER 1970

Recipient/Purpose	Loan or Credit Number	Year of Agreement	Original Principal Amount/ <sup>1</sup> (US\$ mn.)	Interest Rate (%)	Maturities
<u>Australia</u>					
Equipment for Development	29	1950	100.0	4 1/4	1955-75
Equipment for Development	66	1952	50.0	4 3/4	1957-72
Equipment for Development	96	1954	54.0	4 3/4	1957-69
Equipment for Development	111	1955	54.5	4 5/8	1958-70
Equipment for Development	156	1956	50.0	4 3/4	1959-72
<u>Belgium</u>					
Equipment for Development - Congo	47	1951	40.0	4 1/2	1957-76
Equipment for Development	48	1951	30.0	4 1/2	1957-76
<u>Denmark</u>					
Reconstruction	3	1947	40.0	4 1/4	1953-72
<u>France</u>					
Reconstruction-Credit National	1	1947	250.0	4 1/4	1952-77
<u>India</u>					
Coal Mining	292	1961	35.0/2	5 3/4	1966-77
Industrial Imports Project	52	1964	90.0	3/4	1974-2014
Second Industrial Imports Project	78	1965	100.0	3/4	1976-2015
Third Industrial Imports Project	92	1966	150.0	3/4	1977-2016
Fourth Industrial Imports Project	97	1966	65.0	3/4	1977-2017
Fifth Industrial Imports Project	138	1969	125.0	3/4	1979-2019
Sixth Industrial Imports Project	182	1970	75.0	3/4	1980-2020
<u>Iran</u>					
Equipment for Development	160	1957	75.0	5	1959-62
<u>Italy</u>					
Equipment for Development	50	1951	10.0	4 1/2	1956-76
Equipment for Development	88	1953	10.0	5	1958-78
<u>Luxembourg</u>					
Steel and Railway	4	1947	12.0/3	4 1/4	1949-72
<u>Netherlands</u>					
Reconstruction	2	1947	191.0	4 1/4	1954-72
Reconstruction	27	1948	4.0	4 1/4	1953-54
<u>Norway</u>					
Equipment for Development	97	1954	25.0	4 3/4	1957-74
Equipment for Development	115	1955	25.0	4 3/4	1960-75
<u>Pakistan</u>					
Commercial Road Vehicles Project	81	1966	25.0	3/4	1976-2015
Industrial Imports Project	98	1966	25.0	3/4	1977-2016

<sup>1</sup> All loans and credits are fully disbursed except for Credit No. 182, on which \$8.5 million has been disbursed to date.

<sup>2</sup> Of which \$6.2 was cancelled, terminated or refunded.

<sup>3</sup> Of which \$0.2 was cancelled, terminated or refunded.



ANNEX I: ATTACHMENT 2

Financing of Local Expenditure by the Bank and IDA

1. The accompanying table shows, for Bank loans and IDA credits separately, the estimated amounts and proportions of disbursements for foreign expenditure and local expenditure. For a small part of these disbursements the attribution between foreign and local expenditures cannot be made and this is shown under the heading of "undetermined". The absolute amounts are set out in the upper part of the table, and the proportionate amounts, in percentage terms, in the lower.
2. The figures relate not to actual disbursements in each of the years shown, but to the cumulative total of disbursements in relation to the loans or credits that were signed in each of the years referred to, up to June 30, 1970. Thus the first column of the table relates to loans and credits signed in FY 1962, the second column to those signed in FY 1963, and so on. Thus the total amounts of disbursements fall off in the later years, as the figures increasingly relate to projects on which disbursements had not been fully made by June 30, 1970.
3. With respect to IDA credits, the respective figures for foreign and for local expenditures are affected in four of these years (namely 1964, 1966, 1967 and 1969) by the inclusion of disbursements in respect of program credits extended to India and Pakistan. Since no part of these credits is disbursed for local expenditure, the proportionate amounts of disbursements for local expenditure in these years would be appreciably higher if they were excluded.

CUMULATIVE DISBURSEMENTS TO JUNE 30, 1970 OF BANK LOANS<sup>1</sup> AND IDA CREDITS FOR FOREIGN AND LOCAL EXPENDITURES, BY YEAR OF SIGNING, FISCAL YEARS 1962-1970

	Signed in Fiscal Year									Total 1962-70	
	1962	1963	1964	1965	1966	1967	1968	1969	1970		
<u>Amounts in US\$ Millions</u>											
<u>Bank Loans</u> <sup>2</sup>											
Disbursements for:	Foreign Expenditures	544.1	360.5	535.2	548.6	540.9	318.7	361.8	159.5	16.7	3,386.0
	Local Expenditures	134.3	46.1	53.3	99.7	115.6	18.9	53.1	30.5	2.9	554.4
	Undetermined	9.4	9.6	11.7	12.1	13.6	14.1	17.8	15.9	4.5	108.7
TOTAL (June 30, 1970)		<u>687.8</u>	<u>416.2</u>	<u>600.2</u>	<u>660.4</u>	<u>670.1</u>	<u>351.7</u>	<u>432.7</u>	<u>205.9</u>	<u>24.1</u>	<u>4,049.1</u>
<u>IDA Credits</u> <sup>3</sup>											
Disbursements for:	Foreign Expenditures	115.9	205.8	164.2	222.7	233.7	286.1	47.0	142.1	11.8	1,429.4
	Local Expenditures	93.4	39.8	18.9	46.0	4.4	21.7	3.3	3.2	.4	231.1
	Undetermined	13.8	7.6	14.0	10.6	9.4	7.1	4.0	14.6	-	81.1
TOTAL (June 30, 1970)		<u>223.1</u>	<u>253.2</u>	<u>197.2</u>	<u>279.3</u>	<u>247.5</u>	<u>314.9</u>	<u>54.3</u>	<u>159.9</u>	<u>12.2</u>	<u>1,741.6</u>
<u>Percentages</u>											
<u>Bank Loans</u> <sup>2</sup>											
Disbursements for:	Foreign Expenditures	79.1	86.6	89.2	83.1	80.7	90.6	83.6	77.5	69.3	83.6
	Local Expenditures	19.5	11.1	8.9	15.1	17.3	5.4	12.3	14.8	12.0	13.7
	Undetermined	1.4	2.3	1.9	1.8	2.0	4.0	4.1	7.7	18.7	2.7
TOTAL (June 30, 1970)		<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
<u>IDA Credits</u> <sup>3</sup>											
Disbursements for:	Foreign Expenditures	52.0	81.3	83.3	79.7	94.4	90.9	86.6	88.9	96.7	82.1
	Local Expenditures	41.8	15.7	9.6	16.5	1.8	6.9	6.1	2.0	3.3	13.3
	Undetermined	6.2	3.0	7.1	3.8	3.8	2.2	7.3	2.1	-	4.6
TOTAL (June 30, 1970)		<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

<sup>1</sup> Figures refer to cumulative disbursements (up to June 30, 1970) on loans signed in each fiscal year; they do not refer to disbursements made in each fiscal year. The figures for Bank loans reflect a lower level of undetermined expenditures than is revealed in other tabulations of Bank disbursements. In part this is because undetermined category can be reduced quite substantially when all that is required is a classification into "foreign" and "local" (rather than into country of supply), and in part because a special effort has been made to reduce that category for this table by using the most recently available estimates of foreign and local expenditures for each project.

<sup>2</sup> Includes disbursements on loans to all countries which have borrowed from the Bank since FY 1962 except Australia, Austria, Denmark, Italy, Japan, Norway, and South Africa. Disbursements under the loan to IFC have also been excluded.

<sup>3</sup> Four credits totalling \$101.0 million, signed between May 12, 1961 and June 30, 1961 have been included in FY 1962.



ANNEX I: ATTACHMENT 3

Non-Project Assistance from Member Countries  
of the DAC and Multilateral Institutions

A. Member Countries of the DAC

The OECD describes the objectives and arrangements of individual lenders for non-project assistance in its most recent (1970) Resources for the Developing World. The following excerpts are drawn from that volume. In Table 1 accompanying this attachment, some figures are given of the amount of non-project assistance provided by each of the DAC countries in recent years, expressed in terms of the annual average of commitments over the three years from 1967 through 1969.

Australia

"Since 1966-67, Australia has begun supplying program aid to Indonesia through the mechanism of the Indonesian Bonus Export Scheme - disbursements reaching \$5.3 million in 1967-1968 and \$6.6 in 1968-1969 (excluding \$4 million food aid)."

Austria

"... development loans are extended at present to India and Turkey under consortium arrangements in the form of program assistance for the financing of current imports of capital goods."

Canada

"Under its development assistance programs Canada offers those goods and services which the Canadian economy can supply efficiently and which are needed by recipients. Apart from food aid, which is the object of a special appropriation, the main items supplied include non-ferrous metals, railway equipment, power generation installations and feasibility studies and equipment for a fairly wide range of infrastructural projects. .. Non-project assistance is not tied to specific commodities, and an effort is made to provide recipients with a wide variety of goods."

Denmark

"Loans are extended in the form of program assistance to finance current import requirements in investment goods of recipients. They are generally tied to procurements in Denmark."

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France

"... long-term government loans ... at low interest rates ... (to countries incurring balance-of-payments difficulties) are intended to finance imports of light plant and equipment, consumer goods and raw materials for implementing economic development plans. India, Indonesia, Pakistan, Morocco and Tunisia have benefited...."

Germany

"The decision to initiate a comprehensive development loan program was taken in 1960. Since then, the program has expanded rapidly and accounted in 1968 for almost half of total German gross disbursements. The German Government has stated its definite preference for direct project-tied loans, but to an increasing extent loans are also extended to local development banks and for current essential civil import requirements, e.g., maintenance support, commodity aid. The latter reflects the growing need of some recipients for assistance to maintain full utilization of existing productive capacity and for balance of payments support."

Italy

"Program aid has gained in importance in recent years, in particular the financing of current imports of developing countries, e.g., loans to Turkey under the OECD consortium."

Japan

"Although the Japanese Government prefers, in principle, to finance clearly-defined projects, substantial funds are also being extended in the form of non-project assistance especially to India, Pakistan, Indonesia and Ceylon. Non-project assistance is provided by the Export-Import Bank and the Overseas Economic Co-operation Fund to finance imports of raw materials, components and spare parts. The types of commodities eligible for non-project assistance are agreed jointly by the Japanese Government and the government of the recipient country on the basis of requests submitted by the recipient country. They include machinery and spare parts, fertilizers, textiles, commercial vehicles, industrial raw materials, as well as certain consumer goods."

Netherlands

"Virtually all Netherlands' capital assistance is extended in the form of program assistance, i.e., general purposes contributions not related to individual projects ... Following a decision of the Intergovernmental Group for Indonesia (I.G.G.I.) part of



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the assistance to that country has taken the form of project financing in 1968."

Sweden

"With the exception of four program loans extended to India for the purpose of capital equipment and raw materials, and the ... [1967] loan to Tunisia, S.I.D.A. loans have been limited to project loans."

United Kingdom

"An important part of the United Kingdom aid effort is taken up by program aid, although the share of program aid in the total varies substantially according to recipient countries.

"Of the main regular recipients of United Kingdom aid, India, Pakistan, Ceylon and Turkey receive relatively the most program aid. The range of import requirements covered under program loans varies. Under some a very broad list of British goods and services are supplied. For example, the most recent commitment to Pakistan in January 1969 for \$10.8 million is for the import of chemicals, drugs, tractors and agricultural machinery, marine diesel engines, fertilizers, spare parts, etc. ... Other program loans are narrower in their scope. Thus for India, there has been a series of loans for spares and equipment for metal-using industries.

"For the independent African Commonwealth countries program aid is generally supplied on a regular basis, although other forms of aid currently take a larger share of the total than for the first group of countries mentioned..."

United States

" In recent years, the United States has emphasized program loans designed to finance essential imports to enable recipient countries to mobilize domestic resources as compared to project loans which earlier had constituted the bulk of American lending: in 1967, 58 per cent of all A.I.D. development lending was in the form of program loans. The emphasis is put on programming at the country level and on strong country missions. Each year, A.I.D. makes a comprehensive review of each major recipient country's overall development effort. In principle, the review weighs priorities for development goals, examines alternative approaches for attaining them, defines needed self-help measures, and estimates requirements for external assistance. Country programming

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provides the basis for discussing with the recipient country its own efforts. In 1967, the United States introduced sector loans, a variant of program loans in aid programmes directed at the three areas given priority: agriculture, health and education."

. . .

"In order to further development and to make its own assistance more effective, the United States stresses performance by recipient countries, and loan agreements typically call for the recipient country to meet certain mutually agreed-on objectives which are incorporated in the text of the agreement. Special emphasis is placed on such requirements in the case of program loans. The measures required range from local cost financing by the recipient to large-scale reforms of fiscal systems or changes in monetary policies."

B. Multilateral Institutions

Three of the major multilateral institutions, the Asian and Inter-American Development Banks and the European Investment Bank, are project lenders by statute and in practice. The first two have only limited authority to finance local expenditures out of their regular resources. The third, the European Investment Bank, does not generally concern itself with the distinction between foreign and local expenditures, and finances either or both. A fourth multilateral institution, the European Development Fund is, as its name and statutes imply, an institution very different from the others. In addition to financing projects, it engages in a variety of developmental activities. It, like the European Investment Bank, does not concern itself with the distinction between foreign and local expenditures.



Table 1: ESTIMATED ANNUAL AVERAGE COMMITMENTS OF OFFICIAL BILATERAL ASSISTANCE BY MEMBER COUNTRIES OF THE DEVELOPMENT ASSISTANCE COMMITTEE BY TYPE, 1967-1969

(US\$ millions)

Country	Total	Non-Project
Australia	187	141
Austria	22	11
Belgium	82	32
Canada	248	97
Denmark	119	6
France	1,162	172
Germany	659	213
Italy	374	307
Japan	461	354
Netherlands	160	112
Norway	11	5
Portugal	42	18
Sweden	45	8
Switzerland	17	9
United Kingdom	484	193
United States	4,168	2,347
TOTAL	<u>8,162</u>	<u>4,027</u>

Note: Estimates are derived from data in OECD publications.

ANNEX I: ATTACHMENT 4

Receipts of Project and Program Assistance in Six Countries

1. The enclosed set of tables shows the amounts of external assistance committed in recent years to six developing countries, namely Colombia, Ghana, India, Indonesia, Pakistan and Turkey. Each table refers to one of these countries. In all cases, the amounts of project and non-project assistance are shown separately, while for all countries except Turkey the assistance provided from each of the main sources is also shown. The figures relate not to disbursements, but to commitments or to agreements signed, and are drawn either from Bank economic reports or from consortium documents.

2. It can be seen that in the case of each of these countries non-project assistance has been an appreciable part of the total amounts committed. Except in the cases of India in the fiscal years 1966 and 1968, and Pakistan in the fiscal years 1965 and 1966, this form of assistance was provided, for the five countries for which information concerning the sources of assistance is available, entirely by the bilateral lenders. Among these lenders, the United States was generally the most important single source, except in the case of Indonesia where larger amounts of non-project assistance were made available by Japan.



Table 1: COLOMBIA - COMMITMENTS OF ASSISTANCE, 1963-1969

(US\$ millions)

	1963	1964	1965	1966	1967	1968	1969	Total 1963-69
<u>Program Loans</u>	-	50.0	65.0	-	100.0	73.0	85.0	373.0
U.S. Aid	-	50.0	65.0	-	100.0	73.0	85.0	373.0
<u>Project Loans</u>	136.0	111.5	56.7	116.9	116.8	183.7	233.1	954.7
U.S. Aid and Eximbank	28.7	37.9	3.9	19.9	25.5	-	29.5	145.4
IDB	24.9	8.1	37.7	27.4	35.6	48.9	102.3	284.9
IBRD	73.8	45.0	-	41.7	25.0	93.1	60.3	338.9
Others	8.6	20.5	15.1	27.9	30.7	41.7	41.0	185.5
TOTAL (All Loans)	136.0	161.5	121.7	116.9	216.8	256.7	318.1	1,327.7

Source: Economic Growth of Colombia, Vol. II, "Development Projects: 1970", August 4, 1970, Tables 1 and 2.

Table 2: GHANA - EXTERNAL ASSISTANCE COMMITMENTS, 1966-1970

(US\$ millions)

Country	1966		1967		1968		1969		1970		Total 1966-1970	
	Commodity	Project	Commodity	Project	Commodity	Project	Commodity	Project	Commodity	Project	Commodity	Project
Canada	-	-	-	-	-	-	-	7.0	-	-	-	7.0
Denmark	-	-	-	2.7	-	-	-	-	-	-	-	2.7
Germany	5.0	5.0	3.0	3.4	3.6	2.5	-	-	2.7	4.1	14.3	15.0
Italy	-	-	-	-	10.0	-	2.0	-	-	-	12.0	-
United Kingdom	-	-	11.2	-	11.5	-	13.0	-	10.1	6.1	45.8	6.1
United States	7.5	-	30.5	2.0	34.9	-	18.0	-	27.3	-	118.2	2.0
IBRD Group	-	-	-	-	-	10.0	-	12.3	-	8.5	-	30.8
TOTAL	12.5	5.0	44.7	8.1	60.0	12.5	33.0	19.3	40.1	18.7	190.3	63.6

Source: The Current Economic Position and Prospects of Ghana, October 13, 1970, Table X-6.



Table 3: INDIA - CONSORTIUM ASSISTANCE IN FISCAL YEAR 1966-1969<sup>/1</sup>

(US\$ millions)

Country	1966		1967		1968		1969		Total 1966-1969	
	Non- Project	Project	Non- Project	Project	Non- Project	Project	Non- Project	Project	Non- Project	Project
Austria	4.7	-	4.6	-	0.9	-	1.1	-	11.3	-
Belgium	1.2	-	2.5	-	2.5	10.0	3.0	-	9.2	10.0
Canada	9.3	10.4	44.6	65.3	28.9	4.9	28.8	37.0	111.6	117.6
Denmark	-	-	9.3	-	-	-	-	-	9.3	-
France	16.7	11.3	13.6	13.5	19.1	13.5	-	-	49.4	38.3
Germany	60.0	6.5	46.7	18.1	49.0	16.4	56.6	10.9	212.3	51.9
Italy	31.0	-	-	-	21.5	-	7.4	-	59.9	-
Japan	45.0	-	52.0	-	45.0	-	45.0	-	187.0	-
Netherlands	11.0	-	11.0	-	9.7	-	11.6	-	43.3	-
United Kingdom	86.3	-	79.2	-	58.8	27.6	84.0	28.8	308.3	56.4
United States	379.2	12.8	277.7	14.0	225.7	82.0	8.7	38.0	891.3	146.8
IBRD/IDA	215.0	-	-	25.0	125.0	68.0	-	192.5	340.0	285.5
TOTAL	859.4	41.0	541.2	135.9	586.1	222.4	246.2	307.2	2,232.9	706.5

<sup>/1</sup> The Indian fiscal year is April 1-March 31.

Source: India Consortium: Quarterly Report on the Utilization of Aid, November 12, 1970, Tables A-4, A-5.

Table 4: INDONESIA - COMMITMENTS OF EXTERNAL ASSISTANCE IN 1968, 1969 and 1970/71

(US\$ millions)

Country	1968		1969		1970/71 <sup>/1</sup>		Total 1968-1970/71	
	Program	Project	Program	Project	Program	Project	Program	Project
Australia	8.2	2.5	6.1	5.1	7.3	11.4	21.6	19.0
Belgium	0.4	-	1.2	0.8	1.7	3.0	3.3	3.8
Canada	-	-	-	0.2	2.0	0.5	2.0	0.7
Denmark	-	-	-	4.0	-	-	-	4.0
France	6.9	4.2	6.3	6.3	5.0	6.3	18.2	16.8
Germany	12.5	10.5	13.7	16.4	15.2	18.8	41.4	45.7
Japan	65.0	36.4	55.0	34.5	55.0	55.0	175.0	125.9
Netherlands	19.4	5.6	18.1	25.2	16.5	7.6	54.0	38.4
United Kingdom	3.1	0.8	4.4	1.0	7.2	1.8	14.7	3.6
United States	25.0	-	44.0	26.3	40.0	31.4	109.0	57.7
A.D.B.	-	-	-	13.4	-	30.0	-	43.4
I.D.A.	-	7.0	-	89.0	-	74.9	-	170.9
TOTAL	140.5	67.1	148.8	222.0	150.5 <sup>/2</sup>	240.6	439.8 <sup>/2</sup>	529.7

<sup>/1</sup> January 1970 to March 1971.

<sup>/2</sup> Includes \$0.6 million from New Zealand.

Source: The Indonesia Economy, November 27, 1970, Tables 3.8-3.11.



Table 5: PAKISTAN - COMMITMENTS OF CONSORTIUM AID IN FISCAL YEAR 1965-1969

(US\$ millions)

Country	1965		1966		1967		1968		1969		Total 1965-1969	
	Non- Project	Project	Non- Project	Project	Non- Project	Project	Non- Project	Project	Non- Project	Project	Non- Project	Project
Belgium	-	-	0.5	0.6	-	1.4	2.0	2.6	1.5	0.8	4.0	5.4
Canada	7.6	53.2	6.8	9.6	9.9	0.5	15.3	20.0	25.4	13.4	65.0	96.7
France	-	8.6	-	25.3	3.7	4.6	6.4	17.3	-	1.6	10.1	57.4
Germany	7.5	26.4	12.5	49.4	10.0	16.8	10.0	19.9	16.4	37.6	56.4	150.1
Italy	-	23.5	-	13.3	9.6	6.6	18.0	10.8	2.1	3.3	29.7	57.5
Japan	9.0	21.0	9.0	21.0	9.0	21.0	10.0	20.0	9.0	21.0	46.0	104.0
Netherlands	-	-	1.4	3.9	1.4	0.8	3.1	0.2	4.4	3.5	10.3	8.4
Sweden	-	4.8	-	1.8	-	5.0	-	-	-	-	-	11.6
United Kingdom	11.2	16.2	11.2	16.1	10.6	4.8	12.0	1.2	14.4	2.7	59.4	41.0
United States	49.2	25.8	140.0	16.6	140.0	40.2	71.0	6.9	103.0	7.0	503.2	96.5
IBRD	-	30.0	-	35.0	-	35.0	-	129.5	-	19.2	-	248.7
IDA	25.0	32.2	25.0	2.8	-	10.0	-	48.0	-	77.2	50.0	170.2
TOTAL	109.5	241.7	206.4	195.4	194.2	146.7	147.8	276.4	176.2	187.3	834.1	1,047.5

Source: Government of Pakistan, Memorandum to the Consortium 1970/71, Table 6.

Table 6: TURKEY - SUMMARY OF ASSISTANCE PROVIDED IN THE FRAMEWORK  
OF THE CONSORTIUM, 1966-1969

(US\$ millions)

A g r e e m e n t s   S i g n e d   I n									
1966		1967		1968		1969		Total 1966-1969	
Program	Project	Program	Project	Program	Project	Program	Project	Program	Project
100	203	126	124	112	186	87	159	425	672

Source: The Development Prospects of Turkey, Vol. II, CONFIDENTIAL First Draft,  
October 16, 1970, Table 4.5.



ANNEX II

THE CHOICE OF TECHNIQUES FOR DEVELOPMENT LENDING

1. The previous discussion has established that:
  - (i) the available lending techniques range from pure project loans at one extreme to pure program loans at the other;
  - (ii) the techniques differ in emphasis (on investment or imports), in focus (ranging from single projects to the whole economy) and in form of resource transfer;
  - (iii) the effectiveness and suitability of different lending techniques depend on the economic structure and policies of the borrowing country as well as the conditions attached by the lender;
  - (iv) virtually all of the bilateral aid agencies utilize some form of non-project assistance, which for the DAC countries as a whole comprise a large share of development assistance; and that
  - (v) to make a maximum contribution to development, the lending techniques of the Bank Group should take into account the economic structure and policies of the borrowing country and the resources supplied to it by the other lenders.

2. This annex discusses the factors that may make it desirable to employ techniques other than normal project lending. These include the economic structure and policies of the borrowing country, the total resource transfer that is needed, the forms and amounts of loans and grants from other sources, and the extent to which lending by the Bank Group is desirable. Within this general framework, it is then possible to judge whether circumstances justify departures from the normal forms of Bank Group lending (cases A and B in the table in Annex I). Since the Bank's decision is partially determined by the actions of other lenders, the analysis applies initially to the total flow of resources and in the second instance to the Bank Group's actions.

Characteristics of Borrowing Countries

3. In the typical developing country, the net inflow of external resources is on the order of 2% of GNP, but in a number of cases it rises to 5% or more. The nature of a country's requirement for external resources



is affected both by its total resource gap (the difference between total investment and achievable domestic savings) and by its trade gap (the difference between its export possibilities and its requirements for particular imported goods). Among the least developed countries, factors limiting the level of investment and domestic resource mobilization are particularly important. Capital goods and other inputs needed to carry out investment comprise a large proportion of imports and provide a basis for normal project lending. As countries industrialize, the composition of both exports and imports changes, and trade limitations become increasingly important. The effect of each of these structural characteristics on the choice of lending techniques is noted below.

4. The Size and Composition of Investment. The upper limit to the magnitude of the resource transfer that can be based on conventional project lending is determined by the total level of investment and the proportion that can conveniently be treated as a project by lending agencies. Total investment varies from under 10 per cent to over 20 per cent of GNP, with a median of about 15 per cent in developing countries. Typically, considerably less than half of a country's total investment is suitable for project evaluation by international lenders, since they specialize in certain sectors and can rarely consider loans of much less than \$1 million. International financing of intermediate institutions lowers this limit and thus helps to increase the basis for project lending somewhat. From the demand side, therefore, the typical country's capacity to absorb resources through project lending is not likely to be much more than 2-3 per cent of its GNP -- even if 50 or 60 per cent of total project costs were financed.

5. Limited Domestic Resource Mobilization. Under the normal project technique, local costs of investment must be financed from domestic savings. The poorest countries are therefore likely to have their ability to utilize this technique limited by their ability to mobilize domestic resources. In countries with per capita income less than \$100, gross savings are typically only 10 per cent of GNP or less, and feasible levels of tax revenues are the same order of magnitude. Conventional lending based on the foreign exchange component of projects would add less than 2 per cent to this total. When the ability of the country to carry out investment effectively exceeds the amount that can be financed in this way, there is a justifiable case for local cost financing. At higher levels of income and particularly with larger exports and imports, the taxing capacity normally increases. In these circumstances the justifiable amount of local cost financing needed to offset the limited flow of domestic savings declines.

6. The Volume and Composition of Imports. The level of normal project lending may also be limited by the total volume and composition of the country's imports. Total imports range from over 25 per cent of GNP in small countries to less than 10 per cent in large ones. As countries industrialize,



the proportion of investment goods that needs to be imported declines, while the requirement for imported raw materials and semi-finished products increases. This transformation takes place at fairly low levels of income in large countries like India or Brazil because of the size of their domestic markets and the relatively low volume of their trade in relation to GNP. While a resource transfer of 2-3 per cent of GNP composed mainly of investment goods may create no problem for a country having imports of 20 per cent of GNP, it may exceed the need for that type of goods in a country whose total imports are less than 10 per cent of GNP. The limit is even lower when the country itself produces capital goods. For such countries, the limitations on the composition of the resource transfer under normal project lending become quite restrictive, and a case is often established for the financing of local costs.

7. Underutilized Capacity. In the course of industrialization, countries may develop excess capacity - particularly in the newer branches of industry - by investing ahead of the growth of demand. This situation is accentuated when a shortage of foreign exchange curtails the supply of imported goods needed to produce the industrial goods for which a demand already exists. In this event, the imports of intermediate goods and spare parts needed to make maximum efficient use of existing capacity have a higher priority on additional foreign exchange supplies than imports needed to increase capacity. Thus when imports are the effective limit to growth, the productivity of the imported goods needed to utilize existing capacity is very high. Within a given level of lending, the share of the resource transfer that should consist of project-related imports is correspondingly lower.

8. Whether it is desirable for the lenders to insist on a maximum of project lending before furnishing additional resources in the form of commodity loans depends on the development performance of the country and the relative needs of its public and private sectors. Project and sector lending are well adapted to supply the needs of the public sector. Trade liberalization and other measures to improve the efficiency of the private sector can often be supported more effectively by program lending because the commodities imported flow through commercial channels to private investors. In some circumstances, therefore, the "optimum" composition of the resource flow to be provided to a country may need to contain less than a maximum of project-related imports.

9. In summary, the upper limit to the amount of project lending that is economically efficient is determined by the combined effects of the set of factors described in paragraphs 4-8. This limit will vary considerably from country to country in accordance with its income level, size, natural resource endowments, and other factors. While the limits to project lending can be determined with reasonable accuracy from an analysis of a country's development program, the interaction of these factors cannot be reduced to any simple formula or set of criteria.



Illustrative Cases

10. Since these characteristics occur in varying combinations in individual countries, it is rarely possible to specify simple criteria that determine the best combination of lending techniques. Virtually all developing countries receive some development assistance in the form of normal project loans, and most of them receive one or more of the other forms as well. The following paragraphs illustrate typical cases in which there is a strong case for either local cost financing or program lending as part of the total assistance provided.

11. As indicated in paragraphs 24 and 26 of the basic memorandum, the appropriate form of Bank Group lending should be determined in the context of the policies of other lending agencies and the total assistance to be provided. The larger the share of the Bank in the total, the stronger the case is likely to be for it to share in non-project lending when that is needed. There is an increasing number of countries in which the Bank Group provides more than 20 per cent of total public assistance and to which this consideration applies with particular force.

12. The Cases of Reconstruction and Rehabilitation. A number of less developed countries have undergone periods in which their economies were disrupted by war, internal disorder, or political mismanagement. When a responsible government attempts to restore the economy and initiate a process of development, it is confronted by a situation in which the highest priority for external resources must go to imports needed to restore the flow of raw materials and spare parts and rehabilitate existing productive capacity. This situation is illustrated by Korea in the 1950's and currently by Indonesia and Nigeria.

13. In the case of Indonesia (described in the Bank's Economic Report of November 1970), the amount of public external assistance received in fiscal 1970 was about \$360 million or 30 per cent of total imports. The disbursements from project financing amounted to \$52 million. Even financing 100 per cent of the local cost of these projects would have provided considerably less than half of the needed amount of assistance. Although a somewhat higher proportion of total investment might have been taken as a basis for project financing, it could have made only a limited contribution to the import requirements during the period of economic rehabilitation, since project disbursements are spread over a long period. By 1972, the proportion of investment that is suitable for project evaluation is expected to grow and with it the resulting resource transfer in project form is expected to rise to \$175 million. In the longer run, rising exports should cover a growing proportion of the need for current imports. There should therefore be a steady reduction in the share of assistance needed by Indonesia on a program basis. This is a general characteristic of successful programs of reconstruction and rehabilitation.



14. Cases for Fuller Use of Existing Capacity. As indicated in paragraph 7, an imbalance sometimes develops between the amount of capacity installed in each sector and the volume and composition of demand. One cause of such structural imbalance is a failure of agriculture to grow as fast as anticipated - as in India in the early 1960's - with a consequent limitation on the demand for industrial output. Excess capacity may emerge periodically as a consequence of economies of scale in basic industries and transportation, where it is often efficient to build ahead of demand. It may also arise from a shortfall in export earnings or a reduction in expected receipts of external assistance, either of which can mean that imports of raw materials are insufficient for full capacity operation. Whatever the cause of structural imbalance, it results in strains on the balance of payments. If resources of capital and foreign exchange can be allocated to removing the trade and other bottlenecks that have developed, an opportunity for accelerated growth emerges. Efficient allocation often requires liberalization of imports and greater use of the market mechanism in order to influence private producers and investors.

15. Situations of this kind have arisen in recent years in countries such as Colombia, Turkey, Pakistan, and India. In these cases (as well as others), structural imbalance has periodically been reflected in import restrictions, overvalued exchange rates and a shortage of maintenance imports to operate existing industrial capacity. The Bank's reviews of the needs of these countries for external assistance have shown that a substantial component of program assistance was needed to provide for these high-priority needs. A portion of this need could have been met by local cost finance or debt relief if lending agencies had preferred these alternatives. The proportion of total official assistance provided to these countries in recent years in the form of program loans has ranged from under one-third of the total in Colombia to more than two-thirds in India, as indicated in Annex I, Attachment 4.

16. This structural case for program assistance is strongest in countries that have a well-conceived development program and set of policies for allocating available supplies of investment and foreign exchange. While allocation to the public sector can be made directly, the response of the private sector depends on import liberalization and other improvements in the functioning of the market mechanism. To meet the needs of the latter situation, a program loan is typically made against the needs for specified commodity imports so that the annual flow of resources will correspond to the balance of payments needs of the economy.

17. Cases of Limited Savings. In most of the poorest countries, the possibility of generating additional public and private domestic savings, and/or the desirability of doing so, is likely to be one of the principal constraints on growth. Where, for example, the maximum feasible share of savings in GNP is low and there is also little domestic production of manu-



factured goods, an increase in investment may require a large increase in imports in order to satisfy both the direct and indirect requirements for increased consumption as well as for investment goods. In that case, the indirect imports required can be effectively provided through financing the local costs of individual investment projects. More generally, if the government's revenue effort and its restraint on current expenditures have already been pushed to the feasible limit, and if it has done all that could be expected to generate and mobilize private savings, external financing of a substantial portion of the total cost of the additional investment would be justified.

18. Cases of Local Production of Capital Goods. Apart from limited savings capacity, the second principal case for local cost financing is based on the existence of local capacity for the production of capital goods. It is in the interest of the borrowing country to utilize this capacity to the maximum degree that is economic, and to import intermediate products rather than finished machinery and equipment in order to do. Examples of countries in this position include India, Brazil, Mexico, and Argentina. In these cases, the average foreign exchange component of investment is reduced from the 50-60 per cent that is typical of the least industrialized countries to 25-30 per cent or less. Furthermore, there is typically excess capacity (and labor) in the capital goods industries, so that the opportunity cost to the economy of producing capital goods may in the short run consist mainly of the imported materials and semi-finished products required.

19. The amount of local cost financing needed and the extent to which this form of project finance can satisfy the total assistance requirement also depends on the gross public inflow needed in relation to a country's total investment program and debt service requirements. Since the public flow is relatively small in some of the richer countries (e.g., Argentina and Mexico), it can be transferred via the normal process of financing projects or sectors with a moderate amount of local cost financing. By contrast, to transfer the estimated gross official flow of \$1,500 million per year that the Bank has estimated to be currently needed by the Indian economy on the basis of a foreign exchange component of 30 per cent of investment would require annually 250 projects of an average size of \$20 million. This compares to less than 50 projects per year currently being initiated by all external lending agencies. Here it is apparent that the capability and willingness of the lending agencies to review projects, as well as the prospective improvement that might be achieved in the quality of Indian investment, must be assessed in order to arrive at a proper mix of local cost financing and program assistance.

20. Paragraphs 10-19 indicate the effects of the principal factors that combine to determine the suitability of different forms of lending in different cases. More detailed analyses of individual countries are given in the



Bank's annual economic reports. In conclusion, it should be stressed that a decision as to the appropriate combinations of lending techniques rarely depends only on a few simple criteria, but rather involves an assessment of the quality and effectiveness of development policies and programs as well as consideration of the factors discussed here.

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