4 Resource Mobilisation: Soft-Loan Windows

Emergence of the Multilateral Development Funds

This chapter focuses on the addition of soft-loan windows to the MDBs enabling them to finance a wider range of countries and activities than they would otherwise have been able to. It does so in a selective fashion focusing on those aspects of the multilateral development funds (MDFs) which affect and influence the overall resource mobilisation activities of the MDBs. It also raises some cross-cutting issues which affect both the hard-loan and soft-loan windows in each MDB. What this chapter does not do is attempt to provide a comprehensive analysis of every aspect of soft-window operations and administration; for this the reader would need to refer to other sources. Also, specific financial policies relating to soft-window resources, e.g. levels of liquidity, administrative cost-sharing, net income allocation are alluded in the relevant chapters that follow.

As the previous chapter demonstrated, the MDBs which were set up between 1945 and 1966 quickly established their credit ratings on international capital markets. They became adept at mobilising the resources they needed from the market on the strength of their capital bases and their gearing ratios. When these limitations threatened to become binding they were made more elastic. For example, the IBRD's capital was doubled in 1959 to enable continued expansion of its lending when it became evident that its capital base was the only binding constraint on its ability to raise resources on the market. The rapid recovery of the *reconstructed* economies of continental Europe and Japan through the 1950s, resulted in these economies ceasing to borrow from the IBRD although countries like Finland, Greece, Portugal, Singapore and Spain continued to require IBRD support into the early 1970s. With the task of post-war reconstruction having been largely accomplished, it became increasingly apparent that future MDB lending would be focused primarily, if not entirely, on *developing* countries.

Apart from countries in Latin America and those which emerged from division of the Indian sub-continent in 1947, most developing countries achieved independence only during the 1950s and 1960s. Providing international capital for financing *broad-based development* in such countries was a major new undertaking for the international community in the post-1945 order. Previously they had been colonies whose rate of development was determined (or restrained) by colonial governments and private metropolitan

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investors, rather than by any organised effort on the part of the international community. The only external financing these countries had any experience with was primarily for private *enclave* investments in plantations, mining, shipping and railroads. With perhaps the exception of India, no significant investments had been made by colonial governments or by the private sector (either domestic or metropolitan) for broad-based (i.e. non-extractive) infrastructural development or for essential investments in human capital (e.g. in health, education and social security). A small amount of (mainly domestic) private investment had gone into limited import-substitution manufacturing.

Early assessments of the development financing needs of newly independent states made it clear that if their development was to be accelerated, large-scale investment in physical and institutional infrastructure would be necessary. Such investment would need to be coupled with improvement in domestic resource mobilisation capacity i.e. mainly through investment in development finance institutions which aimed at overcoming some of the imperfections of as yet unformed local financial and capital markets. Development investment in *infrastructure* also needed to be accompanied by unprecedented, internationally supported investment in the *agricultural* and *rural* sectors of these economies which accounted for the bulk of their economic output and employment. If development was to be people-oriented, and the aim was to alleviate mass poverty then, in addition to investment focused on large projects involving machinery, bricks-and-mortar, equally large investments would need to be made in developing institutional capacity and human capital in all these individual emerging nations simultaneously. Such investments, in their volume and diversity, involved mobilising funds for aggregate global development investment on a scale which had not hitherto been contemplated.[1] The borrowing experience of India and

1 It is important to recollect one other powerful political reality. The realisation of what needed to be done for financing *development* occurred in the context of the Truman Doctrine shaped by the Cold War. In that war, influencing the political complexion and orientation of newly emergent countries (through whatever means, however unscrupulous) became a paramount objective in its own right for each of the two superpowers whose own development was based on violently opposed, antithetical ideologies. The partial alignment of the former colonial powers with one of these superpowers did not help matters. It triggered almost a reflex reaction on the part of untested, inexperienced governments in emerging economies. Anxious to establish their popularity and longevity in as yet nascent democracies, these indigenous governments pursued voter-friendly, populist and nationalistic policies which were as different as possible from those which former colonial governments had pursued. In such circumstances, influenced by unrealistically high domestic expectations, unproductive superpower competition exerted through the aid mechanism, and by radical academics in developed economies anxious to test new economic theories on blank canvases, it is not difficult to understand in retrospect why governments in the developing world decided to opt for statist, interventionist approaches. In doing so they followed currently fashionable economic thinking, which had become biased against markets and private capital since 1945, and their own political instincts believing that ➛

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Pakistan and some Latin American countries through the 1950s and early 1960s also indicated that borrowing on market terms for these purposes would only result in their piling up more debt than they could possibly cope with and would call into question their creditworthiness for further borrowing from the IBRD.[2]

In such a climate it became clear, that market-based resources alone were not going to be either appropriate or sufficient for the newly independent and emerging developing countries that the MDBs would henceforth be focusing their lending attention upon. Gestation periods of development investments were too long, and the immediate *indirect* foreign exchange earnings generated too uncertain, for them to be financed on terms that the market could provide, even with the intermediation of MDBs supported by developed country capital. Hence, longer-term resources, with longer grace periods at below-market costs came to be envisioned as an essential *accoutrement* in the array of facilities that the international community needed to dispense. It did not require a great leap of logic on their part to conclude that such funds could only be provided by developed country governments in addition to MDB share capital.

Developing countries favoured coursing such funds through the UN in which they felt they had more influence and say. Developed countries were strongly opposed to that notion believing it would result in a loss of control, ineffective use and the possible waste of public resources for which they were directly accountable. They did not see the UN as having been created to perform the function of financial intermediation to promote development. If donor governments were to control the disposition of these funds, then the best way was to course them through MDBs over which they had greater control. They had a choice of providing such resources on soft-loan terms to the MDBs which would then intermediate them in the same way that they intermediated market funds. Alternatively, such funds could be provided to the MDBs *on grant terms* with the MDBs relending those funds as low-cost,

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dirigiste policies would result in more rapid and more equitable development through a fairer redistribution of private income and wealth. Needless to say, the fact that an interventionist approach would also give governments, politicians and their advisors much more power at national and international levels could not have been lost on those in the drivers' seats. It must also be recalled that between 1945-75 heavy doses of government intervention in various types of economies (including most OECD countries as well as those of the former East Bloc) actually worked, and worked quite well, with the foundations being laid for social accomplishments (universal education and health-care) and social security safety-nets which are now blithely taken for granted. It was only in the 1980s and 1990s that the negative features of excessive intervention, the social disincentives of the welfare state, and the fiscal unsustainability of presently structured societies have emerged as key issues triggering fundamental reversals in political and economic thinking.

2 See Mason, E. and Asher, R., "The World Bank since Bretton Woods", The Brookings Institution, Washington DC, 1973, pp. 38-394.

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long-term credits to ultimate borrowers on a revolving basis. Wisely and generously, the donor countries opted for the latter approach. This chain of events established the context for setting up the International Development Association (IDA) as an affiliate of the World Bank although the developing countries had argued strongly for a Special UN Fund for Economic Development (SUNFED) to be established instead. In the event and with the benefit of hindsight, the MDB route proved to be the wiser and the more effective, if only in relative than in absolute terms.

The International Development Association (IDA)

IDA was established in 1960. To informed observers[3] its emergence confirmed:

> "the ability of bureaucracies to remain afloat, to unfurl fresh sail, and to benefit from prevailing winds ... IDA had to be invented to keep the World Bank preeminent, or at least eminent, in the growing complex of multilateral agencies attempting to facilitate international development."

In substance, IDA is, of course, an elaborate fiction. It is not as its separate identity implies a different international institution but merely a fund administered by the World Bank. Its creation was a major step in the evolution of the World Bank itself, marking the beginning of the transformation of that institution from something resembling a *bank* into a *development agency*. Upon its establishment IDA had an authorised capital of US$1 billion to be (paid-in and) used over five years; it came into being when fifteen governments agreed to subscribe a total of under US$690 million. Unlike the IBRD, which could meet its resource requirements through bond-issues on capital markets, IDA's resources were limited to governmental budgetary contributions. Therefore they had to be rationed from the outset bringing into focus the need for both *eligibility* and *allocation* criteria to be applied in the rationing process. These are dealt with more thoroughly later in the chapter.

It was decided by the World Bank management and Executive Board, again from the outset, that the softness of IDA's terms should not influence the type of project that it would finance. Such terms would enable the Bank to finance countries it otherwise would not be able to lend to; but it would finance projects which met the same rigorous tests of financial and economic viability as those that might be financed by the IBRD. IDA's exceedingly soft terms were often combined with standard IBRD loans to provide a *blend*

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3 Mason, E. & Asher, R., op cit., pp. 380.

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which could be varied with a considerable amount of flexibility to suit the circumstances of the country being financed. With each successive replenishment of IDA, however, donors have increasingly asserted their priorities for both the way in which IDA resources are allocated across countries as well as the broad purposes to which they are applied.

IDA's initial credits were provided at no interest cost for a term of 50 years with a 10 year grace period, although a small annual service charge of 0.75% was applied to amount disbursed and outstanding. The grant element of this type of credit (at a discount rate of 10%) was over 86%. In 1982, IDA's income levels fell below those required to cover its own administrative costs; it was decided at the time that a commitment fee of 0.5% should be applied to undisbursed balances but that such a charge should be reviewed if IDA's income position improved sufficiently to so warrant. As a result of the commitment charge, and with an increasing pool of liquidity being managed on IDA's own account (both to cover increasing levels of disbursement and to generate investment income), increasing net income surpluses were generated for IDA between FY83-88. With a much healthier net income position, IDA charges were reviewed in FY88 when it was decided that the commitment fee should be made variable within a 0% to 0.5% band and its level should be reviewed each year. This fee was reduced to zero in FY89 and has been maintained at that level upto FY94. During the negotiations for IDA-8, it was agreed that the terms of IDA credits should be changed to 40 years with the same 10 year grace period for *IDA-only* countries and 35 years with a 10 year grace period for *blend* countries while applying the same service charges. This adjustment reduced the grant element of an IDA credit to 77% with the 0.5% commitment fee and to 79% without it.

IDA's resources have been replenished on ten separate occasions at three-yearly intervals with the first replenishment (IDA-1) of US$750 million being agreed in 1963 and the tenth (IDA-10) being agreed in 1993 for an amount of SDR 13 billion (or US$16 billion equivalent). The total cumulative amount of resources which have been made available to IDA for commitment purposes between 1960 and June 30, 1994 amounted to over US$89 billion and nearly US$100 billion if the remainder of IDA-10 pledges which have yet to be converted into contributions (US$11 billion) are taken into account. Of the US$89 billion in *committable* resources, about US$81 billion had been contributed by IDA members and nearly US$4.2 billion by the IBRD (through annual transfers of a portion of its net income). The remainder (US$4.8 billion) was accounted for by a positive exchange rate translation adjustment reflecting the increased USD value of contributions made by members in their own currencies.

The initial capitalisation of IDA in 1960 required contributions from all member countries, both Part I and Part II. Donors were required to make

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100% of their contributions in convertible currencies (or gold) while recipients were required to make 10% of their subscriptions in convertible currencies and the remaining 90% in their own currencies whose use could be restricted and would depend on their approval. In the first replenishment which was agreed in 1963 (with the first instalment not being due until late 1965), it was suggested that Part II countries make no contributions. This proposal was rejected by the US as being politically unsaleable. It was not until IDA-3 that the principle of Part II countries not making contributions to IDA, except in nominal amounts to maintain their voting rights under a complex arrangement, was accepted.[4]

Upto mid-1993, the donor countries had provided nearly eleven times as much money (by way of politically difficult budgetary provisions) to IDA as they had to the paid-in capital of the IBRD with far less leverage being exerted from IDA contributions. However, the funds provided by donors and the IBRD to IDA before 1980 are now beginning to revolve in increasing amounts. About SDR 2.5 billion (or 16%) of total commitment authority (of SDR 15.5 billion) under IDA-10 is being funded by IDA *reflows*. As time progresses, the proportion of commitment authority funded by reflows relative to new contributions might well increase quite rapidly from the present level of 16% to around 50% or more by the time of IDA-15 (i.e. by the year 2010) especially as commitment authority needs before then will be relieved by the graduation of some major recipients (e.g. China, India and

4 At the time of its inception IDA's initial capital structure carried voting rights with each member being given 500 membership votes plus one vote for every US$5,000 of subscription. Contributions under IDAs 1 and 2 did not carry voting rights. Because the proportions contributed by different donors were different to the pattern of their initial subscriptions, the relative voting power in IDA of nearly all Part I countries got out of kilter with their cumulative contributions. In IDA-3, this situation was corrected by having donor resources separated into two parts: *subscriptions* carrying voting rights and *contributions* without voting rights. For IDA-3 the *subscription* portion (and the votes it carries) for each Part I member was calculated so that the total proportion of its votes, excluding the 500 membership votes, to the total of all Part I votes would equal: its proportionate share of total resources contributed under the 1960 subscription, contributions to IDAs 1 and 2, supplementary contributions, and contributions under IDA-3. To maintain the relative voting power of Part II versus Part I in IDA, recipient members were required to also make subscriptions to maintain their voting positions but such subscriptions could be made entirely in local currencies. From IDA-4 onwards the same formula has been used to maintain relative voting power with some major relative voting adjustments within the Part I grouping; e.g. with a large increase in the voting rights of Japan, Saudi Arabia and Italy. Also many Part II members have now become donors and have not yet been reclassified as Part I countries. This factor, along the with the rapidly improved economic position of many Part II countries relative to many Part I members is resulting in the Part I and Part II classification in the World Bank becoming increasingly obsolete for practical purposes. That division may now even be counterproductive in discouraging many former Part II members from contributing as much to IDA and to IBRD capital as they otherwise might if their relative standing in the institution were to be significantly improved.

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Pakistan) from IDA. This has already happened in the case of the Fund for Special Operations (FSO) in the IDB.

The foregoing paragraphs suggest that the World Bank's efforts to mobilise public resources through IDA have succeeded well beyond what might reasonably have been anticipated. However, such resource mobilisation has, expectedly, resulted in virtually no leverage being exerted in the same way that contributions to IBRD capital have; i.e. by making possible a much larger volume of market borrowings on the strength of the contingent guarantee of callable capital. The only multiplier effect is through reflows. Yet, IDA resources have permitted the World Bank to do far more in terms of the *net transfer function* than it would have been able to had its resources been confined to market borrowings alone. Indeed, IDA has made it possible for the World Bank to remain a *world* bank rather than being reduced to being largely a Latin America and Asia bank. To paraphrase a memorable advertisement, IDA resources have permitted the World Bank to "reach parts that its other resources simply could not reach".

In theory and principle, raising IDA resources should be a simple affair; in practice it is anything but. It usually involves convening a series of periodic meetings of senior officials (known quaintly as the *IDA Deputies*) from donor government aid ministries or treasuries to pledge new resources to the next replenishment based on some increment or occasionally, unfortunately, a *decrement* to that country's IDA's contribution in the previous replenishment. These meetings need considerable preparation both on the part of the World Bank and of donor governments. They incur a level of visible and invisible expenditure which is becoming increasingly difficult to justify. Combined with similar meetings for replenishment of other MDFs and GCIs for MDBs, they require a relentless cycle of 4-5 meetings a year in various parts of the world, imposing heavy burdens on the administrative capacities of donors which are invariably concentrated in a few officials being responsible for oversight of multilateral organisations. Whether this arrangement results in an effective system of governance over MDFs is open to argument.

IDA funding also raises a host of other issues some of which overlap with matters concerning the IBRD. The main issues which have arisen include: (i) disruptions caused by particular donors, in either replenishing IDA resources or in meeting their committed obligations, which have had adverse effects on levels of annual commitment authority – e.g. as happened with the US in IDA-2 and IDA-6; (ii) differing rates of drawdown from donors when their specific budgetary problems have made it difficult for them to meet drawdown schedules on a strictly pro-rata basis with other donors; (iii) the need for IDA liquidity and its impact on the rate of drawdown and on the need for investment income; (iv) the level of service charges and commitment charges required to ensure that IDA covers its operating costs; (v) cost-sharing arrange-

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ments between IDA and IBRD; (vi) the net income surpluses that need to be generated by IDA; (vii) the use of IDA reflows for new commitments versus other purposes; (viii) the size of contribution by the IBRD to IDA from its annual net income; and (ix) the increasingly influential role that IDA Deputies have begun to play in determining overall World Bank lending priorities and policies in the course of replenishment negotiations thus detracting from the role and powers of the Executive Board. It would be impossible to do full justice to an exploration of all these issues in the context of a book on the financial policies of the MDBs. Some issues are mainly of a financial nature and are taken up further in this and other chapters. Others are not. They involve political and operational considerations which are beyond the scope of this book; they have been discussed at length in other volumes and writings.

IDA has its equivalents in all the regional MDBs except (as yet) the EBRD. Its regional counterparts are discussed briefly below. They share many of the same features and characteristics as IDA, and raise many of the same issues although there are some important differences as the following sections will reveal. In addition to IDA, the World Bank manages a plethora of special grant programmes, trust funds, and concessional facilities (including for example the GEF) which are too numerous to list individually. In FY94, there were about 1,800 active trust fund projects under management with total disbursements from these various disparate funds amounting to over US$660 million; *Bank-executed* programmes accounted for about one-third of that amount.

The African Development Fund (AfDF)

The AfDF was set up in 1972 with contributions from non-regional donors who were, interestingly enough, not yet involved in the membership of the core AfDB. Hence, unlike IDA, AfDF's membership was quite different to the original core membership of the AfDB. It remained so until 1982 when non-regional countries were finally invited to become members of the core institution. The initial capital contribution to AfDF was about US$240 million of which US$4.6 million was contributed by the AfDB itself with the remainder being contributed entirely by 26 non-regional donors. This initial contribution was supplemented by a further US$58 million from 12 of the same donors and the AfDB resulting in a total capital base of nearly US$300 million prior to the first replenishment. AfDF has since been replenished six times. Negotiations for AfDF-7 are just about to be concluded. The cumulative resources raised by AfDF upto the end of 1993 amounted to UA/SDR 7.74 billion (US$10.6 billion) of which UA/SDR 6.6 billion (US$9.1 billion) had been made available for commitment. The AfDB's share of this cumulative total is UA/SDR 111.74 million or roughly 1.4%

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(compared to IBRD's contribution of nearly 4.2% to IDA's total resources).

The first three replenishments of AfDF which took place between 1975-81 resulted in total contributions of UA/SDR 1.9 billion. The next three replenishments between 1984-90 saw a three-fold increase in that amount with aggregate contributions under AfDFs 4-6 totalling UA/SDR 5.6 billion. In AfDF-7, management had first aimed at raising UA/SDR 4 billion. It later moderated that target to UA/SDR 3.5 billion. But AfDF-7 is likely to be concluded at a level of UA/SDR 2.8 billion; with a decline in real terms over the resources provided under AfDF-6 (UA/SDR 2.2 billion). This outcome is distressing as AfDF-7 resources will be grossly inadequate in terms of AfDF's needs and the additional burden of providing some debt relief (similar to IDA's Fifth Dimension) for refinancing extant AfDB amortizations with AfDF funds. Of the original 27 donors which contributed to AfDF, four dropped out under AfDF-6. These included the AfDB itself (because its net income position had become too fragile to sustain further transfers to AfDF), Argentina, the United Arab Emirates and Yugoslavia.

Even with the substantial increases in resources provided by donors to the AfDF since 1984, its role as a concessional multilateral financier for Africa remains peripheral to that of IDA. For example, in FY94, IDA's total commitments to sub-Saharan Africa amounted to US$2.7 billion through 57 credits to 27 African countries. This was three times higher than the US$894 million committed by the AfDF in 1993 through 41 credits (and 62 grants for technical assistance) to 25 countries. In terms of disbursements, whereas IDA disbursed nearly US$2.3 billion to sub-Saharan countries, the AfDF disbursed just over US$700 million to all of continental Africa. Perhaps no occurrence demonstrates the inter-linkage between donor contributions to IDA and AfDF as the current round of negotiations for AfDF-7. It has become painfully apparent that donor generosity with IDA-10 may perhaps have been overdone, at a time when budgetary pressures did not seem as acute, at the probable cost of underfunding AfDF-7 when severe budgetary pressures in donor countries (especially in the European ones) are making themselves felt with particular force.

Like IDA credits which are provided on nearly uniform terms, the terms of AfDF loans vary only slightly. AfDF loans are generally extended for terms of 50 years, with a 10-year grace period and back-loaded amortizations. AfDF loans are amortised at an annual rate of 1% between years 11-20 and at 3% thereafter for 40 year loans, and 2.25% per annum for 50 year loans. These loans carry a service charge of 0.75% per annum on amounts disbursed and outstanding with no commitment charges being applied. Lines of credit from AfDF to national development banks of recipient members, however, have a maturity of 20 years and a grace period of 5 years but carry the same service charge.

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Five per cent of the resources available under AfDFs 3 and 4, and ten per cent of those available under AfDFs 5 and 6, have been allocated to a Technical Assistance (TA) Account. Resources for TA from AfDFs 3-4 have been provided to recipients as 50 year loans with 10 years grace and no service charge applied, while those from AfDF 5-6 have been provided as outright grants.[5]

The AfDB also has a small accompanying concessional Fund – the *Nigeria Trust Fund* (NTF) – which was set up in 1976 with an initial capital base of Naira 50 million, paid in two equal instalments made in fully convertible currencies. In dollar terms these two instalments together totalled US$79.5 million. The NTF was replenished once in 1981 with a further Naira 50 million payable in three instalments which, by the time they had been fully paid in 1985 amounted to an equivalent of US$70.2 million. Through prudent investment and accumulated net income surpluses of over UA156 million (after a negative currency translation adjustment of nearly UA79 million), the level of overall resources of the NTF amounted to almost UA300 million at the end of 1993. Loans from the NTF are denominated and repayable in UA; they are made from the interest earnings on the capital corpus of the NTF. They have a maturity of 25 years with 5 years grace on principal repayments with an interest rate of 4% on disbursed and outstanding balances and a 0.75% commitment fee on undisbursed amounts. The AfDB also administers three other small, special purpose Trust Funds; their combined resources amounted to UA18.04 million at the end of 1993.

The processes behind AfDF's resource mobilisation, operations and administration raise issues which are identical to those which arise in the case of IDA. In addition to these issues, perhaps the greater preoccupation on the part of AfDF *State Participants* (i.e. the equivalent of *IDA Deputies*) during AfDF-7 negotiations have focused as much on issues concerning AfDB, as on those concerning AfDF. They included: (i) management of the AfDB and its apparent unpredictability and instability during 1994; (ii) the deteriorating portfolio of AfDB and AfDF resulting in shortfalls of income as a result of non-accruals accompanied by unprecedentedly large provisions against possible loan losses which are affecting the net income positions of both these institutions; (iii) the inadequacy of financial policies and controls; (iv) inappropriate cost-sharing of administrative expenses between AfDF and AfDB; (v) the lack of control over administrative expenses incurred by senior

5 When the AfDF grants loans for the preparation of pre-investment studies which determine that the project is unviable then the grace period is extended to 45 years with repayment of the TA loan being required between years 46-50. The same is true for TA loans granted to strengthen regional cooperation arrangements or regional institutions and such TA is not specifically aimed at projects or programmes.

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management and the Executive Board; (vi) country eligibility, country performance and resource allocation criteria; (vii) the need for an internal debt relief mechanism; (viii) support for micro-enterprises in Africa; and (ix) sectoral and other operational priorities in the use of AfDF funds. As in the case of IDA above, some of these issues will resonate again in later chapters while others, which are of a political and operational nature will not be dealt with in this book.

The Asian Development Fund (AsDF)

AsDF was established in 1974 with an initial (AsDF-1) capitalisation of US$525 million. Since then AsDF's resources have been replenished five times with the last replenishment (AsDF-6) being agreed at a level US$4.2 billion in late 1991. Unlike the regular triennial IDA replenishments, the intervals between AsDF replenishments have varied between one year between AsDFs 1 and 2, to almost six years between AsDFs 5 and 6. This has occurred largely because of: (a) variations in the anticipated growth of AsDF's annual commitment levels; and (b) favourable exchange rate movements which have stretched AsDF's commitment authority unexpectedly. The cumulative resources raised by AsDF upto the end of 1993 amounted to over US$14.5 billion in *negotiated* terms. With Japan being by far the largest contributor to the AsDF (accounting for over 51% of cumulative contributions at the end of 1993) the sustained appreciation of the JPY against other currencies has resulted in the USD value of these resources having increased by about US$1 billion. Of the cumulative amount negotiated by way of donor pledges, a total of US$14.4 billion equivalent has already been contributed by donors.[6] In addition, the AsDF had accumulated a surplus of nearly US$809 million by the end of 1993.

AsDF resources were contributed by only 13 countries in its initial capitalisation. Five of these countries provided contributions which were *tied* to expenditures on procurement from them. When AsDF-6 was agreed, the number of contributors had increased to 21 with some former borrowing members of the AsDB having become donors to AsDF (Korea, Nauru and Taiwan).[7] The three developed regional members (Australia, Japan and New Zealand) contributed 44.5% of total AsDF-6 resources. The largest single recipient of IDA – India – is excluded from access to AsDF as is China. Although AsDF resources have been disbursed to 25 countries throughout the Asian region, the South Pacific sub-region contains ten AsDF recipient

6 The US dollar value of these contributions was actually US$15.1 billion at the end of 1993.
7 Indonesia was a contributor to AsDF-V.

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countries. Six recipients – Bangladesh, Indonesia, Nepal, Pakistan, the Philippines and Sri Lanka – accounted for 87% of the cumulative AsDF resources disbursed and outstanding upto end-1993.

The resources made available to the *African* Fund (AfDF), compare unfavourably with those available to IDA thus preventing the AfDF from playing as prominent a role as IDA in its own region. AfDF is clearly unable to do as much for Africa as IDA is. By contrast, the *Asian* Fund's (AsDF's) resources appear on the surface to be *less* constrained than IDA's. Part of the reason for this impression, of course, lies in the absence of access to AsDF resources for China and India. The internal rationing process thus permits AsDF to lend to certain blend countries which IDA no longer lends to on eligibility grounds (e.g. Indonesia, the Philippines and Papua New Guinea). Nevertheless IDA's operations in Asia are still larger than those of AsDF, although AsDF lending to countries other than India and China is as significant as, or even larger than, IDA lending to these countries. For example, in 1993, total IDA lending to Asia amounted to US$3.44 billion equivalent. However, excluding its lending to India and China, (of US$2.55 billion), IDA's lending to the rest of Asia amounted to US$890 million compared to the AsDF's US$1.3 billion giving AfDF a much more prominent profile among its poorer Asian clientele (other than China and India) vis-à-vis IDA than the AfDF could possibly hope to have in Africa. In FY94, IDA's lending to Asian countries other than India and China, increased to US$1.54 billion, but most of this amount went to Vietnam, Bangladesh and Pakistan with very little by way of allocations to the smaller Asian countries. Providing sufficient commitment authority is available to AsDF, it is likely that AsDF will again in 1994 play as prominent a role in the smaller, poorer countries of Asia as IDA.

Although Asia is generally regarded as the most rapidly developing region in the Third World, the need for AsDF resources, somewhat paradoxically, is likely to rise in the intermediate term. The reason is that several very poor Asian countries, to which the AsDF has not been able to lend over the past five years, have, since the demise of the Cold War, become prospectively active borrowers again. These include the three countries in Indo-China (Cambodia, Laos and Vietnam); Myanmar which is gradually coming out of isolation; Afghanistan whose internal conflicts appear to be subsiding; and three of the newly independent Asian republics of the former Soviet Union – Kazakhstan, Kyrgyzstan and Uzbekistan – which were admitted to the membership of the AsDB in 1993 and whose concessional resource needs for development are likely to be significant. Thus eight more recipients are likely to press their claims on the AsDF for scarce resources which need to be mobilised at a time when the propensity and ability of traditional donors to provide such resources is apparently declining.

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AsDF-6 was intended to finance concessional resource commitments for the four-year period 1992-95. Negotiations for AsDF-7 will begin around the end of 1994 or in early 1995.[8] However, the US has been more than usually dilatory in making its *pro-rata* contributions to AsDF-6[9] resulting in the possibility of other donors also slowing down the rate at which their contributed resources can be used by AsDF. With the changes in commitment authority caused by exchange rate movements and by policies affecting its cumulative lending limitation and its *headroom*, the AsDF's commitment authority at the end of 1993 was only US$720 million compared to the US$1.15 billion that it should have been if all donor contributions had been released on time.

The concerns expressed by donor representatives during negotiations for AsDF-6 were generally similar to those discussed under IDA-10 and AfDF-6 negotiations although in the case of the AfDF many donor concerns were more institution-specific. AsDF donors emphasised the following priorities for lending operations: direct poverty reduction projects and programmes; the promotion of growth-oriented policies; environmental protection; a concern for the role of women in development; and population control through effective, incentive based approaches. Other issues raised by the donors during negotiations concerned: the AsDB's operational policies; strategic planning; criteria for allocating AsDF resources; project quality; private sector promotion; and the Bank's organisation and staffing.

AsDF lending terms were reviewed when IDA terms were changed in 1987. As a result of that review, the terms for *AsDF only* countries remained unchanged while maturities for blend countries were reduced from 40 to 35 years.[10] In addition to AsDF, the AsDB administers two other concessional funds: (i) the Technical Assistance Special Fund (TASF); and (ii) the Japan Special Fund (JSF). TASF was established in 1967 to provide technical

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8 The AsDB concluded negotiations for GCI-4 in mid-1994. Gearing up for AsDF-7 immediately thereafter will strain donors.

9 The US should have made a qualified contribution of its first tranche (US$170 million) under AsDF-6 before end-1992. It could not do so because Congress had not passed the necessary legislation. As a result the contribution of 2nd tranches by other donors was delayed. The US eventually made a partial 1st tranche contribution (US$75 million) at the end of 1993 when most other donors had already made their 2nd, and some their 3rd, tranche contributions. Under the pro-rata rules which apply to all soft-window resources, this meant that other donors could require the AsDB not to use the full amount of their 2nd and 3rd tranches but use only that proportion (44%) which was equal to the proportion of the first tranche which the US had released.

10 Standard AsDF loans carry an annual service charge of 1%, have a maturity of 40 years with a grace period of 10 years and have back-loaded repayments (2% from years 11-20 and 4% from years 21-40). AsDF maturities for *blend* countries were reduced to 35 years in 1987 with the same service charge and grace period, and with back-loading being moderated to repayments of 2.5% for years 11-20 and 5% for years 21-35.

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assistance on a grant basis to the AsDB's borrowing members.[11] It is funded by: direct voluntary contributions by members; allocations from ordinary capital resources; earmarked allocations from AsDF replenishments; income from investments and other sources. At the end of 1993, a total of US$427.5 million had been provided to TASF (including an allocation of US$140 million under AsDF-6) of which a cumulative US$295 million had been utilised.

JSF was established in 1988 when Japan agreed to fund the JSF under AsDB's administration with the specific purpose of "helping developing member economies to restructure their economies and broaden the scope of opportunities for new investments, thereby assisting the recycling of funds to these economies". JSF resources are primarily for technical assistance grants although they can also be used for equity investments. The cumulative amount committed by Japan (through both regular and supplemental contributions)[12] between 1988-93 amounted to ¥43.36 billion (or about US$376.7 million). Of this amount, about US$110 million had been utilised by the end of 1993, mainly for technical assistance (US$108.4 million) and for one equity investment in India.

The IDB's Fund for Special Operations (FSO)

Established in 1960, the FSO had mobilised cumulative resources of about US$10.2 billion by the middle of 1994 when GIR-8 was concluded. This amount comprises US$9.65 billion in quota contributions from all members, its accumulated general reserve (US$534.5 million), and technical cooperation contributions (US$14.65 million). Among the MDB soft windows, FSO is unique in that it was created as a built-in feature in the constitution of the IDB. Therefore it does not have a separate charter (Articles of Agreement) nor is its juridical personality distinct from the IDB. FSO has been replenished eight times since 1960, with a special replenishment in 1976 designed to accommodate the entry of non-regional countries into the IDB's membership. Unlike the other MDBs, and because it is an integral part of the IDB, the resources of FSO have been replenished in the same unified negotiations and at the same time as the ordinary capital resources of the IDB have been increased (i.e. as an integral part of the

11 When technical assistance funded by TASF leads to an AsDB loan, the amount of the grant exceeding US$250,000 is refinanced under the loan thus resulting in some refunding of TASF.

12 Supplemental contributions to JSF amount to ¥5.36 billion (US$48 million) and are to be used for the following purposes: symposia and training activities; gender issue related activities; environment related activities; and specific programmes aimed at promoting the private sector.

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GIRs).[13] As with the AsDB this has resulted in a somewhat irregular replenishments occurring at intervals ranging from 2 years between GIRs 1 and 2, to 7 years between GIRs 6 and 7.

The amount of FSO contributions peaked with GIR-5 in 1980 when the FSO received contributions of US$1.76 billion.[14] They fell sharply thereafter to US$705 million in GIR-6 and to an abysmally low US$200 million in GIR-7 before rising again to US$1 billion in GIR-8. The experience of FSO may be a precursor for all the MDB soft-loan windows. Donor contributions are likely to fall sharply once the corpus of these revolving funds is perceived by donors to have reached a self-sustaining critical mass with reflows becoming the main support for future annual commitment levels to meet aggregate recipient needs under each of the MDFs. It is a matter of debate as to whether the level of funding for all MDFs might not already have peaked (in real terms) with the IDA-10 replenishment and whether the only real issue now concerns the gradient of the downward slope for future MDF replenishments. However, it would be unfortunate if these other soft-loan windows witnessed as precipitate a decline in their future replenishment levels as did the FSO upto GIR-7 before its fortunes were reversed. Obviously, if Cuba becomes a member of the IDB in the foreseeable future, and if Haiti's travails are overcome sufficiently for development investment to resume, donors may have to review the adequacy of even their recently increased support for FSO.

Unlike IDA, AfDF and AsDF which tend to employ standard terms for their loans and credits with slight modifications to reduce concessionality for blend countries, the FSO makes its loans on more widely variable terms. Depending on the development status of the recipient country and the nature of the project being financed, FSO's loans carry interest rates of between 1-4%, with an additional commitment charge of 0.5% on undisbursed balances, maturities of between 25-40 years and grace periods varying between 4-10 years. For the less developed of IDB's borrowing members the interest charge levied is 1% for the first 10 years and 2% for the remainder of the maturity period. The IDB also applies a one-time service fee of 1% of the FSO (or OCR) loan amount for inspection and supervision. Contrary to the view espoused by the managements of the other MDBs that, permitting wide

13 See Culpeper, R., "The Regional Development Banks: Exploiting their Specificity" in the Volume containing the Staff Report and Background Papers prepared for the Bretton Woods Commission, Washington DC, July 1994.

14 The three regular (and one special) replenishments of FSO between 1967-1980 (i.e. GIRs 3-4) varied between US$1.2 to 1.76 billion and averaged around US$1.52 million. The original capital and the first four replenishments of FSO resources required donors to meet MoV obligations whilst the last three did not have any MoV requirements.

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variability in terms of IBRD/AsDB loans and IDA/AsDF credits would lead to intractable problems for managements and staff in convincing borrowing members of the fairness and impartiality of their judgements, the IDB apparently has had no significant problems in this connection. Also, whereas the other MDBs choose not to differentiate the terms of their lending by the type of project being financed, the IDB does.

Given the sharp reductions in donor contributions to FSO under GIRs 6-7, *FSO reflows* now constitute the main resource for supporting continued annual commitment levels. Reflows first emerged as an internal source of funds for supporting annual FSO lending levels under GIR-4 in 1975. From less than US$40 million annually then, reflows now average between US$300-400 million annually and support between 65-75% of FSO's annual lending. The relative importance of reflows is even greater given that they are net of the one-time inclusion of principal repayments projected to become available in the four-year period immediately following the end of the GIR-7 programme period.[15] The substantial dependence of the FSO on reflows to finance new commitments to this extent of course increases its vulnerability to disruptions caused by any delays in the receipt of repayments of FSO loans due. Were such reflows to be seriously affected by prolonged interruptions in repayment the cash-flow consequences would pose serious difficulties for FSO in meeting its contractual obligations for future disbursements against loans already committed.

The FSO has another burden to bear which the soft-loan windows of the other MDBs do not have. Since 1983, when the IDB's Intermediate Financing Facility (IFF)[16] was created, it has depended heavily on transfers of FSO net income for funding the interest subsidy element of the IFF. Total FSO commitments to IFF amounted to nearly US$700 million at the end of 1993 of which US$216 million has already been transferred. A further US$484 million has to be transferred out of future FSO net income requiring transfers of US$15.5 million annually between 1994-96, US$23.5 million annually between 1997-2001, and US$30 million thereafter upto 2010. These amounts are, of course, subject to adjustment depending on the status of FSO's net income.

15 IDB Board Document No FN-461 dated 30 August 1991 on "Review of the Financial Status of the FSO and proposed modifications in FSO encashment procedures" (paras 2.10-2.12).

16 The IFF was created by the IDB Board of Governors to subsidise the interest cost of the IDB's OCR loans to certain eligible borrowing members. IFF also receives transfers from OCR net income (US$35 million from 1991 net income) and can receive contributions from member countries. At the end of 1993, the total assets of the IFF amounted to US$326.5 million kept almost entirely in the form of liquid investments in bank deposits and treasury instruments of various developed country member governments.

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Under GIRs 7 and 8, the priorities emphasised by donors were more or less similar to those negotiated in the MDF replenishments and GCIs of other MDBs which were taking place at the same time. Operationally these placed emphasis on: the IDB's more prominent role in policy-based lending for both structural and sectoral adjustment; an emphasis on lower-income countries as beneficiaries; environmental concerns; the role of women-in development; support for micro entrepreneurs; allocation criteria; and technical assistance programme priorities.

As with the other regional banks, the IDB now manages a plethora of smaller trust funds, in addition to the FSO and IFF which are aimed mainly at financing small loans, as well as technical assistance and cooperation activities. The three largest of these are the Social Progress Trust Fund (SPTF), the Venezuela Trust Fund (VTF) and the Japan Special Fund (JSF). Smaller funds administered by the IDB include various bilaterally supported funds, the European Union Fund, and a plurilateral Technical Cooperation Trust Funds Program to which ten non-regional members and the EU have contributed a total of US$20 million. SPTF was set up by the US in 1961 with an initial contribution of US$525 million, of which about US$184 million had been returned to the US by the end of 1993. VTF was set up in 1975 with total contributions of over US$400 million by Venezuela; its resources were augmented by nearly US$600 million in accumulated earnings on resources provided and invested. Of these amounts which have been on-lent and repaid by IDB's borrowers, over US$727 million has been repaid to the Venezuelan Investment Fund. JSF comprised two contributions by Japan totalling ¥16.5 billion (US$150 million) to finance non-reimbursable technical assistance for project preparation, small projects, emergency assistance and analysis of environmental problems.

Special Funds administered by the EBRD

The EBRD does not have any soft-loan window similar to those of the other MDBs, although its Articles provide for the creation of *Special Funds* (Article 19) which have to be distinguished and managed distinctly from its ordinary capital resources. At present it is thought unlikely that its donor shareholders would be willing to consider setting up a similar window in the EBRD to disburse large volumes of concessional resources to the EBRD's borrowing members. What is more likely is that the EBRD will be urged to set up a number of small special purpose funds which are highly focused and targeted at achieving specific objectives rather than being broadly aimed at enabling it to lend to the poorer countries among its clientele. At the end of 1993, EBRD was administering four small Special Funds: (i) the Baltic Investment Special Fund (ISF); (ii) the Baltic Technical Assistance Special

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Fund (TASF); (iii) the Russia Small Business Investment Special Fund (SBISF) and (iv) the Russia Small Business Technical Cooperation Special Fund (SBTCSF).

The two **Baltic Funds** were set up in 1992 with contributions from the five Nordic countries (Denmark, Finland, Iceland, Norway and Sweden) totalling ECU 60 million for the ISF and ECU 5 million for the TASF. These two funds are open-ended. With targeted equity investments and technical assistance, they are aimed at facilitating the emergence of market economies through the development of *private* small and medium-scale enterprises in Estonia, Latvia and Lithuania. At the end of 1993, the EBRD had made share investments totalling ECU 1.5 million from the ISF and had disbursed ECU 2.64 million from the TASF.

The two **Russia** funds – SBISF and SBTCSF – were set up by the EBRD itself under Article 18 of its Basic Agreement in late 1993 and have yet to be fully funded. As of the end of 1993, the SBISF had attracted resources of only ECU1.48 million from Germany, Italy and Japan with no operations having yet been undertaken. The associated SBTCSF was set up in tandem at the same time and had attracted resources of just under ECU1 million (again from the same three donor countries) with no disbursements having been made by the end of 1993.

At the urging of the G-7 countries, the EBRD also set up the **Nuclear Safety Account** (NSA) in March 1993 aimed at enabling countries in Eastern Europe and FSU to improve safety in their nuclear power plants. The NSA had received pledges of ECU 104 million from thirteen countries at the end of 1993 but none had actually made their contributions available by then.

Common Issues Raised by MDB Soft Loan Windows

As noted in the paragraph relating to IDA, the MDF replenishments raise a host of common issues, some of which are explored briefly below.

Burden-Sharing

All soft window replenishments are funded by donors on the notional principle of *fair burden-sharing*. Most donors usually aim to maintain their shares in previous replenishments while allowing for minor adjustments in succeeding replenishments to accommodate both the entry of new donors and changes in the *relative* economic circumstances of all donors. Of course what is seen to be a *fair share* of any donor in any MDF replenishment is a matter less of objective analysis (although donors invariably ask for such analysis based on various economic indicators to be carried out for each replenishment exercise) than of political bargaining among donors. Such

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bargaining usually occurs within parameters which are bounded by considerations concerning their relative shareholding and voting power in the MDB whose soft-window replenishment is being negotiated. Requests by any donor for a downward adjustment of its share are usually resisted by other donors since that would mean their having to pay a larger share. Nevertheless, significant adjustments in the share of major donors have taken place over time. For example, the US' share in IDA has fallen from 42% in IDA's original capitalisation to just under 21% in IDA-10 while Japan's share has increased from 4% to 19%. Similarly the share of the UK in IDA has fallen from 17% to around 6% over the same period while Germany's share increased from 7% to 13% before falling back to 11%. During the 1970s Saudi Arabia, Kuwait and the United Arab Emirates countries took up fairly large shares of IDA-5 and IDA-6 but their shares have declined dramatically since then. These adjustments, which are also reflected in the replenishment of other soft-windows, have broadly reflected relative changes in the GNP shares and the external accounts of these donors in the world (or regional) economy.

The burden-sharing issue has bedevilled soft-window replenishment negotiations on many occasions. Some replenishments (e.g. IDA-7) have been negotiated at levels substantially below what might have been possible had the donor community as a whole been willing to accept reductions in the share of some donors, most especially the US and the UK. The changed nature of the aid constituency in the US since the Vietnam War, its protracted legislative processes for authorisation and appropriation of contributions to MDBs, and the disinclination of successive US Administrations to expend scarce domestic political capital on the MDBs, which do not win them any domestic votes, has resulted in the US having major problems with contributing an appropriate share to MDB soft-windows and paying-in its contributions on time (see below). In the context of strict burden-sharing rules being applied that feature has become a fundamental structural weakness in the processes of soft-window funding.

It must be acknowledged however that, on occasion, some large European donors have somewhat ingenuously used this characteristic to use the US as an excuse for reducing their own overall budgetary contributions (though not necessarily their shares) to MDB soft-windows while letting the US absorb the opprobrium for failed (i.e. smaller-than-would-have-been-possible) MDF replenishments. On other occasions, other smaller donors (e.g. the Nordic countries) and Japan have done the opposite. They have made *special contributions* over and above their proper shares based on burden-sharing to utilise fully their budgetary appropriations for multilateral aid. Such contributions have been made separately from their regular contributions in order to avoid locking themselves in for a higher share in the next replenishment. In the case

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of IDA-7, for example, the US was unwilling to contribute an amount which, under normal burden-sharing, would have permitted an adequate replenishment. Consequently, other donors set up a large Special Fund (in which Nordic participation and inspiration was particularly strong) to accompany IDA-7. On the other hand, the US has been unwilling to reduce its share in the AsDB; the limitations on its contributions to AsDF therefore constitute a binding constraint on the size of AsDF replenishments.

The way in which the burden-sharing rules have been applied, and the absence of linkage between MDF contributions (which are far more expensive from a budgetary viewpoint than contributions to MDB capital) and *effective* voting power in the MDBs themselves has made it unattractive for some new donors (e.g. Singapore, Taiwan) to contribute as much to MDF replenishments as they could certainly afford while inducing other developing country donors to make token contributions (e.g. Brazil, Colombia, Korea, Mexico, and the former Yugoslavia in IDA; Indonesia, Korea and Nauru in the AsDF; Argentina, Brazil, China, India, Korea, and Yugoslavia in the AfDF).

The principle of burden-sharing has ostensibly provided a disciplined framework of rules within which MDF replenishments are negotiated. But there is a case for believing that some (large European) donors may have been too rigid in attempting to apply that framework – to the possible detriment of MDF replenishments and more so to their recipients. Their actions have been guided by the belief that without such discipline the US would have done even less than it has been inclined to. The US clearly has a particular problem in engendering broad-based political and popular support for multilateral commitments for development financing and now even for its own bilateral aid commitments. European donors, Japan and other donors have not yet had quite the same domestic political problems in funding development assistance. But, with growing (although somewhat ill-judged and unfair) perceptions of the failure of aid[17] these political problems now seem to be growing in other countries as well. On the other hand the US takes on a larger share of the financial burden than other donors in *global systems maintenance*; it spends commensurately more than other countries on global security, its market for goods has generally been much more open to imports from developing countries than those of Europe and Japan; and its labour market has been more open to unskilled immigration (legal and illegal) from developing countries in general but Latin American and Caribbean

17 Public perceptions of aid failure have strengthened with the apparent failure of (and NGO opposition to) structural adjustment programmes in Africa and the more general and increasingly effective opposition of some special-interest lobbies (especially the environmental lobby) to multilateral institutions in general and the World Bank in particular.

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countries in particular.[18] Last, but not least, it cannot be forgotten that the present multilateral edifice for development cooperation is based on the global vision, far-sightedness, generosity and financial support of the US in earlier halcyon days when those attributes were in abundance in a United States that was a much more confident and dominant leader of the global community than it is now. If cumulative contributions are measured in *real* rather than nominal dollars then the past contributions of the US (and by the same token those of the UK) have to be given somewhat greater weight in the reckoning of cumulative burden-sharing upto now than they actually have been.

For all these reasons, while the burden-sharing framework must continue to be applied in negotiating MDF replenishments, it must be applied with sufficient imagination, flexibility and accommodation to acknowledge circumstantial realities without damaging the size of replenishments. Most donors would argue that such flexibility is already present; but that would be a difficult argument to sustain in convincing those intimately involved with replenishment negotiation exercises. In particular, what seems clear is that the way in which the established donor community applies burden-sharing concepts, and de-links soft-window contributions from effective voting power in the core MDBs, provides no particular incentive for new donors like Singapore and Taiwan to emerge and play a prominent role in financing concessional development assistance although they could well afford to.

Pro Rata Note Deposits and Drawdowns

Connected to the burden-sharing principle is the issue of *pro-rata note deposits* and *drawdowns* of donor contributions. The business of MDB managements negotiating instalment payments and drawdowns with donors has now become quite complex; replete with technicalities whose intricacy of detail is mind-bending although not of immediate concern here. In essence the idea behind the issue is quite simple. Whereas soft-window replenishments are negotiated every three years or so (the intervals have been different and variable for different MDB funds) the *commitments* made annually against donor pledges over the replenishment period are actually *disbursed* over a period of 10-12 years. MDB managements cannot prudently make commitments against negotiated pledges until they know that donors have legally obligated themselves (i.e. they have obtained all the due parliamentary and administrative approvals which their internal governmental processes require) to make their pledged funds available in cash to the MDB soft-

18 This thought is not an original one. The author owes it to Professor John Lewis of Princeton University.

window. Such legal obligations are expressed and conveyed in the form of *instruments* (effectively promissory notes) which convey a binding and irrevocable commitment on the part of the donor to pay to the MDB soft-window all or part of its pledged contribution. Since approval has to go through the normal annual budgetary process in each donor country, most donors prefer their contributions to be divided into three or four annual *instalments or tranches* of notes which are then deposited with the MDBs concerned. It is important to appreciate that these instalments are not made in the form of *cash* but in the form of *notes* which can be drawn down upon over a much longer period of time as funds are required to meet disbursement and liquidity requirements.

This process is conditioned by *pro rata* rules which require the MDBs to ask donors for deposits of instruments on a basis which reflect the proportionate shares of donors in the replenishment. In other words, donors have the right to reduce the size of their note deposits or to restrict the amount of their deposits which Management can use for the purposes of commitment authority, to the same level as any other donor which has so far released less than its proper share. This right usually results in a 'lowest common denominator' approach to the management of soft-window commitment authority. It has been sought by other donors in response to the continual lateness of the US in making its deposits of instruments available to MDBs and often depositing notes for less than the agreed instalment amount.[19] This happens now almost a matter of course for each instalment of each MDF replenishment with the US Congress failing to appropriate the amount requested by the Administration to honour its multilateral commitments. Given the separation of powers between the *legislative* and the *executive* branches of government in the US, the Congress often employs such tactics

19 To explain the situation it is perhaps best to quote paragraph 65 of the draft Report and Resolution on IDA-10 (Board Document No IDA/R92-168) dated December 23, 1992. That paragraph conveys a sense of the problem that applies to all the MDBs as far as the US is concerned: "Donor contributions to soft-window replenishments are usually made in three or four equal tranches to support annual commitment authority. The practice of the US is to deposit a Qualified Instrument of Commitment to IDA with its payments being subject to annual legislative approvals. In view of the uncertainties attached to the US legislative schedule and the possibility of delays in receiving the US commitment, pro-rata release arrangements have been incorporated into the replenishment agreements since IDA 5. Under these provisions, other donors may exercise the right to reduce IDA's ability to commit against the second and third tranches of their authorised subscriptions and contributions on a pro-rata basis proportionate to any US shortfall." The same rights for other donors exist in the case of the other MDB soft-window replenishments as well (e.g. AsDB). Other donors are usually informed when there are delays or shortfalls in US tranches and are given thirty days after notification within which they can choose to adhere to their pro rata rights. If they do not respond within those 30 days their rights are assumed to have been waived. In the case of IDA most donors have waived these rights in order to avoid disrupting IDA's commitment authority.

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in order to send a signal to the Administration about priorities or concerns which are often totally unrelated to the issue at hand. The susceptibility of Congress to powerful lobbying by single-issue interests often results in appropriation delays and cut-backs as do Congressional concerns on unrelated budgetary issues and priorities which are advanced by a peculiar process of bargaining between Congress and the Administration. What actually results is a disruption of MDB soft-window operations and considerable irritation throughout the donor community which believes it is bearing a larger than necessary share of the burden up-front, leading to other large donors insisting on having the right (even if they do not use it) to gear down their own deposit levels to proportionately the same levels as those of the US.

More often than not other donors choose to forego exercising their pro rata rights in order to avoid exacerbating disruptions in commitment authority caused by the US' delays. Some donors even offer to advance their own note deposits and sometimes (for budgetary reasons) permit earlier than necessary encashment of those deposits without insisting on pro rata rules. The US' larger cohorts in G-7 however have sometimes been less obliging, choosing to send a message to the US by leveraging down the release of their own contributions in the hope that the resulting disruption to the MDB soft-loan window will compel the US to accelerate the release of its deposits on the basis negotiated. In practice this almost never results, largely because the US Congress is relatively impervious to the views of other donors.

As with the burden sharing principles on which they are based, the pro-rata rules applied under all replenishments are generally sound in theory and intent. They work less effectively in practice. Instead of bringing about the necessary changes in behaviour on the part of a recalcitrant or a disabled donor what the application of such rules usually results in is damage to the MDB soft-window and to its recipients. That point has rarely been accepted by some donors more rigidly inclined in their thinking who believe that any dilution of such rules or laxity in their application would be unfair and who are disinclined to see the damage done to the institution and its recipients as a relevant issue.

The pro rata rules for note deposits and note encashment procedures, while fair in concept, are unwieldy and expensive to apply in practice. They do not achieve the intended result of fairness in encouraging sound behaviour on the part of donors. To the extent they are applied they only achieve a lowest common denominator type of balance in donor contributions which, by definition, damages the interests of recipients. It would be far better for donors to agree to simpler, if somewhat more arbitrary, formulae which would make their contributions more predictable in terms of their own budgetary procedures and make the flow of funds easier for MDB managements to handle. Such rules could be as simple as requiring all donors

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to make three or four equal instalments of their replenishment contributions through the usual note deposits and to have each note encashed in equal or pre-tailored instalments (which can be front-loaded, back-loaded or bell-shaped) over a period of 6-8 years so that actual cash contributions were made over a period of 8-10 years.[20] MDFs could then manage the expansion or contraction of liquidity that might result from differences between profiles of pre-determined note encashment and actual disbursement (which they now do anyway).

Soft-Window Service Charges, Liquidity and Income Management

The service charges which the MDFs levy are intended mainly to cover their costs in administering their concessional funds rather than to generate high levels of income. Depending on the concessional window concerned, these charges may include any combination of: a front-end processing fee; an annual service charge on disbursed and outstanding balances; a low or intermediate interest rate charge; and an annual commitment fee on undisbursed balances. Whereas the other MDFs provide their concessional resources on virtually similar terms, the FSO levies variable charges and terms over a much wider range depending on the country and project being financed. At different times for different funds, the income derived from charges applied has proven insufficient to cover costs[21] and income levels have had to be augmented through a change in either the levels of charges or the introduction of new charges. When income has been restored to adequate levels, these charges have been reviewed and reversed. In the FSO, where interest rates are also levied, the income generated is now becoming an important source of funding for future commitment authority.

MDF Liquidity

Related to the issue of cost recovery, is the associated issue of maintaining sufficient *liquidity* in the accounts of soft-windows in order to: (i) meet

20 In the case of IDA the subscription and contribution payment arrangements provide donors with considerable flexibility in phasing the payment of their contributions. Once made, contributions are drawn down in equal proportions (in terms of their unit of denomination) over an 8 year period. IDA's management consults with donors that experience unforeseen difficulties with meeting the encashment schedule and works out flexible arrangements which accommodate donor constraints as long as all encashments are fully made within a maximum of ten years.

21 In the case of AfDF and FSO too large a proportion of total MDB costs are being covered by the soft-window thus making the hard window appear to be artificially more profitable than it actually is and overloading the resources of the soft-window to finance administrative costs at the expense of depleting future commitment authority.

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expanding disbursement requirements, especially when fast disbursing loans suddenly assume a higher profile in the operational mix of MDF loans as they have done since the mid-1980s in all the MDFs; (ii) generate investment income to supplement income earned through charges and thus reduce the overall cost burden on recipients; and (iii) in exceptional circumstances, to provide a cushion for protecting commitment authority from suffering an excessively sharp fall. In the past, donors took the view that, since concessional windows could meet disbursement requirements on call by encashing notes whenever needed, there was no case for maintaining more than nominal liquid balances in the accounts of the soft windows. Donors were reluctant to make cash payments (which inflated their own domestic borrowing requirements) to MDFs until absolutely necessary and preferred to internalise the returns on liquidity rather than pass them on to the soft-loan windows. Since the late 1980s donors have taken a more relaxed view on the subject (at least with IDA and AsDB though not yet with AfDF) and have been willing to prefund encashment in advance of disbursement needs to permit a greater amount of liquidity to be held by the soft-windows themselves and to permit earnings generated by such liquidity to be used to keep service charges in check or to fund additional commitment authority. The liquidity maintained by IDA at the end of FY94 amounted to nearly US$3.1 billion (against disbursement requirements of about US$5.5 billion) while at the end of 1993 AsDF liquidity was about US$725 million, that of FSO was about US$2 billion and that of the AfDF was US$400 million. In the past, liquidity levels amounting to nearly 60% of annual disbursements were regarded as excessively high with MDF liquidity actually averaging about 25% of annual disbursements upto the mid-1980s.

Administrative Cost-Sharing between MDB Hard and Soft Windows

As the MDFs are operated as separate funds rather than as separate institutions (e.g. like IFC) the issue arises of apportioning administrative costs for the MDB as a whole, between its hard and soft-windows, and of course across other special funds which it might be administering. In the case of IDA and the AsDB the apportionment is done on a basis which appears to bear some justifiable relationship to the relative portfolio sizes and the other identifiable costs of their hard and soft windows. In the case of the AfDF and IDB the basis of cost-sharing is more difficult to comprehend. Neither institution applies a cost accounting system of the same sophistication as the IBRD and AsDB although by best practice norms even the systems of the latter two MDBs are inadequate. The basis for apportionment in the AfDF and IDB is therefore more arbitrary and *political* with an unfairly high burden of cost being borne by the MDF with the MDB proper consequently

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appearing to be more profitable than it actually is.[22] Also, the overloading of costs onto the soft window results in depleting donor provided cost-free funds and depriving potential recipients of scarce concessional resources. In both the IDB and AfDB the basis for cost apportionment was reviewed in 1994 and a new formula is to be adopted in future years to reflect a more appropriate division of administrative expenses.

Concessional Resource Eligibility & Allocation

Among the more difficult issues which arise during soft-window replenishment negotiations are those that concern the criteria applied to: (a) determine the *eligibility* of recipient countries for access to concessional multilateral funds; and (b) determine the actual annual and cumulative *allocation* of concessional resources across eligible recipients under any given soft-window replenishment. Since concessional multilateral resources are, by their very nature, scarce they need to be rationed out in some way which is seen to be fair and acceptable by those which are excluded from access. Another aspect of the same issue concerns the determination of those countries which are ineligible, on creditworthiness grounds, from access to hard window resources and can borrow only from soft windows (e.g. the *IDA-only* countries or their equivalents in the regional banks). These criteria, which have undergone continuous evolution in response to the shortage of concessional resources, also seem to differ across the MDBs at any given point in time with inconsistencies emerging in the treatment of the same country by two different MDBs.

Eligibility Criteria Applied by MDBs

Under IDA-10 the criterion for eligibility of recipient countries was left unchanged at a World Bank calculated GNP per capita cut-off of US$765 per annum or less in 1991 dollars.[23] However, exceptions can be made for access to IDA by: (a) small island economies with a higher per capita income; and (b) for temporary assistance to adjusting countries which have per capita incomes above this cut-off limit but which are not eligible for IBRD lending on creditworthiness grounds. In reality, about 80% of IDA's resources go to countries with GNP/capita of under US$400; recipients whose national per capita incomes are higher are the exceptions. Consideration of whether the

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22 See Mistry, P. S., "A Report on the Financial Condition of the African Development Bank", published by the Swedish Ministry for Foreign Affairs, Stockholm, May 1993, p. 12.

23 In 1993 dollars the theoretical ceiling IDA eligibility was calculated at $1,345 GNP/capita but with the effective operational cut-off being $835 or the equivalent of $765 in 1991 dollars.

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cut-off limit should be lowered to reflect this reality led to the conclusion that the exceptions were important enough not to be excluded altogether and therefore the limit remains unchanged for now. Several of the poorest low-income borrowing countries in Africa, some in Asia and one or two in Latin America and the Caribbean are classified by the World Bank as *IDA-only* countries signifying that they are too poor, too debt-distressed and too uncreditworthy to be eligible for any IBRD financing without incurring the risk of running into difficulties in servicing their hard-window debt. Several others are classified as *blend* countries making them eligible to borrow from both windows but with their access to IDA resources constrained by allocation rules and their access to IBRD being constrained by creditworthiness considerations.[24] These countries generally have GNP/capita levels of between US$290-1,345 in 1993 dollars. Finally, there is the *IBRD only* category of countries whose income levels, creditworthiness, and stage of development preclude them from having access to scarce IDA funds; generally these countries have 1993 per capita income levels of over US$1,345. The *IBRD only* countries are classified into four distinct groups which enjoy different maturities and grace periods on their IBRD loans. The four groups are differentiated by their GNP/capita levels in 1993 dollars. Countries with per capita incomes of: (i) less than US$1,345 are eligible for 20 year maturities; (ii) between US$1,346 to 2,785 are eligible for maturities of 17 years; (iii) above US$2,786 are only eligible for maturities of 15 years; while (iv) countries with GNP per capita above US$4,865 become candidates for graduation from IBRD lending.

The *African Development Fund (AfDF)* has in the past attempted to be more inclusive in applying AfDF resources even to member countries with relatively high per capita incomes. Every single AfDB borrowing country has received AfDF loans and all of them still have outstanding AfDF obligations to repay. However, after AfDF-5 the application of eligibility criteria has become tougher although such criteria are not as rigidly based on income cut-off limits as under IDA. The AfDB categorises its borrowers into three groups: (i) *Category A*: comprising members with a 1990 per capita GNP of US$540 or below; (ii) *Category B*: which includes members whose GNP/capita is between US$541-1,050; and (iii) *Category C*: which includes members with per capita incomes above US$1,050. This categorisation notwithstanding, AfDB has proposed that under AfDF-7, all members

24 Under IDA-10, the proportion of replenishment resources that could be allocated to blend countries was limited to 30-35% of the total amount of commitment authority available during the IDA-10 period. Within this overall limitation there are caps on the amount of IDA funds available to China (10-12%) and India (15-17%).

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eligible for assistance under the Special Programme of Assistance for Africa (SPA) are automatically classified in Category A regardless of their income level.[25] It has also been proposed that the effective income cut-off limit under AfDF-7 should remain the same as for AfDF-6, at US$1,050 although countries with a higher income level should still be eligible for reimbursable technical assistance loans (with a grant element of 50%) financed under AfDF-7. The bulk of AfDF-7 funds (90%) are however expected to be committed to countries with GNP/capita of US$540 or below.

Overall access to AfDF resources is governed by country creditworthiness and level of income. Category A countries with low creditworthiness can borrow only from the AfDF while those which are not debt-distressed and have some residual creditworthiness can borrow from both the AfDF and AfDB as blend countries. Category C countries can borrow only from the AfDB, except for technical assistance as noted. Category B countries are generally blend countries. Until recently, however, the AfDB was disbursing significant amounts of hard-window resources to Category A countries (like Zambia) which had been declared by the World Bank to be patently uncreditworthy and therefore ineligible for IBRD lending. This led to the anomaly of certain countries effectively being given debt relief for their IBRD debt service through IDA when they were servicing their debt to the AfDB and actually increasing their obligations to that institution. This resulted in the AfDB being a *free-rider* on the back of the World Bank's efforts at providing partial debt relief. Hopefully that anomaly will be rectified when negotiations for AfDF-7 conclude with greater consistency between the three borrowing categories identified by both the World Bank and the AfDF.

The effective eligibility criteria for access to *Asian Development Fund (AsDF)* resources are less clearly defined. Like AfDB, the AsDB also classifies its borrowers into three groups but unlike the World Bank and AfDB these do not fall neatly into precisely delineated income categories. For example in AsDB's classification of its borrowers: (i) *Group A* generally includes members with 1990 per capita GNPs of US$610 or below (including China and India, its second and third largest borrowers as well as Bangladesh and Pakistan); but this group also includes eight Pacific Island countries whose GNP/capita is much higher; (ii) *Group B* comprises Indonesia (the AsDB's largest borrower) which had a 1990 GNP/capita of US$550 and three other countries, Papua New Guinea, the Philippines and Thailand, with per capita GNPs of US$760-1,420; and (iii) *Group C* which comprises all other

25 This is justified on the grounds that "most of them are debt-distressed and are undertaking internationally monitored adjustment programmes" not the kind of logic which supports a disciplined approach to scarce resource rationing on a needs-based analysis but one which attempts to open as many loopholes as possible to keep AfDF as inclusive as possible. This proposal of management has not been accepted by the AfDB Deputies.

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borrowers, whose GNP/capita was above US$1,770. All these income levels pertain to 1990 and are measurable in 1990 dollars (the 1993 per capita income levels of Groups B and C were considerably higher). Eligibility for AsDF resources is confined primarily to Group A countries *excluding India and China* and, to a lesser extent, to the three Group B countries *excluding Thailand*. These criteria have their roots in history and in the intra-AsDB politics that have developed between donors and the two populous Asian giants. Therefore they do not reconcile with IDA's eligibility criteria. Thus China and India are IDA recipients but are ineligible for AsDF, while other Asian countries which are now almost ineligible for IDA (Indonesia and the Philippines) remain eligible for AsDF.

In Latin America and the Caribbean, eligibility for *FSO* resources is confined under GIRs 7 and 8 to the low-income, lesser-developed economies of Central & South America, and the islands of the Eastern Caribbean. The FSO-funded interest subsidy for the IFF is applied to some of the lower-middle-income island economies of the Western Caribbean and of Central America. Like the AsDB (but unlike IDA), the IDB does not use clear income cut-off levels to determine eligibility for FSO. It divides its borrowers into *four* groups not by income level but by the relative sizes of these economies and their importance in the region. Accordingly, the IDB's borrowers are classified as: (i) *Group A* which comprises Argentina, Brazil, Mexico and Venezuela, all economies whose GNP per capita in 1993 was in the range between US$2,840-3,750; (ii) *Group B* which includes the three second-tier Latin American economies i.e. Chile, Colombia and Peru with 1993 GNP/capita varying between US$1,490-3,070; (iii) *Group C*, which comprises a more diverse range of eight smaller middle-income economies in Central America and the Caribbean and includes Uruguay whose per capita GNP varies enormously between US$1,390 (for Jamaica) to US$11,500 (for the Bahamas) but with most countries in the group clustering around the US$2,000-3,500 GNP/capita range; and (iv) *Group D* which comprises the ten low-income countries of the region (excluding Cuba which is not yet an IDB member) with 1993 per capita incomes below US$1,200. Eligibility for FSO lending is confined to Group D, while the IFF with its interest subsidy is extended to countries in Groups C and D whose per capita incomes (as published in the IDB's 1993 Annual Report) were below US$1,600.[26]

26 There are significant disparities in the US dollar per capita income figures used by the different MDBs for the same countries in the same year, compounding the problem of significant inconsistencies in the eligibility of countries for concessional assistance across different MDFs. For example, under GIR-8 the applicable per capita income figure for Argentina as published in the 1993 IDB Annual Report is US$4,532 while the World Bank Atlas has published a figure of US$7,290 – hardly a minor difference! It would be more appropriate for all MDBs to use a single data series for this all important indicator.

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Inconsistencies in Eligibility for MDF Resources

As can be seen from the foregoing paragraphs, there are no clear and consistent guiding principles governing the eligibility of countries for multilateral concessional resources across the multilateral system as a whole even though the funds are provided largely in the same way, by more or less the same group of key donor countries. Nor do MDBs classify their borrowers in the same way; nor indeed do they even measure their per capita incomes in the same way. Obviously some flexibility must be allowed to accommodate the different characteristics of the borrowing universe in the different MDBs, and especially in the regional banks. The question is whether the flexibility presently being exercised results in excessive anomalies and incongruities which the donor community – which after all is largely the same for all the MDBs although the proportionate roles and shares of different donors in each might differ – would find it difficult to justify with any economic logic. The least ambiguous eligibility criteria are applied by IDA. The least clear criteria are applied by the *regional* MDFs which operate more or less as a distinct group and (perhaps rightly) attempt to take the peculiarities of their regions into account in determining eligibility. Yet these differences result in inconsistent treatment of specific countries in terms of access to concessional resources with no monitoring being done at the systemic level to determine the fairness of overall concessional flows from the MDBs as a whole. The problem is compounded by inconsistencies within the donor community in the determination of allocations of resources by different donors to different MDFs.

That per capita incomes cannot be the sole determinant of eligibility has been conceded even by IDA which allows for exceptions in the case of island and adjusting economies. Moreover, the GNP/capita indicator used by the World Bank is different from those used by other MDBs even though all of these indicators are based on averaging out official exchange rates over a three-year period. These indicators are subject to large methodological errors and to major year-to-year fluctuations because of their vulnerability to exchange rate distortions. For example, India's per capita income was calculated by the IBRD to be US$330 in 1991, US$310 in 1992 and US$290 in 1993 although, over that period, the IBRD estimated that real per capita income had grown in India by about 3%! At the same time China's per capita income was calculated at US$370 in 1991, US$480 in 1992 and US$490 in 1993 when the IBRD calculated a real increase in China's per capita income of around 10% in 1992 and 12% in 1993. In comparative terms, whereas in 1991 the per capita income gap between India and China was only US$40, it had widened to US$200 by 1993 – which is plainly absurd and obviously

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misrepresents what has been happening in these two economies over the last two years.

Given the anomalies that arise in the use of highly contentious GNP/Capita indicators, it would clearly be more attractive and more appropriate for all MDBs to use the *Purchasing Power Parity (PPP)* based GNP/capita figures which are now published annually in the UNDP Human Development Report as a better basis for determining eligibility. But even these figures, though they are more stable, are still subject to methodological errors although it is open to question whether the size of these errors are of the same magnitude as the present GNP/capita figures calculated by the World Bank. Over time, movement towards using PPP figures has much to recommend it on a conceptual basis if not yet on a practical basis. The MDBs should invest resources jointly in developing, along with UNDP and the IMF, a more acceptable common methodology for deriving PPP figures for classification and differentiation purposes.

Reconsidering the Eligibility Question

Eligibility for concessional resources is constrained because of their scarcity. A uni-product approach of the type followed by all MDFs other than FSO exacerbates the scarcity factor of these resources. The question therefore arises as to whether multilateral concessional resources should be provided on more *variable terms* in a fashion similar to the FSO. If that practice were adopted more widely the eligibility strait-jacket could be loosened considerably. Clearly the World Bank attempts to cater to intermediate terms through the IBRD/IDA *blend*; but the blend is becoming an increasingly blunt device which is not amenable to fine-tuning or to a quick adaptive response to changed circumstances. In any case, the blend in the MDFs is now being determined more by political negotiation than by economic logic. Moreover, there is a case for the *type of project* being financed also to influence the type of resource (and its terms) which an MDB might choose to provide rather than having it be determined exclusively by country income circumstances. For all these reasons it is clear that a fresh approach is needed in rethinking the issue of eligibility.

Another important new factor (i.e. post IDA-10) to consider post-1991 is that the larger MDF-eligible *blend* countries such as China, India, Indonesia, Pakistan, the Philippines and some others, are now able to access *private* external flows of both debt and equity on an unprecedented scale. By pursuing more appropriate policies and reforming faster they can expand access to such resources considerably. Contrary to the concerns of donors and recipients, not all such inflows are inherently *hot* i.e. easily reversible, although they can be if international capital markets lose faith in the

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countries and governments they are investing in. Even portfolio equity flows and non-resident bank deposits can be stable and growing as long as global capital markets are satisfied that the policies being pursued are sustainable and growth-oriented and that they do not risk sudden large changes in external accounts or are subject to unacceptably large devaluation risks. Other poor countries (especially in Africa) which are now almost exclusively dependent on concessional resources simply do not have such access. The large IDA-eligible countries (and some of the smaller ones in Africa) also spend an inordinately large proportion of their public resources on military expenditures. At a time when concessional resource scarcity is growing due to budget pressures in donor countries it is appropriate to reconsider the eligibility of these large regional powers for concessional multilateral resources when the provision of such resources indirectly, because of resource fungibility, supports their ability to expend their own resources in non-productive ways. Moreover, new claimants are emerging for concessional resources whose incremental demands are unlikely to be matched by expansion of supply.

Taking into account all these changing contextual factors in a post-Cold War world, with private external flows dominating official flows in meeting the external resource requirements of developing countries, it is reasonable to suggest that the issue of eligibility for concessional multilateral resources should be reopened and thoroughly reconsidered in the context of IDA-11 and all succeeding soft-window replenishments. The aim of such an exhaustive review should be to make concessional multilateral resources both; (a) *more variable* e.g. with interest rates of 1-4%, maturities of 25-40 years, grace periods of 8-12 years and variable backloading of annual amortisation amounts; and (b) *more accessible* especially to the neediest countries for a wider variety of social investment oriented projects. The FSO provides an interesting model, in terms of the way in which it has evolved both operationally and financially, for the other MDBs and their donors to examine more carefully before considering similar evolutionary changes in their own soft-window facilities.

Allocation of Soft-Window Resources

If *eligibility* criteria are more judgmental, less transparent and less rigid (in terms of the applicability of income cut-offs) than they are often portrayed to be, then the *allocation* criteria, and the way in which they are applied within and across the different MDFs, for annual and cumulative MDF allocations to particular countries are even more so. MDB managements of course strive to make their decision-making on concessional resource allocations *appear* to be as impartial, objective, formula-based, and transparent as possible, with the

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appropriate genuflections to whatever developmental priorities or fashions happen to be in vogue with donors at the time. The reality, however, is that allocations among the major concessional resource recipients (or groups of recipients) are often determined in broad terms by the senior managements of MDBs and the representatives of major donor countries exercising their judgements at the start of any replenishment cycle. These broad allocations are reviewed annually (more on a pro forma than a substantive basis) in the context of each MDB's budget and operational programme review cycle. Given the long gestating cycle of project preparation in the MDBs, and the relative predictability of projects at different stages of processing in the pipeline, the annual reviews do not, however, result in major changes to soft-window allocations except when a major event occurs e.g. in a country's politics or government or policy or major donor preference. For example, until IDA-6 in 1981, it had become almost axiomatic that India would absorb 40% of IDA's total resources and that the other countries of South Asia would absorb a further 20-25%, leaving between 35-40% for Africa and the other regions of the world. The entry of the Reagan Administration in 1981 resulted in a politically driven shift which reduced India's share to below 20%, China's share to around 12%, Africa's share to at least 50% with the remainder being absorbed by other eligible countries. Similar considerations have applied in the other MDBs as well though, in retrospect, none were quite as sharp, public or dramatic.

In addition, the *performance* of recipient countries *as perceived by MDB managements* has a lot to do with soft-window allocations. During and after the 1980s, that has mainly meant performance in terms of recipient willingness to implement MDB promoted economic policy reforms at both macro-economic and sector-specific levels. Since 1990, donor countries have emphasised more or less the same allocation criteria in all the MDF replenishments. Broadly, these include: (i) willingness to engage in *policy dialogue* and performance on policy reform, economic adjustment and growth; (ii) emphasis on *poverty reduction* in the recipient's own development priorities; (iii) recipient sensitivity to *environmental sustainability*, the linkage between environmental sustainability and poverty reduction in development plans and the undertaking of environmental impact assessments for development projects; (iv) responsiveness to *gender* issues (i.e.women-in-development priorities); (v) *good governance* issues (i.e. sound economic management in terms of administrative capabilities, the accountability of politicians, civil servants and public agencies, transparency, rule of law, emphasis on participative consultation with NGOs and groups affected by projects); (vi) emphasis on investments in *human resource development*; and (vii) emphasis on *institutional development* especially of those institutions which support the proper, competitive functioning of market economies and of

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open transparent democracies. In the AfDF and FSO, donors also emphasised *support for micro-enterprises* and for *regional integration initiatives* in determining AfDF allocations. In the FSO, donors further supported an expansion of *sector lending* as a priority in resource allocation. In AsDF, donors placed particular emphasis on *population control* and on *promoting the private sector*, two priorities which are likely to resonate in the next round of all MDF replenishments.

In virtually all the recent MDF replenishments, donors placed a cap of 25-30% of the resources provided, being used for adjustment lending with the remaining 70-75% being applied to project financing. Donors are also more concerned about MDBs undertaking regular portfolio quality reviews, better appraisal quality improved monitoring and supervision, better donor co-ordination, among the MDBs themselves, between MDBs and bilaterals, and between MDBs and NGOs, applying the lessons learnt from ex-post evaluations in their country assistance strategies.

Concessional Resource Reflows

The MDFs are all funded by *grant* resources from donors and by net income transfers from their affiliated MDBs which are permanently endowed. All the MDFs on-lend these resources in the form of long-term repayable credits, except for that small portion (5-10% of the total) which can be disbursed as technical assistance grants in the regional MDFs. The *revolving* nature of these funds was thus always an in-built feature of the MDFs. Donors fully intended that, at some future point in time, the corpus of their cumulative contributions would become sufficiently large, and the demands made on it would become sufficiently small for neutral equilibrium to be reached. At that point no further budgetary contributions from donors would be needed to sustain the *annual commitment authority* of the MDFs. Instead, the annual commitment authority would be fully funded by *reflows* from previous credits and, to a lesser extent, by the income earned on MDF liquidity. That state is closest to occurring in FSO although reflows now feature prominently in supporting IDA's annual commitment authority as well. They are not yet prominent in either AsDF or AfDF although they are likely to become so within a decade.[27]

The degree to which reflows sustain annual commitment authority should, in theory, be seen as a sign of development progress as uncreditworthy

27 This assertion is made on the assumption that these reflows will in fact occur; an assumption which seems reasonably safe to make except perhaps in the case of the AfDF which presently confronts an acute problem of protracted arrears and non-payment by too many of its members.

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countries develop and graduate into becoming creditworthy ones. At the present time, however, it is really more an indication of donor fatigue and resistance to expanding aid allocations to MDFs from their overstrained budgets. Reflows are now sustaining an increasing proportion of commitment authority not because development is succeeding in any spectacular fashion (although in East Asia and perhaps now in Latin America, where few concessional resources are deployed, it undoubtedly is) but because *donors* are choosing to find more justifications for rationing and restricting the flow of concessional resources. Sadly, it is equally true that *recipient* countries are giving donors more than sufficient cause for adopting this posture by wasting scarce resources to an intolerable degree. They do so *deliberately* – as in the case of supporting egregiously high levels of military expenditure, armed conflict and civil wars, public graft and corruption, and the pursuit of patently detrimental economic and social policies – or *inadvertently*, as an unfortunate consequence of being underdeveloped; i.e. not having enough capacity to manage and use scarce resources as well as they should.

In the FSO reflows now constitute the principal source of funds for continued lending. They amounted to about US$400 million annually compared to a 1993 FSO lending level of US$423 million and total donor contributions for FSO in GIR-7 of US$200 million although that amount was quintupled in GIR-8. In addition FSO also generates investment income from its very large pool of liquidity which goes towards financing the interest subsidy account of the IFF. By contrast, reflows are supporting a smaller but growing amount of IDA's commitment authority. The total commitment authority increment from reflows between 1994-96 will be about SDR2.5 billion (or US$3.4 billion) thus financing about 16% of total commitment authority under IDA-10. In the AfDF annual reflows amount to less that UA/SDR 20 million and have not yet been taken into account in augmenting additional commitment authority. In the AsDF reflows are now about US$100 million annually. Although they have not been taken into account for augmenting commitment authority, the future stream of reflows may well be factored into increasing AsDF's commitment authority in the next replenishment.

In addition to reflows, the *investment income* being generated by MDF liquidity is also reaching significant proportions. In FY94, IDA generated US$168 million (US$373 million in FY93) from its pool of investments. By comparison, in 1993 the FSO generated about US$58.5 million, the AsDF earned US$52.3 million and the AfDF earned US$39 million. While forming a part of the overall income stream of these MDFs, these large and growing amounts earned from investments have been earmarked for specific purposes which include: financing increases in commitment authority; funding interest subsidy funds; or funding technical assistance facilities. Clearly further build-

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up of liquidity would generate further income but such a liquidity build-up has obvious costs to donors and recipients. Where MDFs are still being funded largely by donor contributions (not the case in FSO) liquidity requires donors to contribute more cash earlier than is absolutely necessary. At the same time an MDF's store of liquidity also implies that it is withholding resources that could be expended more quickly on disbursements. Thus, in looking to MDFs to generate income from liquidity a reasonable view has to be taken, given the particular circumstances of the MDF in question, on where the overall balance of interest lies.

The Role of Replenishment Negotiators (the MDF Deputies)

A final issue which might be touched upon concerns the role that representatives of donor governments involved in negotiating MDF replenishments (referred to here for convenience as *MDF Deputies* by borrowing terminology from IDA) play in influencing the operational and financial policies not just of the soft-window that they are focused on funding at that particular time but of the entire MDB. This is not a financial issue *per se* but it is a sufficiently important one to be raised here nevertheless. The point has often been made, especially by MDB Executive Directors from developing countries which are usually not represented in MDF Deputies meetings, that a group of donor government officials who only represent a part of the ownership of any MDB, and who have no constitutional standing or formally legitimate role in the governance of the MDBs, have now usurped the roles of both the Board of Governors (as a whole) and the Board of Executive Directors (as a whole). That concern is valid. There can be little doubt in the mind of anyone involved in a MDF replenishment negotiation of the powerful role played by the Deputies in decisively influencing the direction and content of MDB operational, financial, and even internal administrative policies. They do so by conditioning their support and the periodic contributions of their governments on being satisfied that their own *donor conditionalities and priorities* – often subtly and sometimes not so subtly expressed during replenishment negotiations – as to what the MDBs (and not just the MDFs) will do, how they will do it and how they are to be run, will be met by MDB managements.

In playing this role MDF Deputies exert far more influence over MDB policies and far more power over MDB management behaviour than do their Boards of Executive Directors. The development priorities that have crept in recently on issues such as environmental sustainability, good governance and gender sensitivity have really been pushed through less by Executive Boards than by the MDF Deputies. Deputies have also been forceful in supporting the efforts of some MDB Executive Directors in curbing the egregious

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budget excesses of MDB managements and the compensation/benefit levels of MDB staff. Recently, in AfDF-7 negotiations the Deputies intervened to shore up the rapidly eroding financial foundations of the AfDB by insisting that emergency remedial action be taken before the AfDF-7 replenishment was negotiated. In that instance the AfDF Deputies performed a signal service to the institution and its members in the face of clear defalcation on the part of the AfDB's Executive Board; particularly those members representing regional interests. Thus there is no question that MDF Deputies can be a force for the good of the MDBs just as there are times when MDF Deputies can do much to incapacitate and diminish the standing of the MDBs and MDFs. The role of the two Reagan Administrations in the US between 1981-88 was particularly noteworthy in that respect when they succeeded in nearly destroying IDA.

But, the real issue is not whether MDF Deputies exert their power and influence in the interests of the good or the bad. The real issue is whether they – as an extra-constitutional body with no standing or authority granted to them under the charters of these institutions, who are ostensibly gathering together periodically to fund a particular MDF replenishment – should legitimately exert that sort of power at all. Their role in that capacity certainly does much to diminish the standing and credibility of the Executive Boards of the MDBs especially vis-à-vis the MDB's senior management and staff. That reality is incontrovertible. The influence of the MDF Deputies also effectively disenfranchises the developing country members of MDBs from representing their own interests properly and fairly. In theory the question of whether MDF Deputies should be permitted to intervene in such a forceful manner is easy to answer from a strict constructionist viewpoint. Obviously they should not play such a role because there is no provision in the MDB or MDF Articles which permits them to. MDB managements would be quite within their constitutional rights to ignore them should they, somewhat quixotically, choose to do.

In practical terms, however, that theoretical answer is of little value. A tradition has now been established of increasing MDF Deputy intervention in virtually all aspects of MDB (not just MDF) functioning over the last three decades. That entrenched encroachment on Executive Board rights will be nearly impossible to roll back. The Deputies forum provides the major (donor) shareholder governments with almost the perfect forum for collectively deciding on their interests and having them felt without the clutter and inconvenience of putting up with arguments, no matter how legitimate, of the developing country members whom they see as supplicants if not mendicants. The Deputies also provide a more effective layer of intervention between the Executive Board (which does have a tendency to be subject to regulatory capture) and the Governing Boards (of Ministers) who

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simply cannot pay any serious attention to MDBs' institutional or policy issues on any focused basis.

In effect the MDF Deputies intervene so extensively and so forcefully because the Executive Boards of the MDBs in some cases are seen by donor governments as ineffectual and, perhaps occasionally, even inappropriate instruments of MDB governance where key issues are concerned. The issue therefore remains a conundrum wrapped in a dilemma. Unless there is some movement, however, towards examining the role of the MDF Deputies carefully and worrying about the impact it is having on already demoralised and incapacitated Executive Boards, the process of day-to-day institutional governance by shareholders of the MDBs may actually be weakened and not strengthened.

Moreover there is the moral dilemma of donor shareholders of MDBs deliberately choosing to act in a manner which effectively disenfranchises recipient shareholders from having their proper say, as they are entitled to, in the running of the MDBs. Yet the way in which recipient shareholders occasionally conduct themselves, as for example, in the AfDB, often provides just cause for donor intervention in the interests of safeguarding the MDB's integrity. The whole issue therefore needs to be addressed as a matter of urgency with a view to either rolling back the pervasive influence that the Deputies now exert over the affairs of the MDBs or, alternatively, having their role constitutionally legitimised. The present situation of MDF Deputies exerting an authority which they do not, and should not, have is the worst of all possible worlds simply because it is a manifestation of an internationally discarded credo; i.e. that, when it comes down to the nitty gritty, "might is always right".

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