49901

UNITED NATIONS
ECONOMIC AND SOCIAL COUNCIL

Distr.
LIMITED

E/CN.14/ADB/63
28 October 1964

Original : ENGLISH

ECONOMIC COMMISSION FOR AFRICA
Committee of Nine on the
Preparatory Work for the
African Development Bank
Fifth session
Lagos, 26-29 October 1964

OPERATIONAL POLICIES OF THE ADB

64-4680

Preliminary Considerations concerning Operational Policies of the African Development Bank by the Executive Secretary

I. INTRODUCTION

1. Under para. (e) of resolution 3 adopted by the Conference of Finance Ministers at Khartoum,[1/] the Committee of Nine was requested to take any initiative in addition to action specifically mentioned in that resolution which, in its view, would be consistent with the spirit of the resolution and would contribute to an early and orderly commencement of operations by the African Development Bank. In compliance with its mandate, the Committee thought it advisable to discuss some problems which may form the subject of policy considerations by the Bank. Consequently, it requested the Executive Secretary to set out the considerations which are likely to determine, and make some suggestions on operational policies which may be envisaged in the light of the relevant provisions of the Agreement establishing the ADB.

2. This paper deals with "operations" of the ADB only. It is recalled that in such "operations" the Bank can provide or facilitate financing for any of its member States, sub-division or agency thereof or for any institution or undertaking in a member State in three different ways, viz. by direct loans; by guaranteeing loans made by others; or by investing its funds in equity capital (ADB Agreement, Art. 14(1)). Such transactions, and such transactions only, are technically "operations" within the meaning of the ADB Agreement. Furthermore, for the purpose of this paper, operations are

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1/ Resolution 3, para.1(c), on the Preparatory Work for the Establishment of the African Development Bank, adopted by the Conference of Finance Ministers at its final Plenary Session on 4 August 1963 at Khartoum.

deemed to be "ordinary operations" of the Bank, as defined in Article 13(1) of the ADB Agreement. However, occasionally, reference is made to operations which might be considered "special" and give rise to questions relating to the setting up of Special Funds within the Bank.

3. Attention must also be called to the fact that ordinary capital resources of the Bank will, at the outset, be rather limited. Therefore, in considering the different types of ordinary operations the Bank may be able to undertake, it is assumed that the Bank will act in close co-operation with other international and regional financial institutions and, where appropriate, seek to participate in the financing of specific projects.

II. THE ROLE OF THE BANK

Characteristic features of the ADB

4. There are many agencies operating in the development field in Africa. The ADB is unique however in three ways. Firstly, it is an African institution, created by African capital from all over the continent, governed, directed and managed by Africans with the object of promoting the development of Africa as a whole. Secondly, its charter is widely drawn so as to permit considerable flexibility in its approach and methods of financing - to make it, in effect, an IBRD, IFC and IDA all in one. Thirdly, it is charged to give particular attention to multi-national projects. Thus it is uniquely qualified to take a global and comprehensive approach to the problems of African development.

Importance of a Global Approach to African Problems

5. The importance of such a global approach cannot be under-estimated. More perhaps than in any other continent, the political boundaries and existing economic patterns of Africa were determined by accidents of history, particularly of colonial history, rather than by considerations of an ethnological, geographic, climatic or economic character. As a result, such development as has taken place has been largely of an outward-looking character, directed to the exchange of primary products for manufactured goods with more advanced countries, and usually strongly orientated towards the former metropolitan powers; opportunities for trade within Africa itself have received only scanty attention - at least until recently. The inevitable result is that African countries are preoccupied with improvement of their trade with the outside world and the development of industries within their own borders. Both of these objectives are laudable, but it is very doubtful if by themselves they can bring African countries to those standards of development and living which are so ardently desired.

Need for Larger Markets in Africa

6. If the experience of other former colonial and primary producing territories - such as Australia and Latin America - is of any guidance, the road to economic progress requires not merely the raising of productivity in agriculture, mining and other primary activities, but also the development of internal markets sufficiently large to sustain industrial development on a modern and economic scale. But clearly most African territories are too small from the economic point of view to meet such requirements for many decades to come. In the absence of any organization to promote inter-territorial co-ordination and development on a multi-national basis, the prospect would seem to be of a highly uneven development, with some few territories forging ahead while the remaining majority labour painfully behind. If this danger is to be forestalled and the full potentials of Africa to be exploited for the good of all its peoples, it will be necessary for the ADB to look beyond the present political boundaries, to economic arrangements and groupings which will provide the new industries of Africa with markets large enough to offer the economies of scale, and enable the separate political units to co-operate and exchange their products freely and in growing measure as their natural and human resources are developed. Here lies a unique role and opportunity for the Bank.

Complementary Role of the Bank and the Principle of "Additionality"

7. The Bank will not therefore be a competitor with, and much less a substitute for, the World Bank and its affiliates, or the other national or international institutions or programmes offering capital aid or technical assistance. Its role will be complementary and catalytic. Taking always a multi-national viewpoint, it will look for, pursue and assist all possible opportunities for co-operation in economic matters between member countries. It will constantly seek to influence their development in the common interest of the sub-region or region,

e.g. by the enlargement of local markets, the promotion of industries to meet the needs of more than one territory, of communications or telecommunications and multi-national schemes designed to assist the development of intra-African trade and the most economic exploitation of African resources. In these activities the Bank will endeavour, through its contacts and association with sources of capital outside Africa, to obtain additional means for the development of member countries.

Multi-national Projects and the ADB Agreement

8. Such a role for the Bank has been clearly foreseen in the ADB Agreement: Article 2 requires it to give "special priority to projects and programmes which ... concern several members" and to those "designed to make the economies of its members increasingly complementary and to bring about an orderly expansion of their foreign trade". Article 17 repeats that the Bank "shall pay special attention to the selection of suitable multi-national projects".

National Plans and Projects

9. This does not imply that the ADB will pay no attention to national projects. Article 17 favours, for example, projects "forming part of a national or regional development programme urgently required for economic and social development" ---- which clearly embraces both multi-national and national projects. However, the Bank is under a general injunction, under the same Article, that it should "not provide for the financing of a project to the extent that in its opinion the recipient may obtain the finance or facilities elsewhere on terms that the Bank considers are reasonable". Considering the funds that are available from the IBRD, its affiliates, and various international, regional and national institutions and programmes, most of which have in practice concentrated on the financing of national projects, it would seem that in general terms, and subject to what is said later on, the Bank may normally accord a lower priority to purely national

development schemes as compared with multi-national projects or projects with regional or sub-regional implications or effects. The Bank may, however, play a valuable role even in purely national development by assisting members in the drawing up of national plans, the establishment of planning organizations and the preparation of specific projects for external aid.

Mobilization of African Capital

10. In countries with relatively low per capita income, mobilization of local savings always presents difficulties. The generation of budget surpluses by means of increased taxation often offers the most attractive solution of this problem. However, the resources so raised are all too often inadequate to finance even the needs of the public sector; it is much rarer for them to be sufficient - or to be applied in sufficient quantities - for the needs of the private sector. Yet a fast growing private sector may become a most fruitful source for the generation and sound investment of domestic savings, in the form of profits ploughed back into expanding undertakings. If exports have been described as the "joker in the pack" where the balance of payments of developing countries is concerned, domestic savings may often now be similarly described in relation to their capital investment programmes. For this reason it is suggested that the Bank should, from the outset, associate itself closely, particularly with the specialized agencies of the United Nations in a study of the possibilities - and especially of institutional requirements - for increasing the growth of domestic savings in member countries. In this context attention might be paid to the development of indigenous banking and non-banking financial intermediaries - like insurance companies, co-operative saving schemes, trust funds, pensions and benevolent funds, social security schemes, etc.

Education and Development

11. Without denying the importance of capital formation in the development process, current economic thought pays more

and more attention to other factors, notably those which contribute to increasing skill, productivity and adaptability of labour and human resources.

12. It is apparent that economic development is closely associated with important qualitative changes in the human element as a factor of production. Unfortunately, from the administrative point of view, this is not the same thing as saying that economic development is a function of primary, or even technical education. Things are more complicated than that. What is even more significant is that it cannot be assumed that experience of other developed countries, particularly in America or Europe, will automatically apply to the African scene. The sociological patterns are likely to be quite different. It cannot even be assumed that the proportionate distribution of various types of skills which can be found in more advanced countries in various stages of development is an entirely reliable guide to the educational outputs at which African countries should aim. The requirements may prove to be quite different; African countries will not necessarily go through the same technical stages of development as their more advanced forbears. The study of these matters, and the application of the results, may not fall directly within the scope of the Bank's normal operations, but if the African continent is to develop with rapidity, the success of the Bank's work - to say nothing of that of many governments and other agencies - will be powerfully influenced by the approach which is adopted to this problem.

Training

13. The Bank should therefore be much concerned with the study and training of the human factor as an element in the developmental process, possibly co-operating with ILO, UNESCO and other bodies operating in this field and assisting in dissemination and application of the results. It should aid in the establishment of projects in the field of technical,

professional and administrative education related to development; in particular, it may explore the possibility of providing such training more efficiently and economically by financing the setting-up of sub-regional educational or training centres (e.g. for higher medical or teacher training[1/]) to serve several member countries.

14. Although the ADB could carry out such operations under the heading of social development, which falls within its own proper functions, it may be anticipated that there would be some difficulty about justifying them as productive in accordance with some of the operational principles set out in Article 17 of the ADB Agreement. This may, therefore, be a case where the Bank will seek to establish Special Funds for the purpose of carrying out such highly needed development operations.

1/ Note the success of the UNESCO Higher Teacher Training Institute at Khartoum in attracting students from other territories.

III. THE BANK AND DEVELOPMENT PROJECTS

Priorities

15. On the basis of arguments developed in the preceding chapter, it is suggested that it will be in conformity with the provisions of the ADB Agreement and the particular needs of Africa, if the Bank adopts as its principal priorities the promotion of multi-national projects, and the development of intra-African trade and of African exports.

General Activities of the Bank

16. However, before these subjects are discussed, it may be suggested that the Bank should explore the extent to which national and other needs that are not covered by the priorities just mentioned, are reasonably provided for by the various forms of assistance available from other sources, such as the IBRD and its affiliates, the European Investment Bank, the Caisse Centrale, the Commonwealth Development Corporation, the Commonwealth Development and Finance Company and other national and international agencies. If such a survey were to indicate the existence of important needs for which adequate assistance is not forthcoming, or is only available on terms which in the judgement of the ADB are not appropriate to African conditions, the Bank will endeavour to remedy the position either by the use of its own resources or by persuading other agencies to do so or a combination of both. The Bank will also examine the need and possibilities for assisting African development by the promotion of financial and other institutions designed to mobilize domestic savings for development purposes. As has been shown, it will take an active interest in the development of human resources and capacities in relation to economic development and technical change. It will also assist member governments in setting up planning organizations and development institutions.

Multi-national Projects

17. By placing the promotion of multi-national projects among its priorities the ADB will be entering a comparatively new field for international development finance. Few countries provide in their national development plans for projects which are of a regional, sub-regional or multi-national character; consequently, most international development aid is directed to projects of primary concern to a single territory. But, for reasons which have already been explained (see paras. 4 et seq.) economic progress of Africa requires promotion of development on a regional or sub-regional basis rather than on a purely single-nation basis. Despite growing acceptance of this thesis, the task of the Bank will not be easy: Such development is likely to cut across traditional patterns of trade and finance and habits of thinking in respect of economic matters.

Preparation of Multi-national Projects

18. Considerable flexibility on the part of the ADB will be needed in its approach to multi-national projects. Collaboration between member countries in the field of national planning is an obvious first step, but the usefulness of such collaboration will be more easily accepted by the countries concerned if concrete projects beneficial to both sides can be quoted. In this connexion the much publicised "Bellagio Statement of Policy" suggests, for instance, that "governments or firms of, say, three developing countries would take joint shares in the ownership and management of, for example, a cement works in the first country, a chemical plant in the second and a pulp in the third". The idea is excellent. However, before the participants can be brought to take such action a great deal of preparatory work is required. Someone must guage the potential for multi-national development and then reduce it to concrete and practical terms.

19. Mere study and elucidation of possibilities for such multi-national co-operation, however thoroughly and expertly done, may not be enough. Success of the ventures proposed

may require the modification of current trade, payments tariff and fiscal policies among the participating countries; protective measures may be temporarily justifiable and necessary to provide assured markets; the prospective cost and benefits to the various territories concerned may have to be nicely calculated and balanced. Heavy capital investment, far exceeding customary local patterns and resources, may be needed to embark on large scale modern industries. In short, promotion of development on a multi-national basis in Africa is likely to require a combination of expert appraisal, substantial capital and far-reaching agreement between member countries in respect of their economic policies. Initiative and leadership by the Bank are likely to be a key factor in bringing such projects to successful fruition.

20. Certain forms of multi-national co-operation may also give rise to their own particular problems. Thus, the establishment or development of interterritorial networks for power, roads, railways, telecommunications and other services may throw up considerable technical problems (e.g. in the standardization of procedures, facilities and equipment) in the solution of which the ADB and other agencies should play a constructive role.

Organization and Financing of Multi-national Projects

21. Above all, the development of multi-national projects will give rise to organizational and financial problems. In some cases, e.g. the development of a road or rail network, it may be sufficient for each participating member to look after its own particular section; finance may then be provided on a bilateral basis direct between the Bank and its associates and each government concerned - provided that some co-ordinating machinery ensures that the entire operation proceeds on an integrated basis. Inter-territorial power links may perhaps be developed on a similar basis in some cases; in others the establishment of a new multi-national authority may be necessary to carry out the construction or operating stages, or both. In either case the determination of rates and charges may have to be the subject of inter-governmental

agreement. The development of one or more major industries on a sub-regional basis may require prior establishment by the participating governments of a Co-ordinating Committee to plan and guide their development; indeed where large-scale heavy industries (e.g. iron and steel, or chemicals) are concerned, the need may be for something stronger, such as a Sub-regional High Commission established by the participating countries and endowed by them with certain executive powers. It may also be necessary to establish new types of public Corporation to operate the new multi-national industries. Here too the potential role of the ADB can be cearly seen as an instigating and co-ordinating forœ.

Method of Approach to Multi-national Projects

22. It is not suggested that the Bank should attempt all this single-handed. The task is too large and complex. Clearly, it requires collaboration of the various members concerned as well as of international agencies and organizations.

Need for Initiative and Flexibility in relation to Multi-national Projects

23. It is impossible to discuss in this paper all the possibilities which may arise for the Bank in the field of multi-national development. To sum up, it seems evident that it should:

(i) take a general initiative, in association with other international agencies, not merely as regards the study and preparation of multi-national projects on a technical and economic basis, but also in the negotiation of the necessary inter-territorial agreements and the establishment of appropriate executive and business organizations to carry them out; and

(ii) adopt a flexible attitude as regards the methods of financing for these projects: Thus, in some cases concurrent loans to several governments may meet the situation, in others a single consolidated loan to an existing or newly established organization may be appropriate, while in others still a measure of equity participation may be required.

Definition of Multi-national Projects

24. In view of the importance attached to multi-national projects it may be helpful both to the ADB and member countries if such projects were clearly defined in advance. A project, it is suggested, should be eligible for consideration by the Bank under this classification if:

(a) it involves the development and use of raw materials or natural resources of one or more member countries by or for the benefit of another member country or countries; or

(b) it involves the inauguration, development, or linking of communications, power, transportation, telecommunications or other important developmental services between two or more member countries; or

(c) it involves the development, in a member country, or an industry the output of which exceeds the absorptive capacity of the local market, and which is part of a policy of meeting regional or sub-regional needs, facilitating African economic progress by establishing undertakings on a scale that would be beyond the reach of individual territories acting alone; or finally,

(d) although initiated in a member country it is conducive to development of ancillary or complementary activities as well as additional projects or developmental activities in other countries or territories.

Promotion of Intra-African Trade

25. Promotion of intra-African trade and the study of related problems, particularly in the field of finance and payments, has already engaged active attention of ECA. There

is, however, likely to be a useful role for the ADB as will in this field, apart from ancillary activities - such as the promotion of transportation, communications and telecommunications facilities between member countries - which have already been mentioned. Thus, finance may be required by new or existing undertakings to provide processing, storage, marketing or handling services. The Bank may assist in providing it. The Bank may also find a useful outlet for its services in the financing of improvements in coastal shipping and inter-territorial road or rail transport or telecommunication facilities.

26. However, it would not seem appropriate for the ADB, save in exceptional circumstances, to provide working capital for trading operations in the commercial sense. The proper use of such finance is difficult to supervise; supervison becomes virtually impossible when the lender is a long way away. The ADB may confine its assistance in such cases to financing fixed or tangible assets such as processing plant, silos and ware-houses or specialized types of vehicles. Working and general capital should be raised locally from entrepreneurs, commercial banks or specialized financial institutions; if these are incapable of meeting some really urgent need, the Bank might endeavour to help by indirect intervention, e.g. by assisting in the establishment or financing of appropriate institutions, rather than by getting directly involved in foreign trade financing.

Promotion of African Exports: Processing

27. The emphasis given in this paper to the development of multi-national projects and the encouragement of intra-African trade is not intended to disparage the importance of the promotion of other African exports, even of traditional commodities. On the contrary, there is much scope for improvements in this direction and many opportunities for useful intervention by the ADB. Foremost among these may be listed the encouragement - by advice and investment - of processing, handling, and packaging facilities designed to enhance the

f.o.b. value of traditional exports. In the past such developments were inhibited by a combination of factors, e.g. discriminatory duties in developed countries against processed products as compared with basic raw materials; relatively unfavourable freight rates; lethargy or lack of interest on the part of exporters - either because their own return from production of raw materials being adequate they were disinterested in processing; or because of financial links with manufacturing undertakings in metropolitan countries. Such conditions are now all under challenge; mounting pressure is likely to be brought on industrial countries to reduce duties both on raw materials and processed products from developing countries; freight rates will come under similar pressure; attainment of political independence is leading to a re-orientation of business attitudes among expartriate undertakings in developing countries and to the emergence of new national undertakings. The present time therefore seems ripe for a concerted movement in African countries towards a gradual change of their basic exports from raw or unprocessed materials to that of refined, processed and fabricated products. The Bank may well be able to play a most valuable role in providing advice and capital for this purpose. Some African countries have already established their own shipping lines; others may wish to follow. Here, too, the ADB may be able to help not merely with finance but perhaps also in promoting the establishment of lines serving more than one African country.

Development of New Exports

28. In addition, there may be considerable scope for the Bank to assist the development of new African exports. They may take the form of industrial products. There may also be opportunities for development of "sophisticated" exports of natural origin[1] e.g. of dried, canned, processed and fresh livestock and fishery products, the more highly priced fruits

1/ The word "Natural" is used to include all types of products of the soil or waters of the country, other than minerals or industry (discussed in para. 27-28 etc.)

and vegetables, etc. There are many member countries which are naturally endowed to grow, produce and export high quality produce of this kind that can compete with exports from other countries e.g. from South Africa, Australia, Latin America or Israel. As living standards in industrial countries advance, there may be considerable possibilities for such exports from member countries. The principal pre-requisites are likely to be introduction of high quality strains, of modern agricultural techniques (particularly, disease control), and of modern facilities and standards of grading, processing, marketing and presentation. Success will require a combination of improved knowledge, technique and capital investment amounting to a minor revolution in some local economics, the rewards will be commensurate. The ADB may be able, possibly in conjunction with FAO and other appropriate bodies, to assist in the provision of finance and know-how, and to promote the necessary change in outlook.

Mineral Development

29. Among the special activities which may reward interest shown by the Bank is mineral development. Mining can contribute substantially to export earnings of a country and also provide a base for development of technical skills and establishment of various industries. For a variety of reasons - including lack of technical knowledge, adequate capital, and inability to spread the risks involved in prospecting - mineral development in developing countries has been largely an activity of foreign capital. As a result, a considerable share of the income therefrom has flowed out of the countries concerned. Various devices in the realm of export duties and royalties have been introduced to check this, but except in the case of petroleum, it is not always easy to do so effectively without, at the same time, discouraging further prospecting and development.

30. There may therefore be scope for the ADB to participate in mineral development, not so much on the grounds that capital will not otherwise be forthcoming (although this may be a good reason in some cases), but rather on the ground that <u>local</u> capital is not

available. It is therefore in the interests both of the country and the continent as a whole that there should be African participation in order to avoid excessive foreign control. This suggestion does not mean that the Bank should become a prospection or sink its capital in speculative ventures; what is envisaged is that it should consider participation in the development of proven and payable deposits where African participation from other sources is not forthcoming. Although equity participation by the ADB may sometimes be necessary, it is thought assistance should take the form of loans whenever possible; however, in such cases the Bank should consider seeking arrangements whereby loans may be converted into equity participation if the mine is successful, and its subsequent transferability to African shareholdings.

Export Credits and Insurance

31. As part of its policy of promoting African exports, the Bank may also assist in the financing of exports and the provision of credit insurance for African exporters - either through existing banks or institutions or by the establishment of specialized agencies. The Inter-American Bank has already made a notable entry in this field. Although this has been directed mainly to encouragement of export of capital goods from Latin America, there may be scope for the promotion of such services by the ADB as an aid to the general development of African exports. 1/

Relationship between Individual Projects and National and Regional Planning

32. Article 17 of the ADB Agreement indicates that the Bank should favour particularly projects "forming part of a national

1/ The Inter-American Development Bank has set aside $30 million to provide medium term loans for the export of capital goods. This credit is channelled through approved national institutions; it is available for periods from six months to five years and may cover up to 75 per cent of the invoice cost of the goods, provided not more than 50 per cent of the components is drawn from outside Latin America.

or regional development programme". The ADB should attach particular importance to this principle and do all in its power to encourage the development of such planning on a sub-regional or regional basis. Even where purely national projects are concerned, the Bank should encourage member countries to bear in mind any impact which the project may have upon neighbouring countries or Africa generally; where such projects are submitted for its own consideration it might be expected that the Bank would always specifically examine them from this point of view.

National Planning and Multi-national Projects

33. Generally speaking, it is unlikely that national plans of member countries will provide for participation in multi-national projects. Assuming that the governments concerned have already planned for a full use of their prospective resources for their own purposes, the super-imposition of a large multi-national project may, though the foreign element is financed externally, lead to distortions in the local economy, physical bottlenecks, even inflation. There, before embarking on the financing of a multi-national project, it is assumed the Bank will pay particular attention to its repercussions on the economies of the countries concerned. If these appear to be serious, it should consider how they may be alleviated, e.g. by external assistance in the form of skilled or even unskilled labour, liberalization of certain imports and, in special cases

the provision of external finance to cover part of the local costs. It might even, if necessary, propose the rephasing of some parts of a national plan in order to "make room" for a multi-national scheme of overriding importance.

"Specific Projects"

34. The ADB Agreement requires that, "except in special circumstances", the operations of the Bank should provide for the financing of "specific projects or groups of projects, particularly those forming part of a national or regional development programme" (Article 17(1)(a)(i)). The only regular departure from this rule permitted in the Agreement is that in favour of making "global loans or guarantees to African national development banks or other suitable institutions in order that the latter may finance projects of a specified type serving the purpose of the Bank within (their) respective fields". This requirement, which is in line with corresponding provisions of the IBRD and IADB agreements, may in practice attract criticism as limiting unduly the Bank's freedom of action.

35. The object of the restriction is, of course, to ensure that the Bank's funds are used effectively and for clearly defined purposes the usefulness of which can be objectively appraised in advance and reviewed in retrospect. Provided these conditions are fulfilled, it is suggested that the term "specific project" may be construed fairly widely.

Exceptions to the "Specific Projects" Rule

36. The question as to what constitutes "exceptional circumstances" which justify the Bank in making a loan that is not tied to a "specific project" is more difficult. There is, however, no doubt that many developing countries find the administrative work involved as a result of external aid proffered to them being "tied" to specific projects a severe burden. Whilst therefore the Bank should not assume lightly the existence of "exceptional circumstances," it may perhaps

explore with the IBRD and other sources of aid openings for a concerted but controlled movement towards the provision, by multilateral agreement, of <u>global finance</u> for approved and specific development programmes of member countries. Thus, group participation might be secured in an agreed amount of external aid to a given country which would be applied to the foreign exchange component of a comprehensive schedule of projects forming a large part or even the whole of a development plan. The donors would then appoint a single local agent (not being a national of the member State)[1] who would certify and approve releases of the aid in agreed proportions to meet foreign exchange expenditure on the projects scheduled - provided, of course, the government concerned was implementing the programme as planned. Such a procedure could greatly simplify the administrative burden otherwise imposed on the individual member countries in meeting the detailed end-use and control requirements of several creditors on a project by project basis, yet ensuring that the proceeds of the loans were strictly applied to the foreign expenditure elements of an approved plan. It is appreciated, of course, that such "composite" financing might run into complications where loans are raised from countries which restrict their use to payment for their own exports. However, it should be possible to meet these by the member country exercizing suitable control over its executory agencies; better still, the evolution of such schemes for global financing

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1/ Possibly the ADB.

may pave the way for liberalization in international practice of the use of loan funds. In the simplification and rationalization of aid procedures it would be an even greater step if the Bank could persuade capital exporting countries to agree to release external loan or aid funds pari-passu, and in a pre-arranged proportion to, the certified disbursement of funds by the member country on an approved development plan.

IV. RELATIONS WITH MEMBERS AND BENEFICIARIES

Classes of Beneficiaries - Continuing Association of Interests

37. In pursuance of its operations the ADB will enter into relations with four classes of beneficiaries:

(i) Member Governments and Agencies thereof;
(ii) Private enterprises;
(iii) Undertakings whose function is to finance private enterprises; and
(iv) Special undertakings created for multi-national projects.

The one principle which will be common to its relations with all four classes will be that of continuity of interest and association. The Bank's relationship will not begin and end with the negotiation and conclusion of a loan or other agreement; it will proceed from a thorough study of the background to any project, its relationship to the economic development of the country and its neighbours, and its physical feasibility in relation to its objectives as well as to its financial and technical soundness. In the second or operational phase the Bank will maintain close contact with the beneficiary, not merely for the purpose of ensuring that the assistance extended is used properly, but also in order to offer any advice or other help that may become necessary. Although the Bank will not participate in the actual management of any project, it will aim at establishing the relationship of a partner rather than a mere financier to the beneficiary.

Member Governments and their Agencies: General

38. Assistance to member governments and their agencies will normally take the form of medium or long-term loans; in the case of assistance to government agencies the ADB will normally also seek a guarantee from the member government concerned. In considering any loan and its terms, the Bank will pay regard to the nature of the project and the prospective

position of the Government, including its other commitments.

39. It might also be among the Bank's activities to reduce, as far as possible and advisable, both by counsel and assistance, the member countries' dependence on short-term suppliers' credits; they either tend to tie the member country to particular sources of supply - in some instances, regardless of cost - or to lead to an excessive burden of debt servicing. To this end, the Bank could, subject to suitable safeguards, reimburse the cost of purchases paid in respect of a scheme preceding the final approval of the Bank loan and also refinance temporary "bridging credits". This, however, should not include the refinancing of ordinary suppliers' or other credits obtained from the negotiation of an agreement.

Private Enterprise: Limitations

40. Article 14 of the ADB Agreement provides for assistance of private enterprise, which may include equity investment. However, Article 15 limits such investments, if made from the ordinary resources of the Bank, to ten per cent of its ordinary paid-up capital (together with reserves and surplus included therein) and further specifies that such investment may not in any case exceed a certain percentage of the equity capital of the beneficiary to be determined by the Board of Governors.

Types of Eligible Private Enterprise

41. In considering its attitude towards private enterprise the Bank will be guided by the ADB Agreement and its priorities, and particularly the injunction that it should not lend money where this is available from alternative sources on reasonable terms. It might also be influenced by the view taken by the member government in the territory of which the undertaking in question is going to operate and be incorporated as to the role which private enterprise should play in local development. As to the Bank's own attitude to

private enterprise as such, it is suggested that it might require any venture which it assists to contribute to national development in a positive and specific way, e.g. by mobilizing additional local (even foreign) savings, raising the level of industrial skills, or producing goods which will strengthen the balance of payments. As a general principle, it is thought the Bank should not finance enterprises which require an excessive degree of protection and which would be contrarary to the long term interest of the country or the region.

Forms of Assistance to Private Enterprise

42. Assistance to private enterprise may take the form of a loan or equity participation, or of the first convertible into the second. It is suggested that in making assistance available the Bank should always have in mind, as far as circumstances permit, the possibility of eventually disposing of its interest to local investors. For this reason it will expect such enterprises to be able to earn a rate of return acceptable by good management standards, i.e. sufficient to pay a reasonable dividend and to put aside sufficient capital for further development. Without adopting any rigid rule, it may perhaps consider that in order to be "bankable" private projects should be able to earn 15 - 20 per cent on the total capital invested in the undertaking.

Equity Capital and Management

43. In cases where assistance is given to private enterprises by way of loan the ADB is likely to require security, normally over the property and fixed assets of the undertaking; it will also require that sufficient equity capital is assured from other sources and that the debt-equity ratio is not excessive in relation to the type of business involved. Where equity participation is involved particular attention will be paid to ensure that the total prospective equity capital is adequate and that other people's contributions are not "watered" by excessive valuation of any goodwill, patents or other contributions.

44. Although the Bank may not participate in the management of the undertaking, it will be entitled to satisfy itself that the management is efficient; it will normally make some provision to this end in any agreement, e.g. by specifying the composition of the Board of Directors or other devices, or requiring prior consultation before any changes are made in the management at higher level.

Limitation on Equity Participation

45. The maximum percentage to be fixed by the Governors for participation by the Bank in the equity capital of any particular undertaking clearly cannot exceed 50 per cent without involving the control of the Bank over the undertaking, - which is prohibited (Article 16(4)(b)). (In practice it would probably often obtain control with an even smaller percentage participation, if the rest of the capital is divided.) As a working rule, it is therefore suggested that the Bank may regard (33 1/3 per cent) as the ceiling for its participation in the equity capital of any undertaking, and, further that it should expect the promoter or his associates to put up a reasonable proportion of the balance himself.

Undertakings Established to Assist Private Enterprise

46. Experience in Latin America has convinced the Inter-American Bank that assistance to undertakings which re-lend the funds to private enterprise is a most fruitful way of promoting the development of member countries. The ADB, too, may consider the advantages of this form of lending, and may be prepared to finance both public and privately owned undertakings, - such as industrial banks, mortgage banks and building societies, - provided, of course, it is satisfied as to their policies and management.

47. Such assistance could be given by way of loan, the period of which should be determined partly by the type of investment which is to be financed and partly by the prospective long-term needs of the institution; there should be no

objection, in principle, on the part of a Bank to its funds being turned over and used for successive projects; on the contrary, it should expect such recipients to keep their capital revolving. Loans of up to about (15) years appear appropriate to such institutions. They might either be guaranteed by the member government concerned (in cases where it has established the institution) or enjoy prior rights, in the event of liquidation, over the assets of the institution, including any charges over the assets of its debtors.

Undertakings created for Multi-national Projects

48. There is little to be added here except to emphasize the necessity for the Bank to ensure that the project is undertaken in circumstances that assure it every prospect of success, i.e. that participation and necessary support by the various territories concerned is guaranteed, and that the executive agency or agencies are the right ones for the purpose.

Extent of Participation

49. It is frequently specified by banks operating in the development field that they will not provide more than a certain share - often 50% - of the total capital requirements of the project. In the case of the ADB the prescription of a rigid percentage ceiling for participation may have disadvantages since its practical effect will depend to some extent on the nature of the project. Some projects may have a far higher foreign exchange component than others. In other cases the size of the project itself, and hence any corresponding ceiling for participation by the Bank, may be a variable factor depending on the way in which the project is set out for the purposes of the application. It is, therefore, suggested that the Bank should not adopt any rigid rules in this matter except that its general objective should be to deploy its resources in such manner as will be most

conducive to securing additional capital for Africa from other sources. The ADB will never provide the entire capital needed for any particular project. On the other hand, it will require that:

(a) no matter how the scheme is described or defined for the purpose of the formal application, it must either be comprehensive and entirely self-contained, or be part of a comprehensive scheme full particulars of which are available to and approved by the Bank;

(b) estimates of financial requirements, both for the scheme as submitted and for any larger "background" programme, are comprehensively estimated and, when allowance is made for the expected contribution by the Bank, that such requirements are fully provided for by the applicant from his own or other sources;

(c) it will only contribute to local expenditure under the exceptional circumstances foreseen in Article 16 (b) of the ADB Agreement; and that

(d) it will require a substantial contribution to the scheme from other - including local - sources in accordance with their capacity, each case being decided on its merits.

V. FINANCIAL ASPECTS OF OPERATIONS OF THE ADB

Size of Loan

(a) Practice of the IBRD

50. The financial particulars relating to any specific loan operation made by the ADB will be laid down in the Loan Agreement. There are, however, a number of general issues in respect of which the Bank may wish to determine its policy before inviting any loan application. Among these one of the more important are the monetary brackets within which the Bank may be prepared to consider assistance for any particular project. In this context it may be noted that the average size of loan extended by the IBRD is now very large: at the end of 1962/63 it had provided a total of 349 loans with an original capital, net of cancellations, of $6,983,000,000, i.e. an average of about $20,000,000 per loan. This, of course, reflects the relative specialization of the World Bank in the financing of major capital-intensive investments such as power stations, railway and port developments, large dams, etc.

(b) Experience of the IADB and EIB

51. The Inter-American Development Bank, believed to have aimed in its earlier years at operations within the $100,000 and $5,000,000 brackets, has afterwards tended to move towards higher figures. By the end of 1963 it had made 193 loans from ordinary resources totalling $875,000,000 - an average of just over $4,500,000. And in 1963, its average was just over $6,000,000; its loans ranging from $245,000 for a chipboard plant to two operations of the order of $25,000,000 each for agricultural mechanization in Argentine and land settlement in Mexico. The average size of operations by the European Investment

Bank, according to its report for 1962, was also on a similar scale - nearly $7,500,000.

(c) Policy for the ADB

52. Compared with the prospective ordinary capital resources of the ADB of rather less than $250 million (including its capacity to borrow), such figures for average individual loans appear rather large. A distinction must be made, however, between the size of any particular loan by the Bank and the size of the total investment involved, which may be much larger. The Bank will, in implementation of the principle of "additionality", always endeavour to use its capital in the way which is most likely to attract other capital. Hence limitations on its own lending capacity are not the same as limitations on its power to assist the financing of large projects. Having noted this, it would seem desirable for the Bank to have some limits within which it will normally operate. It is suggested that these might be fixed between ($100,000) and ($5,000,000) for any individual investment.

Interest Rates

(a) Ordinary Capital Resources not to be used for "soft" loans

53. Although the first loans made by the ADB may be financed from its ordinary capital resources subscribed by its own members, on which it will not have to pay interest, there are cogent reasons why the Bank should be guided from the outset by what it would be likely to have to pay if it had raised funds on the world market. For its own capital resources are very limited and may be rapidly depleted when its operations get under way. It would also hardly be proper, or in accordance with sound banking principles, for the

Bank to use its ordinary capital subscriptions to make loans on specially favourable or "soft" terms similar to those applied, for example, by the IDA[1]. In effect this would mean that a relatively limited number of projects would receive loans in the earlier years at exceptionally low rates of interest while projects which are financed afterwards will have to carry higher rates (unless member countries were willing and able to effect repeated increases in capital). The practice of making low-interest loans from its ordinary capital will also not be conducive to creating that confidence in international financial circles which the ADB will need when it enters world markets as a borrower on its own account. Thus sound banking principles and its own international reputation demand that the Bank should charge economic rates for all loans made from its ordinary resources.

(b) IBRD and Interest Rates

54. The original practice of the IBRD in this matter was to base its interest charges on what it would cost to raise money on comparable terms in the world markets and add one per cent commission and a further one-quarter of one per cent to cover administrative costs. The latter was necessary because - as also applies in the case of the ADB - the one per cent commission had to be transferred to Special Reserve.

55. With the growth in resources and strength of the IBRD, however, this practice was changed; there are now no formal charges.

1/ There is no interest on IDA loans; but a "service charge" of $\frac{3}{4}$ of 1 per cent on amounts withdrawn and outstanding.

either for commission or for administration. Thus, current lending rates on disbursed portions of loans are $5\frac{1}{2}$ per cent, compared with long term borrowing rates of $4\frac{1}{2}$ per cent in New York and rather more elsewhere.

56. The IFC, however, follows a more flexible policy in conformity with its role as an instrument for financing private enterprise; rates between 6 per cent and 10 per cent appear in its loan schedules, the actual rate in each case being determined by relevant circumstances, including the risk factor and the overall return on the investment.

(c) The Practice of the IADB and the EIB

57. The practice of the Inter-American Bank is somewhat more complicated. It reckons at raising money currently at $4\frac{1}{4}$ - $4\frac{1}{2}$ per cent in New York and between 5 - $5\frac{1}{2}$ per cent in Europe. It relends at $5\frac{3}{4}$ and 6 per cent; in the case of European currency lending, there is, in addition, a "service commission" of a maximum of 1 per cent.

58. The lending rates of the European Investment Bank are calculated having regard to market conditions and are designed to allow the Bank to meet its obligations, cover its expenses and establish a Reserve Fund. There are no specific commissions or administrative charges. Bank borrowings have taken place over the years 1961 to 1964 at rates which have varied between $4\frac{1}{2}$ - 6 per cent, the most recent rate being $5\frac{1}{2}$ per cent (in 1964 for a Dmark loan). The Bank's current lending rate is $5\frac{7}{8}$ per cent.

Considerations regarding Interest Rates for the ADB

59. In determining its rates of interest the ADB will be guided by those Articles in its Agreement which require it to "apply sound banking principles to its operations" and to "take due account of the terms and conditions on which the corresponding funds were obtained by the Bank"1/. For reasons set out in paragraph it is considered that the Bank should take the current rates of lending in world markets into account when making loans from its own capital resources. However, since such rates vary considerably between New York and Europe the question which arises is which rates should be used for this purpose. Since the Bank will wish to make its funds available to members on the most favourable terms it may be inclined to base its initial rates on the long-term borrowing rate in New York2/ and, in addition, to charge its "statutory" commission of 1 per cent and some small additional margin to cover its administrative expenses3/. However, the ADB may also have to consider that:

(a) in due course, it will surely have to raise funds in Europe;

(b) as a general rule, its lending will be made in association with other sources which may include European funds; and that

1/ Cf. ADB Agreement, Articles 17 and 18.

2/ On the assumption (which might not of course remain valid) that long-term interest rates are lower in New York than in Europe.

3/ Since their commission must be applied, under Article 20, to Special Reserve.

(c) members are likely to expect that interest rates should not vary much between loans of similar type for similar projects made about the same time to members or borrowers of comparable status.

60. Even assuming the ADB could expect over the years to borrow all its requirements at prime rates in New York, and that market rates there remained around the $4\frac{1}{2}$ per cent mark, it would thus have to charge <u>at least</u> $5\frac{1}{2}$ per cent as its basic long-term rate including commission <u>plus</u> whatever was considered necessary to cover administrative expenses. The latter could hardly be less than $\frac{1}{8}$ per cent and will more probably be of the order of $\frac{1}{4}$ per cent, thus raising the overall rate to the customer to about 6 per cent. If the Bank was raising funds in Europe, the corresponding figure (at present rates) would be $6\frac{1}{2}$ – 7 per cent. As already mentioned, the Inter-American Bank uses its commission as a means of differentiation between the effective interest rate payable by borrowers of European currencies compared with those borrowing in US Dollars; the ADB could adopt such a device subject to the minimum commission of 1 per cent (Article 19). It may also be argued that so long as its borrowing is made in convertible currencies and its loans therefrom are repayable in such currencies, it would be preferable to apply a flat average rate of interest to its current lending since it may be a matter of chance whether a particular beneficiary of the Bank receives its loan in American or European currencies. It hardly seems possible to come to a definite conclusion on such matters before the ADB is established and has had time to consider its attitude

to borrowing, which will, of course, include not merely consideration of relative interest rates in the different centres (which may by that time exhibit a different pattern) but also the attitude assumed in the markets concerned towards the Bank itself as a prospective borrower. In general terms, however, it is suggested that if the Bank intends to enter both European and American markets as borrower, it should consider effecting such operations within a reasonable time of each other, and then applying a common basic rate of interest to all current relending based on "averaging" the costs. On this basis members would not find themselves discriminated against as a result of the chances which determined whether their particular loan was derived from borrowing from this or that source. This suggestion is based on the assumption that the borrowing itself was effected in convertible currency.

Differentiation of Interest Rates

61. The question may be raised whether the ADB should differentiate in its interest rates between different types of loans. In this connection a line could perhaps be drawn between loans provided for productive projects and for projects of an infrastructural nature. Consideration may therefore perhaps be given by the Bank to establishing a "two-tier" structure of rates, viz:

(i) a basic rate applicable to loans destined to finance infrastructure projects; and

(ii) a discretionary rate applicable to other loans and riding above the basic rate by between (one per cent) and ($2\frac{1}{2}$ per cent) depending on the risk element and the prospective return on the investment.

62. The "basic rate" would be either a single "averaged" rate, as suggested in paragraph , or a rate based upon the corresponding rate at which the funds loaned were actually borrowed, or could have been borrowed, in the currency in which the loan is denominated. Basic rates would (subject to market fluctuations) be kept steady for as long as possible and would apply regardless of the repayment period of the loan. Such interest rates would, of course, be fixed and constant throughout the period of any loan once it had been finalized.

Commitment Charges

63. The ADB Agreement makes no specific reference to commitment charges. These charges, levied on the undrawn portion of any loan which has been "committed" (i.e. pledged) to a borrower, are intended partly to encourage the latter to proceed with his project promptly and partly to compensate the lender for the loss of interest resulting from having to hold the funds at the borrower's disposal. Where the borrower binds himself to make his loan drawings in accordance with a predetermined time schedule the loss to the lender due to the latter may be little.

International Practice regarding Commitment Charges

64. The IBRD originally charged $1\frac{1}{2}$ per cent as commitment charge, but reduced this in 1950 to $\frac{3}{4}$ per cent and has since lowered it still further to $\frac{3}{8}$ per cent. The IADB levies $\frac{3}{4}$ - 1 per cent as commitment charge on loans denominated in US Dollars and up to

$1\frac{3}{4}$ per cent on loans expressed in European currencies.

65. It is suggested that the ADB should keep its commitment charges as low as consistent with sound financial practice. That short-term rates (at which it may invest funds awaiting withdrawal) are now generally higher than they were some years ago may be a helpful factor in this direction. To facilitate this, it may perhaps be made a general rule that borrowing should, wherever possible, be linked with a timed schedule of drawings; so long as the borrower adheres to this he should be subject only to a minimum rate of commitment charge, say, of the order of $\frac{1}{2}$ per cent; in other cases a higher rate, say, 1 per cent should be applied.

Periods of Grace and Repayment

66. Most borrowers need a period of grace before commencing repayment of interest and capital in order to tide them over the construction period and get the new project into full operation. Interest due during this period is capitalized. The ADB should be prepared to grant such grace periods to its beneficiaries depending on the nature of the project, time required for construction, etc. A period of 3 - 5 years may be considered for sizeable projects, while longer periods might be granted in special cases.

67. The period of actual repayment of the loan will similarly be determined by the nature of the project and the financial position of the borrower. Without wishing to prescribe any rigid rules, the Bank might be prepared to contemplate loans of up to 25 years for major capital-intensive investments where the capital-income ratio is relatively high - e.g. ports, dams, large power stations, railways, etc. Loans for ordinary agricultural

or industrial development should, however, normally be amortizable over somewhat shorter periods - say, from 10 to 20 years - and any loans for the purchase of specific plant or equipment should always be amortized well within the prospective economic life of the items concerned. Generally speaking, loans to private enterprise will also be amortizable over shorter periods than those to be guaranteed by member governments, since such investments are likely to carry a somewhat greater risk factor and should also have a higher prospective rate of earnings than may be applicable to public investments.[1]

Resale of Bank Loans and Equity-holdings

68. In order to spread its own resources further and mobilize additional capital for African development, the ADB should always have in mind the resale of its loans and equity investments. Where loans are concerned, it will seek to interest African and international banking institutions in the purchase of the shorter dated

1/ From the 1962-63 Report the average length of IBRD loans appears to be about 18 years, the list ranging from a year to 30 years. However, there are few loans at these extremes. The two 30-year loans include an early reconstruction loan to France and a more recent multi-purpose loan to Pakistan (for $90 million); there are 55 loans of about 25 years terms most of which are for power programmes, although port development, irrigation, railways and even "equipment for development" figure in this list. Investment in power development indeed generally seems to justify loans of 20 to 25 years duration, and railways 15 to 20. Most of the Bank's loans described as being to "agriculture" are however markedly shorter - 10 years or even less, while the bulk of industrial loans are in between, e.g. the industrial loans to Australia, India, Japan and Latin America are from 15 to 17 years. Loans made for the purchase of aircraft have been for 6 to 8 years. The Inter-American Bank seems to favour somewhat shorter periods for its loans, its schedule ranging from 6 to 21 years with an average of about 13. Its loans to public authorities for power, water supplies and irrigation generally run up to the 20 or 21 year mark, while those to private enterprise for industrial development are usually only about half that span.

maturities (either at the initial negotiation of the loan concerned or at a later date). In the case of equity investments, it will look for local investors who would be willing to participate in the industry by taking over part of the Bank's holdings. It is not thought, however, that it should normally resell equity holdings in African undertakings to non-African institutions or investors.

69. In order to facilitate such disposal of its investments the Bank might endeavour to extend loans and equity investments on such terms that these will subsequently be attractive to other investors.