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Urban Poverty Program - General 1977 (Jan-May)

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

Mr. Jaycox D630

Mr. Stone

OFFICE MEMORANDUM

TO: Mr. Alastair Stone, Chief, Operations Review & Support Unit

DATE: May 26, 1977

KL/Gam UPP

FROM: John A. Holsen, Chief Economist, LAC

SUBJECT: Country-Specific Capital/Labor Ratio Thresholds

deadline too tight

1. Your memorandum of May 24 on the above subject indicated that the accompanying country-specific numbers would be assumed correct unless country economists advised you otherwise by the close of business on Tuesday, May 31. This is four working days after your memo was distributed, three working days after I had seen it and probably two working days after the country economists will get it. Moreover, it comes right at the time when we have the end of the fiscal year "crunch" of President's Reports and Board presentations. (I ignore the fact that many of us are meeting with Mr. Jaycox on Friday, May 27, to further discuss the general approach.)

2. The objective seems to be to come up with a "normalized" value for gross domestic investment per worker (line 15) which is expressed in 1976 prices of the country concerned (line 14) and then converted to U.S. dollars at the average 1976 exchange rate (line 5). It is "normalized" in that it is calculated (a) using trend values for the labor force (lines 12 and 13) which are in turn based on "interpolated" participation rates (lines 11 and 4) and the Bank's accepted population data (line 3) and also (b) using trend line values for constant price GDI (lines 2 and 7) which are converted to 1976 domestic prices (line 10) on the assumption that the GDI inflator for 1976 (line 9) can be estimated by taking its 1975 value (line 8 based on lines 1 and 2) and adjusting it by the 1.5% increase in the IPI (line 6) along with any change in the average exchange rate (line 5).

Both

3. It is not clear to me from your memorandum whether you are asking country economists to comment on the reasonableness of the method by which one arrives at the final result (line 15) or simply the adequacy of the inputs used. If it is the latter, about all they can do is comment on whether they have a better consistent series for input lines 1 and 2. If consistent definitions across countries are desired, no one country economist can say much about line 4; lines 3 and 6 are given by DPS and line 5 is from IFS. If it is the former, I doubt if many of them will have the time by Tuesday. As openers, however, I will say that (a) the IPI is an inadequate measure of the change between 1975 and 1976 in the domestic currency deflator for investment in those cases where purchasing power parity exchange rate policies were not maintained in 1975 and 1976 and (b) many of the constant price projections of GDI for 1976 (see line 7) look abnormal rather than "normalized" when compared with the prior few years (line 2).

and again by life of each place

4. Given (a) basic doubts about the general approach (dividing the gross investment flow by the labor force stock and multiplying this by a factor of 2), (b) additional doubts about how the "normalized" values were obtained for 1976 and (c) the limited time available, I am suggesting that LAC country economists confine their comments to whether or not they can provide better time series for input lines 1 and 2.

JAHolsen/ddm
cc: Regional Chief Economists
Messrs. Jaycox, Dunkerley, Churchill and Kahnert (URB)
Mr. McPheeters (EPD)
Mr. Glaessner
LAC Division Chiefs / LAC Senior Economists

X

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

MAY 25

file

OFFICE MEMORANDUM

TO: Messrs. Alastair Stone and Nicholas Lethbridge

DATE: May 25, 1977

FROM: Hans Pollan and Vinod Dubey

SUBJECT: Urban Poverty Program: Capital/Labor Ratio Consumption/Affordability Criterion

We refer to Mr. Lethbridge's memoranda of May 16 and 17 and Mr. Stone's of May 24, all of them requesting inputs to the information stock required to measure our UPP activities. Dates by which data were solicited are essentially the end of this month.

We, in EMENA, would obviously like to be helpful to your endeavour but we do have a number of questions on some of the requests partly nourished by the recent memoranda addressed to your Department by Messrs. Bevan Waide and Bela Balassa. Since Mr. Jaycox has invited a meeting for this Friday, May 27 at 11.00 a.m. to address questions of this type, we would consider it much more sensible to work towards a prior solution of some of these questions before putting in train a data collection effort that would involve an appreciable amount of staff time and some research. We would like to keep this at a minimum and particularly avoid questions in this process which touch in a fundamental sense the suggested methodology.

Once we have resolved the pending questions, we will suggest a suitable early date for the EMENA contribution to your information-gathering effort.

HPollan:db

X

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

MAY 25 REC'D

OFFICE MEMORANDUM

TO: Mr. Nicolas Lethbridge

DATE: May 24, 1977

FROM: Richard N. Middleton (EWTDR) RM

File

SUBJECT: Draft Guidelines on Urban Poverty Projects

Due to staff constraints and mission commitments, we have not ourselves been able to review your draft properly within the very limited time (one and a half days) allowed. However, I attach some comments from Mr. Curry, who as you know is working with us as a consultant on the urban poor impact of water supply projects, which may be of help. They essentially cover three points:

1) The "year-by-year" replicability criterion is oversimplified, and may result in worthwhile projects being rejected.

2) The two cases considered are in fact different aspects of one case (depending on long-term marginal cost trends).

3) The subsidy discussion requires considerable further refinement.

You may wish to discuss these points further with Mr. Curry, who will be working in this Department for the next six weeks.

As regards quantifying impact (paras 10-12), we obviously will not be in a position to agree or disagree with your draft until Mr. Curry's work has advanced further and we have discussed his preliminary conclusions with you.

Attachment

cc: Messrs. van der Tak (PAS); Yudelman (AGP); Zymelmann, Ballantine (EDP); Kalbermatten (EWTDR); Hyde (DFC); F. Mitchell (TMP); Carnemark (TRP); Messenger (PNP); Pollan (EMP); Rajagopalan (ASP); Glaessner (LCP); Bronfman (EAP); Howell (AEP); Pouliquen (WAP); Hablutzel (EANVP); de Azcarate (WANVP); Hasan (AEP); Waide (ASNVP); Dubey (EMNVP); Holsen (LAC); Roth (URB)
Ms. Julius (EWTDR)

RNMiddleton:jbe

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Richard N. Middleton DATE: May 24, 1977

FROM: B. Curry BC

SUBJECT: Comments on Mr. Lethridge's Memorandum Dated May 17, 1977

1. My comments proceed in three parts. The first deals with the notion that projects must be replicable on a year-by-year basis to handle incremental demand. This stipulation could build unwarranted inflexibility into lending processes. The second concentrates on certain assumptions implied in Case 1 situations where replication is fairly easy because price covers cost. The case appears to rely on the assumption that some variance of long-run marginal cost is either constant or decreasing. If this condition does not pertain, unit cost could begin to increase at some output level less than "the limit of market demand." The case blurs into, rather than being distinct from, Case 2. This latter situation is where price does not cover cost. The third point is more general and two-fold: (a) a subsidy to provide replication in a Case 2 situation must be accompanied by a rather detailed evaluation of the subsidizing agency's financing capacity; and (b) a combined subsidy-price situation introduces efficiency-equity consideration that may tax the administrative capacity of the subsidizing agency.

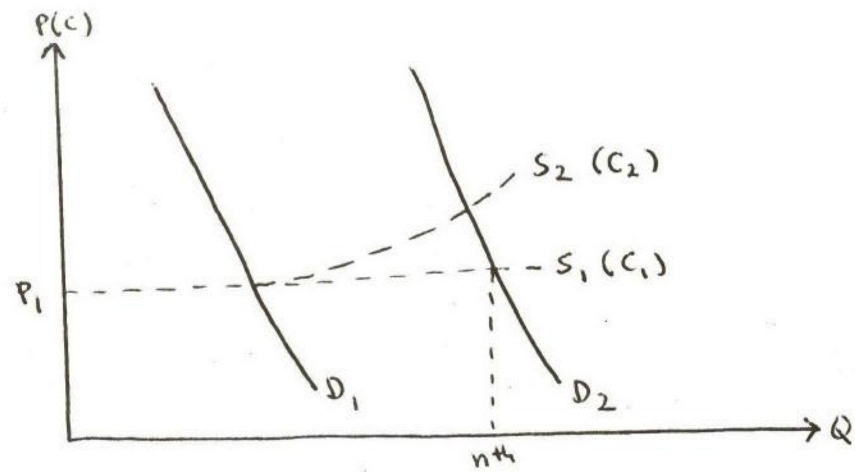
2. The memorandum states that "In addition to serving the target group, poverty projects must be replicable on a reasonable scale (and) unless the venture is profitable it should be shown, at a minimum, that the project would be replicated to handle, year-by-year, the increment to demand for the .... service, without exhausting the resources likely to be available in the market serviced by the project." If this must be done on a year-by-year basis, inflexibility is inserted into the decision process and desirable projects that would replicate over a "reasonable" time period might not be undertaken. Consider the following abstract but not implausible situation.

YEAR	(A) TOTAL URBAN POP.	(B) TOTAL TARGET POP.	(C) TOT.TARGET & TOT.URBAN	(D) TARGET POP. SERVED	(E) % TARGET POP. SERVED	(F) DEFICIENCY (B-D)
Y-n	70	14	0.20	1.5	0.11	12.5
Y-1	80	20	0.25	2.0	0.10	18.0
Y	100	30	0.30	2.7	0.09	27.3
Y+1	130	45	0.35	3.5	0.10	41.5
Y+2	170	68	0.40	13.6	0.20	54.4
Y+m	220	100	0.46	50.0	0.50	50.0

In year Y the Bank lends financial assistance to a project in a deteriorating situation characterized by increasingly deficient urban poor water supply. The heuristic situation is due to rapid urbanization with an increasing urban poor component. Given the proportion of population impact measure, the deterioration is stopped following the investment. By year Y+m, the project is more than fully replicable, and the absolute deficiency level declines. However, in year Y+1 and Y+2 the project was not replicated on a reasonable scale-- incremental demand was not satisfied. To say that the project must be replicable on a year-by-year basis could shift attention away from it even though the project could have replicated over a somewhat longer time period. This should not be taken as a critique of replicability. The point is intended only to suggest that the year-by-year requirement could be too stringent where there are lags in financial, technical and administrative aspects of replicability.

3. The memorandum states, "If the project is covering cost, it is replicable within the present economic condition of the country ...We have not exhausted the resources necessary to make more of the same and sell it too, to the limit of market demand." Somewhere in this argument there appears to be an assumption of constant (if not decreasing) long-run cost. The "limit of market demand" concept can be conceptualized in Figure I where the urban poor, represented by the nth consumer in Figure I, would be willing to consume Q1 at price P1. In this case, demand shifts from D1 to D_2 due to improved access and with no increase in unit cost. This is all very well in a constant (S1,D1) cost situation. The analysis runs into complications when "some varient of long run marginal cost" begins to increase. This would tend to increase average unit cost (S_2).

Figure I



The point here is that Cases 1 and 2 are not necessarily distinct and unrelated. At the nth consumer's level of demand reflecting the "limit of market demand" at the price P1, cost on the margin and average could increase. Case 1 blends into Case 2 rather than being distinct from it. Unit cost exceeds the price at which the representative poor consumer, person n, will demand the product. This introduces the matter of a subsidy.

4. The memorandum suggests that when a subsidy is required in a Case 2 situation, to arrive roughly at its value, multiply "the per capita subsidy in the project by the number of poor people still to be served and see if the resulting total is financially manageable." An increasing cost situation complicates matters. It could require a subsidy the size of which is not politically manageable under circumstances where the urban poor are not a viable force. If they are, then their actions could lead to an urban-rural poor competition in the country. The opportunity cost of providing urban subsidies might be borne by the rural poor.

5. The subsidy discussion brings one to local or national financing capacity and opportunity cost situations. Suppose that local or national financial situations do not permit subsidizing replication at levels servicing the limits of market demand due to revenue insufficiencies and high opportunity costs. Should some other and less inclusive sector of the market demand limit be satisfied? If so, which subset of consumers should be served? And what proportion of unit cost should they pay--long-run marginal cost, or zero cost for equity reasons? For those relatively less poor, should price fully cover cost of service? Or should quality of service to the subsidized be lowered? This raises pricing and raises equity and efficiency optimality questions that I am certain are well recognized.

6. Since these matters are so complicated, may I leave it at this. First, subsidies for replication in Case 2 situations cannot be divorced from the public finance capacities of the agency providing replication both in terms of revenue sufficiency and opportunity cost. The latter is particularly pertinent to situations pitting urban poor against rural poor for scarce financial resources. Second, detailed pricing-subsidizing matters are involved in meeting efficiency and equity optimality and this could tax local administrative capacities. In my more lengthy paper I would like to address some of these points. I know that they are receiving a good bit of attention.

BCurry:jbe

FORM NO. 75
(1–76)

THE WORLD BANK

ROUTING SLIP	DATE: 5/27

NAME	ROOM NO.
~~Mr. Stone~~	~~D716~~
D614	(8088)
Nico	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
✓	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		URGENT

REMARKS:

Came to D716
by mistake

FROM: L. Pouliquen.	ROOM NO.:	EXTENSION:

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

JUN - 2 REC'D

TO: Mr. Antony P. Cole, Chief, WAPED

DATE: May 24, 1977

File

FROM: David G. Davies, Economist, WAPED

SUBJECT: Urban Poverty Projects: Poverty Projects Which Supply Goods and Services to the Poor; Draft Guidelines.

1. This memorandum comments on the Draft Note sent to us by Mr. Lethbridge under a covering note dated May 17, 1977.

2. The first part of the note says that poverty projects must be replicable. A project is "replicable", according to the note, if the operations of the incremental unit can be financed from revenues or by subsidies. I have never understood the replicability criterion. Suppose a project is not replicable by the above definition but is, nevertheless, economically sound even after taking into account distributional weights? The project may be financially viable, although incremental units may not be.

3. The second part of the note deals with the identification of the target group for a project and the attribution of parts of a loan to a poverty group. In the attempt to establish guidelines on these matters, we may be diverting attention from some critical considerations. For example, over the life cycle of a project, which consists of construction and operating phases, its beneficiaries may change radically. If a project takes a long time to yield an output (such as an education project, a long road, or even a power project), how a project is organized in its construction phase becomes very important because we discount the future. The draft note wishes us to consider only the distribution of benefits at the operating phase of a project. This is clearly incorrect.

2

UPP III

Mr. E. Bevan Waide, Chief Economist, ASNVP May 24, 1977

Nicolas Lethbridge, ORSU, URB

Guidelines to Distinguish Urban Poverty Lending

1. Thank you for your comments on the consumption/affordability criterion. I can reply to your first three points quickly:

(a) It will usually be true that a project which qualifies under one of the urban poverty program criteria will not qualify under the other. Meeting either the capital/labor criterion or the consumption/affordability criterion is sufficient for classification as urban poverty lending. The example you quote of a capital intensive textile job, which produces cheaper textiles for the urban poor, would therefore be a dandy poverty project, provided that there is significant demand for the output amongst the target group and that it is accessible to them. A more interesting problem arises when a project qualifies under both criteria. We have wondered for some time whether to allow double counting in these circumstances for programming purposes, but have decided instead to reward such over-achievement with gold stars only.

(b) We have been at pains for some time now to point out that none of these urban poverty program criteria should be interpreted as replacing or superceding sound economic and technical analysis of projects. The long run opportunity costs of perpetual subsidies are, of course, already adequately accounted for in the detailed and accurate economic analysis of projects for which this Bank is so famous.

(c) If an agriculture or transport project lowers the cost of consumer goods to the urban poor, and if the distribution of this consumption advantage to the various segments of the urban and rural population can be estimated or quantified, then I can see no reason why such projects or parts of such projects could not also qualify as urban poverty lending.

2. Your last point raises a concern which has been widely and repeatedly expressed during the discussions about these guidelines. The simple answer is that these criteria are supposed to be useful both for classifying and as specifications for the design or selection of projects. Indeed, it is not clear how they could be useful in one respect without being useful in the other. Whether we can really say that, if these criteria are used, then the projects so selected are the best or even a good set of projects for relieving urban poverty, I do not know. However, these criteria represent the best attempts that we are able to make in this Unit to achieve that end within the Bank, and we certainly believe that

if these criteria are used as specifications for the design and selection of projects, we will emerge with a better set of projects with respect to relieving urban poverty than we have now. Of course, to do this, we shall have to rely on an imaginative or innovative approach to design by projects officers rather than specific design instructions. I am sure we will have an opportunity to discuss this point further during the meeting on the capital/labor criterion. I hope we will be able to give you an adequate reply then.

NLethbridge:bb

cc: Messrs: Jaycox, Dunkerley, Churchill, Stone, Beier, Kahnert (URB); Rajagopalan (ASP).

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

1. F.K.
2. G.B.
3 File

TO: Mr. Nicolas Lethbridge, Acting Chief, Operations Review & Support Unit, URB

DATE: May 24, 1977

FROM: E. Bevan Waide, ASNVP

SUBJECT: Draft Guidelines on How to Distinguish Urban Poverty Projects Using the Consumption/Affordability Criterion

I have four comments on your draft:

1. Is there a possibility that this criterion would conflict with the Capital/Labor criterion? For example if we were asked to finance a capital intensive textile plant that produces cheaper textile for urban poor, and if the project fails to be classified as urban poverty on the first criterion but succeeds on the second, what do we do?

2. You argue that where the project requires a subsidy "...it should be shown, at a minimum, that the project would be replicated to handle, year by year, the increment to demand for the good or service, without exhausting the resources likely to be available in the market serviced by the project." So often subsidies are perpetually available (as in the case, for example, of Sri Lanka) but there is an opportunity cost in the long-run. How should we handle this?

3. If (para. 11) other parts of Bank loans can qualify because of the indirect effects, then would it be fair to include agriculture or transport projects which lower the cost of consumer goods to the urban poor?

4. Lastly while the application of these criteria, to identify whether or not a particular operation should be counted as urban poverty lending, is fairly straight forward (subject to questions of the kind raised above), I think we will be in trouble if we use these same criteria to select or design projects. Can we really say, if these are the criteria used, that the projects so selected are the best or even a good set of projects for relieving urban poverty? It is this last question which, as you will have noted from previous memoranda, has been bothering us for some time. We would welcome your reply.

cc: Messrs. Stern, Jaycox, Rajagopalan, Regional Chief Economists

EBWaide/cml

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

OFFICE MEMORANDUM

MAY 24 REC'D

TO: Mr. J. A. Bronfman **DATE:** May 23, 1977

FROM: E. Erkmen

SUBJECT: Urban Poverty Lending

I have the following comments to offer on the draft note accompanying Mr. Lethbridge memo of May 17:

I feel the proposed approach is somewhat inconsistent.

we talk about 'systemic' subsidies not ~~dist~~ consumer. ?

(a) If we consider two identical water supply projects, Project A in which the tariffs to the poor cover the cost and Project B where there is an intra-sectorial subsidy of the poor. Although the impact on the authorities' financial position is identical, Project A is assumed to be replicable and automatically qualifies as a "poverty project" while Project B will qualify only if it can be shown that year by year money can be obtained to serve at least the increment to the poverty group. In a sector such as water supply where investments tend to be lumpy, this may often not be possible.

(b) If a project is designed to serve the needs of all the present urban poor, it will only be designated an urban poverty project if we are satisfied that funds will also be available to serve the future poor. The philosophy appears to be if you cannot serve all the poor, don't serve any.

not at all
just don't call it a "poverty project"
How many times must we say this.

RReekie:cuc

MAY 24 1977

OFFICE MEMORANDUM

TO: Mr. Edward V. K. Jaycox

DATE: May 23, 1977.

K/L Gen + UPP

FROM: Bela Balassa

SUBJECT: Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending

Introduction

1. In this memorandum, comments are offered on your "Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending" (for short, the Guidelines). The comments concern the establishment of country - specific threshold capital/labor ratios; the measurement of capital/labor ratios for individual projects; and the treatment of future employment. Para 13 provides a summary of the comments.

The Country-Specific Threshold Capital/Labor Ratio

2. The Guidelines cite a rule contained in your earlier memorandum, according to which "A project or sub-project would be considered as meeting poverty lending criteria when the capital/labor ratio of the investment is below a country-specific threshold". The 'Country-Specific Threshold Capital/Labor Ratio' is now defined as follows: "The country specific ratio is simply twice the current gross domestic investment (GDI) divided by current labor force using existing Bank definitions."

Yes, it is

3. This is *not* a capital/labor ratio; nor does it make economic sense to relate gross domestic investment to the labor force. Rather, capital/labor ratios are to be defined either as the ratio of gross domestic investment to the increase in employment (the incremental K/L ratio) or as the ratio of the capital stock to total employment (the average K/L ratio).1/

Yes but he agrees!

4. Questions arise also concerning the multiplication of the GDI/labor force ratio by 2. While this number is said to have been chosen to reflect the "Bank's limited capacity to lend effectively at very low levels of capital intensity", it is essentially arbitrary. And although deviating from the norm "on the basis of good country economic reasons is welcomed", the reasons are not defined and ORSU is to be the final arbiter on the choice of this number.

Totally wrong -

5. But what would the application of the threshold ratio mean in practice? Consider the case of a country that has by-and-large average characteristics in the developing world; i.e. a capital-output ratio (K/Y) of 3 and an investment share (GDI/Y) of 15 percent or .15. Mutiplying GDI by 2, it will be apparent that the average capital/labor ratio (K/L) for the country concerned is ten times the prescribed threshold ratio (GDI/L). This means that, in order to qualify as "urban poverty lending", a project

---

1/ Employment rather than the labor force will be the relevant variable.

How can K/Y be taken as K/L ??

would have to generate ten times as much employment per unit of capital invested than the national average.[1]

6. One may further query the use of a single threshold ratio for a particular country, irrespective of the sector where the investment takes place. According to the Guidelines, this is done in order to encourage investment in new sectors and subsectors whereas "sector-specific ratios might encourage capital saving in all sectors but this would simply be business as usual since the need for capital saving is already embedded in the Bank's existing appraisal criteria". It appears, then, that a new job created in e.g. the service sector is given greater weight than a new job created through the adoption of labor-intensive methods in e.g. construction. Such differentiation is hardly warranted; at any rate, appropriate shadow pricing will account for the employment effects in either case.

[illegible]

Estimating Capital-Labor Ratios for Individual Projects

7. I come next to the calculation of the capital/labor ratio for individual projects. Apart from direct employment effects, it is said that "there are three potential sources of indirect domestic employment: the construction phase of the project; backward and forward linkages to supplying and consuming enterprises; income and saving effects of the employment". Among these sources of employment creation, only employment generated in the construction phase of the project is to be included in the calculations.[2] Also, the guidelines exclude all adverse employment effects. These effects will first be considered in the following.

8. According to the Guidelines "Labor substitution effects, i.e. employment destroyed by the new investment, should not enter into the calculation of the project capital/labor ratio /because/ if the investment meets the efficiency criteria of our investment analysis (correctly applied with appropriate shadow rates) the implied employment changes should have been fully accounted for". It would seem, then, that conventional project selection criteria are considered satisfactory for the destruction, but not for the creation, of employment. Yet, while the shadow price of labor reflects the decline in employment elsewhere in the economy that is due to the withdrawal of labor from alternative uses, as customarily calculated it does not account for employment destroyed by the project that is due to product substitution, e.g. the loss of work to weavers resulting from the establishment of a textile factory. In turn, accounting for employment creation involves double counting, since the valuation of new employment is already incorporated in the shadow wage calculation.

[illegible]

I have sympathy with this

1/ The same conclusion applies in comparisons with the incremental capital/labor ratio if the latter equals the average K/L ratio.

2/ Up-stream and down-stream effects meeting certain criteria are also to be included as discussed below.

9. Further questions arise concerning the statement that "Up-stream and down-stream employment effects and the incremental capital associated with them should not be accounted for in the calculation of the project capital/labor ratio, unless these linked operations are included in the project description". And while the consideration of such indirect employment effects is allowed "if the project provides the potential for a linked operation that has such a good capital/labor ratio that it improves the capital/labor ratio of the project being financed", consistency would require including up-stream and down-stream effects also in cases when these adversely affect the average capital/labor ratio.

10. More generally, there is no rationale for including some indirect effects in the calculations and excluding others. At the same time, as shown in a recent memo by Bell, Blitzer, Little, and Squire (March 15, 1977), indirect employment effects can be taken into account if existing project evaluation criteria are appropriately interpreted.

Savings Effects and Discount Rates

11. The Guidelines exclude the indirect employment effects of additional savings generated by the project on the grounds that "their inclusion would amount to reliance on the unreliable trickle-down effect". While this statement is offered without empirical justification, one needs further to consider possible adverse effects on future employment through reductions in savings associated with the implementation of the criteria contained in the Guidelines. Thus, while the Guidelines state that "employment today substitutes for today's capital and employment in the future for future capital", there may also be substitution between present and future employment.

12. Turning to the question of the appropriate discount rate, according to the Guidelines "capital costs and man-years should both be discounted over time by the current opportunity cost of capital in the country". This proposition is rationalized on the grounds that "the whole urban poverty exercise is predicated on the assumption that where the capital stock has been replaced and the economy fully employed, capital and labor are substitutable on the economy-wide basis at least within the operationally relevant range". But full employment may be beyond the horizon of the exercise and thus have little relevance for the discount rate. Also, the rate of substitution between capital and labor may vary between countries as well as between sectors. Finally, as shown in the Mexico model undertaken at the Bank (Goreux-Manne, "Multi-level Planning: Case Studies in Mexico"), the 'own' discount rates of various factors of production may differ to a considerable extent.

Conclusion

13. It has been shown that the Guidelines provide an inappropriate benchmark (threshold) for establishing poverty lending criteria; the treatment of the employment effects of projects lacks consistency; and an incorrect discount rate is proposed for future employment. Also, using the Guidelines in

conjunction with the Bank's existing project evaluation criteria would lead to double counting the direct employment effects of projects while neglecting some indirect effects. A more appropriate solution would be to introduce income-distributional considerations in the evaluation of urban projects as suggested in a memo by Ahluwalia, Pyatt, and Little addressed to you (November 4, 1976).

cc: Recipients of Guidelines
DPS Directors

[illegible] [illegible] evaluation

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

AS

OFFICE MEMORANDUM

MAY 24 REC'D

TO: Mr. J. A. Bronfman

DATE: May 23, 1977

FROM: E. Erkmen

SUBJECT: Urban Poverty Lending

I have the following comments to offer on the draft note accompanying Mr. Lethbridge memo of May 17:

I feel the proposed approach is somewhat inconsistent.

(a) If we consider two identical water supply projects, Project A in which the tariffs to the poor cover the cost and Project B where there is an intra-sectorial subsidy of the poor. Although the impact on the authorities' financial position is identical, Project A is assumed to be replicable and automatically qualifies as a "poverty project" while Project B will qualify only if it can be shown that year by year money can be obtained to serve at least the increment to the poverty group. In a sector such as water supply where investments tend to be lumpy, this may often not be possible.

substantial?

(b) If a project is designed to serve the needs of all the present urban poor, it will only be designated an urban poverty project if we are satisfied that funds will also be available to serve the future poor. The philosophy appears to be if you cannot serve all the poor, don't serve any.

No

RReekie:cuc

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

UPP Gen
Rec'd
5/19 (Lom's)

OFFICE MEMORANDUM

TO: See Below

DATE: May 17, 1977

FROM: Nicolas Lethbridge, Acting Chief, Operations Review & Support Unit, URB

SUBJECT: Draft Guidelines on How to Distinguish Urban Poverty Projects Using the Consumption/Affordability Criterion

Please find attached a draft note on the above subject for your review and comment. Mr. Jaycox plans to circulate a final version as soon as possible. I would be grateful, therefore, to have your comments by c.o.b., Monday 23rd of May.

Wed Morning

NLethbridge:bb

Distribution:

Messrs: van der Tak (PAS); Yudelman (AGP); Zymelmann, Ballantine (EDP); Kalbermatten (EWT); Hyde (DFC); F. Mitchell (TMP); Carnemark (TRP); Messenger (PNP); Pollan (EMP); Rajagopalan (ASP); Glaessner (LCP); Bronfman (EAP); Howell (AEP); Pouliquen (WAP); Hablutzel (EANVP); de Azcarate (WANVP); Hasan (AEP); Waide (ASNVP); Dubey (EMNVP); Holsen (LAC); Roth (URB).

cc: Messrs: Jaycox, Dunkerley, Churchill, Strombom, McCulloch, Singh (URB).

I have a lot of problems with this.
W
5/20

May 16, 1977

DRAFT NOTE: Poverty Projects Which Supply Goods or Services to the Poor

1. The programming of Bank urban poverty efforts require better definitions of poverty projects than were included in the January 6th memorandum (Jaycox to OVPs), both in projects that ~~are included in the program~~ because of their employment effects and projects that ~~are justified~~ because they produce services for the poor. The employment type poverty projects have been the subject of a separate memorandum to define more precisely the method of identifying them. (Jaycox to Distribution, May 11.) This memorandum outlines the procedure for identifying parts of projects which produce consumption goods and services as poverty projects.

2. The main idea of poverty projects of this type is that they lower the price or increase availability of goods and services demanded by the target group.[1] Most Bank projects of this type have been for the provision of public services, but the category includes projects to stimulate private provision of goods or services (e.g. subprojects under IDF loans). In addition to serving the target group, poverty projects must be replicable on a reasonable scale. Unless the venture is profitable it should be shown, at a minimum, that the project would be replicated to handle, year by year, the increment to demand for the good or service, without exhausting the resources likely to be available in the market serviced by the project. To judge whether or not the replicability requirement set up in this way will be met by a particular future project, two different sets of indicators should be used, depending on whether or not the output will be demanded by the poor at a price which at least covers the costs of the project.

Case 1, Project is Demanded by the Poor at a Price Which Covers Cost[2]

3. In this case, replicability arguments are simple. We assume that if the project is covering cost, it is replicable within the present economic situation in the country (i.e., we have not exhausted the resources necessary to make more of the same and sell it too, to the limit of market demand). This will require projects with low enough costs so they can be sold in the poor people's market. This could result from a lowering of quality standards in project design. Information required, beyond the usual project identification information, relates to the actual market situation in the sector and the geographical region served by the project: we will need some evidence on what the poor currently buy in the sector, the price they pay, the depth of the market, the organization under the project for marketing the goods, and so forth. For early stages of

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1/ The target group is defined as the urban group in relative or absolute poverty, whichever is greater. You have received the latest country estimates of urban poverty thresholds and the percentage of urban poor in each country (Jaycox and Yudelman to Chief Economists, May).

2/ This cost concept is some variant of long run marginal cost. For example, land that happens to be owned by the project executing agency, should be costed at the cost to that agency of acquiring more land. Similar treatment should be used whenever the project benefits from a special and limited resource availability.

programming we may have to fall back on rules of thumb, for example, the poor will be willing to pay 15% of their income for housing, 3-4% for water, etc. But it should be understood that ultimately we are facing a market test with projects of this type, rather than an affordability test. At appraisal we will want to know that the poor demand the output at a cost-covering price, not that they could afford it in some rule of thumb sense. It will generally not be required to predict exactly who will end up buying the output of the project. As long as we can establish with some certainty that it will be demanded by the target group and accessible to them, this is all that is required.

Case 2 - Cost Exceeds Price at Which the Poor Will Demand the Product

4. In this case the project cannot aid the poor without some form of subsidy, such as Government subsidy or a cross subsidy within the executing agency or within the beneficiary group of the project itself. In this case the replicability argument will require more complex analysis going well beyond the ordinary project analysis:

(a) It will be necessary to show that the poor actually get the subsidy and receive the products of the project. This follows from the fact that the poor can't afford products of this type and therefore that each unit produced for them exhausts part of the subsidies potentially available.

(b) It will be necessary to show that more subsidies are available -- that year by year the money can be gotten to serve at least the increment to the poverty group.

5. This requirement is not meant to be so restrictive that it disqualifies all projects which have costs above those that the poor are willing to pay. It does require, however, that the project officer is convinced that a program at that level of subsidy is workable for at least the increment to the poverty group and that it will be done. For example, water authorities often aim to serve the entire urban population. In such cases, the project officer needs to show that the supplying institution is strong enough or can tap enough subsidies, or use enough cross subsidies (or that the project improves sufficiently both financial and managerial competence of the agency) for this aim to be realized at least to the extent of covering the increment to demand by poor people. Similarly, a serviced site project may be part of a general program including squatter upgrading, low cost housing, unserviced sites, and trickle-down of old housing, which, combined, will serve the entire target group in a reasonable time period and make progress on the problem (e.g. serve the poor increment) very soon. If such a program is expected to be executed, within the financial and administrative constraints which exist or which are created by the project, then it could qualify on replicability grounds as a poverty project, assuming that it directly serves the target group.

fact that agency has enough clout to get funds or subsidies is not a [illegible] justification for the subsidies

6. It is important to be explicit in considering the standards incorporated in subsidized projects, and the standards of service that could be offered to the entire poverty group within the financial constraints, both as a guide to whether the standards in the project itself are reasonable and as an indicator of whether a program to serve the whole poverty group can be expected. As a rough indicator, try multiplying the per capita subsidy in the project by the number of poor people still to be served and see if the resulting total is financially manageable. If the project serves the richest of the poverty group, a higher subsidy for the remainder should be used in this calculation.

Identifying the Target Group Served

7. For subsidized projects, it is necessary to show that the output reaches the target group. For some projects the non-poor may be assumed to exclude themselves by choice because the project is not designed to appeal to them, for example, very low standard mass transportation projects. For some projects, income tests to qualify for project benefits may succeed in excluding the nonpoor (e.g. some serviced site projects or credit). In most cases, however, it will be difficult to figure out what income group actually gets the benefits. Two methods can be tried: area identification of the project benefits combined with poverty mapping, and sampling.

8. For area specific projects (e.g. water supply, primary education to serve a particular locality, localized health services, bus service to a particular slum) the project may serve areas where most of the people are poor. It is suggested that a rule of thumb be used to designate such areas, and that any area, served by a project, having 75% poor people be counted as a poverty area, and that all expenditures in that area be counted as poverty expenditures. Because of ~~the~~ weakness of income distribution data and the scarcity of poverty mapping, these estimates will often be very rough, particularly early in the project cycle. To estimate the expenditure on poor people in projects where the poor beneficiaries are geographically scattered, it may be a reasonable project preparation task for the government to undertake cheap sampling surveys to determine the income level of project beneficiaries. This is a necessary part of preparation if project design parameters depend on income. Even where not strictly required for project design, however, sampling to determine various social characteristics of the beneficiary group (among them, income) may be useful and justified. Even a very small and cheap sample will provide a rough indication, in many cases, of the income distribution of beneficiaries.

9. It is extremely difficult to put a fine point on how we can determine replicability far enough in advance of project appraisal to identify poverty projects in the pipeline. It is obvious that additional sector knowledge and a broader guaged discussion with government (beyond that needed for ordinary project analysis) will be required in almost all cases in order to make this kind of replicability judgment with any confidence. It is

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Sample first: design criteria vs classification !

accepted that in many sectors and countries, the urban poverty dialogue with government has not advanced to a point where a reasonable judgment on the government's program commitments can be made. Thus, for projects that depend for their replicability on identifying the specific segment of the target group served, and on fitting into an overall program to serve the poor, the identification of a project as a poverty project is provisional. For cost covering projects (Case 1) the analysis is simpler so that early identification should be less troublesome.

Attributing Parts of a Loan to the Poverty Group

10. So far, we have discussed the identification of poverty projects as if they were whole projects without non-poverty component. It has been agreed, however, that poverty-oriented parts of projects should also be identified and counted as poverty lending. Since it is probable that almost all projects will have a non-poverty component, it will often be necessary to make fairly arbitrary estimates of the amount of the loan that goes to serve the poor.

11. Some costs can be allocated quite easily to the poverty component of the project. These will be mainly the infrastructure, hardware and software financed by the project that are spent directly on the poverty group in an identified poverty area with no share or an insignificant share of the benefits slopping over into the general population or into financing of the overall supply system. In addition to these direct expenditures on the poverty group, other parts of Bank loans can qualify because of their indirect effects. The most obvious examples are water and water-borne sewerage trunk systems, actually financed under the project, which serve the poor among others.

12. The general rule is to allocate these joint costs on the basis of the distribution of the consumption under the project. To apply this rule consider the project in its mature state, where the service and share of costs of the poverty group has developed to its highest level in the project's useful life.

Indicators of Poverty Projects for Programming Purposes

13. Because programming takes place in advance of project identification, it will generally be necessary to guess at or to target the degree of poverty-orientation of a project, in the first instance, and improve on this guess or approach this target as preparation advances. The following indicators are proposed at each programming stage.

1st: % of Lending Directed Toward the Target Group

This indicator is basic in that poverty lending targets are formulated in terms of percentages of total urban lending. It may be useful to consider, even for first attempts at this estimate:

(a) % of project output consumed by target group; and
(b) % of target group consumers in total population served by the project.

2nd: % of Target Group Demand Met Before the Project and After the Project in the Relevant Market.

This indicator gives a rough idea of progress in the sector and potential for more poverty projects in the sector.

3rd: Quantity Consumed by Target Group in the Project, Cost to Supply this Quantity in the Project, Average (Current) Expenditure on the Product by Target Group, Average Expenditure as Percentage of Poverty Group Threshold Income Level

This indicator is meant to provide a first reading on whether the project will meet the poverty project criterion simply (Case 1) or whether more complex analysis will be needed (Case 2).

Sanjay
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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Regional Urban Poverty Program Coordinators

DATE: May 16, 1977

Nicolas Lethbridge

FROM: Nicolas A. Lethbridge, Acting Chief, Urban Operations Review & Support Unit, URB

SUBJECT: <u>Updating the Urban Poverty Program Information System</u>

1. We are now in the process of updating information on the Urban Poverty Program so that we can report on the status of the Program by the end of June. Just before the end of the fiscal year is an obviously inconvenient time for you to update or generate data, so we have tried to lighten the load as much as possible. We are asking for two types of data on projects in the lending program. The first is identical to that you gave us six months ago and updating it now will, I hope, prove to be more routine and less time-consuming. The second is more detailed data on poverty components of the FY77 lending program, which we have not attempted before.

2. For updating the basic data for the whole five-year program, we have attached (Attachment I) copies of the Report 2-1 for your Region. This report shows all non-agricultural lending in the FY77-82 program, and, as you will see, we have already updated, from the latest information available to us, as much as possible.[1] If there are any further changes or additions to be made, please indicate them; otherwise, we shall assume the data are correct. We now need the updated locational and poverty estimates shown in columns 4, 8 and 9 of the report. The accompanying notes (Attachment II) define the concepts used in these reports which have not changed since last time and which should be familiar to you. The unit will be happy to assist you whenever possible in doing this. Please contact Ms. Kinnison (Ext. 5283) if you need help or further explanation. Could you please return the marked up copies of the report as soon as possible and at least by c.o.b. May 27.

3. The more detailed data on FY77 projects relates to data on capital/labor ratios for projects or components in the UPP on account of their urban employment impacts; and on affordability and replicability data for projects qualifying for the urban poor service access or consumption benefits they yield. We would like to have this data, as far as is possible, for all projects with UPP elements in FY77, whether they have already been to the Board or are still to go. The projects affected (i.e., those designated as UPP six months ago) have been marked with a green asterisk on the Report 2-1, and you will find data sheets for each of these prepared as far as we can go attached to this memorandum. Some of these projects may no longer be poverty projects, while there may be others which have become poverty projects so some blank forms have been added. (Attachment III.)

1/ Your Region's five-year program dated   1977, and P&B's Table IV.M of April 12, 1977.

4. To complete these forms will require analysis and data as described in the Jaycox to Distribution memorandum of May 11, for the capital/labor criterion, and as described in the draft note of May 17 on "Poverty Projects Which Supply Goods or Services to the Poor" for that criterion. (Attachments IV and V.)

5. This is the first time that specific data on the poverty program criteria are being solicited, and so getting it is bound to involve something of a learning process on all sides. We shall be available and would like to assist as much as possible in carrying out the required analysis. Perhaps you could let me know how best we can do this in your Region and whom, on the project side, it would be most effective and convenient for us to deal with. I shall contact you soon to discuss it.

Attachments a/s

NLethbridge:bb

Distribution:

Messrs: H. Pollan (EMP); V. Rajagopalan (ASP); P. Glaessner (LCP);
J. Bronfman (EAP); F. Howell (AEP); L. Pouliquen (WAP).

Cleared and cc: Mr. Jaycox

cc: Messrs: Dunkerley, Churchill, Stone (URB).

NOTES ON UPDATING PROCEDURES FOR REPORT 2-1

1. General Project Data:

(a)	Col. 1	Project ID.
(b)	Col. 2	Project name.
(c)	Col. 3	Source (BLND denotes a joint IBRD/IDA loan).
(d)	Col. 5	FY (blank denotes an active project, * denotes a stand-by, M a supplement, and R a reserve project).
(e)	Col. 6	Loan/Credit amount in US$ millions1/.
(f)	Col. 7	Total project cost in US$ millions, if known, or estimate.

2. Locational Data:

Col. 8	Specify category and/or location (refer to definition of categories and allocated associated definitions below).
Col. 9	Specify % share in each category/location.

3. Poverty Data:

Col. 4	% UPP--Specify % share of loan/credit amount which qualifies as urban poverty lending.

1/ Items 1. (a) to (e) included in your 5-year program and have been updated by ORSU.

5/13/77

Definition of Categories (Col. 8)

(1) Rural. Rural lending is lending located in rural areas or designed to directly increase rural/agricultural output. This will not necessarily coincide with the agriculture sector lending since some of that may better be classified in one of the other categories (see below) and because lending in other sectors, such as rural water supply or education, should be included.

(2) Urban. Urban-related lending is lending which is located in urban areas or has a definable and direct effect on consumption, production or access to land and services in urban areas. Urban lending is divided into the following subcategories:

(a) General Urban. It is known that projects or parts thereof will be located in or impact urban areas, but it is not yet known which specific cities or towns will be affected or the relative size of these urban locations;

(b) Cities. It is known that projects or parts thereof will affect identified cities or that they are likely to be in relatively larger[1] urban areas; and

(c) Towns. It is known that projects or parts thereof will affect identified towns or that they will probably affect relatively smaller[1] urban areas.

(3) National. National or spatially distributed lending is lending whose direct impact is indiscriminate with respect to rural and other parts of the country or which is locationally non-specific. Much of recurrent Program Loan lending is spatially distributed with examples to be found in all sectors, most notably Education, Telecommunications, Transportation, and some DFC projects.

(4) Unidentified. Unidentified lending is a temporary residual category, used until projects are identified sufficiently to be classified into one of the above three categories.

1/ Urban status and size will vary for each country. In Botswana, 20,000 pop. is a large city; in Brazil, 20,000 pop. is a small town. Urban areas should be classified into cities and towns on an individual country basis.

Note: An A preceding the category designation in Column 8 denotes that a project has been allocated to a category, but associated with a city or cities, indicating that the project will most likely affect those locations. Again, we will assume the data on file now are correct unless you make changes or additions.

Attachment III

FY77 URBAN POVERTY PROJECTS

Project ID: ______________________

Project Name: ______________________

Source: ______________________

L/C Amount (US$ millions): ______________________

UPP %: ______________________

Urban Poverty Data:

(1) Production:

(a) Capital/labor ratio, $ per man-year of employment ________

(b) % of loan L/C amount qualifying under this rule ________

(2) Consumption: Indicators:

(a) % of L/C amount directed toward the target group

i) % of project output consumed by target group ________

ii) % of target group consumers in total population served by the project or component ________

(b) % of target group demand met before the project ________
and after the project ________

(c) i) Monthly quantity consumed by target group ________

ii) Cost to supply this quantity ________

iii) Average (current) montly expenditure by target group ________

Please explain or supplement the above as necessary.

4. To complete these forms will require analysis and data as described in the Jaycox to Distribution memorandum of May 11, for the capital/labor criterion, and as described in the draft note of May 17 on "Poverty Projects Which Supply Goods or Services to the Poor" for that criterion. (Attachments IV and V.)

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Cleared and cc: Mr. Jaycox

cc: Messrs: Dunkerley, Churchill, Stone (URB).

Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending

Introduction

1. The January 6 memorandum from E.V.K. Jaycox to OVPs which was accepted as a basis for implementing the urban poverty program, set out a rule for distinguishing between "urban poverty lending" and other justified Bank lending. The rule is as follows:

> "A project or subproject would be considered as meeting poverty lending criteria when the capital/labor ratio of the investment is below a country-specific threshold."

2. This memorandum spells out how this rule should be applied in practice. The points contained herein are:

(a) how to calculate the country-specific threshold capital/labor ratio;

(b) to which projects or sub-projects the rule should be applied;

(c) what to include as capital costs in the project and what not to include;

(d) how to calculate direct employment created by the investment;

(e) what to do about indirect employment and capital required to create that indirect employment; and

(f) how to discount both capital costs and employment effects.

3. The calculation of the capital/labor ratios for the projects and project components will begin early in the project cycle at the project design and selection stages. It will be roughly estimated at the early stages and become more definitive as the project moves to the appraisal stage.

4. In the case of lending to an intermediary for onlending to the business sector, the country-specific threshold for the capital/labor ratio and the relevant methods of calculation would be incorporated in the onlending criteria agreed with the intermediary. It could be designed to affect the whole or a part of a given Bank or IDA operation.

Country-Specific Threshold Capital/Labor Ratio

5. The country specific ratio is simply twice the current gross domestic investment (GDI) divided by current labor force using existing Bank definitions. A country-specific threshold was chosen in preference over sector-specific thresholds, in order to encourage the movement of the Bank toward the support of new sectors and subsectors where the bulk

of the urban poor is and is likely to be employed, i.e., the small scale sector, the service sector and the informal sector. Sector-specific ratios might encourage capital saving in all sectors but this would simply be business as usual since the need for capital saving is already embedded in the Bank's existing appraisal criteria.

6. The ratio of current GDI to current labor force is arbitrarily doubled for the definition of the country-specific threshold in order to account for the Bank's limited capacity to lend effectively at very low levels of capital intensity. Any modifications to the arbitrary doubling of the indicator or any refinement of the formulation on the basis of good country economic reasons is welcomed, but must be agreed with ORSU.

7. Country economists are responsible for the actual calculation of the country specific thresholds.1/ This should be done using GDI estimates that are adequately smoothed over a sufficient number of years to remove short-term fluctuations from current figures. Care should also be taken to properly update labor force estimates.

Projects or Sub-Projects to Which the Rule is Applicable

8. The rule is applicable to all Bank-financed projects whose major impact on the urban poor is expected to be through employment creation. This covers projects directly financed by the Bank as well as those financed through intermediaries. In order to encourage the development of ancillary labor intensive operations associated with even the most capital intensive industries and projects, parts of large projects may also be subject to the capital/labor test of poverty lending. An incremental investment would qualify for the test, if it is not an integral part of the manufacturing process but:

(a) could be set up as an independant operation; and

(b) is clearly identifiable on technical and organizational grounds.2/

This rule leaves much to the judgment of project officers; it might be helpful to consider the matter along the "profit center" lines employed by modern businesses.

1/ As a basis for the rapid establishment of the country-specific thresholds, the EPD has prepared a first standardized estimate of 1976 thresholds for all countries in which the Bank has a lending program. Country economists will be asked to endorse these estimates or furnish good reasons why other thresholds or methods of calculation should be adopted for individual countries. Thresholds will be updated regularly as new CPPs are issued.

2/ e.g., a metal working shop set up as part of a steelworks or a plastic-moulding operation set up as part of a basic plastic manufacturing unit, etc.

13. In estimating the employment created during the construction phase, it is important to note that incremental capital requirements may arise in the industry constructing the assets, i.e., the contractor's plant and equipment. These must be estimated and added to the capital cost figures.

14. Up-stream and down-stream employment effects and the incremental capital associated with them should not be accounted for in the calculation of the project capital/labor ratio, unless these linked operations are included in the project description. If the project provides the potential for a linked operation that has such a good capital/labor ratio that it improves the capital/labor ratio of the project being financed, this linkage should be analyzed in the project documents, i.e., it should be quantified as part of project costs and benefits, even if others are going to finance it.

15. Labor substitution effects, i.e., employment destroyed by the new investment, should not enter into the calculation of the project capital/labor ratio. If the investment meets the efficiency criteria of our investment analysis (correctly applied with appropriate shadow rates) the implied employment changes should have been fully accounted for. This, however, is not necessarily the case in projects involving onlending operations, where the actual subproject analysis is carried out by an intermediary. In these cases, it will be necessary to make sure that this subproject analysis takes proper account of substitution effects. In all cases, the rule thus distinguishes between labor intensive investments which have negative substitution effects and capital intensive investments which have negative substitution effects, and it will prefer the former.

16. The indirect employment effects arising from additional income generated by the project are considered too indirect, and it is too difficult to quantify the capital associated with it for this to be included in the calculation of the project capital/labor ratio. Indirect employment effects from additional savings generated by the project are not to be taken into account either. Their inclusion would amount to reliance on the unreliable trickle-down effect.

17. Obviously, only domestic employment and capital effects should be included in the project capital/labor ratio.

Discounting Capital Costs and Man-Years of Employment

18. Capital costs and man-years of employment should both be discounted over time by the current opportunity cost of capital in the country. The rationale for using the same discount rate for both capital and employment is simple. The whole urban poverty exercise is predicated on the assumption that where the capital stock has been replaced and the economy fully employed, capital and labor are substitutable on the economy-wide basis at least within the operationally relevant range. If that is so, employment today substitutes for today's capital and employment in the future for future capital. They should therefore, be discounted at the same rate. The country economists are

responsible for estimating and providing this discount rate.

19. The length of the discounting period chosen should be the same as the expected useful life of the asset combination created.

attachment

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: See Below

DATE: May 17, 1977

FROM: Nicolas Lethbridge, Acting Chief, Operations Review & Support Unit, URB

Nicolas Lethbridge

SUBJECT: Draft Guidelines on How to Distinguish Urban Poverty Projects Using the Consumption/Affordability Criterion

Please find attached a draft note on the above subject for your review and comment. Mr. Jaycox plans to circulate a final version as soon as possible. I would be grateful, therefore, to have your comments by c.o.b., Monday 23rd of May.

NLethbridge:bb

Distribution:

Messrs: van der Tak (PAS); Yudelman (AGP); Zymelmann, Ballantine (EDP); Kalbermatten (EWT); Hyde (DFC); F. Mitchell (TMP); Carnemark (TRP); Messenger (PNP); Pollan (EMP); Rajagopalan (ASP); Glaessner (LCP); Bronfman (EAP); Howell (AEP); Pouliquen (WAP); Hablutzel (EANVP); de Azcarate (WANVP); Hasan (AEP); Waide (ASNVP); Dubey (EMNVP); Holsen (LAC); Roth (URB).

cc: Messrs: Jaycox, Dunkerley, Churchill, Strombom, McCulloch, Singh (URB).

May 16, 1977

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Case 1, Project is Demanded by the Poor at a Price Which Covers Cost[2]

3. In this case, replicability arguments are simple. We assume that if the project is covering cost, it is replicable within the present economic situation in the country (i.e., we have not exhausted the resources necessary to make more of the same and sell it too, to the limit of market demand). This will require projects with low enough costs so they can be sold in the poor people's market. This could result from a lowering of quality standards in project design. Information required, beyond the usual project identification information, relates to the actual market situation in the sector and the geographical region served by the project: we will need some evidence on what the poor currently buy in the sector, the price they pay, the depth of the market, the organization under the project for marketing the goods, and so forth. For early stages of

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2/ This cost concept is some varient of long run marginal cost. For example, land that happens to be owned by the project executing agency, should be costed at the cost to that agency of acquiring more land. Similar treatment should be used whenever the project benefits from a special and limited resource availability.

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Case 2 - Cost Exceeds Price at Which the Poor Will Demand the Product

4. In this case the project cannot aid the poor without some form of subsidy, such as Government subsidy or a cross subsidy within the executing agency or within the beneficiary group of the project itself. In this case the replicability argument will require more complex analysis going well beyond the ordinary project analysis:

(a) It will be necessary to show that the poor actually get the subsidy and receive the products of the project. This follows from the fact that the poor can't afford products of this type and therefore that each unit produced for them exhausts part of the subsidies potentially available.

(b) It will be necessary to show that more subsidies are available -- that year by year the money can be gotten to serve at least the increment to the poverty group.

5. This requirement is not meant to be so restrictive that it disqualifies all projects which have costs above those that the poor are willing to pay. It does require, however, that the project officer is convinced that a program at that level of subsidy is workable for at least the increment to the poverty group and that it will be done. For example, water authorities often aim to serve the entire urban population. In such cases, the project officer needs to show that the supplying institution is strong enough or can tap enough subsidies, or use enough cross subsidies (or that the project improves sufficiently both financial and managerial competence of the agency) for this aim to be realized at least to the extent of covering the increment to demand by poor people. Similarly, a serviced site project may be part of a general program including squatter upgrading, low cost housing, unserviced sites, and trickle-down of old housing, which, combined, will serve the entire target group in a reasonable time period and make progress on the problem (e.g. serve the poor increment) very soon. If such a program is expected to be executed, within the financial and administrative constraints which exist or which are created by the project, then it could qualify on replicability grounds as a poverty project, assuming that it directly serves the target group.

6. It is important to be explicit in considering the standards incorporated in subsidized projects, and the standards of service that could be offered to the entire poverty group within the financial constraints, both as a guide to whether the standards in the project itself are reasonable and as an indicator of whether a program to serve the whole poverty group can be expected. As a rough indicator, try multiplying the per capita subsidy in the project by the number of poor people still to be served and see if the resulting total is financially manageable. If the project serves the richest of the poverty group, a higher subsidy for the remainder should be used in this calculation.

Identifying the Target Group Served

7. For subsidized projects, it is necessary to show that the output reaches the target group. For some projects the non-poor may be assumed to exclude themselves by choice because the project is not designed to appeal to them, for example, very low standard mass transportation projects. For some projects, income tests to qualify for project benefits may succeed in excluding the nonpoor (e.g. some serviced site projects or credit). In most cases, however, it will be difficult to figure out what income group actually gets the benefits. Two methods can be tried: area identification of the project benefits combined with poverty mapping, and sampling.

8. For area specific projects (e.g. water supply, primary education to serve a particular locality, localized health services, bus service to a particular slum) the project may serve areas where most of the people are poor. It is suggested that a rule of thumb be used to designate such areas, and that any area, served by a project, having 75% poor people be counted as a poverty area, and that all expenditures in that area be counted as poverty expenditures. Because of the weakness of income distribution data and the scarcity of poverty mapping, these estimates will often be very rough, particularly early in the project cycle. To estimate the expenditure on poor people in projects where the poor beneficiaries are geographically scattered, it may be a reasonable project preparation task for the government to undertake cheap sampling surveys to determine the income level of project beneficiaries. This is a necessary part of preparation if project design parameters depend on income. Even where not strictly required for project design, however, sampling to determine various social characteristics of the beneficiary group (among them, income) may be useful and justified. Even a very small and cheap sample will provide a rough indication, in many cases, of the income distribution of beneficiaries.

9. It is extremely difficult to put a fine point on how we can determine replicability far enough in advance of project appraisal to identify poverty projects in the pipeline. It is obvious that additional sector knowledge and a broader guaged discussion with government (beyond that needed for ordinary project analysis) will be required in almost all cases in order to make this kind of replicability judgment with any confidence. It is

accepted that in many sectors and countries, the urban poverty dialogue with government has not advanced to a point where a reasonable judgment on the government's program commitments can be made. Thus, for projects that depend for their replicability on identifying the specific segment of the target group served, and on fitting into an overall program to serve the poor, the identification of a project as a poverty project is provisional. For cost covering projects (Case 1) the analysis is simpler so that early identification should be less troublesome.

Attributing Parts of a Loan to the Poverty Group

10. So far, we have discussed the identification of poverty projects as if they were whole projects without non-poverty component. It has been agreed, however, that poverty-oriented parts of projects should also be identified and counted as poverty lending. Since it is probable that almost all projects will have a non-poverty component, it will often be necessary to make fairly arbitrary estimates of the amount of the loan that goes to serve the poor.

11. Some costs can be allocated quite easily to the poverty component of the project. These will be mainly the infrastructure, hardware and software financed by the project that are spent directly on the poverty group in an identified poverty area with no share or an insignificant share of the benefits slopping over into the general population or into financing of the overall supply system. In addition to these direct expenditures on the poverty group, other parts of Bank loans can qualify because of their indirect effects. The most obvious examples are water and waterborne sewerage trunk systems, actually financed under the project, which serve the poor among others.

12. The general rule is to allocate these joint costs on the basis of the distribution of the consumption under the project. To apply this rule consider the project in its mature state, where the service and share of costs of the poverty group has developed to its highest level in the project's useful life.

Indicators of Poverty Projects for Programming Purposes

13. Because programming takes place in advance of project identification, it will generally be necessary to guess at or to target the degree of poverty-orientation of a project, in the first instance, and improve on this guess or approach this target as preparation advances. The following indicators are proposed at each programming stage.

1st: % of Lending Directed Toward the Target Group

This indicator is basic in that poverty lending targets are formulated in terms of percentages of total urban lending. It may be useful to consider, even for first attempts at this estimate:

(a) % of project output consumed by target group; and
(b) % of target group consumers in total population served by the project.

2nd: <u>% of Target Group Demand Met Before the Project and After the Project in the Relevant Market.</u>

This indicator gives a rough idea of progress in the sector and potential for more poverty projects in the sector.

3rd: <u>Quantity Consumed by Target Group in the Project, Cost to Supply this Quantity in the Project, Average (Current) Expenditure on the Product by Target Group, Average Expenditure as Percentage of Poverty Group Threshold Income Level</u>

This indicator is meant to provide a first reading on whether the project will meet the poverty project criterion simply (Case 1) or whether more complex analysis will be needed (Case 2).

UPP

Edward V. K. Jaycox

May 16, 1977

Nicolas A. Lethbridge

Materials on Urban Poverty Program Implementation

1. You requested a package of Bank documentation which would demonstrate the thoroughness of our efforts to implement urban poverty projects. Attached you will find:

(a) Memorandum from Jaycox to Distribution, September 14, 1976. This memorandum provides a definition for the urban target group, defining urban poverty characteristics of urban poverty lending, targets for such lending and a management information designed system to insure speedy implementation;

(b) Memorandum from Stone to Regional Urban Poverty Program Coordinators, October 4, 1976. This memorandum solicits from regional offices data on estimates of the urban poverty impacts in their proposed lending programs through FY80. It provides a description of how the Bank's lending program is classified for purposes of the urban poverty program;

(c) Memorandum, Jaycox to Operational Vice Presidents, January 6, 1977. This memorandum reflects programming and implementation procedures for the urban poverty lending;

(d) Jaycox to Distribution List, May 11, 1977. Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending;

(e) Draft Note: Poverty Projects Which Supply Goods or Services to the Poor;

(f) Memorandum, Jaycox and Yudelman to Chief Economists, May 17, 1977? Gives estimates of urban poverty income thresholds and the proportions of the poverty group in total urban populations for most borrowing countries. It also provides guidelines on how to make improved estimates about the target group.

(g) Data Sheet - An example of the type of data now being compiled to monitor the urban poverty components of projects approved during FY77.

2. Items one and three contain data about the Bank's operations lending program which you may not wish to disclose outside the Bank.

NLethbridge:bb

cc: Messrs: Dunkerley, Churchill.

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Distribution List

DATE: May 11, 1977

FROM: Edward V.K. Jaycox, Chairman, Urban Poverty Task Group

SUBJECT: Guidelines on How to Use the Capital/Labor Ratio ~~to~~ Distinguish Urban Poverty Lending

1. I attach the guidelines to be used in determining the urban poverty content of all Bank-financed projects where major impact on the urban poor is expected to be through employment creation. A separate note on how to determine the poverty content of projects providing basic goods and services to the urban poor is under preparation.

2. The estimate of the 1976 capital labor thresholds mentioned in footnote one to para 7. of the guidelines and the discount rates to be used will be circulated shortly.

3. Regional Urban Poverty Coordinators should distribute the guidelines to both Programs and Projects divisions as necessary. Copies can be obtained from Ms. B. Arias, ext. 8088.

Messrs. Knapp, Baum, Benjenk, Chaufournier,
Husain, Krieger, Stern and Wappenhans

van der Tak, PAS
Hablutzel, Bronfman, EA
de Azcarate, Pouliquen, WA
Hasan, Howell, AE
Waide, Rajagopalan, AS
Dubey, Pollan, EM
Holsen, Glaessner, LAC
Yudelman, Ted Davis, AGP
D. Gordon, IDF
Fuchs, NDP
Tolbert, TMP
Dunkerley, Churchill, McCulloch, D. Singh
Stone, Strombom, Kahnert, Lethbridge, Beier, URB

FKahnert:ba
Enclosure

Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending

Introduction

1. The January 6 memorandum from E.V.K. Jaycox to OVPs which was accepted as a basis for implementing the urban poverty program, set out a rule for distinguishing between "urban poverty lending" and other justified Bank lending. The rule is as follows:

> "A project or subproject would be considered as meeting poverty lending criteria when the capital/labor ratio of the investment is below a country-specific threshold."

2. This memorandum spells out how this rule should be applied in practice. The points contained herein are:

(a) how to calculate the country-specific threshold capital/labor ratio;

(b) to which projects or sub-projects the rule should be applied;

(c) what to include as capital costs in the project and what not to include;

(d) how to calculate direct employment created by the investment;

(e) what to do about indirect employment and capital required to create that indirect employment; and

(f) how to discount both capital costs and employment effects.

3. The calculation of the capital/labor ratios for the projects and project components will begin early in the project cycle at the project design and selection stages. It will be roughly estimated at the early stages and become more definitive as the project moves to the appraisal stage.

4. In the case of lending to an intermediary for onlending to the business sector, the country-specific threshold for the capital/labor ratio and the relevant methods of calculation would be incorporated in the onlending criteria agreed with the intermediary. It could be designed to affect the whole or a part of a given Bank or IDA operation.

Country-Specific Threshold Capital/Labor Ratio

5. The country specific ratio is simply twice the current gross domestic investment (GDI) divided by current labor force using existing Bank definitions. A country-specific threshold was chosen in preference over sector-specific thresholds, in order to encourage the movement of the Bank toward the support of new sectors and subsectors where the bulk

of the urban poor is and is likely to be employed, i.e., the small scale sector, the service sector and the informal sector. Sector-specific ratios might encourage capital saving in all sectors but this would simply be business as usual since the need for capital saving is already embedded in the Bank's existing appraisal criteria.

6. The ratio of current GDI to current labor force is arbitrarily doubled for the definition of the country-specific threshold in order to account for the Bank's limited capacity to lend effectively at very low levels of capital intensity. Any modifications to the arbitrary doubling of the indicator or any refinement of the formulation on the basis of good country economic reasons is welcomed, but must be agreed with ORSU.

7. Country economists are responsible for the actual calculation of the country specific thresholds.1/ This should be done using GDI estimates that are adequately smoothed over a sufficient number of years to remove short-term fluctuations from current figures. Care should also be taken to properly update labor force estimates.

Projects or Sub-Projects to Which the Rule is Applicable

8. The rule is applicable to all Bank-financed projects whose major impact on the urban poor is expected to be through employment creation. This covers projects directly financed by the Bank as well as those financed through intermediaries. In order to encourage the development of ancillary labor intensive operations associated with even the most capital intensive industries and projects, parts of large projects may also be subject to the capital/labor test of poverty lending. An incremental investment would qualify for the test, if it is not an integral part of the manufacturing process but:

(a) could be set up as an independant operation; and

(b) is clearly identifiable on technical and organizational grounds.2/

This rule leaves much to the judgment of project officers; it might be helpful to consider the matter along the "profit center" lines employed by modern businesses.

1/ As a basis for the rapid establishment of the country-specific thresholds, the EPD has prepared a first standardized estimate of 1976 thresholds for all countries in which the Bank has a lending program. Country economists will be asked to endorse these estimates or furnish good reasons why other thresholds or methods of calculation should be adopted for individual countries. Thresholds will be updated regularly as new CPPs are issued.

2/ e.g., a metal working shop set up as part of a steelworks or a plastic-moulding operation set up as part of a basic plastic manufacturing unit, etc.

Calculation of Capital Costs

9. The project specific calculation of capital costs should conform as closely as possible to the concept of GDI. Capital thus includes all reproduceable and tangible assets (including replacements), working capital,1/ major or deferred maintenance expenditure,2/ and self-help labor inputs to capital formation.3/ Capital excludes the price or value of land before improvement under the project, expenditures on research, training, technical assistance, and feasibility studies.

10. A specific question refers to the treatment of residual values of the assets created by the project after the end of the discounting period chosen for calculating the project-specific C/L ratio. If these are to be taken into account in the calculation of this ratio, this would require as a corollary that any assets which benefit the project but which are not part of the projects' asset formation (i.e., pre-project land improvements, etc.) should also be taken into account in the capital figure. For the sake of simplicity, it is here proposed that residual values should be disregarded as a general rule. However, in cases where a project shows an exceptionally high residual value and where the value of assets used but not financed by the project can be reasonably well estimated, exceptions to this general rule can be accepted.

Calculation of Direct Employment Creation

11. Direct employment is here defined as employment arising from the normal operation and maintenance of the assets created. We are defining employment arising from the construction phase as "indirect" and this is discussed below. Manpower utilization estimates should be based on the same estimates of plant utilization as the financial and economic analyses. Local definitions of normal work day, week, year should be used. All employment, full-time, seasonal, etc. should be included. Although we are going to count all employment regardless of wage level, in order to assess the performance of the capital/labor ratio in helping us distinguish projects which benefit the poor, information should be developed on employment according to income levels as part of the project monitoring.

Treatment of Indirect Employment Creation

12. Quantifiable indirect domestic employment should be included in judging the poverty orientation of the project or subproject. There are three potential sources of this indirect domestic employment: the construction phase of the project; backward and forward linkages to supplying and consuming enterprises; income and savings effects of the employment.

1/ Strictly speaking, working capital should exclude small tools and equipment. However, in the range of enterprises likely to meet poverty lending criteria, these are likely to be difficult to separate out from working capital.

2/ In as much as they prolong the life of the asset or increase its productive capacity.

3/ Likely to occur mostly in construction components of SSE operations. They are also likely to be very difficult to estimate and might have to be left out for this reason.

13. In estimating the employment created during the construction phase, it is important to note that incremental capital requirements may arise in the industry constructing the assets, i.e., the contractor's plant and equipment. These must be estimated and added to the capital cost figures.

14. Up-stream and down-stream employment effects and the incremental capital associated with them should not be accounted for in the calculation of the project capital/labor ratio, unless these linked operations are included in the project description. If the project provides the potential for a linked operation that has such a good capital/labor ratio that it improves the capital/labor ratio of the project being financed, this linkage should be analyzed in the project documents, i.e., it should be quantified as part of project costs and benefits, even if others are going to finance it.

15. Labor substitution effects, i.e., employment destroyed by the new investment, should not enter into the calculation of the project capital/labor ratio. If the investment meets the efficiency criteria of our investment analysis (correctly applied with appropriate shadow rates) the implied employment changes should have been fully accounted for. This, however, is not necessarily the case in projects involving onlending operations, where the actual subproject analysis is carried out by an intermediary. In these cases, it will be necessary to make sure that this subproject analysis takes proper account of substitution effects. In all cases, the rule thus distinguishes between labor intensive investments which have negative substitution effects and capital intensive investments which have negative substitution effects, and it will prefer the former.

16. The indirect employment effects arising from additional income generated by the project are considered too indirect, and it is too difficult to quantify the capital associated with it for this to be included in the calculation of the project capital/labor ratio. Indirect employment effects from additional savings generated by the project are not to be taken into account either. Their inclusion would amount to reliance on the unreliable trickle-down effect.

17. Obviously, only domestic employment and capital effects should be included in the project capital/labor ratio.

<u>Discounting Capital Costs and Man-Years of Employment</u>

18. Capital costs and man-years of employment should both be discounted over time by the current opportunity cost of capital in the country. The rationale for using the same discount rate for both capital and employment is simple. The whole urban poverty exercise is predicated on the assumption that where the capital stock has been replaced and the economy fully employed, capital and labor are substitutable on the economy-wide basis at least within the operationally relevant range. If that is so, employment today substitutes for today's capital and employment in the future for future capital. They should therefore, be discounted at the same rate. The country economists are

responsible for estimating and providing this discount rate.

19. The length of the discounting period chosen should be the same as the expected useful life of the asset combination created.

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

K/L Gen & UP

TO: Mr. Friedrich Kahnert, UORSU

DATE: May 10, 1977

FROM: Rudolf Hablutzel, Chief Economist, EAN

SUBJECT: "Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending"

Instead of commenting myself, I feel the same purpose is served by stating that I fully support the comments made by Mr. Waide in his memorandum dated May 6, 1977. The concern he expresses in his last paragraph, particularly about the mixing of stock and flow concepts in the ratios to be used, I would express somewhat more strongly, however. I do not understand the real meaning of a threshold calculated that way, and so long as I do not, the whole exercise of course appears questionable.

[illegible]

cc: Mr. Waide, ASNVP
Mr. Bronfman, EAPDR (with attachment)

RHablutzel:go

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

MAY - 9 ...

TO: Mr. Friedrich Kahnert, UORSU

DATE: May 6, 1977

K/L Gen + VPP

FROM: E. Bevan Waide, Chief Economist, ASNVP BW.

SUBJECT: Comments on "Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending"

I have discussed your memo of April 29 briefly with the Projects and Programs Departments and our initial comments follow. We appreciate the clarity with which your draft is written, which enables us to get straight to the point.

Paragraph 3 and Others. We assume the purpose of these guidelines is to simply show how to use the C/L ratio as the indicator of whether or not a particular operation or project can be classified as urban poverty lending. If so, it would not be necessary to calculate the ratio frequently throughout the selection, design and appraisal stages, but only upon finalization. If the intention is to influence project design, then the ratio, and many other factors, would need to be considered at all stages, but that very complex subject will presumably be the subject of a further note.

You do it

Paragraphs 4 and 15. We do not agree that the Bank is ready to require our DFC's to use a country specific threshold for the C/L ratio or to ask them to implement new lending criteria on our behalf. Once again we are surely concerned here only with measurement for Bank programming purposes. The Bank is far from the point at which it can indicate clearly to DFC's how to set about designing sub-projects which meet the overall objective of improving the long-run welfare of the urban poor.

But we should! let's start.

Paragraph 6 suggests that we might wish to modify the arbitrary doubling of the GDI/labor force indicator. Surely, the same decision rule ought to be used throughout the Bank. Otherwise, each Region will be tempted to get into the business of trying to modify the decision rule in its own favor. If this is proposed, then all Regions should have the chance of commenting on any change in the rules that you propose to accept. There is, after all, nothing objective about the (doubled) ratio!

Oh, but we need a tightened

Paragraph 7. The calculation of the threshold ratio would involve the use of an exchange rate to convert capital costs in local currency to international prices. We would be grateful if you could supply us with an appropriate set of (shadow) exchange rates.

Questions

Paragraph 8. Surely the decision rule should be applicable to all projects which have some significant impact on the urban poor. This impact may be through employment creation but could also be through the provision of, say, clean water to the urban poor. Why should the latter be excluded? We also consider that it is inappropriate to divide up a project into individual components: this gives the impression that it is legitimate to scratch around for sub-projects which meet the urban poverty criterion. The last sentence in this paragraph leaves a judgement on this to project officers. If it is intended to proceed with this,

affordability

Yes, if that helps

No, let's see what they come up with!

Why don't you do that?

I would be grateful if you could issue a draft set of guidelines on how they are to make up their minds on this subject.

Paragraph 11 introduces a completely new point. Information is sought on employment, in every project, classified by income levels. Could you explain how this is related to the calculation of the C/L ratio? A project with a favorable capital/labor ratio, which meets all the Bank's usual criteria on economic and financial rates of return, is hardly likely to employ large numbers of highly paid people.

But it may employ people paid too low

Paragraph 12 suggests we should only include indirect employment if it is quantifiable. There are many cases in which a project could have a large but unquantifiable indirect effect: should it be excluded while a project with a small quantifiable effect is included? Various experiments a few years ago in the application of cost-benefit analysis to urban planning showed that the use of general magnitudes (+ or -) was quite practicable.

Paragraph 14 suggests that upstream and downstream employment effects may be included if these operations "are included in the project description." This is going to generate new Bank skills in the art of description! What does it mean? In general, paragraphs 14 and 15 give the impression that if a project has a good capital/labor ratio by virtue of linked operations, it should be counted, but if it has unfavorable effects then it should be excluded. Is this what is intended? For example, if (as suggested) employment destroyed by a new investment is to be excluded from the calculation, are we not deceiving ourselves and our borrowers?

Paragraph 16. The exclusion of "indirect employment effects from additional savings generated by the project" means that projects which are highly profitable and therefore likely to expand employment rapidly are given the same weight as projects with no growth potential. Three cheers for rescuing lame ducks.

publish

We would like to conclude with three general points. Firstly, as is clear from the above, there are all kinds of conceptual and practical problems to be cleared up before we can guide project officers on how to set about the job of calculating a consistent set of C/L ratios. We would like to request therefore that before issuing this note you let us have a series of practical examples in various sectors, taken from ongoing Bank projects, that indicate how your guidelines would be applied in practice, covering each of the various considerations that are mentioned. We would be glad to review these with you. Secondly, we would like to stress that any use of the C/L ratio, to influence the design of projects so that they help achieve the agreed long-term objective of increasing the welfare of the urban poor, is at a very early stage. This was noted in Mr. Jaycox's memo of January 6 and that sense of caution is vividly reinforced by a recent study, "The Employment Impact of Industrial Investment" prepared for CPS by the Harvard Institute for International Development (January 1977) which shows very clearly that we have a long way to go before mastering the art of planning for employment maximization, and which explicitly warns against the use of simplified ratios.

us, ummary

Thirdly, these new calculations, including the income-distribution of wages (para. 11) will impose a considerable burden on project officers, for whom no additional time has been budgeted. We would appreciate it, therefore, if any guidelines you issue could be brief, and simple in their application.

Lastly, we should perhaps mention that nothing in the draft note has allayed our concern over the logic of the January 6 memorandum on matters such as (i) the adoption of a country threshold calculated as a flow divided by a stock whereas the project ratio is the ratio of two flows; or (ii) the arbitrary doubling of the country ratio. Nor have we yet been able to remove our need for guidance on techniques for designing urban projects in such a way that urban employment and welfare are maximized over a long period.

|| fool || oh

cc: Messrs. Stern, Picciotto, Blobel, Rajagopalan, Jansen/Pilvin
Taylor, Jaycox, Dunkerly, Stone, Lethbridge, van der Tak
Regional Chief Economists.

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

MAY - 9 RECD

TO: Mr. Friedrich Kahnert, UORSU

DATE: May 4, 1977

FROM: John A. Holsen, Chief Economist, LAC JAH

SUBJECT: "Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending -- Some Quick Comments

KH
JPP

1. I am about to leave on a mission and am unable to give a proper reply to your memorandum of April 29 on the above subject. I am sending this note mainly to avoid silence being confused with support.

Yes

2. The chief merit of the Capital/Labor ratio, as discussed last January, was its simplicity, not its economic logic. It was a very rough rule of thumb which at least pointed in the right general direction. (See Holsen and Glaessner to Jaycox, January 3, 1977.) Not much more could be said for it and a great deal could be said against it.

So what

3. I am distressed to see a draft guideline that takes "the rule" so seriously. Both the guideline and the application of "the rule" might be more acceptable if we began with a confession of our sins and inadequacies. I am also concerned about (a) the flexibility in what we consider as "the project" (b) the admission of some kind of indirect employment generation into the calculation and (c) the provision for "sound arguments" which justify different discount rates for capital and employment. With this much freedom, sufficient time and effort will permit the analysts to make a very wide range of projects fit within "the rule." But it will be a poor use of our abilities.

Calculate only

Yes

4. One minor technical point: someone should go over paragraph 9 carefully if you really want to limit included capital costs to what goes into "GDI" in the national accounts. The latter is strictly physical investment (fixed plus inventories); certainly financial working capital and most maintenance expenditures will not be included in "GDI". In practice "self-help labor inputs" are probably also excluded, although they should be there in theory.

This was me. Read carefully and you will have to agree.

JAHolsen/ddm

cc: Regional Chief Economists
Messrs. Dunkerley, Churchill, Stone

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Distribution List
THROUGH: Mr. Nicolas Lethbridge, Acting Chief, UORSU
FROM: Friedrich Kahnert

DATE: April 29, 1977

SUBJECT: Guidelines on How to Use the Capital/Labor Ratio to Distinguish Urban Poverty Lending

1. I attach a note on the above subject which Mr. Jaycox hopes to circulate as soon as possible. Please let me have any comments by close of business on Thursday, May 5th.

2. We would now like to move rapidly into implementation of this capital/labor ratio test. The above guidelines place the responsibility for calculating the country specific thresholds on the country economists, and also stipulate that the country economists will supply the discount rate for the discounting of capital and employment streams.

3. In order to expedite matters, we have requested the Economic Analysis and Projections Department to produce a first standardized calculation of the country thresholds, and I will send you a printout of this calculation and a description of the method used as soon as they become available. I would be grateful if you could then ask the country economists to check the figures for their country and, if there are good reasons to do so, to suggest different ratios or different methods of calculation. At the same time, we hope that you will be able to let us have the discount rates to be used for the time being. Changes in these could, of course, be notified to us at any time.

To: Messrs. H. G. van der Tak (PAS)
R. Hablutzel (EANVP)
L. de Azcarate (WANVP)
P. Hasan (AENVP)
E. B. Waide (ASNVP)
V. Dubey (EMNVP)
J. A. Holsen (LCNVP)

cc. Messrs. Jaycox
Dunkerley
Churchill
Stone

FKahnert:ba

DRAFT
FKahnert:bb/ba
4/25/77

Guidelines on how to use the Capital/Labor Ratio to Distinguish Urban Poverty Lending

Introduction

1. The January 6 memorandum from E. Jaycox to OVPs which was accepted as a basis for implementing the urban poverty program, set out a rule for distinguishing between "urban poverty lending" and other justified Bank lending. The rule is as follows:

> "A project or subproject would be considered as meeting poverty lending criteria when the capital/labor ratio of the investment is below a country-specific threshold."

2. This memorandum spells out how this rule should be applied in practice. The points contained herein are:

   (a) how to calculate the country-specific threshold capital/labor ratio;

   (b) to which projects or sub-projects the rule should be applied;

   (c) what to include as capital costs in the project and what not to include;

   (d) how to calculate direct employment created by the investment;

   (e) what to do about indirect employment and capital required to create that indirect employment; and

   (f) how to discount both capital costs and employment effects.

3. The calculation of the capital/labor ratios for the projects and project components will begin early in the project cycle at the project design and selection stages. It will be roughly estimated at the early stages and become more definitive as the project moves to the appraisal stage.

4. In the case of lending to an intermediary for onlending to the

business sector, the country-specific threshold for the capital/labor ratio and the relevant methods of calculation would be incorporated in the onlending criteria agreed with the intermediary. It could be designed to affect the whole or a part of a given Bank or IDA operation.

Country-Specific Threshold Capital/Labor Ratio

5. The country specific ratio is simply twice the current gross domestic investment (GDI) divided by current labor force using existing Bank definitions. A country-specific threshold was chosen in preference over sector-specific thresholds, in order to encourage the movement of the Bank toward the support of new sectors and subsectors where the bulk of the urban poor is and is likely to be employed, i.e., the small scale sector, the service sector and the informal sector. Sector-specific ratios might encourage capital saving in all sectors but this would simply be business as usual since the need for capital saving is already embedded in the Bank's existing appraisal criteria.

6. The ratio of current GDI to current labor force is arbitrarily doubled for the definition of the country-specific threshold in order to account for the Bank's limited capacity to lend effectively at very low levels of capital intensity. Any modifications to the arbitrary doubling of the indicator or any refinement of the formulation on the basis of good country economic reasons is welcomed, but must be agreed with ORSU.

7. Country economists are responsible for the actual calculation of the country specific threshold[1/]. This should be done using GDI estimates

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1/ As a basis for the rapid establishment of the country-specific thresholds, the EPD has prepared a first standardized estimate of 1976 thresholds for all countries in which the Bank has a lending program. Country economists will be asked to endorse these estimates or furnish good reasons why other thresholds or methods of calculation should be adopted for individual countries. Thresholds will be updated regualrly as new CPP's are issued.

that are adequately smoothed over a sufficient number of years to remove short-term fluctuations from current figures. Care should also be taken to properly update labor force estimates.

Projects or Sub-Projects to Which the Rule is Applicable

8. The rule is applicable to all Bank-financed projects whose major impact on the urban poor is expected to be through employment creation. This covers projects directly financed by the Bank as well as those financed through intermediaries. In order to encourage the development of ancillary labor intensive operations associated with even the most capital intensive industries and projects, parts of large projects may also be subject to the capital/labor test of poverty lending. An incremental investment would qualify for the test, if it is not an integral part of the manufacturing process but:

(a) could be set up as an independant operation; and

(b) is clearly identifiable on technical and organizational grounds1/.

This rule leaves much to the judgment of project officers; it might be helpful to consider the matter along the "profit center" lines employed by modern businesses.

Calculation of Capital Costs

9. The project specific calculation of capital costs should conform as closely as possible to the concept of GDI. Capital thus includes all re-produceable and tangible assets (including replacements), working capital2/, major or deferred maintenance expenditure3/, and self-help labor inputs to capital formation4/. Capital excludes the price or value of land before

1/ E.g., a metal working shop set up as part of a steelworks or a plastic-moulding operation set up as part of a basic plastic manufacturing unit, etc.

2/ Strictly speaking, working capital should exclude small tools and equipment. However, in the range of enterprises likely to meet poverty lending criteria, these are likely to be difficult to separate out from working capital.

3/ In as much as they prolong the life of the asset or increase its productive capacity.

4/ Likely to occur mostly in construction components of SSE operations. They are also likely to be very difficult to estimate and might have to be left out for this reason.

improvement under the project, expenditures on research, training, technical assistance, and feasibility studies.

10. A specific question refers to the treatment of residual values of the assets created by the project after the end of the discounting period chosen for calculating the project-specific C/L ratio. If these are to be taking into account in the calculation of this ratio, this would require as a corollary that any assets which benefit the project but which are not part of the projects' asset formation (i.e., pre-project land improvements, etc.) should also be taken into account in the capital figure. For the sake of simplicity, it is here proposed that residual values should be disregarded as a general rule. However, in cases where a project shows an exceptionally high residual value and where the value of assets used but not financed by the project can be reasonably well estimated, exceptions to this general rule can be accepted.

Calculation of Direct Employment Creation

11. Direct employment is here defined as employment arising from the normal operation and maintenance of the assets created. We are defining employment arising from the construction phase as "indirect" and this is discussed below. Manpower utilization estimates should be based on the same estimates of plant utilization as the financial and economic analyses. Local definitions of normal work day, week, year should be used. All employment, full-time, part-time, seasonal, etc. should be included. Although we are going to count all employment regardless of wage level, in order to assess the performance of the capital/labor ratio in helping us distinguish projects which benefit the poor, information should be developed on employment according to income levels as part of the project monitoring.

Treatment of Indirect Employment Creation

12. Quantifiable indirect domestic employment should be included in judging the poverty orientation of the project/or subproject. There are three potential sources of this indirect domestic employment: the construction phase of the project; backward and forward linkages to supplying and consuming enterprises; income and savings effects of the employment.

13. In estimating the employment created during the construction phase, it is important to note that incremental capital requirements may arise in the industry constructing the assets, i.e., the contractor's plant and equipment. These must be estimated and added to the capital cost figures.

14. Up-stream and down-stream employment effects and the incremental capital associated with them should not be accounted for in the calculation of the project capital/labor ratio, unless these linked operations are included in the project description. If the project provides the potential for a linked operation that has such a good capital/labor ra io that it improves the capital/labor ratio of the project being financed, this linkage should be analyzed in the project documents, i.e., it should be quantified as part of project costs and benefits, even if others are going to finance it.

15. Labor substitution effects, i.e., employment destroyed by the new investment, should not enter into the calculation of the project capital/labor ratio. If the investment meets the efficiency criteria of our investment analysis (correctly applied with appropriate shadow rates) the implied employment changes should have been fully accounted for. This, however, is not

necessarily the case in projects involving onlending operations, where the actual subproject analysis is carried out by an intermediary. In these cases, it will be necessary to make sure that this subproject analysis takes proper account of substitution effects. In all cases, the rule thus distinguishes between labor intensive investments which have negative substitution effects and capital intensive investments which have negative substitution effects, and it will prefer the former.

16. The indirect employment effects arising from additional income generated by the project are considered too indirect, and it is too difficult to quantify the capital associated with it for this to be included in the calculation of the project capital/labor ratio. Indirect employment effects from additional savings generated by the project are not to be taken into account either. Their inclusion would amount to reliance on the unreliable trickle-down effect.

17. Obviously, only domestic employment and capital effects should be included in the project capital/labor ratio.

Discounting Capital Costs and Man-Years of Employment

18. Capital costs and man-years of employment should both be discounted over time by the current opportunity cost of capital in the country. The rationale for using the same discount rate for both capital and employment is simple. The whole urban poverty exercise is predicated on the assumption that where the capital stock has been replaced and the economy fully employed, capital and labor are subsitutable on the economy-wide basis at least within the operationally relevant range. If that is so, employment today substitutes for today's capital and employment in the future for future capital. They should therefore, be

discounted at the same rate. The country economists are responsible for estimating and providing this discount rate[1/].

19. The length of the discounting period chosen should be the same as the expected useful life of the asset combination created.

1/ If, based on sound argument, country economists feel that the discount rate for man-years of employment should be different from the discount rate of capital for a given country, this could be agreed.

Mr. Jaycox

MAR 28 REC'D

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

① ~~FRITZ~~
② ~~GEORGE~~
③ ~~NHO~~
④ FILE

TO: Mr. David Gordon, Director, IDFD
(thru Mr. G.B.H. Renger, Chief, LCPID)

DATE: March 25, 1977

FROM: Paul F. Knotter, LCPID

SUBJECT: Urban Poverty Program Implementation Guidelines and their Implication to DFC Lending

1. I refer to Mr. Jaycox's memorandum dated January 6, 1977 to the Operational Vice Presidents on the revised guidelines for determining eligibility of projects in the Urban Poverty Program (UPP), and Mr. Hyde's memorandum of March 4, 1977 on the implications of the revised guidelines on investment cost per job to our DFC operations. The issues raised in these memoranda have generated much interest as well as some concern among the staff of LCPID. The opinions expressed are typified by <u>four</u> recent memos from staff of this division (copies attached). This memorandum summarizes the main concerns of LCPID.

2. The approach proposed under the revised UPP guidelines appears to suffer from a number of conceptual and methodological problems, particularly in the context of projects financed through DFCs. First, perhaps for reasons of simplicity, the proposed country limit on investment per job ignores differences among countries with respect to population growth rates, current and target unemployment rates, and cost of generating new jobs.[1/] Second, the proposed index also ignores differences among sectors with respect to indirect employment generation (for example, employment generated through linkages and additional income from projects with high economic rate of return)[2/] and the average life of capital employed; this is likely to significantly bias the country limit downwards in the case of DFC projects. Third, difficulties in getting reliable estimates of employment generated are particularly severe in the case of the small enterprise subprojects financed through DFCs. Finally, the reasoning behind discounting man-years of employment at a rate equal to the opportunity cost of capital is questionable; a lower or zero discount rate is probably more appropriate.

3. In its present unrefined form, the proposed criterion for determining UPP eligibility in the case of employment generating projects may be useful for determining the overall shape of Bank lending programs. It would be far less useful for making decisions about eligibility of specific DFC projects; it may in fact give misleading signals in many cases.

1/ For example, it can be easily verified that there is a very high correlation (0.90 or more) between the suggested index (country limit on investment cost per job) and the per capita income of the country. This suggests that per capita income, which offers the additional advantages of ease of measurement, may be just as good an index as the proposed index.

2/ The sample of Colombian subprojects studied by the IDF Department showed that there was poor correlation between direct employment and direct plus indirect employment; in 5 of the 29 projects studied, the direct employment input was positive, but the inclusion of indirect employment yielded a negative result for total employment (see page 25 of the DFC Sector Policy Paper).

4. In case we do adopt criteria along the lines proposed in the January 6 memo to judge the eligibility of DFC projects for inclusion in UPP, full account should be taken of the above problems in designing the criteria. Furthermore, in applying such criteria, a sufficiently broad and flexible view would be necessary to avoid inaccurate signals with regard to UPP eligibility. In particular, the country economists should be encouraged to provide limits on investment per job specific to the industrial sector wherever possible, and to include a factor to consider differentials between investments of small industrial enterprises and investment in the economy as a whole with respect to the average life of capital employed and indirect employment generation. They should also be encouraged to smooth out data on gross domestic investment and total labor force over a sufficient number of years to avoid unduly large shifts in country limits as a result of short-term changes in the economy. To the extent that conceptual and methodological deficiencies remain in the country limits computed, projects staff should be allowed to refine appropriately the methodology for determining eligibility of specific projects.

5. Finally, the above discussion raises a number of important questions at a more general level. Is employment generation the only way in which DFC projects help the urban poor? For instance, couldn't the goods and services produced by DFC subprojects help the urban poor to some extent in the same way as Bank projects in other sectors such as energy and water supply do? Also, are the projects suggested by the UPP guidelines the type of projects in which the Bank has a comparative advantage for attacking urban poverty? Is it in fact realistic to expect to meet all the existing appraisal and supervision criteria for Bank-financed DFC projects and also meet the UPP guidelines in a significant portion of our DFC lending?

KChalla:gl KC

cc: Messrs. Jaycox, URB
Churchill, URB
Glaessner, LCP
Holsen, LCNVP
Bentley, LCPID
Hutcheson (o/r), LCPID
Nogales (o/r), LCPID

Attachments.

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

Attachment 1

OFFICE MEMORANDUM

TO: Mr. Gary Hyde, TPFD

DATE: March 10, 1977

FROM: J. [illegible] Bentley, LCPID

SUBJECT: UPP Limits on Investment Cost per Job

1. While I am very happy to see the strong emphasis being placed on employment generation, I am quite concerned about the measures being proposed in the UPP guidelines.

2. The reasons for not using "direct jobs created" to measure employment generation impacts of a firm are well-known and numerous. The important ones worth noting in this case are:

(i) How are renovation or relocalization subprojects that do not create much employment but maintain or improve the viability of a firm to be handled? These should not automatically be penalized;

(ii) The indirect employment generation effects (e.g., backward and forward linkages, income effect, savings effect, balance of payments effect, etc.) should be taken into account;

(iii) As Mr. Hutcheson points out in his memo, the ERR is tremendously important in employment generation, especially in regard to future jobs. Any serious measure would have to give weight to this effect; and

(iv) The difficulty of making accurate employment generation projections are substantial and thus projections would be subject to widespread manipulation.

3. Instead, I would propose that the Bank/countries/DFC's undertake sectoral and subsectoral research to identify industries or technologies within industries that generate relatively more employment, and offer comparative advantages and adequate ERR's. Priority lists could then be established, and both Bank and Government lending could be directed to the extent possible to these areas. In any case, the major problem facing most DFC's is identifying (or developing) good subprojects, and not just screening a variety of good candidates. These lists could also be useful in identifying good projects for DFC loans with other-than-Bank funds. These lists would provide appropriate weights to employment generation, export promotion, resource utilization, etc., in light of the objectives of the country.

4. Before establishing any employment generation targets, let's be sure we know what we are measuring and have adequate tools.

JBentley:ngs
cc: Messrs. Renger, LCPID, Knotter, LCPID,
Hutcheson, LCPID, Stone, URB,
Nelsen, LCRVP.

Attachment 2

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

OFFICE MEMORANDUM

9c

TO: Mr. Gary Hyde, IDF

DATE: March 18, 1977

FROM: Krishna Challa, LCPID KC

SUBJECT: Urban Poverty Program (UPP) Implementation and its Implications to DFC Lending

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1. I refer to Mr. Jaycox's memorandum of January 6, 1977 addressed to the Operational Vice Presidents and your memorandum of March 4, 1977 which examines the implications of the UPP limits on investment cost per job to our DFC operations. While the employment generation goals under the UPP limits are commendable, I see a number of problems with the suggested approach for determining eligibility of DFC projects for inclusion in UPP.

Measurement Problems

2. (a) The difficulties in getting reliable estimates of employment generation for the smallest of our DFC subprojects are formidable, and so applying rigid guidelines on investment cost for job may not be the best way to determine UPP eligibility.

3. (b) Unless the values of Gross Domestic Investment (GDI) and total labor force required to be used under the suggested thumb rule are smoothed over a sufficiently long time, the threshold investment cost per job under the rule would fluctuate unduly in reaction to short term changes in these variables.

Conceptual Problems and Biases of the Suggested Index for Investment Cost per Job

4. (a) By using the total labor force currently employed as a surrogate for the total incremental jobs required to be created in the country, the index suggested in the Jaycox memorandum of January 6, 1977 ignores large differences that exist among countries with respect to population growth rates and prevailing unemployment rates. It also ignores differences in what may be considered "reasonable" target unemployment rates in various countries achievable in, say, 5 years in the light of the macroeconomic situation and the cost of providing new jobs. (See footnote 1 below)

1/ Let's assume a reasonable thumb rule (similar to the one suggested in the earlier Jaycox memo of September, 1976) is

$$\left\{\frac{\text{Capital cost of the project}}{\text{Number of jobs created through the project}}\right\} \leq \left[\frac{\text{Gross Domestic Investment (GDI)}}{\text{Total incremental employment required to be created each year plus employees working on the replacement capital } (\Delta L)}\right].$$

Continuation of footnote 1

Where q is an arbitrary factor (equal to 2 in the memo), to consider indirect employment effect and to place the threshold within the operationally feasible range of Bank operations.

Then, ΔL can be approximated as

$$\Delta L = (L.g + UE) + L.k = L.\ (g + k) + UE$$

where L = total labor force currently employed

g = annual rate of population growth in the country

k = annual rate at which the existing capital in the economy wears out and needs to be replaced.

UE = Number of people within the total target labor force who are currently unemployed.

If we define the index in terms of man-years of employment rather than number of "jobs", the rule becomes

$$\left\{\frac{\text{Capital cost of the project}}{\text{Equivalent (discounted) man-years of employment created by the project}}\right\} \leq \left[\frac{GDI}{\Delta L.t}\right] q$$

where t = average discounted man-years of employment in an average employee's life span.

The revised guidelines presented in Mr. Jaycox's January 6 memorandum appear

to be implicitly assume that $\Delta L.t \approx L$, yielding the rule

$$\left\{\frac{\text{Capital cost of the project}}{\text{Man-years of employment created through the project}}\right\} \leq \left(\frac{GDI}{L}\right).q$$

5. (b) The index also appears to assume implicitly that (i) the average life of the capital employed in the economy is roughly equal to the number of equivalent (discounted) man-years in an average employee's life span (see footnote 1 in the previous page) and (ii) the life of the capital is roughly the same across all projects. The merits of using the above approximation uniformly across all countries are questionable, partly as a result of the points raised under (a). More importantly, the procedure biases the threshold capital/labor ratio downwards because capital employed by the smallest enterprises tends to have a lower life than that for the nation as a whole.

6. (c) The indirect employment generation effect has been ignored in the suggested index. Indirect employment through linkages and income generation is not uniformly distributed across all projects; it is likely to be high precisely in projects with high ratios of capital to direct jobs created. Also, the indirect employment effects of investments in the industrial sector are likely to be significantly higher than those for the economy as whole in most countries.

7. (d) While I understand the reasoning presented in Mr. Jaycox's memorandum of January 6, 1977 for deriving the threshold capital/labor ratio on an economy-wide basis rather than for the individual sectors (convenience and possible need to change the sectoral distribution of Bank's lending in order to attack urban poverty), I continue to be skeptical of its applicability in its simplistic form to the industrial sector, primarily for the reason stated in (c) above.

An Alternative Approach

8. At the minimum, I think a separate index should be devised for the industrial sector 1/ that takes account of the indirect employment generation effects and differences in average life of the capital by size of the enterprise. It should also correct for differences among countries with respect to population growth rates as well as existing and target unemployment rates. A better appreach to address the whole issue might be to determine the approximate distribution with respect to investment cost per job created of all industrial projects considered feasible for financing under the current appraisal criteria for DFC projects and direct at least a third of all DFC lending to projects following in the lowest 40% of the investment per job scale.

9. Since urban poverty lending is required to meet all existing criteria for Bank lending, depending on which of the above UPP guidelines is finally adopted, it may also become necessary to reexamine our criteria for DFC lending as a whole.

1/ Getting separate indices for individual sectors may not be as difficult as was assumed: for one thing, the indices need to be computed only the sectors in which the principal benefit to the urban poor is seen to be employment creation, that is, primarily industrial and tourism sectors.

KCHALLA/slb

cc. Messrs. Renger, LCPID, Stone, URB, Knotter, LCPID, Hutcheson, LCPID, Nogales, LCPID, Bentley, LCPID

Attachment 3

Mr. Gary Hyde, DFCD

March 8, 1977

C/L

Thomas L. Hutcheson, LCPID

UPP Limits on Investment Cost per Job

1. You are definitely on to an important problem here, but I think you may be exaggerating its severity.

2. First, who says that employment is supposed to be discounted? Maybe with population planning the problem will be getting less severe in the future. Kidding aside, why should it be discounted? I remember we discount capital because a dollar invested today multiplies up by compounding to a larger amount in the future. And if (a long string of ifs) then the future dollar is worth less than the current one. What is the analogous process with respect to labor?

3. Second, suppose we consider reductions in unemployment a public consumer good and therefore subject to discount like other consumption. Would the correct discount rate not be the rate of pure time preference rather than something like the Marginal Productivity of Investment? On the other hand, if projections show the employment problem getting worse in the future, should we not use a negative discount rate? If employment is getting to be more scarce, maybe we should give more weight to future employment than present employment.

4. This use of a time-preference type of discount rate has two important implications: (a) the UPP target is not quite so hard to reach, and (b) the estimated life of the project is important in reaching it.

5. For example, in your India case, if we assume that employment is discounted by the rate of time preference, say 3% p.a., the number of discounted job years in the 10-year project would be 42.5 rather than 30.7 and the cost per job-year would be \$235 rather than \$325, much closer to the acceptable \$160. But watch what happens if the project lasts 15 years. The number of discounted job years is 64 instead of 38, the cost falls to \$156/job and the project passes the test. And a twenty-year project lowers the cost to \$128/job.

7. Turning to your Turkey example, if these TSKB projects last 20 years (and I have seen a lot of 20-year old capital goods in use around the world) and if you use my 3% discount rate, projects costing \$16,370/job are acceptable and even \$20,000/job projects pass if they last 30 years.

8. Another point on job creation. Why could we not give extra employment points to projects that have high ERRs? After all, those projects generate resources that can be invested to produce more jobs in the future. And the discounted number of those jobs should go towards our target. Bring on those petrochemical complexes!

THutcheson:gl

cc: Messrs. Renger
Knotter
Bentley
A. Stone
J. Holsen

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

Attachment 4

OFFICE MEMORANDUM

TO: Mr. Gary Hyde, IDF

DATE: March 24, 1977

FROM: Javier I. Nogales, LCPID

SUBJECT: Urban Poverty Program Limits on Assets Size and on Investment Cost per Job

1. I would like to comment on two different aspects about Employment Creation and Small Scale Enterprise Development, which are of concern to this division: (a) the maximum fixed asset size limitation of US$250,000 in 1976 prices, and (b) the "Country Investment Cost per Job Limit" of twice the quotient on Gross Domestic Investment divided by labor force.

2. First, the US$250,000 asset size limitation is too arbitrary if it is applied to all countries. Such a limit may be too small for a country like Brazil and too large for a country like Paraguay. Instead, a country-by-country limit should be estimated by setting the target of reaching enterprises in the lower asset size percentiles, say the smallest 20 or 30%.

3. Second, the Investment cost per job limit has been defined as 2(I/L), where I is a flow variable and L is a stock variable and is therefore not conceptually correct. This definition makes the limit too arbitrary with the following deficiencies: (a) It is not related to a country's capability of employment generation. The previous definition (Jaycox's memo of September, 1976), based on the ratio of gross domestic investment to incremental labor, was better conceptually than the present one; (b) it is not related to a country's unemployment (or subemployment) situation[1/]; (c) it is almost completely correlated (r^2 = 99%) to countries' income per capita[2/]; (d) it does not provide a good basis when short-to-medium term perturbances occur in an economy. For example, if gross investment declines in a country, say due to political instability in a 4-year period, the limit will also decline as I is more elastic to the disturbance than L, and as a result Bank operations would be modified, but not in the correct direction.

4. Given the deficiencies in the "limit" definition, it is necessary to modify it. A better approach would be a limit based on ($I/\Delta L$), to take rather into account, the countries' marginal cost of employment generation. In addition, the limit should be applied only when unemployment (plus subemployment) in a country exceeds a given limit to be established, say 10% of the labor force. Alternatively, the limit should be allowed to vary in a reasonable range, to take the unemployment situation into account, growing when unemployment increases.

cc: Messrs. Renger, LCPID; Stone, URB; Knotter, LCPID

JNogales/KChalla/mcs

1/ For two similar economies of the same size, one with large unemployment and the other with small unemployment, the same "limit" would be used in both cases, as I and L would be the same.

2/ Of a sample of 15 economies, a linear regression was estimated, using IMF data, a determination coefficient (r^2) of 0.987 was found, indicating that 98.7% of the changes in the "limit" were explained by changes in income per capita alone.

February 24, 1977

Ms. Jane Joplin
Executive Office of the
Secretary General
United Nations
New York, New York 10017

Dear Ms. Joplin:

Harold Dunkerley asked me to send you a short note to bring you up to date on some of the wider aspects of the Bank's ambitions in the field of urban poverty alleviation which have developed since the publication of "Analysis of Programmes of the Organisations in the United Nations System in the Field of Human Settlements". I understand that we are not required, at this stage, to correct or update the references already contained in the report. I hope the attached will be useful to you in preparing your report for the ACC meeting in Geneva. Also enclosed for your personal use as background is a copy of the "Interim Report of the Urban Poverty Task Force" which was produced in the Bank.

Yours sincerely,

Nicolas A. Lethbridge
Operations Review & Support Unit
Urban Projects Department

NLethbridge:bb

cc: Messrs. Jaycox, Dunkerley, Churchill

DRAFT
NLethbridge:bb
2/25/77

Background Summary of World Bank Urban Poverty Program

1. Recognition in the Bank that the problems associated with urban poverty, although often of a different nature, are at least as urgent as those in rural poverty, has led to the formulation during the last two years, of an urban poverty program parallel to the rural development program. Almost all sectors of Bank lending affect urban development and institutions and therefore the urban poverty program is not confined to investments in any one sector. Emphasis is given to raising the productivity and incomes of a target group, comprising the urban poor, through increased employment opportunities and through extending access of the target group to urban services. Very broadly, about 10-12% of the total Bank lending will fall into the urban poverty program. To do so, projects should meet one or both of two simple criteria, on either the consumption/service side; or the production/increased income side, as well as meet all the usual criteria of Bank lending in conventional economic and technical terms.

2. On the employment side, this means a considerably increased emphasis on projects which generate productive employment at very low levels of capital intensity. A simple capital labor ratio criterion has been established such that lending falling within the urban poverty program should have a ratio of capital to man-year of employment created by the project less than twice the GDI to total labor force ratio for the country as a whole. Of course, this criterion will influence project design in all sectors, but its most important impact is expected to be in Development Finance Company lending, industrial and industrial credit projects.

On the service and consumption side, the program calls for projects whose output meets a demonstrated and unsatisfied demand by the urban poor and increases supply or lowers cost to the urban poor. It should be demonstrated that such outputs are affordable to the target group, or if subsidized, the rate of subsidy and the institutional forms required are capable of allowing continued expansion of output until demand is met. Sectors primarily affected by this criterion include: water supply and waste disposal, education, housing, energy and transportation and perhaps health and nutrition projects.

3. In preparation and support for project activity under the urban poverty program, there has recently been quite a range of policy and project research some of which is nearing completion. Worth mentioning is quite intensive activity on the small-scale industrial and informal sector, urban labor markets, guidelines for the analysis of local fiscal systems and their inter-actions with projects, and a series of papers on project design alterations required for a poverty emphasis in the education, water supply and waste, and health/nutrition sectors.

4. Work which has already been done includes guidelines for country economic analysis incorporating urban and regional analysis, estimates of the target group in urban areas throughout the developing world, draft guidelines for small scale industry and employment data gathering and analysis, and guidelines for health/nutrition data analysis in urban areas.

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February 23, 1977

DEPARTMENT DIRECTORS' MEETING

Board Room, February 7, 1977, 10:00 a.m.

Present: Mr. McNamara (Chairman), Vice Presidents and Department Heads

FUTURE ROLE OF THE BANK

1. Mr. McNamara called attention to the memorandum "Future Role of the World Bank and its Associated Capital Requirements", urging the Department Directors to read it and bring forward any questions or comments they might have on its contents. While the paper had been a long time in preparation and had been thoroughly discussed by the President's Council, many of the questions it raised were still open for further discussion and decision.

2. The paper made only two recommendations:

> That the lending program for FY78 be increased from the present \$5.8 billion ceiling to \$6.1 billion, and that for FY79 be raised to \$6.8 billion; and,
>
> Decisions relating to the Bank's capital structure and a General Capital Increase be deferred pending a thorough review of all associated matters. It was felt that such a decision could be deferred up to 17 months.

3. The remainder of the memorandum's 70 pages were addressed to issues affecting the future role of the Bank. He anticipated Board discussions on these questions would take place over several months, with each issue being presented in somewhat greater depth before it was taken up by the Executive Directors.

Distribution:

President
Vice Presidents and Department Heads (Bank and IFC)

URBAN POVERTY PROGRAM

4. Mr. Jaycox said that more than a year of studies and discussions by the urban policy task group had culminated in January in an agreement among the Bank's Operational Vice Presidents as to the approach to be taken in attacking urban poverty.

5. The task group's efforts had focussed on:

Defining the urban poverty target population;

Setting criteria by which to distinguish urban poverty ~~and~~ from other urban area lending; and

Setting up a functional information system with which to set program targets and allow effective monitoring.

6. The target group had been defined as the most inclusive of the absolute and relative poverty groups within the urban population of each country. Absolute poverty was defined as an income level below that needed to obtain a minimum caloric intake; relative poverty as having purchasing power less than one-third the national average. The data base for these estimates was poor in many countries and it had been agreed to upgrade it in the course of country economic work.

7. Urban poverty lending had been defined as lending reducing the costs of, or increasing the access to, basic goods and services by the poverty group and financially or technically replicable, or, lending creating urban employment at a cost at or below a country-specific indicator defined as twice ~~the~~ a national capital/labor ratio. Simply, it meant lending that benefitted the target population.

8. He emphasized that poverty lending must meet all the criteria, both economic and financial, set up for normal Bank lending. Showcase projects were to be avoided in favor of those which could be afforded by the poor and repeated both financially and institutionally, if successful, by member countries. The program would be characterized by projects which spread resources over a large number of recipients: in education, they would typically attempt to achieve literacy for large groups rather than higher level education for an elite; in industry they would tend to concentrate on labor-intensive operations rather than those utilizing higher capital ratios and providing high salaries for small groups of workers; in water supply they would mean mass access to clean water rather than the provision of higher class service for a few.

9. In setting operational targets, it had been agreed that urban poverty lending should not compete with rural development for the Bank's resources. The financing for urban poverty projects should, thus, come from the resources (about 35 percent of Bank lending) already devoted to the urban areas. Some 30-35 percent of the urban population met the poverty cirteria, and the devotion of at least a third of urban lending to

poverty-directed projects by 1980 had been agreed upon as an indicative target. Poverty lending was expected to reach roughly 20 percent of total urban lending in FY77, and rise to 25 percent in FY78. It was hoped that 30 percent ($750 million) could be reached in FY79, and 33 percent ($1 billion) in FY80.

10. Mr. Jaycox said too much reliance had, heretofore, been placed on the Urban Projects Department in developing the Bank's urban program. It had been agreed that sector-specific strategies in such areas as water supply, industry, and education should be developed in the regions and he felt this would readily be accomplished with the help of CPS.

11. The small unit set up more than a year ago in the Urban Projects Department to develop the above-mentioned criteria and targets must now turn its efforts to the development of substantive programs in cooperation with the operational managers.

12. Mr. Blobel said he felt the targets which had been set were mainly a measure of the Bank's own anticipated effort in the urban poverty field and might require considerable modification and broadening in practice. He further expected that it might prove easier to carry out the goods- and service-related than the job-creation objectives of the urban poverty policy; lending for productive purposes often required a basis of sound macro policies, and development of the policies member countries needed to effectively support such projects might well prove a larger task than expected.

13. Mr. McNamara, while congratulating the urban task group on its progress in defining both its target group and policy objectives, said he felt that the linkage between the provision of services such as water and education and increased productivity had not been adequately established. While the provision of services was a necessary objective of the urban poverty program, it should not be allowed to substitute for more difficult efforts in direct employment creation.

14. Mr. Chenery said he felt the urban poverty effort was worthwhile, despite the somewhat crude mechanisms which would be used to measure its success. While he found the number of poor folk affected by urban projects an accessible surrogate for more sophisticated evaluations based on weighting economic impacts by income levels, he warned that these measures must be used with caution. The nature of an effective urban development program for the poor was still largely unknown, and he felt it was important to get the program underway so that the learning process could begin. He felt that a great deal of research was needed to uncover the linkages between the provision of basic services and job creation; the Research Committee had recently approved its first urban study, the results of which would probably not be available for another 18 months.

15. Mr. Husain asked the status of the Bank's dialogue with member countries on questions of urban poverty policy. Mr. Jaycox replied that this dialogue was neither systematic nor adequate; a great deal of sector work had been carried out in individual countries over the past 18 months and a good dialogue was developing on particular sub-sectors with some African and South Asian countries.

16. Mr. McNamara added that he felt the urban program was not as well understood or accepted by member countries as the Bank's rural development initiative, largely because it involved more difficult theoretical and practical problems. He felt the program was now at a point at which the regions should begin formal discussions on urban poverty programs with member governments.

INDUSTRY/DFC FUNCTIONAL REALIGNMENT

17. Mr. Gordon said that industry had been given relatively low priority in the Bank's early years and industrial projects had been dealt with ad hoc, rather than in a strategic context. Industrial investment had been considered a private preserve, and government involvement regarded warily. IFC had been seen as the Bank Group's industrial arm, with the Bank merely providing needed finance beyond IFC's capability.

18. The Development Finance Companies Department had, thus, been originally placed within IFC and assisted only privately-owned and controlled intermediaries until 1968, while the Bank's Industrial Projects Department was established still later. Although the volume of Bank financing for manufacturing industries had increased rapidly in the late 60's and early 70's, its sophistication had lagged behind other sectors.

19. The Bank had become increasingly conscious of the importance of the industry sector in development and the new attention being given to urban poverty had highlighted its employment-creating role. This suggested greater emphasis on smaller, less capital-intensive operations and non-manufacturing activities employing large numbers of workers, such as construction, transport and warehousing.

20. The financing of such activities required the use of national or local intermediaries. It had also become increasingly clear that the kind of DFC model the Bank had promoted over the years -- exemplified by TSKB in Turkey, ICICI in India or the Colombian Financieras -- could not get down to small-scale enterprises; the elaborate methodology that it had tried to inculcate in its traditional DFC clients was too expensive, necessary data were unavailable, and many of the DFCs had little desire, and perhaps even less capability, to finance small firms. A policy paper

discussing the problems and needs of such firms, and proposing certain new approaches on the part of the Bank to assist them, would shortly be submitted to Management.

21. A task force had been set up in 1975 to examine how industrial sector work should be realigned and refocused to meet these concerns, and its recommendations had recently been approved. The realignment would continue the Industrial Projects Department as a CPS unit responsible for direct Bank/IDA lending for very large, discrete industrial projects and sub-sector studies related to such operations.

22. The regions would be assigned primary responsibility for overall industrial sector work, the definition of priorities and analysis of policy issues, through new Industrial Development and Finance Divisions in each regional Projects Department, reporting to the same Assistant Projects Directors who dealt with urban development. While new IDF Divisions would call on DPS and CPS for major or specifically focused sector studies, they would have continuing responsibility and initiative for industrial sector issues and analyses in their regions.

23. The new IDF Divisions would be responsible for developing lending strategies and programs broader than the typical past DFC operations, giving greater attention to small enterprises and linkages between small and large firms and between industry and urban/rural development programs. They would help to prepare, appraise and implement industrial components of urban and rural development projects.

24. The existing DFC Department would also become the IDF Department and provide guidance and staff reinforcement to the regional divisions. The DFC Division for Africa that had been an appendage to the central DFC since the 1972 reorganization would be transferred to the respective Africa Regions; the spectacular upsurge in the number of DFC operations in Africa over the past 2-3 years had eliminated the rationale for the previous combination and centralization of this unit.

25. It was hoped that the reallocation of responsibilities would induce more comprehensiveness and continuity of focus on country industrial sector issues, encourage broader and more imaginative use of intermediary institutions to deal with a more varied range of industrial and related sector needs, and facilitate systematic and mutually reinforcing consultation among the regions and the central projects and policy units concerned with the industrial sector.

26. Mr. McNamara said that the proposed realignment would constitute only a small step toward overcoming the obvious organizational disorder which had characterized the Bank's approach to industrial sector and DFC operations for many years. In response to a question as to the location of responsibility for capital markets development under the reorganization, he said that this function would be retained by the IFC Capital Markets Department. Although Mr. Gill had performed well, it

was small and could only confine its attention to a few countries at a time.

27. In reply to a question from Mr. Gabriel, Mr. Gordon said that the Bank, although not capable of directly financing small-scale industrial ventures, was thought to have a comparative advantage in relation to the other international financial institutions. While it must work through intermediaries, the Bank was moving beyond traditional approaches into such areas as the use of commercial banking networks, cooperative organizations and the organizational framework set up under urban and rural development projects.

28. Another speaker asked how the economic and financial services provided for small-scale enterprises would be supplemented by the equally important technical, administrative, and social "extension services" they also needed. Mr. Gordon said this could be achieved through cooperation with other organizations such as UNIDO and the ILO. Mr. McNamara added that he felt that the equivalent of agricultural extension services were needed, but that it was difficult to devise institutional formats in which this could be provided and more experimentation was still needed.

BORROWING PROSPECTS IN GERMANY AND SWITZERLAND

29. Mr. Rotberg said he had recently visited the European capital markets, particularly Frankfurt, Zurich and Paris to discuss the Bank with government officials, financial intermediaries, bankers, investors, and the press. In these talks, three concerns had been expressed: whether developing country borrowing needs were such that the Bank was likely to put out considerable substantial resources at risks which were inappropriate; whether the Bank was still reasonably profitable and financially secure; and, whether the Bank could continue to rely on its major stockholders for full support of its policy directions.

30. Mr. Rotberg said he felt he had been able to meet all three concerns. He had found strong support for the financial integrity and potential growth of the Bank in both the press and the banking community.

31. One factor supporting the Bank's strong position had been its access to borrowing in Switzerland and Germany. Seven borrowing operations in those countries were planned in the following six weeks. In the past seven months the Bank had borrowed more than ever before in Switzerland and Germany -- some 8-10 times as much as in the 1966-71 period. This reflected the market's receptivity to World Bank borrowings, both because investors were comfortable with the institution and because of the substantial demand for Deutsche Marks and Swiss Francs. He felt it significant that yields on Bank bonds in these two countries had not deteriorated, despite the increase in its borrowings.

ADMINISTRATIVE BUDGET FOR FY78

32. Mr. Gabriel said that preliminary work programs and manpower requests had been received from the operating departments; review of this material was expected to be completed by February 21. Budgets for the non-operating departments were due by the end of the month, and a comprehensive budget proposal would be placed before the President in late March. On the basis of the provisional data, it was clear that the operating departments would seek sizeable increases in their budgetary allowances.

33. Mr. McNamara said that preparation of the budget was of great importance in reaching agreement with the Board on the Bank's lending program for fiscal years 1978 and 1979. The Bank had already lost the capability to process operations much above the present $5.8 billion ceiling in FY78 because the FY77 budget had been prepared on the assumption of no further increase in Bank lending during the following years. Some additional manpower would have to be provided for in the upcoming budget if operations were to be meaningfully increased in the following year.

ADJOURNMENT

34. The meeting adjourned at 11:04 a.m.

H-J. Polak
Acting Secretary
Department Directors' Meeting

Mr. Stone
File

FEB 22 REC'D

Urban Edge
Newsletter

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. John E. Merriam, Director, IPA

DATE: February 17, 1977

FROM: Edward V.K. Jaycox, Director, URB

SUBJECT: Urban Poverty Newsletter

1. I would like to see the Bank support the establishment of a newsletter or bulletin with international circulation which would report regularly on activities and ideas in the urban field with particular emphasis on poverty alleviation. My ideas are still in the formative stage, but I would like your reaction to them and suggestions as to how we could get this kind of a publication started. I'm not at all sure that George Wynne's group (Council for International Urban Liaison) or INTERMET, a Canadian-supported information exchange, are the right people even to do the proposal.

2. The kind of publication I have in mind would not be primarily a Bank "voice" but would provide a network for a two-way flow of ideas and notices of events: (1) a channel for straightforward delivery of Bank ideas and news of project events and technology choices to officials and professionals at a range of levels in member countries who deal with shelter, urban services (physical and social), employment and other areas, with specific reference to serving the needs of the poor; (2) a reverse flow of ideas and news of events taking place in the same areas in member countries and other agencies.

3. More specifically, this bulletin would operate along the following lines:

<u>Content</u>: From the Bank - selected project events throughout the project cycle; interim reports on urban poverty work. From other contributors - selected project and study activities.

<u>Style</u>: Telegrammatic short news items rather than the longer, abstract-like style used by Wynne's group. Items could include name and number of contact for further information.

<u>Target readers</u>: Top and middle-level urban management and their staff in at least (or at first) the cities where our projects are under way.

<u>Frequency</u>: Monthly or bi-monthly.

4. It seems clear to me that the local contacts known to the staff of the Urban Projects Department and the EDI urban management course participants' list could form the core of an initial mailing list, and someone in this department could act as our contact for the group doing the bulletin. It also seems clear that the bulletin itself would have to be run by a group outside the Bank which would receive some funding from the Bank. However what is not clear is: (1) how much would it cost and how long would it take to get this kind of effort under way, essentially from scratch? (2) what kind of an outfit can give us a reliable answer to this question, e.g., a proposal for set-up and operation of such a publication?

5. I would appreciate your reactions to these ideas and specific suggestions of individuals or groups, perhaps newsletter specialists, whom we could get in touch with to explore their feasibility.

cc: Messrs. McCulloch, Pellegrini, Stone, Strombom, Venkateswaran
Ms. Henneman

SHenneman:ar

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

UPP

OFFICE MEMORANDUM

TO: Files

DATE: February 11, 1977

FROM: Isaac K. Sam, Personal Assistant to the Senior Vice President

SUBJECT: Operational Vice Presidents' Meeting - February 2 & 3, 1977

circulate & N.B. item #3

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Present: Messrs. Knapp (Chairman), Baum, Chaufournier, Husain, Wapenhans, Bart, Blobel, van der Meer, van der Tak, Gue, Jaycox, Lethem, Stone, Yudelman, Alter, Horsley, Dosik, Hornstein and Sam.

Project Brief System

1. The discussion of Mr. van der Tak's memorandum of January 18, 1977 focused on the findings resulting from the review of the experience acquired since the Project Brief (PB) system was introduced about a year ago. The meeting recognized that the PB system had proved to be a useful instrument for early resolution of project issues, and a good basis for co-financing discussions and continuing dialogue with field offices, borrowers and project preparation sub-contractors such as FAO. It should, therefore, be adopted as an integral part of the Bank's procedures. However, many found the proposed guidelines too long and too specific and emphasized that the PB system should not be used an an additional monitoring device but rather as a tool for regional management. Drawing on some of the review's findings, the meeting concluded that the PB system should be flexible to permit it being substituted for an identification/preparation Back-to-Office report where applicable. The Chairman asked CPS to review the guidelines in the light of the meeting's reactions.

Future Role of the Bank

2. Mr. Knapp referred to Mr. McNamara's memorandum of January 31, 1977 on the Future Role of the Bank distributed to the Board this week, and drew attention to the two immediate issues facing the Bank, namely:

(a) the establishment of planning assumptions for IBRD lending in FY78 and FY79; and

(b) the fixing of a timetable for concluding the negotiations in the Board regarding a General Capital Increase.

3. He invited the meeting to channel any new ideas on the subject to him personally. An informal discussion of the memorandum with the Executive Directors will be scheduled prior to the formal Board discussion on March 8, 1977, mainly to discuss how the Board will tackle its review of the paper.

Urban Poverty Program Implementation

4. The meeting accepted the income cut-off definition contained in Mr. Jaycox's memorandum of January 6 which defines the target population for urban lending as people in "absolute" poverty with incomes below that necessary to obtain a minimum caloric intake in their diets plus people in "relative" poverty with purchasing power less than one-third the national average in any given country. While recognizing the weaknesses in the data base used for determining the target population in most countries, the meeting agreed to use the above definition and the estimates of the target group derived therefrom for project design and programming purposes and, in the course of routine operations, to encourage borrowers to upgrade the data base.

5. The meeting emphasized that all urban poverty projects should meet the existing Bank appraisal criteria, and accepted the following additional criteria as characteristics to distinguish urban poverty projects:

(a) that the projects produce basic goods and services that directly benefit the target population and are affordable by the target population and/or otherwise are financially, administratively and technically replicable on a scale significant in relation to the size of the deficiency being addressed;

really?

(b) or that the projects be sufficiently labor-intensive to achieve country-specific capital-labor ratios along the lines outlined in the memorandum.

However, while accepting the concept of capital/labor ratio as an operational device, the meeting felt that both the concept and its specific formulation should be kept under review in order to achieve appropriate country standards for labor intensity on urban poverty projects.

6. The proportion of Bank lending expected to be identified with the target group during FY77-79 is estimated by the Regions at about 20% of the part of the lending program that is directly related to urban areas during the period. The meeting accepted Mr. Jaycox's recommendation that the Bank seek to expand urban poverty lending to reach 33% of all urban-related lending by FY80, and noted the availability of operational support in the Urban Projects Department as a resource to assist the operational staff in their endeavor.

Bank/IFAD Relations

7. A draft paper exploring the options of an effective Bank/IFAD working relationship was discussed at the February 3 meeting. The paper, drafted by a working party of four, chaired by Mr. Dosik, was prepared as a briefing paper for Mr. McNamara who was to meet on February 7 with a three-man delegation from IFAD led by Ambassador Sudeary. (Dr. Sudeary is the Chairman of IFAD's Preparatory Commission).

8. IFAD (International Fund for Agricultural Development) was created about a year ago by the World Food Council for the purpose of promoting food production in developing countries, with particular emphasis on the "poorest food deficit" countries, and the welfare of the poorest segment of the population. It is expected to be operational in a few months with the equivalent of US$1 billion pledged contributions from OECD and OPEC countries, and is expected to commit most of the resources in the initial three years of operation. The IFAD delegation came to the Bank as part of its effort to establish cooperative working relations with existing international financial institutions.

9. The Operational Vice Presidents discussed the possible roles for the Bank as proposed in the draft paper including (1) co-financing with IFAD; and (2) undertaking on a reimbursable basis the appraisal and supervision of "direct" loans by IFAD.

Next Meeting

10. The next Operational Vice Presidents' meeting was held on Wednesday, February 9 at 9:30 a.m. in Conference Room E1208.

cc: Participants
Messrs. Chadenet, Gabriel, Burmester and Mrs. Boskey

ISam:pat

FEB 16 REC'D Mr. Jaycox
UPP
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circulate

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Department Directors and Projects Advisory Staff in Central Projects Staff

DATE: February 4, 1977

FROM: Anandarup Ray, Office of the V.P., Projects Staff

SUBJECT: Items of Interest at February 2 Meeting of Directors and Advisers

PRESENT: Messrs. Baum, van der Tak, Fuchs, Gordon, Hultin, Jaycox, Kanagaratnam, Lejeune, Rovani, Tolbert, Willoughby, Yudelman, Finne, Israel, Lee, Raizen, Ray, Weiss, and Mrs. Scott.

Re-organization of Industry Work

Mr. Baum said that the principal recommendations of the Industry/DFC Task Force Report on the re-organization of industrial operations and sector work have been accepted, viz. the regionalization of the Africa Division of the DFC Department by creating DFC Divisions in the two African Regions; the transfer of responsibility for industrial sector work to Industrial Development and Finance Divisions in each Region; the establishment in CPS of a new Industrial Development and Finance Department, made up of the former front office of the DFC Department and certain additional staff with responsibility for policy and functional control of work in the traditional DFC sector and in the small-scale industry sector, and for functional control of general industry sector work; leaving the Industrial Projects Department in CPS with responsibility for major industrial projects and for industrial sub-sector work related to those projects. The responsibility for financial sector work has not been determined yet. Pending further study, the Industrial Development and Finance Department will deal with financial sector issues to the extent that its resources permit.

PRC Review of Paper on Small-scale Enterprises

Mr. Gordon reported on the Policy Review Committee discussion of the recent paper on Employment Creation and Small-scale Enterprise Development. The paper was well received, and its conclusions and recommendations were generally endorsed, except the one concerning the creation of a technology referral service in the Bank. The paper, after revisions to take account of comments received, will provide the basis for a Board discussion of the topic.

Procurement Policy

Mr. Baum reported that a new version of the statement of the Bank's policy on boycotts has been approved and will shortly be incorporated in the procurement guidelines. The Legal Department will also issue supplementary instructions regarding the application of the policy.

.../2.

Department Directors and Projects Advisory Staff in Central Projects Staff

February 4, 1977

Functional and Quality Control

A sub-committee has been set up by the President's Council, to be chaired by Mr. Baum, to review matters related to functional and quality control. Among matters on which Mr. Baum stated he would welcome suggestions were how high quality in project work can be most effectively reflected in the programming and budgeting system and in the rewards system for staff performance.

CPS Staff Positions

Mr. Baum noted that the budget requests he had received, although based primarily on the operational work programs, were far in excess of what could reasonably be expected to be approved. Moreover, he will recommend that a proper balance between operational and advisory work be maintained in CPS. He stated that this matter, including the extent of the Region's requests for operational work from CPS Departments, will have to be reconsidered.

Urban Poverty Lending

Mr. Jaycox reported that his paper on urban poverty lending had been discussed by the Operational Vice Presidents and agreement reached on such matters as the appropriate definition of the target group, the distinction between poverty and other urban lending and on the bench-mark to be used for guiding choice of labor-intensive projects. It was noted in particular that a poverty lending target has been set for 1980 as 35% of total urban-related lending.

Project Brief

The experience acquired with the Project Brief (PB) System has been discussed at the Operational Vice Presidents Meeting, based on a paper prepared by Mr. Lethem. It has been agreed to introduce PBs for all projects. Guidelines will be issued to facilitate this process, emphasizing the importance of flexibility in adapting the Brief to the circumstances of each operation. Mr. Baum suggested that the CPS Departments should be sure that they respond to all PBs they receive, even if only to indicate "no comment".

Outside Panels for Reviewing Research and Operations

In past Board discussions of the World Bank's research program, several Directors have suggested reviews by outside panels. Mr. van der Tak invited comments and suggestions on priority research areas which could benefit from reviews by outside panels and how best to organize this. There was a general discussion of the issues but no general consensus was reached.

DISTRIBUTION: Messrs. Fuchs, Hultin, Jaycox, Kanagaratnam, Lejeune, Rovani, Sadove, Tolbert, van der Tak, Willoughby, Yudelman, King, Israel, Lee, Lethem, Morse, Raizen, Ray, Weiss and Bhatnagar (o/r). Mrs. Scott.

cc: Messrs. Knapp, Baum, Benjenk, Chadenet, Chaufournier, W. Clark, Krieger, Stern, Wapenhans, Alter, Weiner, Chang, Gabriel, Gordon, Burmester, Finne.

ARay:lic

Chr Stone
~~D Nico~~
~~Roberto~~
(3) ~~George~~
~~John~~
(5) File

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

OFFICE MEMORANDUM

TO: Mr. E. Jaycox, Chairman, Urban Poverty Task Group **DATE:** January 31, 1977

FROM: Adalbert Krieger

SUBJECT: Urban Poverty Program Implementation - Status Report and Request for Confirmation of Certain Plans

1. I have carefully reviewed your memorandum of January 6, 1977 in which you report on the status of the urban poverty program and ask for confirmation of a number of tentative agreements reached at the working level between your Department and Regional staff. The proposals for which you seek my approval cover the following points:

(i) the definition of the target population;
(ii) the criteria to distinguish urban poverty lending; and
(iii) the desirable size of the urban poverty lending program and the need to pay more attention to the sectoral distribution of that program.

I shall be able to keep my comments brief because most of the LAC Region's views concerning the above matters were brought to your attention in the memorandum of Messrs. Holsen and Glaessner of January 3, 1977 of which I attach a copy.

2. Target Population: As a result of consultations between staff of your Department and the Region country economists, first estimates have been made for each country of a personal income figure which sets the ceiling income for the target population of the urban poverty program. In the case of the LAC Region the target population as defined is 25% of the total urban population. This is acceptable to us as a first estimate for project design and programming purposes as long as the weakness of the underlying data base is recognized and as long as improvements or refinements of this first estimate can be carried out as a by-product of ongoing country and sector and project economic work.

3. Criteria to Distinguish Urban Poverty Lending: I confirm our agreement with the criteria to distinguish urban poverty lending spelled out in paragraphs 9-15 of your memorandum. I give this agreement reluctantly, as I share the doubts expressed by Regional staff concerning the "spreading" of development resources and the particular form of the capital/labor ratio which is proposed to determine whether projects in manufacturing, tourism, other services and other sectors which might provide employment for the urban target population, can be considered urban poverty

projects. My doubts are somewhat allayed, only by your assurance that urban poverty lending will have to meet all existing criteria by which Bank lending is justified and that the criteria established will be reviewed in the light of practical experience. At the same time, I would like to confirm my full agreement with the following features of the approach you have suggested:

(i) the appropriateness of affordability and replicability in terms of the target population as the major criteria for the delivery of basic services to the urban poor;

(ii) the need for the Bank to seek innovative approaches in trying to help speed the expansion of labor intensive sectors which might directly or indirectly employ the bulk of the target population; and

(iii) the desirability of encouraging the attainment of higher labor capital ratios for projects in the higher income countries than those presently proposed.

4. I have no problem with the proposal that "the proportion of urban-related lending that should be "poverty lending" should by FY80 amount to at least the proportion of the target population in the total urban population." In fact, as shown in the Summary Table of the proposed FY77-81 Lending Program by Region (page 7 of your memorandum), 30% of the proposed urban-related lending in the LAC Region is expected to be "poverty" lending while the target population is estimated to constitute only 25% of the total urban population in the Region. At the same time, I am pleased to note that you stress the point that only the regions can judge what is the most appropriate size and composition of a regional urban poverty program. This will enable us to take into account specific country circumstances, the roles of other donors and to compare the likely benefits of the urban poverty projects which we may be able to generate with other high priority projects. Only such flexibility will enable our overall lending programs to have an appropriate balance.

Attachment

Cleared with & cc: Messrs. van der Meer, LCP
Lerdau, LC1
Wiese, LC11
Holsen, ICNVP

cc: Messrs. Knapp, Chenery, van der Tak, Stone (URB)
Goffin and Wyss (LCP), Greene and Ross (LC11)
Nowicki and Pfeffermann (LC1), Perez (LCNVP)
LAC Projects Division Chiefs
LAC Programs Division Chiefs

cc: Members Urban Poverty Task Force
Chief Economists

PG:eg

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Edward U. K. Jaycox

DATE: January 3, 1977

FROM: P. Claessner and J. Holsen, LAC

SUBJECT: Urban Poverty Program Implementation

1. In our view your subject memorandum offers a satisfactory basis for proceeding in the complex area of urban poverty lending. This is not because we are intellectually satisfied with the proposed procedures; we share the doubts and hesitations of others who have questioned both the adequacy of basic data and the rationale for the specific measures. We believe, however, that it is better to proceed on a tentative and flexible basis, modifying the procedures on the basis of subsequent experience, than to prolong the present somewhat abstract discussion of target groups, search criteria and appropriate performance objectives.

2. Regarding target groups, we await the promised further memorandum discussing updating and improving the present "first estimates... for working purposes." We trust that these improvements can be obtained largely as a by-product of on-going country and sector economic work; if not, the benefit/cost ratio of any special effort will need careful study.

3. The objective for the size of the urban poverty program -- about 25-30% of current programmed total urban lending (or about 10% of all Bank lending) -- does not seem unreasonable. The fact that this objective will not apply at country or even regional levels will permit us to take into account specific country circumstances, the roles of other donors, etc. We assume that the overall objective will be reviewed in due course in the light of the probable benefits from the urban poverty projects we are able to generate in comparison with what could be accomplished in other areas with the same staff and financial resources. A specific objective is desirable to insure that this important area is not neglected, but ex post opportunity cost should be monitored.

4. The criteria to distinguish urban poverty lending have aroused the greatest controversy. Doubts have been raised about the general approach of "spreading" development expenditures and also about the particular form of capital/labor ratio that is proposed. We suspect that the indirect and multiplier effects are often more important than the direct and immediate consequences of well designed development activities. Insofar as this is true, doubt is cast upon the adequacy of the "spreading" approach. The insistence that "the proper micro-economic criteria are also satisfied" (paragraph 9) should, however, provide protection against errors of commission. Let us hope that any promising projects which get dropped from the "urban poverty" list, because they do not pass the test based on macro-economic factors, can be included in the urban lending which is not formally classified as "poverty lending."

5. Regarding the specific formulation of the capital/labor ratio criterion contained in paragraph 15 of the December 6 memorandum, we are awaiting the details in the forthcoming memorandum which is to specify maximum "cost per job" for various Bank countries. It seems to us that

there are conceptual and/or data problems in all of the approaches which we have seen discussed. In these circumstances, the simplicity of what you propose is a major virtue. The maximum investment levels which result seem too high as average investment levels per new job created for members of the target group, but are far below what most planners have in mind. They can serve as useful "rules of thumb" to help get us moving in the right direction -- which is the important thing at the moment.

JAHolsen/PGlaessner:ddm

cc: Messrs. Krieger
van der Meer
Lerdau
Wiese
Perez

cc: Messrs. Goffin and Wyss
Messrs. Greene / Nowicki / Pfeffermann / Ross
LAC Projects Division Chiefs
LAC Programs Division Chiefs

cc: Members Urban Poverty Task Force
Chief Economists

Mr. W. C. Baum, Vice President Central Projects January 31, 1977

Alastair Stone, Chief, Operations Review and Support Unit

Urban Poverty Program - January 6, Memo, Background Note

1. The January 6 memo is the culmination of discussions triggered by a September 14 memo which outlined a strategy and management system for implementing the Bank's urban poverty policy. These discussions were with the Regions at Chief Economist and Assistant Director level and equivalent levels in DPS and CPS. Consensus was fairly easily achieved on target population, program size and a criterion for identifying lending which spread urban services to the target group.

2. Some misinterpretations such as whether or not the proposed criteria replace standard project economic analysis and whether urban poverty policies conflict with rural development policies were readily dispelled. However, the criterion for defining lending which creates employment and other income opportunities for the target group produced a lively debate. The ultimate consensus on the capital/labor criterion came from an agreement that direct creation of employment for the poor depended on spreading capital, and that a simple country specific reference point was desirable to direct investments into low capital sectors where such opportunities exist. Then the capital/labor ratio, (because it highlights the critical factor i.e., the relative availability of capital and labor and because it was very similar to suggested alternatives such as the capital/output ratio), was accepted as the most appropriate criterion.

3. We believe a general consensus exists at the working level (a) that the concepts and estimates of the January 6 memo (on definition of target group, criteria to distinguish urban poverty lending and size of the program) are an acceptable starting point, (b) that much work is required to interpret the criteria in circumstances of particular projects, and (c) that we should monitor our experience and be open to change as may be indicated.

AStone:ba

cc: Messrs. van der Tak
Jaycox
Dunkerley
Churchill

Proj Bruce

Project Approval

Mr. Colin Bruce, AGP

January 27, 1977

Alastair Stone, Chief, Operations Review & Support Unit, URB

① UPP
② K/L discussion

Cost Per Beneficiary and Capital Labour Ratios as Criteria for Appraising Projects

1. Mr. Jaycox passed your note to me for comment. The main thrust of the paper - that cost per beneficiary (C/B) and Capital/Labour (K/L) ratios are entirely inadequate as economic or social cost benefit criteria - is one I entirely agree with. Furthermore, I am glad to see your support for the early adoption throughout the Bank and on a consistent basis of modern social cost benefit techniques. But at no point, at least during the development of the urban poverty program criteria, was it suggested that existing or improved appraisal criteria for projects should be changed or superceded by C/B or K/L ratio tests. Indeed, we have been at pains to emphasize that all first order economic criteria must be met in all urban poverty lending and also at pains to encourage the adoption of Little-Merrlees or van der Tak-Squire (LMVS) appraisal techniques as early as possible in the project cycle.

2. As far as urban poverty projects are concerned, these ratios have been proposed as search criteria used to distinguish poverty lending from other projects and to monitor the urban poverty program only. I take it that you would not dispute that some such criteria are needed at least until more sophisticated appraisal techniques are in widespread use in the Bank. Indeed, the very fact that the Bank has explicit poverty programs at all indicates this need: to quote from your paper - "To put it another way, if costs and benefits (including capital and labour) are given their correct social accounting values, taking into account the relative scarcity of capital and savings and relative abundance of labour will be reflected in the net present values of projects"; such procedures would not only eradicate the need for C/B or K/L criteria but also for separate poverty oriented programs. In practice, of course, this is not so and the existence of explicit poverty programs recognizes this as well as the fact that insufficient numbers of projects are presented to the Bank which give adequate weight to the needs of the poor.

3. The question, then, is whether C/B and K/L ratios are useful indicators for identifying potential investments from which identifiable benefits do flow to the target group and whether they successfully highlight to member governments the types of projects which the Bank would include in its poverty programs; and if so, whether they compromise in any way a sound economic and social appraisal of the proposed investments?

4. The C/B criterion as it is used in the urban poverty program (to identify service investments which are to qualify as urban poverty projects and productive investments increasing consumption opportunities for the target group) is not the simple least cost solution you assume and which I imagine you have drawn from the rural counterpart. It states simply that costs should be affordable to the target group and to the economy before such a project can legitimately claim to be a solution to the supply constraints and of the target group and is therefore purely an affordability and replicability criterion. In exactly the same way as the K/L criterion, its force is intended to encourage spreading of available resources and services to the target group. The criteria thus interpreted are intended to force identification and implementation of new and lower cost types of projects, which, for a given cost benefit ratio, spread both costs and benefits over a wide population. To the extent that they are successful, I believe that LMVS appraisal methods would show them to have very high net present values and they are therefore not in conflict either with the methodology itself or the claimed advantages of its use. Indeed it is my belief that we shall find that an attempt by the Bank to find investments which are characterized by low C/Bs and K/Ls will lead to rather higher rates of social return than many of those we have come accustomed to in the Bank.

5. It is the same logic which led us towards an arbitrary cut-off criterion for the K/L ratio. (You will note that there is no such cut-off for the C/B rule: as we have used it it is very similar to your own suggestions in the conclusion to your paper which you allow would have a healthy influence on project design) because although it is of course important to save and spread capital throughout the economy, in all sectors and at all levels of labour intensity, the intent of a single economy-wide measure is to draw attention to economically feasible and justifiable investments or sectors which are most likely to bring identifiable employment and income benefits to the urban poor. And then to do more of them.

6. There are some points of detail to which I would like to draw your attention:

Paragraphs 4 & 6: The urban poverty program criteria have suggested that all fixed costs and working capital should be included with suitable adjustments for the life of the project. Particular details of these calculations should be and are being worked out for different sectors by the responsible sector departments.

Paragraph 5: We have suggested that any identifiable indirect beneficiaries (or workers) and costs should be included in all calculations.

Paragraph 6: Of course it is not "self-evident that all economic development at all times should be equally labour intensive or have K/L ratios below a certain point."

7. I will be happy to discuss any of these points with you.

NLethbridge:bb

cc: Messrs: van der Tak, Ray (PAS); Yudelman (AGP); Hultin (EDP); Rovani (EWT); Fuchs (NDP); Kanagaratnam (PNP); Tolbert (TMP); Willoughby (TRP); Jaycox, Dunkerley, Churchill, Kahnert (URB).

UPP

Mr. W. C. Baum, Vice President Central Projects January 26, 1977

Alastair Stone, Chief, Operations Review and Support Unit

OVP's January 31 Meeting: Agreements to be Confirmed

For your guidance and perhaps Mr. Knapp's as well, I have summarized from Mr. Jaycox's January 6 memo the agreements to be confirmed by the OVP's as follows:

1. Urban poverty target population is the current estimates of the larger of the group with incomes below either the absolute poverty cut off, or the relative poverty cut off, and the present estimates should be updated in the course of routine economic work.

2. Urban poverty lending is distinguished from other lending by criteria for project selection, design, and monitoring as follows:

   (a) lending for the production of goods and services that are affordable by the target population and/or otherwise replicable on a scale sufficient to cover the deficiency being addressed;

   (b) lending for employment creation at a cost per job which is less than

$$\frac{\text{GDI}}{\text{Labor force}} \times 2$$

   multiplied by the discounted stream of employment years created.

3. The size of the urban poverty program Bank wide as a proportion of urban lending should be at least equal to the proportion of the target population in the urban population. This suggests that we should expand the present program to reach 30% of the urban related lending by FY79, and 33% of the urban lending by FY80.

AStone:ba

cc: Messrs. van der Tak
Jaycox
Dunkerley
Churchill

X
Sector General ?

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

File

TO: Messrs. Fuchs, Hultin, Jaycox, Kanagaratnam, Rovani, Tolbert, Willoughby and Yudelman

DATE: January 14, 1977

FROM: Colin Bruce CB

SUBJECT: "Is Cost Per Beneficiary a Legitimate Criterion for Appraising Projects?"

I attach for your consideration and comment by close of business on Wednesday, January 26, a draft paper I have written, which responds to an issue currently under discussion in many parts of the Bank. My first draft was written specifically with agriculture and rural development in mind, but, since the issue is one common to all sectors in varying degrees, I have attempted to broaden it to make it a general issues paper. Clearly, if it is to be a general paper, it will need strengthening with respect to concerns felt by other sectors than agriculture and rural development and examples taken from these sectors, but you may feel that separate papers may be needed for your sector. I have modified my first draft on the basis of a complementary draft paper written by Anandarup Ray and comments received from Regional Assistant Directors of Agriculture and their staffs and some Chief Economists, but I alone am responsible for the attached draft.

Attachment:

cc: Messrs. van der Tak, Ray
AGPER Staff

CBruce:ssp

REDRAFT
CBruce:ssp
January 14, 1977

IS COST PER BENEFICIARY A LEGITIMATE CRITERION FOR APPRAISING PROJECTS?

The Issue

1. A cost per beneficiary issue has arisen recently in connection with the Staff Level Review of the Land Settlement Issues Paper, with a Loan Committee discussion about a Yugoslav irrigation project and a pre-Board meeting on the Sategui-Deressia Irrigation Project in Chad.1/ It was discussed in the Rural Development Policy Paper 2/ and, in the form of a capital/labor ratio, has been under active consideration in the Urban Projects Department. It is an issue which has arisen out of a concern for replicability and the need to generate and conserve public sector savings. While there may be different practical nuances for different sectors, the principles involved apply to all sectors in varying degrees of importance. Criticisms have been levelled at the high investment cost per beneficiary in some projects, and the issue is whether cost per beneficiary (C/B), or alternatively a capital/labor ratio (K/L) is a legitimate criteria (primary or secondary) to use in Bank cost-benefit methodology? If so, how do we judge when the C/B or the K/L ratio is too high? Should the cut-off point be, or the warning bells ring, at the same point for all kinds of projects or be different for different kinds of projects? If different, how do we differentiate? How are costs to be defined and who are the beneficiaries?

Principles

2. In principle, the validity of the C/B and K/L criteria is questionable. Economic theory tells us that marginal social cost per family ought to equal marginal social benefit per family. But marginal social benefits can vary

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1/ See "Cost of Irrigation Agriculture in the Sahel", Memorandum by A. Robert Whyte October 7, 1976.

2/ Rural Development Sector Policy Paper, World Bank, February 1975, p. 8.

considerably between projects--even for similar ones. Hence setting absolute limits to the cost side of the equation makes no sense; to do so is to reduce the analysis to a least-cost solution problem in situations where benefits can be estimated, and this makes no sense. To put it another way, if costs and benefits (including capital and labor) are given their correct social accounting values (shadow prices), taking into account savings scarcities and the maldistribution of income, then the relative scarcity of capital and savings and the relative abundance of labor will be reflected in the net present values of projects. It is wrong, therefore, to single out in a very partial equilibrium way the C/B or the K/L and test them against what can only be arbitrary cut-off points. Modern social cost-benefit methodology, as developed by e.g. Little-Mirrlees [1/] and Squire-van der Tak [2/], enables the value of projects to society to be assessed by estimating a number of social value parameters and conversion factors, in addition to the economic efficiency ones, which can be applied to the costs and benefits valued at market prices. The Bank is in the process of introducing this new but still evolving methodology in so far as economic efficiency prices are concerned. Social accounting values (social value of public income/savings and income distribution weights) are being applied in the appraisal of a number of projects, but on an experimental basis and no decision has yet been taken as to whether to adopt the new methodology in full. The feeling that some Bank projects have too high C/Bs, and K/Ls reflects in part the growing concern for helping the very large numbers of rural and urban poor to raise their productivity and improve their standard of living. When coupled with the need in most developing countries to increase public savings and the

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1/ Project Appraisal and Planning for Developing Countries, I.M.D. Little and J.A. Mirrlees, Heinemann, London 1974 (or Basic Books, Inc., New York, 1974).

2/ Economic Analysis of Projects, Johns Hopkins University Press, Baltimore and London, 1975.

importance of having equitable development policies, the issues being analyzed here, strengthen the arguments in favor of the Bank adopting the new social cost-benefit methodology as soon as possible. However, until this question has been decided, the fact remains that existing Bank appraisal methodology does not take adequate account of the strongly felt concern about too high C/Bs and K/Ls in some projects. It is necessary, therefore, to examine more closely whether and how these very understandable and legitimate concerns might be met within the existing system.

Analysis of C/B and K/L Criteria

3. There are basically two problems in using C/B and K/L criteria in any meaningful way. First, there is the problem in defining and using the terms in a consistent manner; and second, there is the problem of setting the upper limits.

4. (a) Definitions. Taking the C/B first, how do we define the numerator: costs? Do we take just capital costs (as defined by national income statisticians) or do we take recurrent costs as well, or do we take those parts of recurrent costs which are considered developmental and are often financed by the Bank? The answer is not easy and is complicated by the fact that by their very nature some projects have high capital costs and low recurrent costs and *vice versa*.

5. Next, how do we define the denominator: beneficiaries? Do we include only those people and their families participating directly in the production processes of any project? This is the current practice in the Bank, but it is open to serious question since many projects have indirect benefits for non-project participants which may be more important than the benefits for direct production participants. On the basis of C/Bs, how do we compare, say, a seed project, where the seeds are produced by a state farm or a few private farmers, but where thousands if not millions of farmers benefit from improved seeds with,

say, an irrigation project which benefits many farmers directly but where the indirect benefits cannot be estimated easily?

6. The definitional problems with respect to the K/L ratio are less, although there is still a problem of whether to define K strictly in national income accounting terms or to use "development costs" which would add some recurrent costs to strictly capital costs; and defining labor is not as simple as may seem at first sight. For example, how is the labor of women, children and part-time labor to be weighted relative to full-time male labor?

7. (b) Cut-off Criteria. The problem here is that by virtue of the technological processes involved, some kinds of projects are more capital intensive and will have higher cost per direct beneficiary than others, and it is not self evident that all economic development at all times should be equally labor intensive, or have a capital/labor ratios below a certain point. Rural development projects are not always better than textile plants and textile plants are not always better than steel mills. There may be need for all three. No doubt within each kind or category there are technologies--less capital intensive ones--which are more appropriate to the stages of economic development of each developing country, and certainly this is something which needs to be looked at carefully in the context of overall farming/household systems and firms, but there appears to be no theoretical basis for going further than this. To illustrate this, consider on the basis of their respective C/Bs how we can compare two irrigation projects--one where there are considerable sunk costs in the form of a dam and primary and secondary canals and drains and the project consists of on-farm developments with another project where the dam and main canal structures have to be constructed as well. The first is likely to have a much lower C/B, but without taking account of a whole lot of other factors we cannot necessarily conclude that the one with the lower C/B is to be preferred. Other things being equal, projects with lower

C/Bs may be preferable to those with higher C/Bs, but other things seldom are equal--in particular the benefits per beneficiary are not equal--and this brings us back to the need for a more rigorous and systematic methodology, where replicability, savings and income distribution are taken into account along with efficiency and balance of payments considerations, even if the weighting of these various criteria is not done precisely, quantified and summarized in a social rate of return or net present value.

Conclusions

8. Thus we again return to the point that if capital and labor are given their appropriate social accounting (shadow) prices, projects will be selected, designed and appraised which will take account of societies' felt economic and social objectives. To use C/Bs and/or K/Ls as primary or even secondary criteria for appraising projects is not only wrong in principle and likely to give wrong results, but it would necessitate the setting of multiple cut-off ratios within each sector, if complete arbitrariness is to be avoided. Even so, sub-sector ratios would be pretty arbitrary, and account would have to be taken of differing price-cost levels in different countries. Surely, what is important in project preparation and appraisal is a reasoned analysis of all the issues discussed here which are relevant in each country/sector/sub-sector situation. Is there merit, however, in using C/Bs and/or K/Ls as aids in identifying projects in the sense of providing warning signals to see if a more appropriate development system cannot be devised? If there is, then it is recommended that benefits per beneficiary ratios (B/Bs) also be estimated and set alongside the C/Bs, so as to present a more balanced and rational assessment. But the problems still remain of defining benefits and costs and of setting the limits at which warning bells should ring. In situations where benefits can be estimated, it would probably be much better to set approximate limits to target incomes. For example, the

design of land settlement schemes should be such that the target net income per settler family should not exceed the net mean income per family in the rural areas by more than, say, 25 percent.[1/] Such income limitations would have a healthy influence on the design of projects so as to meet replicability and equity criteria.

1/ See "The World Bank and the Settlement of Agricultural Lands", draft Issues Paper.

UPP

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

FEB - 2 REC'D

OFFICE MEMORANDUM

TO: Mr. Vinod Dubey   on mission until Feb 24   DATE: January 13, 1977

FROM: A. David Knox

SUBJECT: Comments on Memorandum by Jaycox on Urban Poverty Implementation

I agree in general with the proposals contained in Mr. Jaycox's memorandum on the urban poverty program. As regards what he has to say on the lending program, it seems to me that his proposals for FY79 and FY80 as stated in para. 18 are quite sensible and indeed possibly even modest. I agree also with his repeated statement that to achieve these objectives will require much new thinking and effort in the DFC, water supply, education and other sectors. In this connection I might just mention two things. The first is that there are few signs of the new emphasis to which Jaycox refers in our current program for FY79, particularly in that for the DFC sector. Secondly, that I have already asked the DFC Division to do some serious thinking on longer term objectives so as to be able to make some constructive proposals for CPP's.

Turning now to the criteria he suggests for defining urban poverty lending, I agree with what he proposes in para. 10 on lending related to the delivery of basic goods and services. On the other hand, I do have some problems with the concepts set out in paras. 11 to 14 on criteria for employment creating lending. The basic criterion, stated in para. 11, for dividing gross domestic investment by the total labor force is peculiar. It divides a flow by a stock and it is difficult to see that it has any economic or social meaning. I have to agree, however, that the illustrations given in para. 12 of what the application of this criterion would produce in terms of maximum acceptable cost per job created suggest that the final result is fairly sensible. Perhaps, therefore, we should conclude that the methodology is peculiar but the final results do not affront common sense and that in consequence the proposals should be accepted but kept under review as the paper suggests.

cc: Messrs. Bart .
Paijmans
El Darwish
Pollan (o/r)

ADKnox/mv

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

UPP

OFFICE MEMORANDUM

TO: Regional Coordinators, Urban Poverty Program

DATE: January 7, 1977

FROM: Alastair J. Stone, Chief, Operations Review and Support Unit

SUBJECT: Urban Poverty Lending

Appended are summaries of Bank and Regional urban poverty lending for 1977-81 by year and by sector for two periods - FY77-81 and FY77-79. These have been compiled to be available to answer detailed questions which may come from the Vice Presidents upon reading Mr. Jaycox's memo of January 6, 1977 titled Urban Poverty Program Implementation - Status Report and Request for Confirmation of Certain Plans.

AJStone:ce
Attachment

Distribution: Messrs. Pouliquen (WAP); Howell (AEP); Bronfman (EAP); Glaessner (LCP); Rajagopalan (ASP); Pollan (EMP)

cc: Messrs. Baum (CPSVP), Van der Tak (AGP)

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LENDING PROGRAM TOTALS 1/

	Total Lending Amounts (U.S. $Mil.)						Equivalent Percentages					
	1977-81	1977	1978	1979	1980 4/	1981 4/	1977-81	1977	1978	1979	1980	1981
WORLD BANK												
URL TOTAL	9183.8	2465.1	2364.3	2129.1	1466.3	760.0	39.7	50.5	45.0	40.2	31.6	24.7
RURAL 2/	2506.2	826.6	674.0	450.9	295.8	259.0	10.8	16.9	12.8	8.5	6.4	8.4
NATIONAL 3/	5805.4	1492.2	1372.2	1003.0	1018.0	920.0	25.1	30.6	26.1	19.9	21.9	29.9
UNIDENTIFIED	5661.0	98.5	848.5	1715.0	1859.0	1140.0	24.4	2.0	16.1	32.4	40.1	37.0
TOTAL WORLD BANK	23156.4	4882.4	5259.0	5297.0	4639.0	3079.0	100.0	100.0	100.0	100.0	100.0	100.0

URBAN POVERTY

	1977-81	1977	1978	1979	1980	1981
UPP(URL) AMOUNT	2360.6	499.1	586.0	495.1	399.1	381.3
UPP(URL) AS % OF URL	25.7	20.2	24.8	23.3	27.2	50.2

Target Population as % of Urban Population = 32%.

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category = included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).
3/ National is defined as lending which will have a national impact, spatially distributed throughout the country.
4/ Total program understated in FY80 and FY81 due to unspecified lending programs in some countries.

1977-1981 LENDING PROGRAM,1/ BY SECTOR

WORLD BANK TOTALS

SECTOR	NO.	LOAN/ CREDIT AMOUNT	LOAN/CREDIT AMOUNT URBAN(%) --URL--	RURAL(%) --RAL--	NATIONAL(%) --SDL--	UNIDENTIFIED(% --UNI--	Urban Poverty UPP(URL) AMOUNT	UPP(URL) AS % OF URL
AGRICULTURE	5(---)	82.0	25	46	29	0	3.8	18.3
TELECOMMUNICATIONS	15(---)	545.0	27	10	37	27	0.0	0.0
DEV FIN COS	93(---)	2869.7	64	2	23	11	261.8	14.2
EDUCATION	86(1)	1613.3	15	22	22	41	74.8	30.9
NON-PROJECT	12(---)	751.5	4	0	83	13	25.2	95.0
INDUSTRY	68(---)	2744.0	40	29	7	24	91.0	8.2
MAINT. IMPORTS	4(---)	400.0	0	0	100	0	0.0	0.0
POPULATION	13(---)	280.0	28	40	29	4	2.3	2.9
POWER	81(---)	4290.2	29	13	16	41	39.7	3.1
TOURISM	16(---)	309.0	60	16	3	21	76.5	41.0
TRANSPORTATION	170(---)	5349.5	17	6	47	31	4.4	0.5
URBANIZATION	53(---)	1601.5	97	1	0	2	1252.5	80.6
WATER SUPPLY	72(---)	2272.5	81	8	1	11	523.7	28.8
UNALLOCATED AMOUNT	2(---)	26.0	0	0	0	100	0.0	0.0
TECHNICAL ASSISTANCE	5(---)	22.2	0	14	86	0	0.0	0.0
WORLD BANK TOTAL	695(1)	23156.4	40	11	25	24	2360.6	25.7

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Non-project or Program Lending.
3/ Industrial Imports loans to India.

LENDING PROGRAM TOTALS 1/

	TOTAL LENDING AMOUNTS(U.S. $MIL.)						EQUIVALENT PERCENTAGES					
	1977-81	1977	1978	1979	1980 4/	1981 4/	1977-81	1977	1978	1979	1980	1981
E. AFRICA												
URL TOTAL	680.6	202.1	123.5	209.0	86.0	60.0	32.2	39.5	35.0	33.1	18.5	39.7
RURAL 2/	126.7	25.2	79.5	22.0	0.0	0.0	6.0	4.9	22.6	3.5	0.0	0.0
NATIONAL 3/	681.3	274.8	124.5	151.0	121.0	10.0	32.3	53.7	35.3	23.9	26.0	6.6
UNIDENTIFIED	623.0	10.0	25.0	249.0	258.0	81.0	29.5	2.0	7.1	39.5	55.5	53.6
TOTAL E. AFRICA	2111.5	512.0	352.5	631.0	465.0	151.0	100.0	100.0	100.0	100.0	100.0	100.0

URBAN POVERTY

	1977-81	1977	1978	1979	1980	1981
UPP(URL) AMOUNT	113.8	43.9	15.3	38.0	13.1	3.6
UPP(URL) AS % OF URL	16.7	21.7	12.4	18.2	15.2	6.0

Target population as % of Urban Population = 26%.

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category = included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).
3/ National is defined as lending which will have a national impact, spatially distributed throughout the country.
4/ Total program understated in FY80 and FY81 due to unspecified lending programs in some countries.

1977-1981 LENDING PROGRAM 1/ BY SECTOR

REGION: E. AFRICA

SECTOR	NO.	LOAN/ CREDIT AMOUNT	LOAN/CREDIT AMOUNT URBAN(%) --URL--	RURAL(%) --RAL--	NATIONAL(%) ----SDL----	UNIDENTIFIED(%) ------UNI------	Urban Poverty UPP(URL) AMOUNT	UPP(URL) AS % OF URL
AGRICULTURE	2(--)	32.0	25	0	75	0	0.0	0.0
TELECOMMUNICATIONS	3(--)	115.0	0	0	70	30	0.0	0.0
DEV FIN COS	18(--)	196.5	51	0	29	20	12.4	12.3
EDUCATION	22(--)	315.5	7	17	22	55	2.2	10.2
NON-PROJECT 2/	3(--)	80.0	0	0	100	0	0.0	0.0
INDUSTRY	7(--)	188.0	44	0	0	56	0.0	0.0
POPULATION	1(--)	20.0	0	0	100	0	0.0	0.0
POWER	9(--)	235.0	59	0	36	4	3.3	2.3
TOURISM	3(--)	62.0	0	68	0	32	0.0	0.0
TRANSPORTATION	32(--)	622.0	20	2	40	39	0.0	0.0
URBANIZATION	6(--)	92.0	100	0	0	0	3.9	3.1
WATER SUPPLY	10(--)	151.5	73	15	13	0	76.4	83.0
TECHNICAL ASSISTANCE	1(--)	2.0	0	0	100	0	15.8	14.3
							0.0	0.0
TOTAL E. AFRICA	117(---)	2111.5	32	6	32	30	113.8	16.7

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category = included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects.)

LENDING PROGRAM TOTALS 1/

	TOTAL LENDING AMOUNTS(U.S. $MIL.)						: EQUIVALENT PERCENTAGES					
	1977-81	1977	1978	1979	1980 4/	1981 4/	1977-81	1977	1978	1979	1980	1981
W. AFRICA												
GENERAL URBAN	99.1	12.4	21.7	30.0	10.0	25.0	6.3	4.0	8.4	9.6	3.3	6.5
CITIES	297.6	115.0	80.6	67.0	20.0	15.0	19.0	37.1	31.4	21.5	6.7	3.9
TOWNS	97.6	36.4	6.2	10.0	25.0	20.0	6.2	11.7	2.4	3.2	8.4	5.2
URL TOTAL	494.3	163.8	108.5	107.0	55.0	60.0	31.6	52.8	42.2	34.4	18.4	15.6
RURAL 2/	108.6	38.0	35.6	10.0	15.0	10.0	7.0	12.2	13.9	3.2	5.0	2.6
NATIONAL 3/	516.0	100.1	47.9	103.0	45.0	220.0	33.0	32.2	18.6	33.1	15.1	57.1
UNIDENTIFIED	443.5	8.5	65.0	91.0	184.0	95.0	28.4	2.7	25.3	29.3	61.5	24.7
TOTAL W. AFRICA	1562.4	310.4	257.0	311.0	299.0	385.0	100.0	100.0	100.0	100.0	100.0	100.0

URBAN POVERTY

	1977-81	1977	1978	1979	1980	1981
UPP(URL) AMOUNT	156.4	26.7	44.6	24.3	41.0	19.8
UPP(URL) AS % OF URL	31.6	16.3	41.1	22.7	74.5	32.9

Target Population as % of Urban Population = 29%.

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category = included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).
3/ National is defined as lending which will have a national impact, spatially distributed throughout the country.
4/ Total programs understated in FY80 and FY81 due to unspecified lending programs in some countries.

1977-1981 LENDING PROGRAM[1/] BY SECTOR

REGION: W. AFRICA

SECTOR	NO.	LOAN/ CREDIT AMOUNT	LOAN/CREDIT AMOUNT: URBAN(%) --URL--	RURAL(%) --RAL--	NATIONAL(%) --SDL--	UNIDENTIFIED(%) --UNI--	Urban Poverty: UPP(URL) AMOUNT	UPP(URL) AS % OF URL
TELECOMMUNICATIONS	3(--)	45.0	67	11	0	22	0.0	0.0
DEV FIN COS	12(--)	109.2	36	0	41	23	10.7	27.3
EDUCATION	14(1)	150.3	12	13	17	59	9.0	50.6
INDUSTRY	6(--)	207.0	11	0	87	2	11.8	53.6
POPULATION	1(--)	5.0	0	0	100	0	0.0	0.0
POWER	7(--)	160.2	29	0	37	34	2.0	4.3
TOURISM	2(--)	23.0	51	0	6	43	0.0	0.0
TRANSPORTATION	44(--)	629.5	19	13	31	37	0.0	0.0
URBANIZATION	8(--)	145.0	100	0	0	0	98.3	67.8
WATER SUPPLY	7(--)	78.0	79	2	0	19	24.6	40.1
TECHNICAL ASSISTANCE	3(--)	10.2	0	29	71	0	0.0	0.0
TOTAL W. AFRICA	107(1)	1562.4	32	7	33	28	156.4	31.6

1/ Agriculture excluded except for five projects which impact urban areas.

LENDING PROGRAM TOTALS[1/]

	TOTAL LENDING AMOUNTS(U.S. $MIL.)						EQUIVALENT PERCENTAGES					
	1977-81	1977	1978	1979	1980 [4/]	1981 [4/]	1977-81	1977	1978	1979	1980	1981
E.M.E.N.A.												
URL TOTAL	1981.4	680.6	462.0	514.8	240.0	84.0	43.7	51.5	43.3	41.2	38.4	30.7
RURAL [2/]	388.1	200.4	61.5	57.3	19.0	50.0	8.6	15.2	5.8	4.6	3.0	18.2
NATIONAL [3/]	852.0	361.0	185.0	176.0	100.0	30.0	18.8	27.3	17.3	14.1	16.0	10.9
UNIDENTIFIED	1314.5	80.0	358.5	500.0	266.0	110.0	29.0	6.1	33.6	40.1	42.6	40.1
TOTAL E.M.E.N.A.	4536.0	1322.0	1067.0	1248.0	625.0	274.0	100.0	100.0	100.0	100.0	100.0	100.0

URBAN POVERTY

UPP(URL) AMOUNT	290.2	73.0	86.2	64.6	62.0	4.5
UPP(URL) AS % OF URL	14.6	10.7	18.6	12.6	25.8	5.4

Target Population as % of Urban Population = 16%.

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category - included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).
3/ National is defined as lending which will have a national impact, spatially distributed throughout the country.
4/ Total program understated in FY80 and FY81 due to unspecified lending programs in some countries.

1977-81 LENDING PROGRAM 1/ BY SECTOR

REGION: E.M.E.N.A.

SECTOR	NO.	LOAN/ CREDIT AMOUNT	LOAN/CREDIT AMOUNT: URBAN(%) --URL--	RURAL(%) --RAL--	NATIONAL(%) ----SDL----	UNIDENTIFIED(%) ------UNI------	Urban Poverty: UPP(URL) AMOUNT	UPP(URL) AS % OF URL
AGRICULTURE	3(--)	50.0	25	75	0	0	3.8	30.0
TELECOMMUNICATIONS	2(--)	75.0	0	0	0	100	0.0	0.0
DEV FIN COS	13(--)	488.0	84	0	15	1	51.3	12.5
EDUCATION 2/	18(--)	435.5	13	7	13	68	18.0	33.0
NON-PROJECT	1(--)	70.0	0	0	100	0	0.0	0.0
INDUSTRY	21(--)	749.0	63	9	0	28	30.0	6.4
POPULATION	2(--)	35.0	71	0	0	29	1.3	5.0
POWER	17(--)	626.0	2	15	54	30	0.0	0.0
TOURISM	4(--)	57.0	70	12	0	18	0.0	0.0
TRANSPORTATION	27(--)	941.0	23	3	34	39	0.0	0.0
URBANIZATION	9(--)	279.0	89	0	0	11	103.8	41.7
WATER SUPPLY	20(--)	704.5	69	17	0	14	82.1	16.9
UNALLOCATED AMOUNT	2(--)	26.0	0	0	0	100	0.0	0.0
TOTAL E.M.E.N.A.	139(---)	4536.0	44	9	19	29	290.2	14.6

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category = included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects.)

LENDING PROGRAM TOTALS 1/

	TOTAL LENDING AMOUNTS (U.S. $MIL.)						EQUIVALENT PERCENTAGES					
	1977-81	1977	1978	1979	1980 4/	1981 4/	1977-81	1977	1978	1979	1980	1981
L.A.C.												
URL TOTAL	3223.9	602.4	902.6	760.6	650.3	308.0	50.0	45.9	64.1	50.8	43.1	43.0
RURAL 2/	1103.5	461.3	160.1	258.4	171.8	52.0	17.1	35.2	11.4	17.3	11.4	7.3
NATIONAL 3/	983.1	248.3	259.8	98.0	362.0	15.0	15.3	18.9	18.5	6.5	24.0	2.1
UNIDENTIFIED	1132.0	0.0	85.0	380.0	325.0	342.0	17.6	0.0	6.0	25.4	21.5	47.7
TOTAL L.A.C.	6442.5	1312.0	1407.5	1497.0	1509.0	717.0	100.0	100.0	100.0	100.0	100.0	100.0

URBAN POVERTY

Target Population as % of Urban Population = 25%.

	1977-81	1977	1978	1979	1980	1981
UPP(URL) AMOUNT	1092.5	174.9	316.2	190.2	214.9	196.4
UPP(URL) AS % OF URL	33.9	29.0	35.0	25.0	33.0	63.8

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category = included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).
3/ National is defined as lending which will have a national impact, spatially distributed throughout the country.
4/ Total program understated in FY80 and FY81 due to unspecified lending programs in some countries.

1977-1981 LENDING PROGRAM 1/ BY SECTOR

REGION: L.A.C.

SECTOR	NO.	LOAN/ CREDIT AMOUNT	LOAN/CREDIT AMOUNT URBAN(%) --URL--	RURAL(%) --RAL--	NATIONAL(%) ----SDL----	UNIDENTIFIED(%) ------UNI------	Urban Poverty UPP(URL) AMOUNT	UPP(URL) AS % OF URL
TELECOMMUNICATIONS	3(--)	100.0	75	0	0	25	0.0	0.0
DEV FIN COS	24(--)	861.0	73	5	12	10	126.5	20.1
EDUCATION	19(--)	340.5	29	54	8	9	40.3	40.8
NON-PROJECT 2/	3(--)	226.5	12	0	44	44	25.2	95.0
INDUSTRY	15(--)	930.0	34	55	2	9	12.5	3.9
POPULATION	3(--)	60.0	69	31	0	0	0.0	0.0
POWER	24(--)	1284.0	52	13	11	24	34.4	5.2
TOURISM	5(--)	127.0	75	0	6	20	75.0	78.9
TRANSPORTATION	30(--)	1298.0	14	11	45	30	0.0	0.0
URBANIZATION	15(--)	492.0	96	4	0	0	463.0	97.6
WATER SUPPLY	19(--)	723.5	86	2	0	12	315.7	50.9
TOTAL L.A.C.	160(---)	6442.5	50	17	15	18	1092.5	33.9

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category - included here are other than agricultural projects as parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).

LENDING PROGRAM TOTALS 1/

	TOTAL LENDING AMOUNTS(U.S. $MIL.)						: EQUIVALENT PERCENTAGES					
	1977-81	1977	1978	1979	1980 4/	1981 4/	1977-81	1977	1978	1979	1980	1981
E.ASIA,PCFC												
URL TOTAL	1563.5	447.3	451.2	265.0	300.0	100.0	38.3	62.1	34.7	41.4	27.8	29.0
RURAL 2/	273.5	39.7	163.8	0.0	60.0	10.0	6.7	5.5	12.6	0.0	5.6	2.9
NATIONAL 3/	1208.0	233.0	460.0	200.0	215.0	100.0	29.6	32.4	35.4	31.3	19.9	29.0
UNIDENTIFIED	1040.0	0.0	225.0	175.0	505.0	135.0	25.5	0.0	17.3	27.3	46.8	39.1
TOTAL E.ASIA,PCFC	4085.0	720.0	1300.0	640.0	1080.0	345.0	100.0	100.0	100.0	100.0	100.0	100.0

URBAN POVERTY

	1977-81	1977	1978	1979	1980	1981
UPP AMOUNT	401.8	84.1	97.7	101.0	57.0	62.0
UPP(URL) AMOUNT	382.6	82.9	92.2	101.0	44.5	62.0
UPP(URL) AS % OF URL	24.5	18.5	20.4	38.1	14.8	62.0

Target Population as % of Urban Population = 29%.

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category - included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).
3/ National is defined as lending which will have a national impact, spatially distributed throughout the country.
4/ Total programs understated in FY80 and FY81 due to unspecified lending programs in some countries.

1977-1981 LENDING PROGRAM[1/] BY SECTOR

REGION: E.ASIA,PCFC

SECTOR	NO.	LOAN/ CREDIT AMOUNT	LOAN/CREDIT AMOUNT URBAN(%) --URL--	RURAL(%) --RAL--	NATIONAL(%) ----SDL----	UNIDENTIFIED(%) ------UNI------	Urban Poverty UPP(URL) AMOUNT	UPP(URL) AS % OF URL
TELECOMMUNICATIONS	1(--)	40.0	0	0	100	0	0.0	0.0
DEV FIN COS	13(--)	660.0	79	0	11	10	61.0	11.7
EDUCATION	10(--)	296.5	16	7	62	15	5.4	11.2
INDUSTRY	8(--)	225.0	42	44	0	13	36.0	37.9
POPULATION	4(--)	65.0	0	35	65	0	0.0	0.0
POWER	15(--)	850.0	13	8	9	69	0.0	0.0
TOURISM	1(--)	30.0	100	0	0	0	1.5	5.0
TRANSPORTATION	24(--)	1316.0	17	4	59	21	0.5	0.2
URBANIZATION	7(--)	254.5	100	0	0	0	206.9	81.3
WATER SUPPLY	9(--)	328.0	87	1	0	12	71.4	25.1
TOTAL E.ASIA,PCFC	92(---)	4085.0	38	7	30	25	382.6	24.5

1/ Agriculture excluded except for five projects which impact urban areas.

LENDING PROGRAM TOTALS 1/

	TOTAL LENDING AMOUNTS(U.S. $MIL.)						: EQUIVALENT PERCENTAGES					
	1977-81	1977	1978	1979	1980 4/	1981 4/	1977-81	1977	1978	1979	1980	198'
SOUTH ASIA												
URL TOTAL	1240.2	368.9	316.5	271.8	135.0	148.0	28.1	52.3	36.2	28.0	20.4	12.3
RURAL 2/	505.9	62.1	173.5	103.3	30.0	137.0	11.4	8.8	19.8	10.6	4.5	11.4
NATIONAL 3/	1565.0	275.0	295.0	275.0	175.0	545.0	35.4	39.0	33.7	28.4	26.5	45.2
UNIDENTIFIED	1108.0	0.0	90.0	320.0	321.0	377.0	25.1	0.0	10.3	33.0	48.6	31.2
TOTAL SOUTH ASIA	4419.0	706.0	875.0	970.0	661.0	1207.0	100.0	100.0	100.0	100.0	100.0	100.0

URBAN POVERTY

	1977-81	1977	1978	1979	1980	1981
UPP(URL) AMOUNT	325.0	97.8	31.5	77.0	23.8	95.0
UPP(URL) AS % OF URL	26.2	26.5	10.0	28.3	17.6	64.2

Target Population as % of Urban Population = 51%

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category - included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).
3/ National is defined as lending which will have a national impact, spatially distributed throughout the country.
4/ Total program understated in FY80 and FY81 due to unspecified lending programs in some countries.

1977-1981 LENDING PROGRAM 1/ BY SECTOR

REGION: SOUTH ASIA

SECTOR	NO.	LOAN/ CREDIT AMOUNT	LOAN/CREDIT AMOUNT URBAN(%) --URL--	RURAL(%) --RAL--	NATIONAL(%) --SDL--	UNIDENTIFIED(%) --UNI--	Urban Poverty UPP(URL) AMOUNT	UPP(URL) AS % OF URL
TELECOMMUNICATIONS	3(--)	170.0	25	28	47	0	0.0	0.0
DEV FIN COS	13(--)	555.0	25	1	58	16	0.0	0.0
EDUCATION 2/	3(--)	75.0	3	57	0	40	0.0	0.0
NON-PROJECT 2/	5(--)	375.0	0	0	100	0	0.0	0.0
INDUSTRY	11(--)	445.0	26	24	2	48	0.8	0.7
MAINT. IMPORTS 3/	4(--)	400.0	0	0	100	0	0.0	0.0
POPULATION	2(--)	75.0	16	84	0	0	1.0	8.3
POWER	9(--)	1135.0	26	19	0	56	0.0	0.0
TOURISM	1(--)	10.0	100	0	0	0	0.0	0.0
TRANSPORTATION	13(--)	543.0	3	2	68	26	0.0	0.0
URBANIZATION	8(--)	339.0	100	0	0	0	304.2	89.7
WATER SUPPLY	7(--)	287.0	95	5	0	0	19.1	7.0
TECHNICAL ASSISTANCE	1(--)	10.0	0	0	100	0	0.0	0.0
TOTAL SOUTH ASIA	80(---)	4419.0	28	11	35	25	325.0	26.2

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Rural as a locational category = included here are other than agricultural projects or parts thereof which are impacting rural areas (e.g., rural education, rural electrification projects).
3/ National is defined as lending which will have a national impact, spatially distributed throughout the country.

FORM NO. 89
(2.66)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL FINANCE CORPORATION

ROUTING SLIP	Date 1/10/77
OFFICE OF THE PRESIDENT	
Name	Room No.
Mr. Jaycox	

	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
	Information		Signature
	Initial		Send On

Remarks

Mr. Jayc ox:

I have not xeroxed this entire memorandum, assuming you have it. I have sent a separate copy of Mr. McNamara's note to Mr. Baum.

B

From

B. M. Moore X2001

ONAL BANK FOR
N AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

VPP
Gen

1/8 To Messrs Baum
Jaycox

MORANDUM

. Chaufournier, DATE: January 6, 1977
ns
ı Poverty

on - Status
ı of Certain Plans

Excellent memo.
But when Baum returns please
explain to me the ... the

andum is to bring you up to date on the
n and to seek your confirmation of certain
e working level on how we should proceed.

operating departments, in cooperation
nd Support Unit, have just completed the
e "urban poverty" content of the FY77-81
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fort to realize this potential. As the
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ts to the target population, rising from
bout 27% in FY80 and then jumping to
y undefined elements in FY81. These
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ervices, slum upgrading) as compared with
tle active intervention in other sectors to
o that it reflects our concern for the

g will require difficult case-by-case
in all sectors, and new style country
o country-specific strategies. That work
n I anticipated, and is certainly the area
where the Urban Poverty Task Group, and all concerned with implementing the program have now to focus attention. What we have accomplished to date, I regard as perhaps the easier and less important of the tasks before us, i.e., (a) establishing working definitions of the target population, (b) setting working criteria to distinguish urban poverty lending from other justified urban lending, and (c) getting a functional information system to help us set program targets and monitor our achievements. These tasks are necessary, preliminary tasks for launching any kind of program and seeing it through. These targets and definitions as arbitrary and contentious as they may be are essential management tools, without which it would be impossible for any manager in the Bank to assess the level of effort that is appropriate or the results being achieved. While these targets and definitions are important, we should also recognize that once we have established them, we have yet to put any substance into the program

implications of using the "Output/Urban ratio" as the measure of urban poverty lending.

RMcN

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

OFFICE MEMORANDUM

TO: Messrs. Knapp, Baum, Bell, Benjenk, Chaufournier, Krieger, Stern and Wappenhans

DATE: January 6, 1977

FROM: Edward V.K. Jaycox, Chairman, Urban Poverty Task Group

SUBJECT: Urban Poverty Program Implementation - Status Report and Request for Confirmation of Certain Plans

INTRODUCTION

1. The purpose of this memorandum is to bring you up to date on the status of the urban poverty program and to seek your confirmation of certain tentative agreements reached at the working level on how we should proceed.

2. The regional and central operating departments, in cooperation with the Urban Operations Review and Support Unit, have just completed the first comprehensive analysis of the "urban poverty" content of the FY77-81 lending program. This analysis, though it contains a few anomalies and raises a few questions that must be sorted out, indicates considerable potential for development of the urban poverty program. It shows, however, that it will take a substantial effort to realize this potential. As the program now stands, about 25% of all urban-related lending in dollar terms is expected to yield direct benefits to the target population, rising from about 20% in the current year to about 27% in FY80 and then jumping to implausibly higher levels with very undefined elements in FY81. These latter years need to be discounted. The first years, in my opinion, reflect pretty much business as usual, with the exception of a big increase in basic urbanization projects (sites and services, slum upgrading) as compared with the past. There has been very little active intervention in other sectors to affect the urban lending program so that it reflects our concern for the lower income groups.

3. To get this program moving will require difficult case-by-case work on project design and content in all sectors, and new style country economic and sector work to develop country-specific strategies. That work is proceeding much more slowly than I anticipated, and is certainly the area where the Urban Poverty Task Group, and all concerned with implementing the program have now to focus attention. What we have accomplished to date, I regard as perhaps the easier and less important of the tasks before us, i.e., (a) establishing working definitions of the target population, (b) setting working criteria to distinguish urban poverty lending from other justified urban lending, and (c) getting a functional information system to help us set program targets and monitor our achievements. These tasks are necessary, preliminary tasks for launching any kind of program and seeing it through. These targets and definitions as arbitrary and contentious as they may be are essential management tools, without which it would be impossible for any manager in the Bank to assess the level of effort that is appropriate or the results being achieved. While these targets and definitions are important, we should also recognize that once we have established them, we have yet to put any substance into the program

itself. I believe we have spent more than enough time on these preliminary tasks. Therefore, I am seeking your confirmation of the tentative agreements reached on these points so that program implementation can move ahead to a more productive phase.

TARGET POPULATION

4. It has been agreed that the target population should be defined by the level of their personal incomes. Instead of using world-wide averages, or even regional averages, we have tried to define income thresholds that are country-specific and adjusted for urban costs of living. We are continuing to use the concepts of "absolute poverty" and "relative poverty" that have become familiar throughout the Bank in the rural development effort. People in absolute poverty are defined as those with incomes below that necessary to obtain a minimum caloric intake in their diets. People in relative poverty are those with purchasing power less than one-third the national average. The target population consists of the more inclusive of the two groups in any country.

5. Every country in the Bank's lending program now has an estimated personal income figure which sets the ceiling income for those in the target population. These estimates are in many cases based on very crude data but they have been arrived at after extensive discussion with the Regions, and reflect Regional staff judgements.

6. Using the agreed income cut-offs and applying often very rough income distribution estimates, we have derived the following distributions of the target population within the urban population of each Region.

	Eastern Africa	Western Africa	EMENA	LAC	EAP	South Asia	Total
Proportion of Target Population in Total Urban Population (%)	26	29	16	25	29	51	32

7. The income cut-off estimates and the "map" of urban poverty that results will be quite useful as a working tool in implementing the program. Country economists have the worksheets and assumptions on which these estimates are based and have generally agreed to up-date the data as opportunities occur in country, sector, and project economic work. As new data is received, new estimates will be made and revised series issued periodically.

8. I request your confirmation that we can proceed to use the agreed income cut-off estimates for project design and programming purposes, and that, in the course of routine operations, some priority can be given to upgrading (and encouraging our borrowers to upgrade) the data base.

CRITERIA TO DISTINGUISH URBAN POVERTY LENDING

9. Agreement has been reached on a number of fundamental points in the lively discussion of this subject that has taken place with DPS and Regional economic and operational staff. First, some confusion has been cleared up and complete agreement has been reached that urban poverty lending must meet all existing criteria by which Bank lending is justified. The criteria that are proposed to distinguish urban poverty lending from other justified lending are in no way substitutes for existing appraisal criteria. Second, we have agreed that the objective of the program is to increase the income and the consumption of the target population, since low income and low consumption of the basics for a productive life are the key descriptors of poverty. This objective will be approached in two ways: by reducing the cost of, or otherwise increasing access to, basic goods and services; and by increasing income-earning opportunities and capacity. There is wide agreement that a key part of both of these approaches is the spreading of available resources to increase the productivity of or serve the mass of the people--i.e., to include the target population among those having access to these resources and services at some basic level. Some crude examples: In education projects, it means that instead of concentrating the education dollar on getting relatively few people through the higher levels of education, countries spread enough of it over the mass to achieve basic literacy. In water projects, instead of bringing a few to a very high, "western" level of amenity, it means first (or also) ensuring that the mass have access to the minimum required to avoid cholera and other debilitating disease. In manufacturing, it means that instead of concentrating available capital over a very small proportion of the labor force and achieving high rates of productivity (and perhaps income) for the few, countries spread capital more evenly over the labor force in labor-intensive operations so that more of the people achieve some reasonable level of individual productivity and income. This spreading idea has been central, if implicit, in our rural development effort, i.e., spreading resources to include the small farmer in the rural as opposed to urban areas. In the urban poverty program we are now concerned with spreading resources within the urban areas to include the poor as well as the better-off elements of society.

10. In the case of lending for the delivery of basic goods and services we have agreed that such lending constitutes "poverty lending" to the extent that, in addition to meeting all existing criteria for Bank lending, it delivers direct 1/ benefits to the target population, that are affordable by that population and/or otherwise financially, administratively and technically replicable on a scale that is significant in relation to the size of the deficiency being addressed. The resource spreading idea is implicit in the affordability/replicability criterion; affordability by the target population implies very low costs and low standards, i.e., more people served at a basic level per dollar expended/invested.

1/ And indirect if they can be quantified.

11. In the case of projects in manufacturing, tourism, service enterprise, and other sectors which can produce employment for the target population, many alternative criteria to distinguish poverty lending from other justified operations have been discussed and debated. The basic idea is to have an indicator of what constitutes adequate capital spreading given the availability of capital and the number of people to be productively employed in a specific economy. Some reluctant agreement has been reached to count as "poverty lending" projects or sub-projects where the capital/labor ratio is below a country-specific threshold. This threshold ratio would be expressed as a capital cost per man-year of employment indicator derived by dividing gross domestic investment by the total labor force. Lending which would constitute "poverty lending" would consist of projects or identifiable components, which, in addition to meeting all existing criteria for Bank lending, have capital/labor ratios less than twice the national indicator. The arbitrary doubling of the indicator is merely to account for the Bank's limited capacity to lend effectively at very low levels of capital intensity.

12. This formulation would work in the following way: a project or sub-project would be considered as meeting poverty lending criteria when the capital cost of the project divided by the number of man-years of employment created by the investment (with both costs and man-years discounted over time by the opportunity cost of capital) does not exceed the threshold capital/labor ratio. For examples we have roughly estimated for a few representative countries, the threshold capital/labor ratio, and the implied ceiling capital cost per work place with a ten-year and a fifteen-year life, using a 10% discount rate.

	$\left(\frac{\text{GDI}}{\text{Labor Force}}\right) \times 2$ (US$)	Maximum Cost Per 10 Consecutive Man-Years of Employment (US$)	Maximum Cost Per 15 Consecutive Man-Years of Employment (US$)
Kenya	190	1,100	1,400
Sierra Leone	170	1,000	1,300
Turkey	940	5,800	7,100
Brazil	1,300	8,000	9,900
Indonesia	300	1,800	2,300
India	120	700	900

Notes: (1) All figures adjusted to 1975 prices.
(2) GDI estimated by smoothing over 3-5 years.
(3) Man-years of employmemt discounted at 10% p.a.

13. The results reasonably reflect the relative availability of capital and labor in the various countries. They realistically present relatively easy operational targets in richer countries and quite difficult ones in the poorest countries. Overall, they are far below the average capital/labor ratios of what the Bank is now financing in virtually every country. They are, however, significantly higher than what these countries can afford on average, given the arbitrary doubling for our own operational needs, and also the need for capital deepening and investment in final goods, which in practice reduce the amount of GDI available for employment of the growth of the labor force and the under-employed. Any modifications to the arbitrary doubling of the national indicator, or refinement of the formulation on the basis of good country economic reasons is welcomed and can be readily agreed. I would be especially interested in seeing more challenging thresholds for the higher income countries.

14. You will note that the threshold capital/labor ratio is derived on an economy-wide basis rather than for individual sectors. Generating the latter becomes very complicated and cannot be done with the data common to all of our country economic reports. More importantly, however, is that while sector-specific ratios might encourage capital saving in all sectors, this is really business as usual. The need for capital saving is already embedded in our existing appraisal criteria. The economy-wide ratio encourages the movement of the Bank toward the support of new sectors and sub-sectors where the bulk of the target population is and is likely to be employed, e.g., the small-scale sector, the service sector, and the informal sector. This movement is at the center of the urban poverty program, as I see it, and developing the modus operandi and intermediaries necessary for this is, to my mind, the main operational task we face.

15. I request your confirmation that we may proceed to use these distinguishing characteristics of urban poverty lending (basic service delivery and employment creating) for the purpose of influencing project sector and design and for monitoring our performance. After all the internal debate on the capital/labor ratio, I recognize only too well the problematical aspects of using it even for these limited purposes; our experience with its use will be properly monitored and will be reviewed at an appropriate future date.

PROGRAMMING URBAN POVERTY LENDING

16. In the deliberations of the Urban Poverty Task Group, we and the Regional staff have reached general agreement on what would be a reasonable size of the urban poverty program. First, it is agreed that the urban poverty program should not compete for Bank resources with the rural development effort. Therefore, the program should be scaled as a proportion of urban-related lending, i.e., lending that will directly impact upon or benefit urban population. In the current five-year lending program, directly urban-related lending amounts to 30-35% of total Bank lending. The urban

poverty program would be a part of that 30-35%. Secondly, we have agreed that the proportion of urban-related lending that should be "poverty lending" should by FY80 amount to at least the proportion of the target population in the total urban population. Overall, amongst our borrowers, this proportion is estimated at about 30-35% with wide variations amongst Regions. Thirdly, we have agreed that the target for urban poverty lending should not and cannot be used in a rigid manner that would overly constrain programming at the country or even the Regional level. The target should affect programming at all levels, but should be held up as a Bank-wide target, allowing the kind of flexibility at country and Regional levels that is necessary. The agreed program target then is that by FY80, at least one-third of all urban-related lending by the Bank Group as a whole will yield direct benefits to the target population. In practice, as the program now stands, we are talking about 10-12% of total Bank lending. I request your confirmation of these agreements.

17. On the basis of the above understandings, each Region has estimated the amount of lending and identified the projects that will contribute to the urban poverty program in the FY77-81 period. The program for FYs 77, 78 and 79 is fairly concrete; the latter years are only very roughly indicative, and in the discussion that follows FYs 80 and 81 have been left out of the analysis. The results can be summarized as follows: first by year, second by region, and third by sector.

FY77-81 Non-Agricultural Lending Program 2/ by Year
(US$M)

	1977	1978	1979	1977-79	1980 4/	1981 4/	1977-81 4/
Total Non-Agricultural 1/	4,882	5,259	5,297	15,438	4,639	3,079	23,156
Rural 2/	827	674	451	1,951	296	259	2,506
Locationally Unspecific 3/	1,492	1,372	1,003	3,867	1,018	920	5,805
Unidentified Projects	98	848	1,715	2,662	1,859	1,140	5,661
Urban Related	2,465	2,364	2,128	6,957	1,466	760	9,184
Urban Poverty	499	586	495	1,580	399	381	2,360
Urban Poverty as % of Urban Related	20%	25%	23%	23%	27%	50%	25%
Urban Poverty as % of Total Non-Agricultural	10%	11%	9%	10%	9%	12%	10%

1/ Agriculture excluded except for five projects which impact urban areas.
2/ Non-agricultural lending located outside cities.
3/ Non-agricultural lending of national character with no specific identified locations.
4/ Total program understated in FY80 and FY81 due to unspecified lending programs in some countries.

January 6, 1977

FY 77-79 Non-Agricultural Lending Program[1/] by Region
(US$m)

	East Africa	West Africa	EMENA	LAC	EAP	South Asia	Bank
Total Non-Agricultural[1/]	1,496	878	3,637	4,216	2,660	2,551	15,438
Rural[2/]	127	83	319	880	203	339	1,951
Locationally Unspecific[3/]	550	251	722	606	893	845	3,867
Unidentified Projects	284	165	938	465	400	410	2,662
Urban Related	535	379	1,657	2,266	1,163	957	6,957
Urban Poverty	97	96	224	681	276	206	1,580
Urban Poverty as % of Urban Related	18%	25%	13%	30%	24%	21%	23%
Target Population as % of Urban Population	26%	29%	16%	25%	29%	51%	32%
Urban Poverty as % of Total Non-Agricultural	6%	11%	6%	16%	10%	8%	10%

1/ Agriculture excluded except for five projects which impact urban areas.

2/ Non-agricultural lending located outside cities.

3/ Non-agricultural lending of national character with no specific identified locations.

FY77-79 Non-Agricultural Lending Program[1/] by Sector

Sector	No. of Projects	Loan/Credit Amount (US$m)	Urban Related (US$m)	Urban Poverty (US$m)	Urban Poverty as % of Urban Related	Urban Poverty as % of Non-Agricultural Total
DFC/IDF	64	1,917	1,417	183	13	10
Education	55	1,017	203	56	27	5
Industry	43	1,801	900	40	4	2
Population	9	215	76	2	3	1
Power	58	2,926	1,082	20	2	1
Tourism	11	214	147	75	51	35
Transportation	113	3,530	670	4	1	0
Urbanization	39	1,045	990	769	77	74
Water Supply	50	1,502	1,290	403	31	27
Other[2/]	32	1,271	182	28	15	2
Total	474	15,438	6,957	1,580	23	10

1/ Agriculture excluded except for five projects which impact urban areas.

2/ Includes, inter alia lending for technical assistance telecommunications, program lending, and the 5 agriculture sector projects mentioned in 1/ above.

18. The overall size of the urban poverty program is probably as large as can be expected for FY77 and even for FY78. For these years, the program is now quite fixed and reflects pretty much business as usual, with the exception of some marginal changes in project concepts and a very substantial increase in sites and services and squatter settlement upgrading projects. During these first years we should be developing good design criteria and some proto-typical projects in each sector, but I do not think we could expect to have a much larger program than that indicated for FYs77 and 78. The real potential for the program is in FY79 and beyond. In 1979 I believe we should aim to reach 30% of urban-related lending--about $700-750 million in 1976 dollars or roughly 14% of total non-agricultural lending. In 1980 we should aim for at least 33% of urban-related lending or about 17% of total non-agricultural lending. Although the size of the FY80 total program is not known at this point, we are probably talking here about at least $1 billion (1976 dollars) in urban poverty lending by 1980. To get this volume of lending consistent with the poverty lending criteria by 1980 will require substantial effort.

19. What is a reasonable program for each of the individual Regions is for each Region to judge. Two points need to be borne in mind in reaching this judgement. First, the fact that a Regional economy is mostly agrarian and the lending program must properly reflect that, is not a good reason for whatever urban lending there is to be relatively capital-intensive and lack direct benefits for the urban poor. Second, urban poverty lending for the Bank as a whole that is proportional to the incidence of the target population should be viewed as a minimal target. To exceed it would not be at all unreasonable in many countries or Regions especially where income distribution is particularly skewed.

20. Sectoral performance in the urban poverty program should, I believe, be broader than now indicated. The burden of the program falls inordinately upon urbanization projects, and lending for these purposes cannot be expanded much beyond present levels. Nor would such concentration on basic service delivery be consistent with the need for much more attention to productive employment opportunities. The DFC/IDF contribution, in view of the fact that it has a major role to play on the productive employment side of the urban poverty program, is much too low. I would not expect a much greater contribution in the next two years, but by FY79, I would think the intermediaries could be developed and appropriate projects designed on a larger scale. I believe water supply "poverty lending" is very low, given the fact that existing water shortages in LDC cities fall most heavily on the target population. Water supply benefits merely in line with the proportion of the poor in total population is considerably out of line with the backlog situation that exists and the proportion of poor people in the population growth of LDC cities. (On the other hand, the strikingly high proportion of total water supply lending that is urban-related raises certain questions. Perhaps this reflects the relative safety of traditional supply in less densely populated rural areas, but if not, then perhaps some re-thinking at

the sector level is required.) Power and transport should also be able to do more; I find it hard to imagine that, world-wide, these important sectors have so little potential for direct beneficial impact on the poor. In Education, the total urban-related lending is only about 20%. This may be appropriate, given the relative deprivation of rural areas, but if the sector strategy is to emphasize neglected areas, I would think that a much higher proportion of this 20% should be aimed at the urban poor.

21. In my view, the sectoral distribution of poverty lending needs more attention in the Regional Projects Departments and in the CPS sector departments. While some progress has been made on the development of guidelines for project design, the contribution of each sector in the current program reflects at this point in time very little active intervention to increase the beneficial impacts for the target population. I have been urging the sector departments of CPS in consultation with the Regional Projects Divisions in each sector to establish their own sectoral goals which over time and through the CPP process would begin to shape the total program. The model for this is our experience in agriculture and rural development lending where sector-specific goals have been very effective. This sector planning for the urban poverty program has not taken place; the two exceptions to my knowledge are the Education Projects Division of Western Africa Region, which has produced its own strategy and program, and the Urban Projects Department. I shall be continuing to encourage this sort of operationally relevant thought and programming and request your support in this matter.

MANAGEMENT INFORMATION SYSTEM

22. An information system has been developed to provide management at all levels with the necessary information on the progress of the program. The summaries presented above were drawn from this system. The detailed statements are now in the hands of the Regional Assistant Directors for their use. The system now contains the non-agricultural lending program detailed by year, loan amount, project costs, location, urban poverty content and population affected. CAD is cleaning up the system to make it efficient and more flexible. The Agriculture Department and the Regional Projects Departments have requested that the cleaned up system be designed to ultimately be able to incorporate the agricultural lending program as well. The system is now being managed by the Urban Operations Review and Support Unit (URBOR), using operational information from three sources: (a) the annual budget incorporating the five-year lending program; (b) CPPs; and (c) a one-page data sheet attachment to project briefs or other pre-appraisal mission reports. Other information for the system is drawn from the existing files of P&B and the Economic Analysis and Projections Department. The system requires the equivalent of about one man-year of assistant level staff to operate, and places minimal demands on operational staff in the form of phone calls and brief meetings.

23. The URBOR should now be able to turn its attention to the development of sectoral plans and operational support in project design and sector work. A full work program along these lines is currently being developed in consultation with CPS sector departments and the Regional operating units.

24. This report brings you up to date on the status of the urban poverty effort; I seek your support in moving along the lines I believe we have established in consultation with Regional staff. I am ready to discuss this with you at an OVP meeting whenever convenient.

Attachment

cc: Mr. McNamara
Mr. Chenery
Mr. van der Tak
Regional Coordinators, Urban Poverty Program
Mr. Stone

EVKJaycox:ncp

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Edward U. K. Jaycox DATE: January 3, 1977

FROM: P. Glaessner and J. Holsen, LAC

SUBJECT: Urban Poverty Program Implementation

1. In our view your subject memorandum offers a satisfactory basis for proceeding in the complex area of urban poverty lending. This is not because we are intellectually satisfied with the proposed procedures; we share the doubts and hesitations of others who have questioned both the adequacy of basic data and the rationale for the specific measures. We believe, however, that it is better to proceed on a tentative and flexible basis, modifying the procedures on the basis of subsequent experience, than to prolong the present somewhat abstract discussion of target groups, search criteria and appropriate performance objectives.

2. Regarding target groups, we await the promised further memorandum discussing updating and improving the present "first estimates... for working purposes." We trust that these improvements can be obtained largely as a by-product of on-going country and sector economic work; if not, the benefit/cost ratio of any special effort will need careful study.

3. The objective for the size of the urban poverty program -- about 25-30% of current programmed total urban lending (or about 10% of all Bank lending) -- does not seem unreasonable. The fact that this objective will not apply at country or even regional levels will permit us to take into account specific country circumstances, the roles of other donors, etc. We assume that the overall objective will be reviewed in due course in the light of the probable benefits from the urban poverty projects we are able to generate in comparison with what could be accomplished in other areas with the same staff and financial resources. A specific objective is desirable to insure that this important area is not neglected, but ex post opportunity cost should be monitored.

4. The criteria to distinguish urban poverty lending have aroused the greatest controversy. Doubts have been raised about the general approach of "spreading" development expenditures and also about the particular form of capital/labor ratio that is proposed. We suspect that the indirect and multiplier effects are often more important than the direct and immediate consequences of well designed development activities. Insofar as this is true, doubt is cast upon the adequacy of the "spreading" approach. The insistence that "the proper micro-economic criteria are also satisfied" (paragraph 9) should, however, provide protection against errors of commission. Let us hope that any promising projects which get dropped from the "urban poverty" list, because they do not pass the test based on macro-economic factors, can be included in the urban lending which is not formally classified as "poverty lending."

5. Regarding the specific formulation of the capital/labor ratio criterion contained in paragraph 15 of the December 6 memorandum, we are awaiting the details in the forthcoming memorandum which is to specify maximum "cost per job" for various Bank countries. It seems to us that

there are conceptual and/or data problems in all of the approaches which we have seen discussed. In these circumstances, the simplicity of what you propose is a major virtue. The maximum investment levels which result seem too high as average investment levels per new job created for members of the target group, but are far below what most planners have in mind. They can serve as useful "rules of thumb" to help get us moving in the right direction -- which is the important thing at the moment.

JAHolsen/PGlaessner:ddm

cc: Messrs. Krieger
van der Meer
Lerdau
Wiese
Perez

cc: Messrs. Goffin and Wyss
Messrs. Greene / Nowicki / Pfeffermann / Ross
LAC Projects Division Chiefs
LAC Programs Division Chiefs

cc: Members Urban Poverty Task Force
Chief Economists