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The "Pipeline" Problem in Bilateral Financial Cooperation

by Wolfgang Buch, Paris*

It has been observed since about 1976 that financial commitments to developing countries have been disbursed more slowly than in the past. At the same time there have been increasing complaints from recipients that the commitment, appraisal and disbursement procedures of the donor countries were excessively complicated, resulting in a delay of disbursements. The Western industrialized countries, both individually and jointly in the Development Assistance Committee of the OECD, therefore initiated investigations into the importance to be assigned to this phenomenon as well as into the question of whether there are any possible ways of simplifying the administrative procedures. The following article sums up the results of such a study by the German Institute for Development Policy in respect of the Federal Republic of Germany.¹

The fact that open commitments by the Federal Republic of Germany to developing countries had risen from DM 5.17 bn to DM 10.68 bn between 1972 and 1978 has, among other things, caused some concern that grave risks have arisen in this area for the medium-term planning of expenditure by the Federal Government. Moreover, it has raised the question of whether the further increase of commitment authorisations in the budget of the Federal Ministry for Economic Cooperation – in itself regarded as urgently necessary – can be justified from the point of view of development policy.

The Federal Government therefore commissioned the German Institute for Development Policy in Berlin to study the connections between planning procedures and financial resource flows in bilateral financial cooperation (formerly capital aid) with developing countries. At the focus of this study was the question of whether the planning and implementation procedures for projects or programmes in developing countries have led to excessively long preparatory periods and to a backlog of open commitments. For this reason the planning process in financial cooperation, the administrative procedure and the available data on financial commitments and outflows were subjected to a close analysis.

Outline of the Procedure

To provide a clearer understanding of the problems involved a brief explanation will be given of the

procedural steps from the appropriation of funds in the Federal Budget through to the disbursement to the recipient (institution in the developing country). There are two planning and decision processes running in parallel or interacting: budgetary planning and project planning. On the basis of government proposals Parliament approves two sums in the Budget: the cash expenditure and the commitment authorisations for the budgetary year concerned. The latter enable the Federal Republic to undertake commitments for expenditures in future budgetary years; any such expenditure requires the prior drawing on a commitment authorisation, i.e. an appropriate promise to the developing country. This authorisation is of considerable importance to financial cooperation because the protracted and time-consuming preparation of projects as a rule results in expenditure not arising until future budgetary years. The subject of planning, therefore, is the commitment authorisation.

Under what is known as framework planning the commitment authorisation is shared out among individual recipient countries and projects. Factors in its formulation are criteria of development policy, foreign policy and economic policy. At its centre is the fixing of so-called national quotas, i.e. the amounts to be allotted to individual developing countries for the budgetary year concerned, amounts which have to be filled up with projects.

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¹ Wolfgang Buch, Horst P. Wiesebach: Planungsverfahren und Mittelabfluß bei der bilateralen finanziellen Zusammenarbeit (Planning Procedures and Resource Flow in Bilateral Financial Cooperation), Berlin, 1980.

While planning and coordination of projects is in the hands of the Federal Ministry for Economic Cooperation, it is the Reconstruction Loan Corporation (Kreditanstalt für Wiederaufbau – KfW) that is entrusted with their implementation. The procedure provides for the following steps:

(1) On the basis of an application – e.g. in inter-governmental negotiations – from the government of the developing country the Federal Government, involving KfW, decides whether the project applied for is deserving and capable of appraisal. Whether it is capable of appraisal depends on whether sufficient background data (studies, etc.) on the project are available or can be obtained; whether it is deserving of appraisal largely depends on the development-policy objectives and effects aimed at by the project. If both these conditions are met the Federal Government commissions the KfW to conduct an appraisal.

(2) The KfW appraises the project on its own discretion and its own responsibility. Appraisal is based on a list of general appraisal criteria, the list comprising, among other aspects, the macro-economic justification of the project, the extent of the need for the project, its technical implementation, costs and financing, as well as its effects in micro-economic, macro-economic and socio-economic respect. The appraisal is based on available data and additional investigations in the developing country.

(3) On the strength of this appraisal the Federal Government decides whether the project deserves

support and instructs the KfW to enter into negotiations with the recipient concerning the loan (or grant) agreement and any other necessary agreements.

(4) The KfW next negotiates the details of the agreements with the recipient of the loan or grant in the developing country.

(5) Once the agreements are signed the implementation of the loan becomes possible. Invitation of tenders and allocation of contracts are the responsibility of the project executor in the developing country. He also submits a timetable, costing and financing schedule to the KfW. Disbursement of funds is effected, as a matter of principle, in line with the progress of the project.

Another essential feature of the German procedure that deserves emphasis is the practice of making financial commitments that are binding under international law at a relatively early point in time. One frequent result of this practice is that commitments have subsequently to be “reallocated” because projects have, in the course of further processing, proved unviable. A great deal of time can thus elapse between uptake of the commitment authorisation and the actual start of a project, with the result that open commitments often pile up.

Two questions should be distinguished in an examination of the problem here posed: first, the question of the extent of resources committed but not yet disbursed (open commitments) and, second, that of

Table 1
Commitments, Disbursements and Concluded Loan Agreements, 1970-1979
(in DM mn)

Year	Commitments (commitment authorizations)	Cumulated commitments as of Dec. 31	Disbursements	Cumulated disbursements as of Dec. 31	Cumulated loan agreements	Open commitments (2)-(4)	Open commitments as % of cumulated commitments (6) : (2)	“Commitment pipeline” (cumulated commitments minus cumulated loan agreements) (2) - (5)	“Disbursement pipeline” (cumulated loan agreements minus cumulated disbursements) (5) - (4)	“Commitment pipeline” as % of open commitments (8) : (6)	“Disbursement pipeline” as % of open commitments (9) : (6)
	1	2	3	4	5	6	7	8	9	10	11
1970	1,390	15,037	1,058	11,055	13,164	3,982	26	1,873	2,109	47	53
1971	1,815	16,852	1,109	12,164	14,018	4,688	28	2,834	1,854	60	40
1972	1,636	18,488	1,150	13,314	15,337	5,174	28	3,151	2,023	61	39
1973	2,074	20,562	1,345	14,659	16,943	5,903	29	3,619	2,284	61	39
1974	3,344	23,906	1,773	16,432	19,882	7,474	31	4,024	3,450	54	46
1975	2,350	26,256	1,787	18,219	21,570	8,037	31	4,686	3,351	58	42
1976	2,384	28,641	1,865	20,084	23,629	8,557	30	5,012	3,545	59	41
1977	2,611	31,252	1,605	21,689	25,792	9,563	31	5,460	4,103	57	43
1978	3,128	34,380	2,007	23,696	28,436	10,684	31	5,944	4,740	56	44
1979	3,842	38,222	2,520	26,216	31,988	12,006	31	6,234	5,772	52	48

Source: Federal Budget, EPI. 23 and KfW data.

the time needed for the preparation and implementation of projects.

Examination of the time dimension was made from two different points of view. In order to deal with the budgetary aspect the time required from the allocation of the commitment authorisation to the final disbursement of the sum was established. Since, as mentioned above, the sum committed is frequently not identical with the amount required for a certain project, it was also necessary to examine the progress of individual projects from application to disbursement.

Analysis of Open Commitments

Table 1 shows the open commitments for the years 1970 to 1979, comparing them with the cumulated commitments, disbursements and concluded loans. It emerges that the ratio between open commitments and total commitments increased from 26 % in 1970 to 31 % in 1979 (column 7). Although this rise indicates that the committed sums were furnished more slowly than in the past, this trend need not be regarded as alarming, especially as the ratio has been steady at around 31 % since 1974. The rise is largely due to the marked increase in annual commitment authorisations since 1973.

If the open commitments are broken down into one part for the timespan between commitment and conclusion of the loan agreement (commitment pipeline) and another for the timespan from the conclusion of the loan agreement to disbursement, i.e. for that part of concluded loan agreements which has not yet been paid out (disbursement pipeline), we find that a significant restructuring has taken place. Whereas up to 1970 less than half the open commitments were due to the fact that projects for which a commitment had already been made but which were not yet ready for final agreement were in the "pipeline" and the projects already in course of implementation accounted for the major part of the sum, the opposite has been the case since 1971. In 1979 projects in preparation accounted for 52 % of open commitments while concluded loans now accounted for merely 48 % (columns 10 and 11). This means that at the end of 1979 projects totalling DM 6.2 bn were in preparation. Of this total, however, DM 3.8 bn had been committed only in the course of 1979.

Project Processing Time

The time needed for the preparation and implementation of Financial Cooperation projects was established on the basis of specific projects which had at least reached the negotiation stage. For all projects in

respect of which the KfW was instructed to negotiate during the years 1973 to 1978 (680 projects totalling DM 13.5 bn) the time required for the above-named five processing steps was determined and average figures worked out.

These figures were:

- From the date of application by the developing country to the KfW's being commissioned to perform an appraisal: 7.6 months.
- From its being commissioned to perform an appraisal to the submission of its appraisal report to the government departments: 8.7 months.
- From the date of the appraisal report to the instruction to the KfW to conduct negotiations: 3.9 months.
- From the date of the instruction to conduct negotiations to the date of conclusion of the agreement by the KfW: 7.6 months.
- From the date of conclusion of the agreement to the first disbursement: 9.4 months.

Hence the so-called project pipeline during those years averaged approximately 37 months. Until 1976 processing time tended to rise (up to 40 months) but in 1977 drastically dropped to 32 months. This is probably partially due to a number of procedural changes introduced at that time.

Of the various processing steps it was the final one, from the conclusion of the agreement to the first disbursement, that took longest. A particularly favourable trend was exhibited by the time needed for project appraisal proper by the KfW. This has declined by about one quarter since 1973.

Main Characteristics of Projects

In order to trace the causes of the length of time needed the projects were sub-divided according to the following characteristics:

- Types of aid: project aid, development bank credits, general commodity aid, increasing of funds for existing projects, project or programme-tied commodity aid.
- Groups of countries: LLDC, MSAC, medium-income countries, advanced developing countries.
- Scale of project: up to DM 5 mn, DM 5-15 mn, DM 15-50 mn, over DM 50 mn.
- Sectors: energy, water, telecommunications, transport, agriculture, industry, trade and development banks, education, social institutions, commodity aid, etc.

It was found that some of these characteristics greatly affect the processing time:

□ Among the different types of aid general commodity aid was clearly the fastest by far since in this case project appraisal does not arise at all and the only timespan operating is that from instruction to enter into negotiations to the first disbursement (approximately 11 months), which again is shorter than average. Aid to development banks was also faster than project aid, thanks to constant cooperation with the same bodies.

□ Comparison of the groups of countries shows that aid to the least developed countries (LLDC), which enjoy special emphasis in German development aid, required by far the longest preparation period of 43 months. Even though the phase between conclusion of the loan agreement and the start of disbursement appreciably diminished between 1973 and 1977, it is nevertheless a fact that the difficulties encountered in the planning and implementation of projects in these countries are considerably greater than on average for the developing countries as a whole. The other groups, however, are too heterogeneous in their composition to permit of clear conclusions. (This applies also to the group of advanced countries.)

□ An examination of the projects according to their scale led to the conclusion that a project was processed the more quickly the bigger it was. Whereas projects of

up to DM 5 mn required approximately 43 months, projects in excess of DM 50 mn reached their first disbursement date after approximately 31 months. The reason presumably is that major projects are pursued with particular emphasis. There are no correlations between categories of magnitude and groups of countries, e.g. on the lines that smaller projects were implemented predominantly in LLDCs.

□ There were also clear sectoral divergencies. Thus water supply projects (49 months) and agricultural projects (44 months) were considerably above the average, while e.g. energy projects tended to require a below-average amount of time. Here it was shown again that the present development-policy emphasis (e.g. of giving preference to rural development programmes) tends to require a prolonged period of processing and hence results in increased open commitments.

Slowing Down of the Financial Outflow

As mentioned before, disbursement of the committed finance takes place in step with project progress. No statement on the average time requirement between the first and the final disbursement is possible because a large part of the projects initiated within the period under investigation had not yet been completed. It was, however, possible to determine how expenditure based on individual commitments in past years was distributed

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V E R L A G W E L T A R C H I V G M B H - H A M B U R G

Table 2

Year	Year of commitment	2 nd	3 rd	4 th	5 th	6 th	7 th	8 th	9 th	10 th	11 th	Subsequent years
Disbursements in %	0.1	4.6	12.6	15.0	16.7	14.0	12.8	6.0	6.0	4.5	2.4	5.3

among subsequent years. This so-called disbursement breakdown states what percentage of the commitments made for specific projects in a particular budgetary year is paid out during that same year and during subsequent years (see Table 2).

Compared with a calculation made in 1974 this reveals a clear slowing down of the disbursement rate. Whereas at that time the largest share was disbursed in the years three and four, with approximately 60 % of the committed amount disbursed by the end of the fifth year, the highest rate of disbursement now lies in the fourth and fifth years, with no more than 49 % of the committed sum having been disbursed by the end of five years. These figures refer only to project aid and not to general commodity aid which is disbursed considerably faster.

Causes of Divergencies

Divergencies between planning and financial resource outflow may arise at all procedural stages, and these may in turn affect the budget:

- The measures actually committed may differ from those envisaged in the confidential elucidations or they may deviate in amount;
- The measure for which the commitment authorisation was obtained may be dropped during its preparatory stages and replaced by another;
- Disbursements are delayed and the outflow of finance shifts towards later budgetary years.

The cases in which these causes played a decisive part have not been ascertained empirically and cannot therefore be weighted according to their importance. In the phase prior to the completion of the appraisal any change in priorities by the developing country plays a major part. During the next phase lack of appraisal data and administrative obstacles probably play the greatest role. In the implementation stage delays in the conclusion of the various contracts and difficulties in financing local costs are important causes.

A systematic arrangement of the principal causes of divergencies is presented in Table 3.

Essentially the study permits of the following conclusions. The timelag between commitment of aid

and ultimate disbursement of finance has increased since the mid-seventies. If, however, the total time required is broken down into a preparatory phase and an implementation phase two opposed trends emerge. The time needed during the preparatory phase, when the Federal Republic is able to display initiative and activity, has (slightly) shortened over the years thanks to appropriate measures taken by the Federal Government and the KfW, while the implementation phase, which is essentially the responsibility of the developing countries, reveals a slowing down. This finding agrees with the experience of other development aid donors to the effect that disbursements are declining relative to commitments.

It emerged clearly that budgetary reservations concerning the magnitude of the Federal Republic's open commitments towards the Third World are unjustified. These commitments have grown only insignificantly in relative terms, even though absolutely they amount to an appreciable total. In 1978 they accounted for exactly 5.7 % of the total budget. Yet this "mountain of commitments" makes considerable demands on the skill of the disbursement planners; since the expenditure approved annually in the budget is limited by the scope of the total Federal Budget the commitments entered into can only be fulfilled within these limits. This may result in disbursement bottlenecks towards the end of the year and in some cases to delays in project realisation. However, so long as the disbursement rate is, if anything, slowing down no serious liquidity shortage need be expected in project realisation. On the contrary, if the amount of disbursements is not to decline, commitment authorisations will in fact have to be increased.

Inadequacies in the Recipient Countries

A major reason for the increase in open commitments is doubtless to be found in the disproportionate increase, since the mid-seventies, of world-wide aid commitments; these are facing both donors and recipients with capacity problems in planning, administration and implementation. A further cause may be the shift in sectoral emphases effected by most donors, since projects for rural development and

projects securing the fulfillment of basic needs are more difficult to plan and implement and are also of longer duration. A shift of aid towards the poorer countries and, more particularly, towards the least developed countries likewise has a retarding effect because the administrative structures in those countries are even weaker and the numbers of qualified personnel even smaller. On the other hand it is the wish and objective of both donors and recipients to allow local administrations to exercise their full weight, in order thereby to contribute to the development of institutions. Alongside the shortage of qualified personnel there is also an increasingly noticeable shortage in the budgets of recipient countries of the financial resources needed to meet their own share of the costs (both investment costs and current expenses). This aspect is particularly serious in the poorest countries and is being exacerbated by the rise in the price of oil.

There is no doubt that the donor countries, including the Federal Republic of Germany are in a position to take account – at least partially – of these factors. They

can contribute to improving the administration in the recipient countries, they can participate to a greater extent in the financing of local costs, they can reduce administrative demands on the developing countries by simplifying their own procedures and advising the recipients to a greater extent than hitherto. Moreover, the proportion of those forms of aid which are disbursed relatively rapidly (e.g. commodity aid) can be increased. There is certainly also some scope for simplifying and abridging the donor procedures which, as the description of the complicated German procedure above has shown, consist essentially of the application of regulations and procedures developed for domestic conditions or else, at the time of their introduction, not tailored to the present volume of development aid, nor indeed to the now very much more complex structures of the developing countries. But even if such simplifications were effected (simplifications which can only be achieved politically) they would in no way change the fundamental problem – i.e. that the absorptive structures in the recipient countries have yet to be developed.

Table 3
Causes of Divergencies between Planning and Financial Resource Outflow

Processing steps	In the developing country	In the Federal Republic of Germany
Between application and commissioning of appraisal	<ul style="list-style-type: none"> – government withdraws application because of other priorities and expresses other wishes – political changes – economic changes (balance of payments, public finances, etc.) – implementation by other donors – lack of studies and other data – more precise detailed calculation 	<ul style="list-style-type: none"> – changes in national quota for political or budgetary reasons
Between commissioning of appraisal and conclusion of the loan agreement	<ul style="list-style-type: none"> – lack of appraisal data – changes in project concept (scale, location, procedure, financing) – administrative obstacles (delay in decision-making, problems of competence) – political or economic developments which render the conclusion of the agreement inadvisable (for the time being) 	<ul style="list-style-type: none"> – negative project appraisal (for political, economic, socio-economic reasons)
Between conclusion of the loan agreement and completion of the project	<p><i>additionally:</i></p> <ul style="list-style-type: none"> – deficient contributions by partner (local cost financing) – delays in commissioning consultants – delayed conclusion of supply and service contracts – delays in supplies 	<ul style="list-style-type: none"> – supply difficulties – price increases – shortage of skilled labour – budget-conditioned delays

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applies also to other supplying countries