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THE WORLD BANK AND UTILITIES IN THE DEVELOPING NATIONS

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Those of you who attended the 1969 conference will recall the address* by Mr. Garlinghouse, Vice President of A.T. & T., in which he advocated a wider regulatory horizon, with regulatory and utility goals being aligned with State and National goals in these days of social, technological and economic change.

As may be seen from perusal of any industry or regulatory publication, this widening of horizons has indeed taken place over the past two years, with utility companies, with regulatory sanction, becoming increasingly involved in such things as manpower retraining, job corp programs and low cost housing.

Additionally, we have seen the arrival of the word, "ecology" with all the associated activities which stem therefrom. This word probably has differing meanings for different people but I suppose the general interpretation brings to mind anti-pollution measures intended to preserve or restore the natural balance of the physical world on which we depend for our existence, in other words our "environment", or the world in which we live.

I am going to suggest to you that "environment" is world-wide, both in the sense of the world in which we live and in the sense of the people who live in the world with us, and for this reason I believe that the widening utility horizons must be widened still further to take in the

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international scene. Most particularly in this address, I want to deal with the aspect of the people who live in the world with us - the people in the under-developed nations of the world.

To deal with Foreign Aid in general would require a book rather than this short paper; nor is this the forum for such a general discourse. I therefore propose to restrict my comments to the activities of the World Bank Group in financing utilities in the developing nations. This choice is made for several reasons. Firstly, the Bank's Head Office is located in Washington, D.C., secondly, approximately one-third of its funds have been derived from sources in the United States and, thirdly, approximately one-third of all loans made have been for utility purposes.

Perhaps a very short outline of the Bank's history and its functions would be a logical starting point.

Its origin goes back to 1944, to the time of the Bretton Woods Monetary Agreements and to the establishment of the International Monetary Fund. Since that time, it has been carrying out its appointed purpose of lending money for purposes of economic development. The funds which are lent are provided from a number of sources; share capital subscriptions from member countries, borrowing on the world capital markets, re-sale of loans previously made and from loan repayments by Borrowers.

As funds are raised largely on market terms it follows that lending rates must be at about the same level, although the existence of share capital which is non-dividend earning does provide some room for lending at less than actual cost of borrowing. However, the benefit

to the Borrower lies in the Bank's ability to obtain rates which the Borrower itself could not obtain directly, if, in fact, it could borrow at all.

Even this beneficial financing was too "hard" in many cases and in 1960, a further step in Aid development saw the creation of a Bank subsidiary, the International Development Agency (IDA).

IDA funds were obtained as subscriptions, grants or loans from supporting member countries, and by transfer of profits from the Bank. All these sources of capital are interest and dividend free, thus enabling loans to be made on very "soft" terms. (As with Bank financing, one-third of total IDA funds to date have been provided from U.S. sources.)

At present, a typical Bank loan for utility purposes might be for a 20-year term, with 4 years grace, at 7-1/4% interest, while an IDA loan would be for 50 years, with 10 years grace, at 3/4% interest. However IDA loans are made to the Government concerned who will relend to the ultimate Borrower, at higher rates of interest.

Obviously, the foregoing is little more than a thumb nail sketch but the purpose of this paper is to develop some of the Bank's activities in the utility field in more depth so that time does not permit a detailed reporting of the Bank's history and procedures in any detail, although this would be an interesting paper in itself.

Assuming that the Bank (and IDA) has both money to lend and a number of applications for various projects, the first task must be to select those which are thought to be the most beneficial from an economic point of view. Is it better to supply funds for roads in country A, railways in country B, power development in country C, water supply in country D, agriculture in country E, and so on; or even within a country, which is the most beneficial,

roads in the north, agriculture in the south, sewerage in the major cities, water supply in rural areas or any combination of these? The Bank endeavours to assess the relative merits of such applications by attempting to determine the economic benefits which might be reasonably attributable to each potential project. Some of the factors to be taken into account include country "need" and country "performance", priority of the sector involved and priority within the sector, direct earnings and indirect benefits.

Such overall assessments are not easy to make and a utility listener may see an analogy with a regulatory rate case decision where, after all the evidence is in and all the calculations made, much will depend upon the informed judgement of the regulatory body. In the same way, the economic evaluation of a proposed project must be subject to the informed judgement of the Bank executive management. If this were not so, a literal acceptance of preferable economic solutions to a problem might require abandonment of an area, movement of populations to other countries or even require an amalgamation of countries which are less than viable units in themselves; solutions which might be termed outside the Bank's "jurisdiction". Again, consideration from the "need" and "performance" points of view may well be conflicting - perhaps not unlike the comparison of the hardworking son and the less industrious brother in the parable of the "prodigal son".

Currently, the process of economic selection is being redeveloped with considerable emphasis on Country Economic Missions which will be carried out in cooperation with other U.N. Agencies such as the United Nations

Development Program, the Food and Agriculture Organization and the World Health Organization. These missions will produce country Economic Reports which will serve as overall development plans and enable project development such as utility construction to be coordinated with other projects within the overall Master Plan.

However, again for simplicity, we might assume that we have a utility project which is at least prima facie economically desirable - an assumption which is not too unreasonable as, in fact, approximately one-third of all past Bank loans have been for utility purposes, with total utility lending to date exceeding $5,000 million.

Up to this point, all I have said may have been much as you might have expected, but you may not be as aware of the Bank's requirement that a utility be "self-supporting" in much the same manner as on this continent.

In view of the use of terms like "development" and "under-developed" and so on, there is perhaps a natural tendency to believe that the Bank merely functions as a form of "aid dispenser" or a kind of super welfare organization. This is far from the truth. In fact, I personally sometimes think that our requirements may in some circumstances, be even more stringent than we might expect in North America.

Basically, the Bank endeavours to lend for projects which initially require capital on favourable terms but which can be made financially viable in reasonable time. As previously indicated, loans may vary considerably; a typical example might be a Bank loan at 7-1/4%, repayable over 20 years

with a 3 to 5 year grace period before first capital repayment -- terms which your own utility companies would be happy to obtain in present money market conditions, nevertheless not that far below prevailing rates and requirements, while an IDA loan at 3/4% interest (or service charge) with capital repayable over 50 years and first refunding after 10 years will be re-lent by the recipient government to the utility concerned at a rate somewhere between this rate and current market rates.

Again, it may be thought that the Bank is involved in 100% debt financing, so that the utility concerned will have a capital structure which looks like that of some of our government excursions into the utility field on this continent. However, this is not so, for the Bank usually seeks a capital structure which incorporates a substantial measure of equity.

Initially, anyone with a North American background might be surprised to find higher proportions of equity than he may have come to regard as normal. There are at least two good reasons for this difference where it exists; firstly, the Income Tax disadvantage of equity financing applicable on this continent does not normally apply in the case of Bank financed projects and secondly, the economic circumstances are such that it is difficult to achieve a rate level which creates a viable financial enterprise so that a large proportion of equity is desirable to minimize the heavy initial cash flow liabilities which result from large interest and sinking fund requirements.

Perhaps the word equity requires some explanation too. Very often, the organizations with which we are concerned are quasi-governmental, e.g., the "national" water and sewerage corporation so that equity is government supplied funds. However, its characteristics, being generally non-repayable and entitled only to possible future dividends, are essentially those of equity. It is perhaps of interest to note that government-owned utilities in Canada, which were originally 100% debt financed, are now themselves building up equities from retained earnings, e.g., Alberta Government Telephones and Saskatchewan Power Corporation. It may also be speculated that the St. Lawrence Seaway Authority may have had less financial problems if its capital structure had contained a substantial equity base. Indeed one might be tempted to generalize that there is some circular effect in that enterprises of what we might loosely call a "marginal" financial nature tend to be government-supported, then in turn 100% debt financed, which only ultimately compounds their problems.

Even with relatively high equity proportions, perhaps 60 - 70% - figures which I am sure will be music to Bell Telephone ears - the initial debt coverage may be little more than one.

Coupled with the resolution of capital structure, there is the serious problem of rate adjustments to provide the necessary revenues, and when I say serious problems, I mean just that. Those of you listening, have almost all experienced the problems of rate adjustment on this

continent, where these increases are probably of the magnitude of perhaps 10% or less, in an economy where the ratio of utility bills to consumer income is relatively minor. By comparison, increases in the countries of which we are talking may well be 100%, in an economy where the ratio of utility bills to income is already very significant.

In addition to the financial aspects, the Bank will also overview the specific project plans for what may be generally termed its "engineering economics". What may well be a technically sound scheme may not be the most desirable when tested by discounting procedures and related to consumer ability to pay. Not infrequently schemes submitted to the Bank for financing are substantially reduced by such tests.

The Bank also pays considerable attention to the administrative and organizational problems of the utilities, both as a pre-requisite of the loan and on a continuing basis. In fact, it is Bank policy to despatch regular supervision missions to borrowing organizations in order to assist in such organizational development.

Perhaps a good summary of the areas in which the Bank is actively interested when financing utility projects may be provided by listing below some summarized example clauses, typical of those which may be found in Loan Agreements between the Bank (or IDA) and its utility borrowers.

1. The lender and the utility shall cooperate fully to insure that the purposes of the financing will be accomplished. To that end, the lender and the utility shall from time to time, exchange views with regard to matters relating to the utility's performance.

2. The utility shall employ qualified and experienced consultants and contractors acceptable to the lender, in both the carrying out of the project and to assist the utility in the fields of financial control and technical operations.

3. The utility shall have its accounts audited annually by independent accountants acceptable to the lender and shall transmit copies thereto.

4. The utility shall not sell, lease, transfer or otherwise dispose of any of its properties or assets required for the efficient carrying on of its operations.

5. The utility shall consult the lender concerning the utility's proposed investment program for the succeeding fiscal year.

6. The utility shall operate its business and conduct its affairs in accordance with sound business, public utility and financial practices under the supervision of qualified and experienced management and shall operate and maintain its plant in accordance with sound engineering and public utility practices.

7. The utility shall consult the lender about any proposed appointment to the position of Manager.

8. The utility shall not make any material changes in the structure of its organization without approval of the lender.

9. The utility shall take all reasonable action required to (1) reduce by means of normal attrition and transfers the number of employees in the utility; (2) use existing employees in the construction and operation of improvements to and extensions of the utility system.

10. The utility shall not incur any debt unless the utility's net revenues for the preceding financial year shall be not less than 1.5 times the maximum debt service requirement on all the utility's debt.

11. In the event that the utility establishes or acquires any subsidiary, the utility shall cause such subsidiary to observe the obligations of the utility as appropriate.

12. The utility shall establish rates for its utility services sufficient to: (1) cover operating expenses including depreciation, and (2) produce an annual rate of return of % on the value of the average net fixed assets.

During a recent visit to Africa, the Manager of a utility in receipt of Bank loans mentioned to me that he had been reading Garfield & Lovejoy's "Public Utility Economics" and that it appeared to him that the Bank was performing many of the functions of a Regulatory Body. While, of course, no regulatory jurisdiction exists, it may be that this description is a fairly accurate overall description of many of the Bank's actions. As I have outlined on previous occasions, I see regulation as something which should be based on those words found in most regulatory legislation - "fair and reasonable". With this philosophy as a cornerstone, both rates and earnings should be "fair and reasonable" with a maximum of respect and cooperation between regulators, utilities and consumers. In this context, the view of the Bank as a regulator would seem to be an acceptable, even a desirable, one.

In a relatively few paragraphs, I have outlined to you some of the functions of the Bank and perhaps I might conclude by emphasizing one particular problem area, and it is this area in which I would like to see our horizons widened in a practical way. In the under-developed countries

there is a shortage of trained utility personnel at all levels, both technical and administrative. The magnitude of this problem may be judged if you care to imagine that 75% of your trained staff leave overnight and are irreplaceable. The ensuing difficulties of maintaining a high level of service and the burden which would fall upon the remaining 25% of the trained staff is perhaps an indicative capsule example of the problems of many of the newer nations and of the tremendous efforts which are being made by such management personnel in these utilities.

The Bank is therefore endeavouring to assist by advice and by providing funds for retention of consultants and for academic and practical training for the utility personnel. However, to fill my analogous 75% gap will be a slow process and it is this management gap, which is probably the largest single problem which faces utilities in developing countries. Financing and construction are relatively short-term problems which can be met by the Bank and other Aid groups, and by retention of consultants. Operation and management are essentially continuing long-term problems and although advice and use of consultants are valuable in the short-term, the only complete answer is a fully trained and competent national staff.

As I am sure you are aware the whole question of Aid has been dealt with in a report recently published under the title "Partners in Development", being the result of studies carried out by an International Commission under the Chairmanship of Mr. Lester B. Pearson. Among many recommendations is one which refers to the matter of "technical assistance" - defined as "for facilitating the transfer of technology and management". The report states:

"Donor countries, in planning and reviewing their own education and training facilities, should take into account the needs of the developing countries for technical assistance personnel ..... Private sector employers ..... should be encouraged to adopt similar policies. If advisory work is to be of genuine relevance, it must draw on a whole range of institutional support. This might, for instance, involve the use of integrated teams from universities or from development advisory services furnished by private or public institutions".

The relevant section concludes with the following recommendation:

"We recommend, therefore, that international technical assistance be strengthened by the creation of national and international corps of technical assistance personnel with adequate career opportunities".

I do not know what action will ultimately be taken on this recommendation but I do know that the utility industry in North America represents the greatest single source of trained utility manpower and utility experience and I venture to suggest that utility companies could make a major contribution to resolving this problem, and in so doing, would be making the most practical contribution possible to the economic well-being of the developing nations.

In conclusion, and perhaps as a brief justification for having taken up your time, may I just summarize by saying that I believe my audience has a vital interest in the matters I have outlined. As American citizens, you have provided substantial funds for disbursement by the World Bank and as utility personnel, you have an additional interest in that

a substantial portion of these moneys have been advanced to public utilities. Perhaps, if nothing else, I am attempting to convince you that these funds have been wisely invested. But more than that, as we know from our domestic experience, any development program must involve not only money, but people. I hope that the utility industry of North America will consider involvement of not only its money but of its people, indeed of itself as an industry, in the development of utilities throughout the world.