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Mixed Forms of Capital Aid

by Lothar Gref, Aachen

Capital Aid comprises various forms of providing development finance under easier conditions than those under which beneficiaries would be able to obtain funds in the international capital market on the basis of their financial standing. When bilateral forms of financing are used, funds reach the developing countries directly; multilateral aid uses as intermediaries international organisations to which the funds flow, on whose application these organisations decide independently. The composition of such organisations as to membership, and the areas to which they direct their help, make it possible to classify them as either international, regional, or multilateral organisations. For the methods of financing discussed in the present article, three organisations are of special importance — the International Bank for Reconstruction and Development (IBRD), also known as "World Bank", the International Development Association (IDA), and the Inter-American Development Bank (IDB).

Bilaterally and multilaterally distributed capital aid may be used jointly for financing a specific project. Depending on how the funds are mobilised and through which organisation they are channelled, we may distinguish between joint financing, parallel financing, consortial financing, and financing through special funds — all these forms of financing being mixed or intermediate forms of aid.

Joint Financing

Joint Financing is the mobilisation of funds for given projects through bilateral or multilateral capital aid jointly with the provision of finance through other donor states or donor organisations. In such cases, individual donors remain separate and independent partners-in-aid of the recipients, but on condition that bilateral and multilateral funds are, in fact, being used for financing the said project.

As two examples for such financing which have occurred in 1968/69 we can mention that:

□ Sweden and the World Bank have jointly provided \$ 9 mn for improving and enlarging the network of Ethiopian telecommunications. The World Bank lent Ethiopia \$ 4.5 mn for repayment after twenty years, carrying an annual interest at a rate of 6.5 p.c., and redemption payments starting after 4½ years. Sweden gave Ethiopia a loan for the same sum, but charging only 2 p.c. interest and expecting repayment over 25 years, the first redemption rate becoming due after 10 years. The debtor country itself promised to provide \$ 12.5 mn.

□ The World Bank, IDA, and Sweden agreed to provide joint finance for an Ethiopian road building programme. The World Bank's loan amounts to \$ 13.5 mn, repayable over 24 years, repayments start after four years, and interest chargeable at 6.25 p.c. p.a. IDA made its contribution to the extent of \$ 7.7 mn for a period of 50 years. Repayment will start after 10 years, the annual repayment rate being 1 p.c. of the capital sum during the next 10 years, and thereafter 3 p.c. during the remaining 30 years. Though no interest is charged by IDA, an administrative fee of between 0.75 and 1 p.c. p.a. of the remaining debt outstanding has to be paid by Ethiopia. Sweden has contributed a credit of \$ 5.8 mn, also for 50 years, at an interest rate changing between 0.75 and 1 p.c. annually. Ethiopia's own contribution to the road building programme will be \$ 11.4 mn.

Multilateral Effectiveness

Another form of joint financing occurs when multilateral organisations transfer credit balances owned by them, which have arisen from credits granted to developing countries, to donor states or their financial organisations (banks, etc.). In such cases, for example, debtor states will issue loan bonds of their own to the World Bank which, in its turn, may sell them in the capital market at the time of their issue (loan participation) or later (portfolio sales).

Joint financing has many advantages which, in the last analysis, make for higher effectiveness of

capital aid in the developing countries. Some of these advantages may be described here:

☐ Individual donor states and donor organisations may be in possession of exhaustive and specific information about certain developing countries, lacking in other donor states completely or in part. Thus, former colonial powers, e.g. France and the UK, will generally be better informed than other nations. To a limited extent, this is probably also the case with the US and the Federal Republic of Germany, because they are such important trading partners, and it is surely the case with the group of institutions ranged round the World Bank, by virtue of their expert knowledge as providers of intercontinental finance. This means that joint financing may lead to the tapping of such sources of information in relation to a project to be supported.

☐ It is easier to finance large projects through joint finance, because individual creditors will be able to take over the provision of aid for parts or subdivisions of the project in hand, consulting in the process their own possibilities and inclinations. This also permits a welcome spreading of risks. Debtor countries very often also benefit from the mixture of conditions for obtaining capital aid from diverse sources. The World Bank at present charges annual interest rates of 6.5 p.c., and on average its loans are being granted for more than 20 years. IDA requires repayment after 50 years; it charges no interest but only an administrative commission averaging an annual 0.75 p.c. of the debt still outstanding. The Inter-American Development Bank at present issues its credits at 7.75 p.c. interest for up to 20 years. Weighted average conditions of all creditor states affiliated to DAC (Development Assistance Committee) worked out at 3.3 p.c. annual interest in 1968 and a median repayment time of 25 years. The 16 DAC members provided 95 p.c. of all aid granted to developing countries in 1968.

☐ For the multilateral part of project finance, debtor countries escape all possible political "strings" and ties to individual exporting countries in the form of delivery clauses. If and when multilateral organisations contribute to development finance, this probably also increases the degree of continuity of aid, since the funds vested in such organisations are hardly subject to fluctuations through political or economic changes (e.g. international payments difficulties of individual countries). Also, their attitudes regarding the financial contributions expected of debtor countries is more consistent than that of creditor states, which also works for increased effectiveness of capital aid.

☐ There is little risk that joint financing will enable developing countries to indulge in building showy "monuments" to their economic policies, or creditor states to finance "windowdressing". If supplementary finance becomes necessary later,

these requirements can again be shared by participants, and individual creditors have to shoulder lighter burdens. Mixed forms of aid, at the same time, improve coordinated development policies.

Parallel Financing

Parallel financing is a specialised form of joint financing, when multilateral capital aid is blended with private export credits derived from one or several creditor states for making given projects possible. Also bilateral capital aid may additionally be used as a source of funds. Such forms of combining both bilateral and multilateral aid are not subject to any coordinating authority, and individual creditors remain independent contracting partners of the debtor.

Such mixed financing increases the funds made available for a given project through a multilateral organisation by adding to them bilateral export credits, without giving up the method of free worldwide tendering and awarding of contracts. Cases of parallel financing were hitherto drawn up in the form that tendering was invited and awards were made exactly as under normal conditions of multilateral financing of projects. However, creditor states whose exporters were awarded contracts had always to promise capital aid up to a certain percentage share in the total value of such contracts. If worldwide tendering and awarding is to be retained, as a matter of principle, without permitting suppliers to obtain contract awards without their countries of origin subscribing to development aid under the same financing scheme, all creditor states involved in such a scheme must be persuaded to promise credits before tendering starts.

An actual case of parallel financing was the following one: In Bogotá (Colombia), it was intended to improve public utility piped water supply and the electricity distribution network. Finance was to be provided jointly by the World Bank, Belgium, the Federal Republic of Germany, France, the UK, Italy, Japan, Canada, the Netherlands, Sweden, Switzerland, Spain, and the US, the total requirements being \$ 42 mn. The World Bank decided to grant, a 6.25 p.c. loan of \$ 32 mn for a period of 20 years. The loan will be used to finance contracts that are not awarded to manufacturers in the participating countries. How much the individual creditor countries lend the city of Bogotá depends on the value of the orders awarded to them under an international tendering system. It is expected that the countries named will mobilise in this way jointly at least \$ 10 mn. If this amount should be higher, the World Bank will be in a position to reduce its own loan correspondingly. Costs arising in local currency to the equivalent of about \$ 35 mn will be covered by Colombia itself.

The advantages found to be connected with joint financing are also present in parallel financing. In addition, exporters resident in creditor states will be more willing to take part in projects of development aid, as every such project is made financially secure in an almost cast-iron fashion through the well-known care of multilateral organisations in designing and supervising projects under their sponsorship. Suppliers may be required to contract for supplying management staff during the initial period of running in the completed project, which will ease leadership problems in developing countries.

Should creditor governments take part in such a mixed form of financing, they may individually support their own industries through subsidies, without tying such help to individual deliveries. Debtor countries benefit from international tendering, as this system enables them to buy goods and services at optimum conditions. The weak side of parallel financing is probably the usually moderate size of suppliers' credits, the usually short periods for which they are granted, and the necessity of obtaining promises of finance before suppliers will tender and accept contract awards.

Consortia

When creditor countries and creditor organisations come together for the purpose of making available capital jointly for projects in developing countries through a joint coordinating body, such bodies are described as consortia. In most cases, consortia of this kind have been set up to aid one single country (national consortium). Consortia centering round projects have been rare and refer only to one individual project. Consortia covering several debtor countries (regional consortia) have not yet been formed.

Members of consortia constantly discuss with the recipient of their aid the problems of the country or project scheme so assisted, they act as consultants for the making of development and project plans, and they study and examine existing plans. Members of consortia pledge their credit up to definite limits, and they guarantee continuity in making credit funds available. Aid granted by donors is being coordinated with the special requirements of recipients of aid, and among members of the consortium as to size, type, and conditions. For such purposes, members of any consortium must continuously exchange information and data.

In 1958, the World Bank sponsored the formation of the Indian consortium, and in 1960, the formation of one for Pakistan. Consortia for Greece and for Turkey were set up in 1962 at the behest of the OECD.

An example of a project consortium is that for the waters of the Indus river and its tributaries, which

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was formed in 1960, in order to organise and create an irrigation system for parts of India and Pakistan. Apart from the two ripuary states, India and Pakistan, Australia, the Federal Republic of Germany, the UK, Canada, New Zealand, the US, the World Bank and its subsidiary IDA, all became members of the consortium and contributed finance.

Consortia are capable of examining the economic state of a development country without bias, and without the debtor country needing to fear any individual creditor countries bringing undue political influence to bear. By coordinating multinational aid, available funds will be applied more effectively. At the same time, debtor countries are enabled to plan their development over the long term. Their indebtedness may be discussed more dispassionately among a large circle of creditors. It will be easier to agree upon a conversion of the debt and to mobilise additional finance. In addition, all the advantages found to be connected with joint and parallel financing are present also in these cases. On the other hand, there is one disadvantage in consortial work: co-operation within a consortium forces the individual creditors to spend much more time and work of their expert staffs on given projects.

There are also advisory panels, which do not pledge their members to make binding promises of granting capital aid. Such panels make only recommendations on the size, kind, and conditions of credits made available by their members, without making decisions on, or influencing credit decisions of, their members. Otherwise, the tasks of advisory panels are more or less identical with those of consortia — they may work on national development policies, on regional aid, and on finance for certain projects.

Functions of the World Bank

Within the national consortia formed under its sponsorship, the World Bank has assumed the following tasks:

- ☐ to draw up reports in depth on the economic situation and future development chances of the corresponding country;
- ☐ to give advice for drawing up development programmes, and to do consultants' work on the way they are being carried out, if the debtor country asks for such services;
- ☐ to help in looking for suitable projects, in drafting them, and in recruiting the required technical aid;
- ☐ to make recommendations to members of the consortium, and to the developing country aided by it, as to desirable priorities for certain sectors of the economy and for individual projects;
- ☐ to make estimates as to the volume of aid required, and to draw up proposals for mobilising the required funds, working out the conditions under which such funds may be supplied;
- ☐ to coordinate all financial aid given by the members of the consortium, to supervise the execution of projects, and to make successive evaluations of their progress.

Special Funds

Monies handed to a multilateral organisation for administering them, which are passed on through such an organisation to one or more recipient countries, are vested in special funds. The credit organisation selects projects to be financed by them, supervising their execution, and reporting back to the donors regularly on the state which such projects have reached at any time. Conditions for lending out such monies are being fixed after previous consultations with the donor country. Granting loans may be tied to awarding supply contracts to, or make use of the services of, the donor country. By setting up special funds, even non-members of multilateral organisations may contribute to their work.

Special funds have gained especially high importance in the work of the Inter-American Devel-

opment Bank. In addition to credits granted to the "Social Progress Trust Fund" by the United States, the Federal Republic of Germany, the UK, Canada, the Netherlands and Sweden have all made available credits to special funds, some of them large, but except in the case of Sweden, all of them were made conditional on purchases in the creditor countries.

Mixed Forms of Aid with Future

The following examples illustrate the purposes for which some such funds have been set up, and the conditions under which they may be drawn upon:

- ☐ the Dutch government has promised \$ 10 mn for financing projects serving Latin American economic development, which at the same time also enjoy IDB support. Repayment, after seven years without redemption, may be deferred for a total period of 25 years. Rates of interest must not be higher than those charged by the Bank for credits drawn from its own funds. Of these Dutch credits, 80 p.c. are conditional on supplies being bought from Dutch industry, whereas the balance of 20 p.c. may be used for bearing local costs.
- ☐ the British government has agreed with IDB the uses to be made of an \$ 11.6 mn fund, also for supporting economic development in Latin America. Repayment may be extended over 15–25 years; repayment need not start before 7 years have passed. Rates of interest are to be fixed on the merits of the individual cases. Credits are conditional on buying British goods.

Regional development banks, as well, intend to begin setting up special funds in future. The first one to do so is the Asian Development Bank, which will form a Special Fund for Promoting Agricultural Development, to be financed by the US with \$ 200 mn, by Japan with \$ 100 mn, and by other donor countries with a total of \$ 100 mn.

By taking over the management of special funds, multilateral organisations are enabled to add to the regular flow of funds derived from membership contributions of affiliated countries, and thus to increase the volume of their aid. Individual donor states, in their turn, via the special funds, may utilise the good services of experienced organisations, e.g. for examining projects and watching their progress, without giving up their influence on the purposes for which their donations are used, and on the conditions for granting credits. Donor countries in this way show their faces to recipient countries, as their benefactors, which may strengthen their reputation, as they hope. Debtor countries enjoy the advantages of all the other mixed forms of aid, and these advantages also make for more effective use of capital aid.