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Regional Development Banking

by T. E. Mswaka, St. Andrews*

Although regional development banking is a recent institution in the field of international cooperation, the author asks the question whether in the light of current and possible events in the 1970s its fundamental policies are appropriate to those developments in particular, and to economic development in general.

At the close of the 1960s, in Africa and Latin America in particular, a wave of nationalisation of private companies and properties by governments could be witnessed. In Africa, nationalisation has been accompanied or preceded by restrictions and protection which sought to assign areas of economic activity between citizens and non-citizens. Notable examples here are the restrictions against the Asians in East Africa and the Zambian and Nigerian restrictions against non-citizen traders. This apparently represents a new nationalist strategy of economic development which can be expected to continue. The immediate question, however, is how far these developments affect the activities and operations of regional development banks [1], and what modifications are necessary in their present strategy to meet these requirements of the 1970s? In other words, what should regional development banks do about it?

In order to answer this question, it is important first of all to look briefly at what their strategy is. While each regional bank operates within its specified regional area, little fundamental differences exist between them in their conception of their role, as well as in the basic philosophy underlying their activities[2].

The catalyst in this field from which these policies emanate is the World Bank and its Associates. The earlier conception of the process of development by the World Bank and of its role in that process was in favouring lending for infrastructural investment concentrating on power and transportation[3], at the almost complete exclusion of agriculture and education. Part of that strategy also was to shy away from lending to countries which had large publicly owned sectors and/or which nationalised private enterprise[4].

World Bank Framework

While the World Bank has not abandoned its earlier framework, it has considerably diversified its field of operations. Not only does it now lend on educational projects, but it also extends loans for family planning. The establishment of the International Development Association (IDA) and the International Finance Corporation (IFC) as associates of the Bank, with the former enabling it to extend soft long-term loans, and the latter to participate in and even initiate industrial projects, facilitated a change of emphasis and resource allocation by the World Bank.

The imprint which this institutional apparatus of the World Bank has made on the newer regional development banks can be seen, and has its equivalence, in the sprawling Special Funds resources which have become somewhat a hallmark of development banking activities and success, or lack of it. In the case of the Inter-American and the Asian Development Banks, Special Funds resources play a crucial if not a decisive role in the volume and multiplicity of their activities. Both the Charters of the African and the Caribbean Development Banks make provision for the establishment of special funds. The African Development Bank is currently in the process of establishing an African Development Fund which it sees as crucial to its future activities.

There are a number of distinguishable phases which indicate shifts in emphasis in the activities of international banking, both in terms of the nature and form of finance made available for development and of the sectors in which those financial resources are spent. The shift in the emphasis has

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[1] The oldest of these banks is the Inter-American Bank established in December 1959. The African Development Bank was established in September 1964. The Asian Development Bank in August 1966 and the Caribbean in 1969.

[2] They are aptly summed up in the First Annual Report of the African Development Bank; Abidjan 1966, p. 32.

[3] World Bank and IDA, Questions and Answers, Washington D.C., September 1971, p. 34, answer to question 56.

[4] Andrew Shonfield, The Attack on World Poverty, 1961.

been from power and transportation to industrialisation, while now more emphasis is placed on agriculture and infrastructure[5].

Shifts in Emphasis

The shift in resource allocation among sectors of the economies of the less developed countries (LDCs) is not the only significant thing which has taken place in recent years. Significant, too, is the fact that the new nationalist policy of "indigenousation of the economy" should follow closely the abandonment of the rigid attitude against nationalisation and public authority participation in the economy. The strategy, which is manifest in the trend towards greater indigenous participation, ownership and control of the economy in the majority of LDCs today, raises questions of the propriety and sufficiency of the approach and strategy of international development banking.

Much as the fluctuating emphasis raises the question of whether these institutions have correctly identified the real needs of the LDCs, the immediate question is whether they should not adjust their strategy in order to take account of and to support this new trend. This new strategy of development in LDCs suggests two basic points. The first is that there is an urgent need for a reappraisal of the whole development effort and strategy by both the World Bank and the regional development banks. Secondly, that such an appraisal must take into account the fact that it is no longer enough to provide financial resources to whoever is capable of using them without distinguishing between indigenous and non-indigenous, but that it must actively seek to bring about indigenous ownership of the economy.

It can be argued that there is no need for any fundamental change in approach since no company, state or privately owned, national or foreign, can raise funds from these institutions without at least the approach and/or guarantee of the national government. Because of this unique position, any national government is therefore able to discriminate, through the exercise of its power of approval, in such a way as to ensure that such funds are channelled to wholly indigenous companies.

While recognising this argument, the point to be made here is that a clear and open declaration of policy is what is called for. For the LDCs do not only need the provision of funds and technical assistance, but also a channelling of these resources in order to increase indigenous control and ownership, not just participation. This approach is not incompatible with, but essential to a sound long-term development strategy.

Furthermore, there must be an overall review of the banks' lending policy away from infrastructure towards the small-scale sectors. In coming to this conclusion a number of important factors have been taken into account. The first was to recognise that regional development banks prescribe minimum sizes of loans below which they are not prepared or below which it would not be economic for them to lend. For the African Development Bank the minimum amount it is prepared to lend (studies being exceptional to this) is $ 100,000. These minima are very likely to be outside the reach of a majority of small scale entrepreneurs.

Equity Participation Instead of Loans

As the other extreme example, the Industrial and Commercial Development Corporation of Kenya in the period 1970–71 approved a total sum of K£ 2,553,000 to 958 traders and industrialists, which represents an average size of loan of only K£ 2,664. It is not difficult to see the financial gap which exists given both the need for funds at the small-scale level and the very high minimum size loans laid down by regional development banks. While recognising that the global loans are extended presently to cover some type of small-scale entrepreneurs, nevertheless the proportion of these funds is very much smaller compared to what goes to other activities financed by these institutions. The amount of financial help which can be extended to the individual units is smaller than that going to the medium-sized units.

Even if this is accepted as being inevitable and necessary, the second question of the effectiveness of this type of loan and its purpose is still relevant in relation to needs of the entrepreneurs and to the development needs in general. In their study of African businessmen in Kenya, Morris and Somerset concluded that there was no shortage of finance in Kenya as such for the established business activities, if only there was greater knowledge of the sources of finance on the side of businessmen as well as willingness on the part of financial institutions to understand the African businessmen and their problems. It was their view that government should instead seek equity participation rather than loans, and more important, that its role should be increased in financing African enterprises in new fields which would be hard to finance commercially, "since there are no precedents to assess their competence"[6].

[5] Address to the Board of Governors by Robert S. McNamara, President World Bank Group, Washington D.C., Sept. 27, 1971. Also see the Interim Report by the Board of Directors of the African Development Bank, Board of Governors, Seventh Annual Meeting held at Kampala, July 1971.

[6] Peter Morris and Antony Somerset, African Businessman, A study of Entrepreneurship and Development in Kenya. London 1971, p. 235-6.

Oddly enough, the area of development banking is one whose precise contribution to economic development we know little or nothing about. The standard approach of all development banks is to measure their contribution in terms of their own volume of financial input in the development effort. Annual reports of development banks are invariably pre-fixed by the volume of loans given and other financial resources made available to the LDCs. Readers of these reports are then showered with innumerable photographs of projects in which the funds have been expended, with, in some cases, detailed statistical tables and charts showing a breakdown of this material into suitable components. Nowhere in these reports or elsewhere is there any precise quantification of the contribution which these resources have made to the development effort of the countries for which they are intended. The only exception interesting to note is the World Bank which has somehow rather belatedly awakened to this fact. For 90 p.c. of its projects in 1971, the Bank estimated an average of rate of return of 18 p.c. to the LDCs. On the other hand the International Finance Corporation estimated that the projects in which it took part added 19,000 new jobs, and provided £ 53 mn in new export capacity while reducing imports by approximately £ 167 mn[7]. But it is necessary to know the precise impact of the development finance on the economies of the countries which receive financial help from regional development banks.

Additional Employment

What is required today are precise ways of monitoring the economies of the LDCs in respect of their key development variables, as well as attempting to assess precisely the benefits which accrue to them from the resources made available. In this connection, we need to know the precise additional employment created as a result of the projects undertaken. This assessment will have to be made both in terms of the sectors of the individual projects and in terms of the economy as a whole in order to ensure that the increase in employment is a genuine net addition.

Assessing the net additional employment has become urgent not only because of the development of serious unemployment in the LDCs but also for a number of other reasons. Firstly, although the rate of growth of GNP in many countries has been faster, the rate of employment absorption has been much slower resulting in fewer people being employed and also resulting in even wider inequalities in income distribution. A number of statistics illustrate this point. In the decade 1950–60 the population of the LDCs grew on average at a rate of 2.3 p.c. while the labour force grew at a rate of 1.6 p.c. over the same period. In the decade 1960–70 the average rate of growth of the population was 2.6 p.c. and of the labour force 1.9 p.c. Projections for the next decade after 1970 are that while the population will grow by 2.8 p.c. the labour force (15 years and over) will grow at the rate of 2.3 p.c. In the period 1970–80 the proportion of the labour force fully employed (excluding mainland China) in the LDCs is expected to decline from 75.3 p.c. in 1970 to 70.5 p.c. in 1980[8].

The evidence in the case of income distribution is equally bad. Brazil's real per-capita GNP in the decade 1960–70 grew by 2.5 p.c. per annum. The share of national income received by the poorest 40 p.c. of the population was 8 p.c. in 1970 compared with 10 p.c. in 1960. This compared with 38 p.c. in 1970 and 29 p.c. in 1960 of the share of national income going to the richest 5 p.c. of the population. The share of the poorest 20 p.c. in Mexico in 1950 was 6 p.c., declining to 4 p.c. in 1969[9]. What is disturbing, however, is the fact that, in spite of this evidence, nothing has been done to assess the exact manner in which external development finance may – or may not – be contributing to these developments.

Foreign Exchange Savings

It is almost without exception that a very large proportion of the loans extended by both the World Bank Group and the Regional and Sub-Regional Development Banks is for meeting the foreign exchange components of the project for which the loans are made. In a programme of import substitution, for which these loans are extended, it would not be impossible to compute the extent of foreign exchange savings. Such savings originate from two sources: First, from the foreign exchange which the country would have had to find otherwise (although account has to be taken of the currency in which the loan has to be repaid), and secondly from substituting domestic production for imports which are not required anymore. This information has never been made public, although it must form part of the project appraisal studies of these banks. A project by project approach to foreign exchange savings along these lines cannot be satisfactory when the impact of the project on the balance of payments through the income it generates is not known. This is particularly important when account is taken of the nature of the unequal distribution of national income and possible high import propensities to consume which this might entail.

[7] McNamara's Address to the Board of Governors, p. 1; IFC Annual Report of 1970, p. 8.

[8] McNamara's Address to the Board of Governors, p. 10.

[9] These figures are taken from McNamara's Address to the UNCTAD, April 1972, p. 4.