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REPORT TO THE CONGRESS

More Effective United States Participation Needed In World Bank And International Development Association

B-161470

Department of the Treasury
Department of State
and other agencies

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This is our report on more effective United States participation needed in the World Bank and the International Development Association. Federal participation in this program is administered by the Secretary of the Treasury with assistance from the National Advisory Council on International Monetary and Financial Policies.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretaries of the Treasury, State, and Commerce; the Chairman of the Board of Governors of the Federal Reserve System; and the President and Chairman of the Export-Import Bank of the United States.

Elmer B. Staats
Comptroller General
of the United States

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ABBREVIATIONS

ADB	Asian Development Bank
AID	Agency for International Development
GAO	General Accounting Office
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
NAC	National Advisory Council on International Monetary and Financial Policies

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

MORE EFFECTIVE UNITED STATES PARTICIPATION NEEDED IN WORLD BANK AND INTERNATIONAL DEVELOPMENT ASSOCIATION
B-161470

D I G E S T

WHY THE REVIEW WAS MADE

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How have U.S. officials managed participation by the United States in the World Bank and one of its affiliates, the International Development Association? This is the question to which the General Accounting Office (GAO) has sought answers in this review. Oversight of this participation has been vested in the Departments of the Treasury, State, and Commerce; the Export-Import Bank of the United States; and the Federal Reserve System.

Creation and operation of the Bank and Association

The International Bank for Reconstruction and Development (the World Bank) was established in 1945, after World War II, to help finance--through loans to governments or their agents at conventional interest rates--reconstruction and economic recovery in war-devastated countries and to finance economic development in countries where private capital was not available on reasonable terms. For many years the latter function has been its principal one.

The International Development Association was created in 1960 to provide loans to governments or their agents at no interest other than a service charge. This service was restricted to poorer developing countries, lacking credit for conventional borrowing, to improve their economies.

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From inception to June 30, 1972, the Bank made loans totaling $18 billion in 89 countries; repayments as of June 30, 1972, totaled nearly $3 billion. Since 1960 the Association has extended extra-long-term credits of $4 billion in 61 countries. During fiscal year 1972, the Bank approved loans of $2 billion and the Association approved credits of $1 billion.

The Bank and Association continue to expand their lending in both volume and range of activities, with major emphasis in transportation, electric power, agriculture, industry, and education. Recently, attention has been given to population planning, tourism, and urbanization.

Most Bank and the Association financing has been designated for specific projects, although some loans have been made for general economic development purposes, such as commodity import financing.

U.S. financial support and voting power

The United States is the largest financial contributor to these institutions:

--26 percent ($635 million) of total capital subscribed and paid in to the Bank by its member nations.

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--33 percent ($1,112 million) of the total contributed to the Association.

Its financial participation in the Bank provides the United States with 23 percent of the voting power in the Bank and 25 percent of the voting power in the Association.

The main source of Bank funds is the sale of its bonds, secured by the member governments. About 35 percent of the Bank's obligations as of June 30, 1972, were held by U.S. investors, more than by any other country.

U.S. participation in the Bank and Association

U.S. membership in the Bank was authorized by the Bretton Woods Agreements Act and in the Association was authorized by the International Development Association Act.

The Secretary of the Treasury has primary responsibility for directing and managing U.S. interests in the Bank and the Association. He is assisted by the National Advisory Council on International Monetary and Financial Policies. U.S. dealings with the Bank and the Association are carried out by the U.S. member of the Bank's and Association's Boards of Executive Directors.

The World Bank and the Association, being international organizations, are outside GAO's audit authority. Therefore GAO did not examine operations of either institution.

FINDINGS AND CONCLUSIONS

For a national government to manage its participation in an international organization, it needs a system for (1) appraising information on proposed activities, (2) following up on the implementation of those activities, and (3) independently evaluating the results.

In GAO's opinion, the Treasury does not yet have a fully functioning system for managing U.S. participation in the Bank and the Association and is not in a position to assure the Congress that funds contributed by the United States are being used efficiently and effectively by the Bank and Association to accomplish their objectives. There have been recent improvements in the substance and timeliness of information received by the Treasury but not sufficient to offset the above observation. (See p. 46.)

The current U.S. system of management needs strengthening in the following areas:

--The review by the National Advisory Council, which was the principal means for determining the U.S. position concerning proposed loans, appeared to be uneven and without formal guidelines or criteria for assessing the soundness of proposed projects. (See pp. 26 to 28.)

--The information available during the informal review stage, the point at which questions on loans should be resolved, appeared to be insufficient for assessing a loan's soundness. (See pp. 25 and 26.)

--Although questions raised by the National Advisory Council in its review of proposed Bank and Association projects appeared not to have been fully resolved, the Council recommended approval of the loans. (See pp. 29 and 30.)

--According to Bank documents, the Bank proposed loans when the applicant had unresolved management and/or administrative problems which later delayed the execution of the projects and which may have had a detrimental effect on the projects. GAO found no evidence that the Council had raised any questions regarding these weaknesses. (See pp. 30 to 34.)

--U.S. Embassies and Agency for International Development Missions supplied little information on Bank and Association projects because they had received no instructions or guidelines on providing such information. (See pp. 41 to 43.)

--Appraisals of Bank and Association projects by U.S. officials are sporadic and informal. Regular, independent, evaluative reporting to the Bank's member governments on (1) efficiency of its operations, (2) success or failure of projects, and (3) results achieved, is virtually nonexistent. (See p. 37.)

GAO noted the following trends in the Bank's and the Association's financing of development projects.

1. Although the Bank has successfully increased loan commitments during the past several years, loan disbursements have continued to lag, as evidenced by the continuous increase in the undisbursed balance of loans from $1.2 billion on June 30, 1963, to $4.1 billion on June 30, 1972. (See pp. 17 to 20.)

2. Because of the slow growth in getting projects underway--as measured by gross disbursements--and the rapid growth in principal and interest payments and commitment charges on older loans, the Bank has not been a significant factor in the net transfer of resources to developing countries in recent years. (See pp. 20 to 21.)

RECOMMENDATIONS OR SUGGESTIONS

To improve management of the U.S. participation in the Bank and the Association, the Secretary of the Treasury should arrange to:

--Receive more substantive information on proposed projects earlier in the project preparation process to resolve questions at an early stage. (See p. 48.)

--Develop instructions to guide U.S. officials in appraising loans proposals. (See p. 48.)

--Develop instructions requiring U.S. missions to obtain and furnish information on Bank and Association projects proposed and being implemented. (See p. 48.)

The Secretary of the Treasury should propose, and actively seek, the establishment of a review body of size and competence appropriate to meet the need for effectively independently evaluating Bank and Association activities. This independent review body should be responsible only to the Bank's Board of Executive Directors. (See p. 48.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Treasury generally accepted GAO's recommendations for improving U.S. participation in the Bank and the Association. Although Treasury agreed in principle with GAO's recommendation for the establishment of an independent review body, it felt that it should wait and see how useful the Bank's recently established Operational Evaluation Unit will be. Treasury stated that it would reexamine this recommendation after further experience with this Unit. (See pp. 43 to 45.)

All U.S. agencies as members of the Council commented on GAO's report to the effect (1) that it was a useful study of the Council's role in reviewing and evaluating Bank loans and (2) that GAO's observations and recommendations dealt with problems which had concerned them for some time.

Several Council agencies thought that GAO underestimated the amount of U.S. influence on Bank development policies and activities.

Determining the extent of U.S. influence on Bank policy would be difficult, if not impossible, since much of the influence would not be documented. Also GAO was denied access to the minutes of the Board of Executive Directors' meetings.

MATTERS FOR CONSIDERATION BY THE CONGRESS

Because of congressional interest and concern over the increasing levels of U.S. participation in the international financial institutions and the lack of U.S. control over the funds provided, we believe that this report should be particularly useful to the Congress at this time.

The Congress should consider having the U.S. representative to the Bank and the Association propose a program of continuing independent reviews of the development activities of the Bank and the Association to provide the Treasury Department and other agencies in the executive branch with adequate information to determine whether funds are being used efficiently and effectively to accomplish objectives.

CHAPTER 1

INTRODUCTION

PRESIDENT'S FOREIGN AID PROPOSALS FOR THE 1970s

On September 15, 1970, the President submitted his message to the Congress on foreign assistance for the 1970s. He proposed a sweeping reorganization of U.S. bilateral foreign aid and greater reliance on a multilateral approach to foreign assistance. He said that:

> "The U.S. should channel an increasing share of its development assistance through the multilateral institutions as rapidly as practicable. ***
>
> "Our remaining bilateral assistance should be provided largely within a framework established by the international institutions."

The principal international institutions to which the President referred are:

The World Bank Group:

- --International Bank for Reconstruction and Development, called the World Bank.
- --International Development Association (IDA).
- --International Finance Corporation (IFC).

Regional development organizations:

- --Inter-American Development Bank (IDB).
- --Asian Development Bank (ADB).
- --African Development Bank.

United Nations Development Program.

The governing body of each institution consists of representatives of member governments. The United States holds membership in all but the African Development Bank, to which the United States has made only a small technical assistance grant of $1 million.

On April 21, 1971, the President submitted another message to the Congress on the reorganization of U.S. foreign assistance and again emphasized the role of the international institutions. He said that the international institutions could effectively meet the initiatives and efforts of the lower income countries and that the United States should place greater reliance on the institutions and encourage them to increase their leadership in world development. The President said that his proposals would bring about greater efficiency and help other nations to increasingly shoulder their own responsibilities so that we can reduce our direct involvement abroad.

LEVEL AND TREND OF U.S. FINANCIAL SUPPORT

The President's proposal for increased reliance on multilateral institutions is an enunciation of a trend started some years ago. Over the past decade, annual appropriations for U.S. contributions to international organizations and institutions have increased several hundred percent. In contrast, funds made available in the annual Foreign Assistance Appropriations Act for U.S. bilateral economic assistance have decreased.

The United States is the largest single financial participant in these organizations. For example, as of June 30, 1972, the United States had contributed 26 percent of the total amount paid to the World Bank by its members and 33 percent of the total contributions to IDA. The next highest contribution to the World Bank was 11 percent, by the United Kingdom, and to IDA was 14 percent, also by the United Kingdom.

SCOPE OF REVIEW

On August 22, 1972, we issued a report dealing with U.S. participation in the Inter-American Development Bank, and we have in process a report concerning the Asian Development Bank. As discussed in greater detail in chapter 4, the Secretary of the Treasury, who is advised by the National Advisory Council on International Monetary and Financial Policies (NAC), manages U.S. participation in these institutions.

We did not examine the World Bank and IDA operations since, as international organizations, they are outside our audit authority. To gain some insight into the effectiveness of World Bank and IDA performance and to measure the soundness of U.S. actions as a participating member, we obtained such information on World Bank and IDA operations as was available from the U.S. executive departments and agencies participating in the work of NAC; namely--the Departments of the Treasury, State, and Commerce; the Federal Reserve System; and the Export-Import Bank of the United States. We also obtained information from the Agency for International Development (AID) and discussed the management of U.S. participation with U.S. Embassy and AID officials in Argentina, Brazil, Paraguay, Korea, Malaysia, the Philippines, Taiwan, Kenya, Tanzania, Uganda, Nepal, India, and Pakistan.

We did not make an in-depth analysis of the impact of the institutions' borrowings, investments, and procurement policies and practices on the U.S. balance of payments.

We did review and assess the adequacy of the procedures within the U.S. executive departments and agencies for appraising proposed projects and programs to be financed by the institutions and for evaluating the efficiency and effectiveness with which the projects and programs are carried out.

CHAPTER 2

DESCRIPTION OF THE WORLD BANK AND IDA AND U.S. PARTICIPATION IN THEM

CREATION, PURPOSE, AND MEMBERSHIP

In planning for economic development after World War II, two complementary, international, financial institutions were organized in December 1945. The International Monetary Fund (IMF) was organized to promote international currency stability by helping to finance temporary balance-of-payments deficits and by providing for the progressive elimination of exchange restrictions and the observance of accepted rules of international financial conduct.

The World Bank was organized primarily to help finance the reconstruction of war-devastated economies and the development of productive facilities in countries where private capital was not available on reasonable terms. Both private investors and member countries provided capital and thereby shared risks that one nation could not cope with alone. At the outset, the World Bank granted loans mainly to European countries for reconstruction. However, when the Marshall plan came into being, the World Bank shifted its emphasis to the economic development of member countries throughout the world.

The Bretton Woods Agreements Act (22 U.S.C. 286), approved July 31, 1945, authorized the President to accept membership for the United States in both IMF and the World Bank.

In the 1950s financial experts felt that too many economic problems were not being met successfully by the international financial structure. As a result, two World Bank affiliates were organized which had more specialized functions. IFC was created in 1956 to encourage private enterprise in developing member countries by granting loans to qualified private interests that were unable to obtain a government guarantee that was required for a World Bank loan. The International Finance Corporation Act (22 U.S.C. 282), approved August 11, 1955, authorized U.S. membership in IFC. We did not include this organization in our review.

The second affiliate, IDA, was created in January 1960 to meet a specific need that the World Bank was unable to satisfy. IDA makes loans, on concession, to developing countries that meet certain criteria of poverty and lack of credit worthiness for conventional borrowing, on the one hand, and of acceptable effort to improve economic performance, on the other. The International Development Association Act (22 U.S.C. 284), approved June 30, 1960, authorized the President to accept membership for the United States in IDA.

To qualify for membership in IDA and IFC, a country must be a member of the World Bank, which, in turn, requires membership in IMF. Notwithstanding the qualification for membership, IDA and IFC are legally and financially independent of the Bank, although IDA and the Bank share the same staff. A Board of Executive Directors manages each institution.

MANAGEMENT STRUCTURE

The work of each institution is carried out by a Board of Governors, a Board of Executive Directors, and an administrative staff headed by the Bank President.

All powers of the Bank and IDA are vested in their Boards of Governors, consisting of one governor and usually one alternate appointed by each of the member governments. The Secretary of the Treasury is the U.S. Governor; the alternate is the Deputy Under Secretary of State for Economic Affairs. Although the Boards of Governors have delegated most of their authority to the Executive Directors, certain powers are specifically reserved to the Governors by the Articles of Agreement. These include the powers to admit or suspend members; to increase or decrease the capital stock of the Bank, or, in IDA's case, to authorize and fix the terms and conditions of additional subscriptions; to suspend operations and distribute the organization's assets; and to determine the distribution of the Bank's net income. Each governor and alternate is appointed for 5 years. The Boards of Governors hold annual meetings and such other meetings as may be provided for by the Governors or called by the Executive Directors.

Voting power is related to shareholdings. Subscriptions by member countries to the capital stock of the Bank are based on each member's quota in IMF, which is designed to reflect the country's relative economic strength. Each Bank member has 250 votes plus one additional vote for each $100,000 of capital stock subscribed by it. Each member of IDA has 500 votes plus one vote for each $5,000 of its initial subscription.

The Executive Directors are responsible for the general operations of the Bank and IDA and for exercising all powers delegated to them by the Boards of Governors. In recent years, the post of Executive Director has been a full-time job. There are 21 Executive Directors who serve terms of 2 years. Six Directors are appointed, one by each of the six members having the largest number of shares, and 15 Directors are elected by the Governors for other members. Each Director is entitled to cast the number of votes allotted, as explained above, for the country or countries he represents.

The President of the Bank and IDA is selected by the Executive Directors and is their chairman although he has no vote, except in a tie. He may participate in the Boards of Governors' meetings, but he has no voting rights. Subject to direction by the Executive Directors on questions of policy, the President conducts ordinary business of the Bank and IDA. The officers and staff of the Bank also serve IDA. The President has always been an American.

The Bank maintains its headquarters in Washington, D.C., and offices in New York, N.Y.; London, England; Paris, France; and Tokyo, Japan. It also has resident staffs in 14 other countries. Most of the Bank staff is located in Washington. As of June 30, 1972, the professional staff totaled 1,568, an increase from 1,348 on June 30, 1971. Washington staff members travel extensively to the borrowing countries in connection with the appraisal and implementation of projects.

DEVELOPMENT ACTIVITIES

The Bank had made loans totaling $18 billion in 89 countries and IDA had extended credits totaling $4 billion in 61 countries, as of June 30, 1972. Most of these loans and credits have been made for specific development projects; but loans and credits have also been made for more general economic development purposes, such as financing commodity imports.

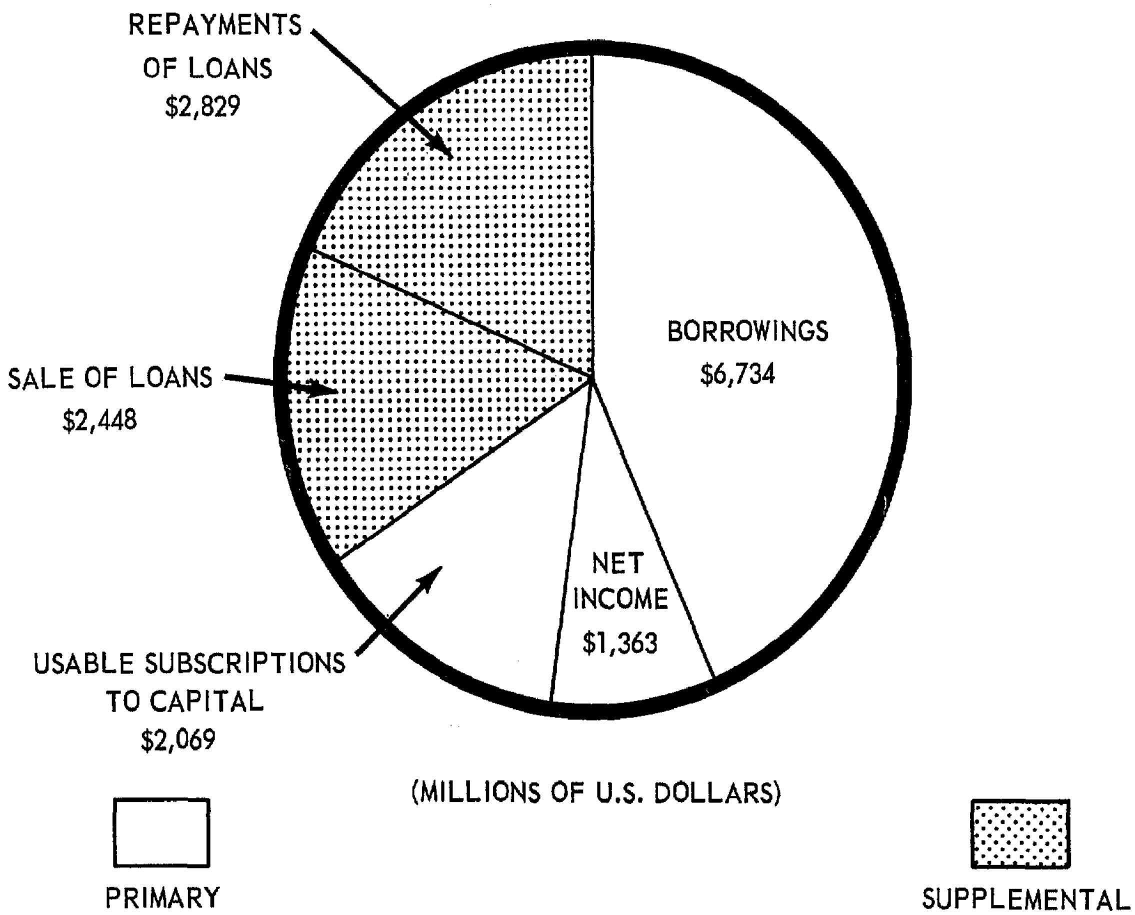
The fundamental difference in the operating policies of the two institutions is in the terms of their financing. The Bank makes long-term (15 to 25 years) loans at more or less conventional rates of interest (currently 7-1/4 percent); IDA makes still longer term (10-year grace period and 40-year repayment period) loans with no interest, charging instead three-fourths of 1 percent on amounts disbursed. To be eligible for an IDA credit, developing countries must meet certain criteria of poverty and lack of credit worthiness for conventional borrowing on the one hand and acceptable efforts to improve economic performance on the other.

Throughout most of the 1960s, the Bank's commitments remained below $900 million a year. In 1968 the Bank Group started a major expansion of its activities. The Bank Group President's stated objective at that time was to double the lending for the 5-year period 1969-73 compared with that for the period 1964-68. Commitments have increased from $847 million in fiscal year 1968 to $1,966 million in fiscal year 1972. IDA's commitments remained below $400 million through 1969, and in fiscal year 1970 they increased to $606 million and in 1972 to $1,000 million.

In recent years much greater emphasis has been placed on Africa and countries where, in the past, Bank activities have been very limited or nonexistent. In the last 3 years, the Bank and IDA made commitments for the first time to 17 countries, 10 of them in Africa. Furthermore, emphasis has begun to shift somewhat from the Bank's traditional areas, such as power and transportation, to newer areas, such as agriculture; education; and, to a lesser extent, tourism, family planning, and urbanization. However, power and transportation still represent almost 50 percent of all Bank lending. With the expansion of the Bank's lending program, the scope of its technical assistance also expanded.

SOURCES OF FINANCING (WORLD BANK)

As of June 30, 1972, $15,443 million had been made available to the Bank for loan disbursements. The primary and supplemental sources of these funds are shown in the following illustration.



Capital subscriptions

Ten percent of each Bank member's subscription is paid-in capital--1 percent in U.S. dollars and 9 percent in the member's own currency; U.S. dollars; or nonnegotiable, non-interest-bearing demand notes. The remaining 90 percent is subject to call when required to meet Bank obligations. As of June 30, 1972, the Bank had the following subscriptions to capital and amounts paid in:

	Amount (in millions of U.S. dollars)
Subscriptions	$24,506
Paid in:	
Currency	2,069
Nonnegotiable, non-interest-bearing demand notes	382
Total paid in	2,451
Subject to call to meet Bank obligations	22,055
	$24,506

The United States is the largest stockholder with subscriptions of $6,350 million and paid-in capital of $635 million, or 26 percent of the Bank's total capital. The voting power of members is related to capital subscriptions. Each member receives 250 votes plus one additional vote for each $100,000 of its capital subscriptions. The United States has 63,750 votes, or 23 percent of the total.

Effective December 31, 1970, the authorized capital of the Bank was increased from $24 billion to $27 billion to enable the Bank to accept special increases in the subscriptions of 75 member countries. These special increases corresponded to the increases in the IMF quotas resulting from its 5th general review of member countries' quotas. The special increase in the U.S. subscription amounted to $246.1 million with 10 percent or $24.61 million, to be paid in. An appropriation for the $246.1 million was authorized on December 31, 1970. On March 8, 1972, $123.05 million (one-half of the U.S. share) was appropriated. As of October 25, 1972, the balance of the U.S. share had not been appropriated.

Borrowings in the world's capital markets

The main source of Bank funds is the sale of its bonds. The Bank's total borrowings from inception to June 30, 1972, totaled $11,623 million, of which $6,734 million were new funds for loan disbursement. Outstanding Bank obligations totaling $6,951 million were held by investors in the following countries: about 35 percent in the United States, 26 percent in Germany, 10 percent in Japan, 6 percent in Switzerland, and 4 percent in Canada. The remaining 19 percent was held largely by central banks and other governmental accounts in about 85 countries. The Bank's borrowings in fiscal year 1972 reached a record level of $1,744 million, compared with $1,368 million in fiscal year 1971 and $735 million in fiscal year 1970.

Sales of Bank loans

Sales of Bank loans and of items from the Bank's loan portfolio totaled $2,448 million as of June 30, 1972. Fiscal year 1972 sales of $75 million were substantially more than the fiscal year 1971 sales of $24 million. Changing interest-rate patterns during the year brought rates on World Bank loans more closely into line with general market rates and contributed to the rise in loan sales.

Repayment

Repayments to the Bank on outstanding loans in fiscal year 1972 amounted to $385 million. Cumulative principal repayments, at June 30, 1972, amounted to $2,829 million.

Net income

Cumulative net income from operations of the Bank through June 30, 1972, provided about $1,363 million for Bank loans. As of June 30, 1972, the Bank had allocated $595 million of its income to IDA. For fiscal year 1972, the Bank's gross income was $646 million and its net income was $183 million. The largest single item of expense was interest on borrowings of $392 million. At June 30, 1972, the Bank's liquid resources were $3,228 million, an increase of $662 million during the fiscal year. According to the Bank, its cash resources have been built up to meet the increase in disbursements which is expected to follow the recent rapid rise in Bank commitments.

Administrative costs are financed from gross income and for fiscal year 1972 were $95 million for the Bank and IDA. Administrative costs for fiscal year 1973 are estimated at $107 million.

SOURCES OF FINANCING (IDA)

As of June 30, 1972, an aggregate of $4,003 million had been made available to IDA. The sources of these funds were (1) initial subscriptions, (2) replenishments, (3) net income, and (4) as noted above, transfers from the Bank. IDA is not expected to obtain funds from commercial sources and, therefore, must rely mainly on fund replenishments by the industrialized member countries. Devaluation of the U.S. dollar during the year increased the value of funds available for commitment in currencies other than U.S. dollars by $103 million. Also, IDA received $2 million in repayment of development credits.

Subscriptions

Members' initial subscriptions to IDA amounted to $1,017 million, shares being based on the members' subscriptions to the capital stock of the Bank. Part I countries (industrialized countries) pay their subscriptions entirely in convertible currency, all of which IDA may use for lending without restriction. Part II countries (developing countries) pay only 10 percent of their subscriptions in convertible currencies and the balance in the member's currency which may not be used by IDA without the member's consent. A total of $798 million has been made available to IDA.

Replenishments

The first replenishment, under which $745 million was made available to IDA, was approved in 1964. The second general replenishment, delayed because the U.S. Congress did not act on the replenishment in 1968, did not become effective until July 1969. It provided about $1,188 million over a 3-year period. Three member countries made special supplementary contributions of about $66 million, and Switzerland granted a loan of $12 million.

On February 17, 1971, the Governors voted a third replenishment of IDA resources. Over a 3-year period, 18 part I countries and three part II countries (Ireland, Spain, and Yugoslavia) were to make available a total of $2,409 million. Switzerland (a nonmember) agreed to lend IDA about $32 million without interest. For the third replenishment to become effective, pledges of not less than

$1,900 million of additional resources must be made to IDA, including pledges from at least 12 part I members. The original target date for the third replenishment was June 30, 1971. However, as of June 30, 1972, the United States had not yet pledged its $960 million share and, as a result, the third replenishment could not become effective. Advance contributions of $448 million have been made by 15 member governments toward the third replenishment of IDA's resources without waiting for the replenishment agreement to become effective.

The resolution covering the third replenishment also provided that the voting power of the part I countries would be adjusted to reflect more accurately the share of each in total part I contributions to IDA.

Net income

Net income for fiscal year 1972 amounted to about $1 million. Accumulated net income at June 30, 1972, totaled $47 million, exclusive of currency revaluations.

Transfers from Bank

As of June 30, 1972, $595 million of the Bank's net income had been allocated to IDA.

The United States is the largest contributor to IDA with subscriptions to initial capital of $320 million, or 32 percent. As in the case of the Bank, the voting power of members is related to capital subscriptions. Each member receives 500 votes plus one additional vote for each $5,000 of its initial capital subscription. The United States has 25 percent of the voting power. The United States had contributed, including replenishments, about 33 percent of the total contributions to IDA as of June 30, 1972.

CHAPTER 3

TRENDS IN FINANCING DEVELOPMENT

PROJECTS BY THE WORLD BANK AND IDA

Certain trends were noted in the Bank's financing of development projects that showed the Bank had not assisted in the economic development of the countries to the extent indicated by the Bank's loan commitment record.

Admittedly, we do not have all of the facts concerning the points described in the following sections of this chapter because of the very nature of a review of U.S. management of an international organization and the fact that a review of the international organization itself is outside our audit authority. However, we feel that these indicated trends cannot be ignored. In particular, we lacked information concerning the lending criteria, planning, and processing used by the Bank in specific projects and the overall effectiveness of the Bank-financed projects. Information available to GAO was obtained from documentation furnished by the Bank to the United States as a member of the Bank and did not include the above type of data.

The areas described in this chapter warrant further inquiry by U.S. management and serve to point up the need for an independent review group, the establishment of which we are recommending in this report.

LOAN COMMITMENTS AND DISBURSEMENTS

In 1968 the President of the Bank Group instituted a plan to double lending in the 5-year period 1969-73 compared with that for the period 1964-68. The plan called for doubling annual loan commitments until more aid was available on more concessional terms.

By fiscal year 1970, the Bank's annual loan commitments amounted to $1,580 million compared with $847 million in fiscal year 1968 and an average of $859 million for the 5-year period 1964-68. However, loan disbursements in fiscal year 1970 amounted to only $754 million, about the same as during the 1967-69 period. In fiscal years 1971 and 1972, commitments again increased to $1,921 million and $1,966 million, respectively, while disbursements for the same years increased to $915 million and $1,182 million, respectively.

Although the lag in loan disbursements has been more pronounced since the 1968 plan to increase Bank lending was instituted, the problem of delayed disbursements appears to have existed for a number of years, as evidenced by the almost constant year-to-year increase in the undisbursed balance of effective loans held by the Bank. This undisbursed balance increased from $1,245 million on June 30, 1963, to $4,095 million on June 30, 1972.

Fiscal yearend	Undisbursed balance of effective loans held by Bank (millions)
1963	$1,245
1964	1,488
1965	1,663
1966	2,085
1967	2,261
1968	2,001
1969	2,373
1970	2,926
1971	3,394
1972	4,095

The rapid increase in lending after 1968 raised questions from a number of quarters as to whether a certain amount of liberalization of the Bank's lending criteria had taken place. When the projects are planned with less care, their effective implementation is probably slower and disbursements are slower.

Our analysis of loan commitments from 1969 through 1972 indicated that less time was being spent on planning and/or processing loans.

Fiscal year	Percentage of loans approved in last quarter	Percentage of loans approved in last month
1969	47	33
1970	51	30
1971	64	44
1972	60	39

We found, as a further indication of the rush to process loans, that the total dollar value of loans signed but not yet effective at yearend had increased from $400 million in 1968 to $1,386 million in 1972. They would not become effective and disbursements would not start until the borrowers and guarantors, if any, took certain actions and furnished certain documents to the Bank.

The increase in IDA commitments has not been as marked as that of the World Bank. Nonetheless, it appears that disbursements of IDA credits are not keeping pace with its commitments.

On February 11, 1971, the Bank issued a memorandum its review of the lag in disbursements. The memorandum stated that the length of time between loan commitments and disbursements depended upon such factors as the type of projects, payment terms, disbursement procedures, and the stage of project preparation at the time of the loan commitment. It stated further that the decline in the rate of disbursement was due to: (1) a shift away from developed countries, (2) a shift to project lending from program lending which contributed to the high level of early disbursements during the period 1948-60, (3) the limitation of retroactive financing, (4) increased administrative delays in declaring loans effective, (5) increased complexity of projects, and (6) a shift from older countries and traditional borrowers to newer countries and first-time borrowers.

The Bank concluded that the mix of loans was the main cause of the slower disbursements and that this reflected a natural evolution of Bank lending in response to the needs of developing countries. The Bank also recognized that, during a rapid buildup of lending, the immediate effect was an increase of undisbursed funds committed to specific projects. The Bank stated that it could increase the disbursement rate slightly by increasing assistance in financing engineering costs and by closer cooperation with the less sophisticated loan recipients in procurement, project execution, and disbursement.

Although the Bank suggested several causes for the lag in the disbursement rate, the many management and administrative weaknesses in the borrowers' organizations at the time of loan approval frequently delayed the implementation of the projects which, in turn, caused the disbursements to be delayed. Some U.S. officials suggested that, because Bank loans were approved and projects started under this handicap, Bank quality was sacrificed to meet its increased lending goal.

Agency comments and GAO analysis

The Department of the Treasury, in commenting on our draft report, agreed that the disbursement rate should be watched and stated that it would watch the rate. However, the Department felt that the Bank had made a good case for its position that a decline in its disbursement rate was due to the six specific factors referred to above, as well as the fact that, during a period of rapid buildup of lending, there would be a temporary increase of undisbursed funds in the pipeline.

According to the Bank and the Department, the disbursement lag is a temporary problem caused by new areas of lending and the recent rapid buildup in lending and it will resolve itself in the next few years. We disagree in view of the continuous increase in the undisbursed balance of loans held by the Bank during the last 10 years.

NET TRANSFER OF RESOURCES TO DEVELOPING COUNTRIES

Because of the slow growth of project implementation--as measured by gross disbursements--and the rapid growth in principal and interest payments and commitment charges on older loans, the Bank, in recent years, has not been a significant factor in the net transfer of resources to developing countries.

During the 5-year period from 1966 through 1970, the Bank disbursed an average of $535 million per year to 72 less developed countries; repayments of principal and interest during the same period averaged $427 million a year with an average net transfer to the borrowers of $108 million a year. During this period, 21 of the 72 less developed countries had negative net transfers of Bank funds. In fiscal year 1971, the picture may have improved somewhat as there was a 24-percent increase in total disbursements over the previous year.

IDA lending is a different matter. It provides the countries with a much higher percentage of net resources because repayments are spread over longer periods (see p. 11); it charges no interest; and it makes only a small service charge of three-fourths of 1 percent to cover its expenses.

Only countries which lack credit worthiness for borrowing on conventional terms or have only limited capacity to service such debt are eligible for IDA credits. Furthermore, to be eligible countries must be among the poorest and have per capita incomes of less than $300.

However, two factors cause IDA funds to be rationed and can aggravate the net transfer of funds. First, the demand for funds by developing countries which meet the criteria for IDA credits is substantially greater than the funds normally available to IDA. Second, during fiscal years 1969 to 1972, replenishments of IDA funds were delayed by some of its members, including the United States. As a result, proposed projects were delayed or Bank loans were granted instead of IDA credits which the country was qualified to receive.

Agency comments and GAO analysis

The Department of the Treasury stated that it did not regard a small or even negative net transfer of funds as a source of concern but rather as a description of the capital flow process, inasmuch as Bank lending was for productive projects which ultimately yield an economic return substantially in excess of loan repayments. Further, the Department felt that we were inconsistent in criticizing the low level of net transfers of resources to the developing countries and at the same time criticizing the Bank's lending to certain countries because of a shortage of IDA funds.

We recognize, as the Treasury Department pointed out, that Bank lending is designed to yield an economic return and that, as a country approaches self-sufficiency, loan repayments are expected to exceed new loans. For those countries at or near the bottom of the economic development ladder, additional Bank loans can aggravate their debt service problems because Bank loans require amortized repayments that start several years earlier and are made over a much shorter period than IDA credits and at substantially higher interest rates.

The Department further commented that it had carefully considered the transfer of resources, the debt service capacity, and the need for IDA funds and that it had been influential in the Bank's studies of these problems. The Bank's 1969 study of debt service burden concluded that there were only four countries that might encounter serious and protracted debt service difficulties unless large amounts of external assistance were available to them on concession. These four countries were Ceylon, Ghana, India, and Pakistan--all primary IDA countries and not the recipients of much Bank lending in recent years.

Substantial Bank loans were made to these four countries during the period January 1, 1969, to June 30, 1972, as follows:

	Number of loans	Amount (millions)
Ceylon	3	$ 43.5
Ghana	1	6.0
India	4	140.5
Pakistan	4	81.7

These Bank loans represented 70, 23, 14, and 33 percent of the total financing provided to these countries, respectively, by the Bank and IDA.

CHAPTER 4

IMPROVEMENTS NEEDED IN MANAGEMENT OF U.S. PARTICIPATION IN THE WORLD BANK AND IDA

U.S. MANAGEMENT SYSTEM

In a general sense, the role of the U.S. Government relative to proposed projects is, like that of all members, restricted to reviewing the project proposed by the Bank President, voting its approval or disapproval of financing the project, and suggesting changes in the project when it believes such changes to be needed. Proposed projects are reviewed principally to insure that they are in accord with U.S. policies and objectives, both formally and informally.

The focal point for the formal mechanism is the U.S. Executive Director, who is a full-time director of the Bank and IDA and, at the same time, a full-time representative of the U.S. Government. The Executive Director makes inquiries of Bank management and staff to resolve questions raised by NAC during its review of proposed Bank and IDA projects. Since taking over the position in November 1969, the present Executive Director has spent a large part of his time in handling complaints from U.S. suppliers relative to procurement procedures and practices under World Bank and IDA loans. He has one full-time staff member, and an engineering consultant was assigned to his staff for about 7 months in 1971 to review the Bank's procurement and billing procedures.

The Executive Director receives his instructions from the Secretary of the Treasury, who has primary responsibility for managing U.S. interests in the Bank and IDA. The Secretary is assisted by NAC. The principal functions of NAC are to coordinate policies, advise on problems, and recommend legislation regarding international monetary and financial affairs. In carrying out these functions, NAC is authorized to review proposed individual loan, financial, exchange, or monetary transactions to the extent necessary or desirable to insure that they are in accord with U.S. policies and objectives. NAC also makes recommendations to the Secretary of the Treasury for the guidance of the U.S. representatives of the international financial institutions.

Informal review consists of personal contacts between officials of the U.S. Government and the Bank staff. Being informal, ad hoc, and subject to the uncertainties of personal relationships and the expected circumstance that such contacts are not documented, this review is extremely difficult to assess.

Project identification, appraisal, and approval

According to the World Bank, projects are identified for World Bank and IDA financing in any of several ways. A member country may propose a project; the Bank's staff, while supervising an existing project, may suggest a related one; the Bank may send a mission to a given country to identify suitable projects; resident representatives may identify projects; and other organizations, such as the United Nations, may suggest projects.

After a project has been identified, it is appraised by a team of Bank specialists, although the Bank may obtain outside assistance in this appraisal. The team examines the following aspects of the project.

1. Economic.
2. Technical.
3. Institutional, managerial, and organizational.
4. Procurement and commercial.
5. Financial (for revenue-earning entities).

After appraisal of the project, the Bank and the borrower negotiate the terms and conditions of the loan, and the loan is presented by the Bank President to the Board of Executive Directors for approval. The presentation includes reports on the country's economy, the technical description of the proposed project, the terms and conditions of the loan, and related material.

These documents are made available to the Board of Executive Directors 10 days to several weeks before it votes on the loan. During this period U.S. officials decide how the U.S. Executive Director should vote on the proposed loan.

Informal review

According to most officials participating in the work of NAC, much of the meaningful review of proposed loans is done before the formal Bank loan documents are distributed. Information is exchanged informally during this period between U.S. agency personnel and their counterparts on the Bank staff. If any question arises, it is discussed and resolved orally. A Federal Reserve official stated that this was the time for resolving issues because, once the proposed loan was fully developed, the Bank seldom made changes.

An AID official stated that, because AID's contacts with Bank personnel during the early stages of a loan provided it with enough information to appraise the loan, the formal review (discussed below) merely verified the consistency of the loan provisions with the earlier information obtained.

Apparently much of the information received informally from the Bank staff was oral. We found evidence of very little documented information received by U.S. officials on proposed Bank loans before the formal loan documents. The type of information noted would not have been sufficient, in our opinion, to assess the soundness of the loan. The only loan information received consistently was (1) a monthly summary of Bank and IDA projects which listed the borrower, loan amount, purpose of loan, stage of processing, and certain available information on procurement and (2) a bimonthly list of projects reviewed by the Bank staff. The bimonthly list does not include the results of the reviews.

According to Department of State and AID officials, a second source of information which aided them in informal reviews was U.S. Embassies and AID Missions. Although no instructions or guidelines had been issued to the Embassies and AID Missions for reporting information on Bank loans, several officials in Washington said that the Embassies and Missions were expected to know what the Bank and IDA were doing in their respective countries.

NAC officials in Washington stated that, although there were no requirements for monitoring Bank and IDA projects in the field, there was an informal information flow from the field. A State Department official said that, although the Embassies and Missions did not have a responsibility over the projects, they did obtain a considerable amount of data concerning Bank and IDA activities.

Our review at U.S. Embassies and AID Missions in several countries, however, showed that there was very little voluntary reporting to Washington on Bank and IDA activities. We also found that, except for joint Bank/AID-financed projects, most of the Embassies and AID Missions had very little knowledge of Bank and IDA projects in their respective countries.

Formal NAC review

Formal NAC review is initiated upon the Bank's release of the formal loan proposal documents to the U.S. Executive Director. These documents are distributed to the various NAC members.

NAC review and decision actually include three separate functional levels. NAC has the final voice in any decision. However, much of the interagency review and coordination is carried out by the NAC Staff Committee. The Staff Committee is chaired by an official of the Treasury Department and is attended by representatives of NAC member agencies. The third level is less formal; the Alternates (Assistant Secretary of the Treasury, Deputy Assistant Secretary of State, etc.) meet from time to time to discuss policy issues and, on an "as needed" basis, to resolve issues.

Generally, the formal loan proposal documents are received by the official who represents the agency on the NAC Staff Committee and who, in turn, sends the documents to the agency's appropriate country desk staff and functional area staff for review and evaluation. This formal stage usually lasts 2 weeks or less, depending on when the Bank documents are received relative to the date set for voting on the proposed loan. The information exchange on the results of the review is generally oral and flows from the actual reviewer to the individual who represents the agency on the NAC Staff Committee.

The NAC Staff Committee meets weekly, at which time proposed loans are discussed among representatives of the NAC agencies and the U.S. Executive Director. These discussions form the basis for instructions from the Secretary of the Treasury to the Executive Director on the tenor of his remarks regarding the loan at the Board meeting and on how to vote.

If disagreement is expressed, a vote is taken, and the majority rules. After the Staff Committee meetings, the representatives from each agency report the results of Committee actions to the NAC principal in his agency (e.g., the Secretary of State or someone designated to act for him). Each agency then decides which way it will vote; and several days after the Staff Committee meeting, the NAC Secretary (a Treasury Department official) obtains the vote of each principal by telephone. Instructions for the Executive Director are prepared by or on behalf of the Secretary of the Treasury.

In addition to the formal instructions given to the Executive Director, questions raised in the Staff Committee are passed on to the Bank staff. There is a procedure whereby the office of the Executive Director advises the secretariat of NAC as to the Bank staff's response to these questions.

Although the formal NAC review was established to determine the U.S. position on proposed loans, it was unstructured and uneven and was performed without firm guidelines or criteria against which to assess the soundness of proposed projects.

We found that none of the NAC member agencies had formal guidelines for their review and evaluation of loan documents. Although, in June 1970, NAC queried its members to determine what elements of loans and projects were considered in examining Bank documents, the only responses available to us were from the Treasury Department, the Federal Reserve System, and AID.

The Treasury Department's response included such elements as appropriateness of terms, priority of projects within the countries' development plans, procurement provisions, economic positions of borrowers, and types of projects. The Federal Reserve System provided a list of seven elements which were similar to those furnished by the Treasury Department. AID's list of elements considered in reviewing proposed loans was limited and was primarily restricted to AID's goals in relation to the Bank's goals. AID's topics were (1) relationship with AID activities, (2) whether the

Bank's country sector analysis agreed with AID's, (3) priorities, (4) financial terms, and (5) Bank policies.

During 1971 NAC members discussed the subject of guidelines for the review of loan proposals and decided to publish their thoughts in the NAC annual report for fiscal year 1971. However, the actual guidelines used by the NAC member agencies in evaluating proposed loans were apparently left to the discretion of the individual loan reviewer, who determined the type and quality of the review.

Loans brought before NAC for review are in the final approval stages, and, according to officials involved in the NAC review, there is little chance that the Bank would be willing to make changes. Any questions on the loans would have to be resolved during the so-called informal review stage. However, we found that the information available during the informal review stage appeared to be insufficient to assess the soundness of a loan. Therefore the NAC review, as it is presently operating, cannot be expected to provide a firm basis for determining whether development funds are used for sound, worthwhile projects.

Treasury officials maintain, however, that comments made on any loan have an impact on future loans. These officials say, for example, that, if a question is raised concerning a certain undesirable aspect of the loan from the U.S. viewpoint, it is likely that that aspect will not appear in a future loan.

Evaluation of NAC review of proposed loans

Because loans brought before the NAC Staff Committee for review are in the final approval stage, where implicit commitments and promises have already been made by the Bank and could be broken only at considerable cost, they are virtually assured an affirmative vote by the U.S. Government.

In its fiscal year 1970 Annual Report to the President and to the Congress, NAC stated that the discussions of the proposed loans at NAC meetings formed the basis for instructions from the Secretary of the Treasury to the Executive Director on the tenor of his remarks and on how to vote at board meetings of the Bank. NAC further stated that the Executive Director used his influence to insure that development funds were being used prudently and effectively.

To determine the significance of the NAC discussions in relation to their recommendations on the proposed loans, we reviewed the minutes of NAC meetings covering the discussions of 35 proposed loans. One or more questions were raised on 20 of the loans. On occasion, attempts were made to resolve these matters during the meetings, but often they were left unanswered. In four cases, the Executive Director was instructed to discuss the matters with the Bank or at the Board of Executive Directors' meeting. All loans were recommended for approval by NAC. Financing of local costs, procurement practices, overly generous loans terms, and the questionable use of IDA funds were frequently questioned by NAC.

We were not able to determine what effect the Executive Director's comments may have had at the Board meetings or what influence he was able to exert to insure that development funds were used efficiently and effectively because we were denied access by the Treasury Department to the minutes of the Board of Directors' meetings on the basis that they were considered to be privileged information.

A Treasury Department official explained that questions raised by NAC during its reviews of proposed loans were resolved by the Executive Director through contacts with the Bank staff and that since January 1971 the results of these inquiries had been provided to NAC in writing. Many of the points covered in the Executive Director's memorandums were technical and were not the broad policy issues which the Treasury Department emphasized, in its comments on our draft report, as the most important role of U.S. management. In fact, we found that many of the questions relating to policy matters, which had been raised during the discussion of proposed loans in the NAC Staff Committee meetings--such as allocation criteria for IDA funds, loans to marginal countries, and availability of alternate financing--had not been covered in the Executive Director's memorandums.

We also reviewed selected loan proposals to determine the extent of information available for use by NAC in deciding whether to recommend approval of the proposed loans.

When the Bank President submits a project proposal to the Board of Executive Directors which is a follow-on of an earlier Bank project, the documentation will sometimes include information on the earlier project. This information showed that both the Bank and IDA had granted loans when the agencies designated to execute the projects had unresolved management and/or administrative problems. These problems sometimes delayed the execution of the projects and may have had detrimental effects on the projects. Treasury officials took the position that the Bank's management would not have submitted these loans for approval by the Board of Executive Directors if they considered them to be unsound. Treasury officials also said that it is Bank strategy to work with the borrowers to correct these weaknesses as the projects progressed.

Attempts to correct these problems have sometimes aggravated the situation because of their improper timing. In some cases, a reorganization was be be carried out concurrently with the execution of the project. In other cases, weaknesses were to be corrected at a future time and, as a result, the same problem plagued an entire series of loans. Weaknesses in the borrower's organization result in delays in executing the project and, in turn, delay the desired development assistance to the country.

In connection with the problems noted during our review, an AID official stated that the United States should not expect too much from the developing countries. This apparently reflects the U.S. position because we found no evidence that NAC discussed these administrative and management problems during its appraisal of the project proposal.

The Bank's President in 1968 stated, concerning the policy for increasing Bank lending, that "minor blemishes have been overlooked and mismanagement has had to be serious before a country has been denied IDA assistance on performance grounds." Although NAC member agencies have been informed of the "minor blemishes" in management through the loan proposal documents provided by the Bank, very few comments were made by NAC member agencies as to the effect the blemishes might have on the execution of the proposed project. In fact, we found no instance where these problems deterred NAC from recommending approval of the loan.

The loan papers prepared by the Bank noted the following weaknesses in the executing agencies at the time the loans were approved. These weaknesses existed in about 40 percent of the projects for which we reviewed the project documentation.

--Cumbersome and outmoded operating procedures.

--Duplicated services.

--Understaffing and lack of technical expertise.

--Lack of preparedness in contracting for project.

--Lack of basic financial data.

--Procedure for establishing investment priorities inefficient or lacking.

--Indefinite lines of responsibility.

--Loans granted for the construction of roads when roads constructed under prior loans were not being adequately maintained.

Following are examples illustrating several of the above weaknesses.

Example 1

The Bank granted the following loans to a country to finance road projects.

June 30, 1961--$48.5 million
June 24, 1969--$25.0 million
May 5, 1971--$67.5 million

The initial loan was to finance the foreign exchange cost of the reconstruction and improvement of about 2,600 kilometers of road, maintenance equipment, and spare parts. This initial project encountered many problems caused by a shortage of local funds, ineffective management of the project, ineffective use of consultants, and loss of qualified personnel. Some of the problems experienced were poor quality of work, rising costs, and delays in construction.

The shortages of funds delayed payments to contractors and, as a result, the executing agency had difficulty enforcing specifications and construction schedules. Completion dates were extended repeatedly without sufficient technical justification. At the same time, the executing agency delayed in letting new contracts. The closing date for the loan was postponed 3 years, from December 1965 to December 1968. In addition, the scope of the project was reduced and $17.5 million was canceled.

Although certain improvements were made, many problems remained at the time the Bank proposed the second road loan in June 1969. The Bank's appraisal of the second project noted the following problems.

1. For a country with so extensive a road network, many of the executing agency's activities were too centralized. Furthermore, there was unnecessary duplication of services supplied by the national and provincial authorities, especially in the more developed and populated provinces which had fairly good organizations, although many of the more remote provinces were entirely dependent on the technical expertise of the executing agency's district offices.

2. Major obstacles to efficient highway management were the lack of basic data (such as a highway inventory and reliable traffic counts) for planning and administration purposes, the equipment to collect such data, and a satisfactory cost accounting system.

3. Another obstacle to efficient highway administration was the chronic understaffing of the executing agency due to low salaries.

The second loan was approved in June 1969 but did not become effective until January 1970 because of delays in completing the legal formalities. The minutes of the meeting of the NAC Staff Committee at which the second loan was discussed suggested that these problems had been ignored in reaching the decision to recommend approval of the loan.

Although the country had only partially improved its management and administration of the transport sector, the Bank approved a third road loan for $67.5 million in May 1971.

Since 1961 the Bank has granted the country $141 million for road projects which, for the most part, have been plagued by administrative problems during the entire period.

Example 2

The Bank granted the following loans to another country for road projects.

October 23, 1968--$26 million
May 25, 1970--$100 million

Generally, these funds have been for construction and for improvement of highways, engineering, supervision, and consulting services.

The Bank's appraisal of the second road project revealed the following shortcomings in the executing agencies.

1. To justify separate operations of the national and state highway departments, studies were being undertaken with a view to eliminating duplication of highway maintenance and construction services.

2. One of the main causes for problems in administration had been the chronic understaffing of national departments resulting from the low salaries offered and the freeze on government recruitment. Due to a lack of proper staffing in the planning department, new highway investments were not being controlled.

The shortage of personnel often led to inadequate supervision. As a result, quality of construction was often poor and long extension of contractual work periods was common.

3. Maintenance had long been neglected in the country. The lack of proper organization, equipment, and funds made it difficult to keep roads at a suitable level of traffic serviceability. However, there were marked improvements in the last few years.

Although disbursements were delayed 9 months from the effective date on the first project because of administrative problems associated with the signing of contracts for construction, the Bank did not propose to make approval of the second loan contingent upon the signing of the construction contracts.

In recommending approval of the second road loan, the NAC Staff Committee did not question the ability of the executing agency to effectively administer the project.

Example 3

The Bank and IDA granted the following assistance to another country for road projects.

February 5, 1964--IDA credit--$14 million
March 21, 1968--IDA credit--$3 million
February 24, 1969--Bank loan--$15 million
November 24, 1969--IDA credit--$7.5 million

The project financed by the February 5, 1964, credit experienced substantial delays and cost overruns because of a shortage of personnel in the executing agency. To cover the cost overruns, the government of the country requested and received the March 21, 1968, credit of $3 million. Again the project was plagued by delays because of difficulties in recruiting experts for the staffing and training program for the project. Almost 3 years after the supplemental credit of $3 million was granted, these experts had still not been obtained. A Bank status report on the project at that time noted that "Recruitment of these experts is now in process." In the midst of this unfilled need, the country was granted an additional $22.5 million under the February 24 loan and November 24 credit.

Agency comments and GAO analysis

In commenting on our draft report, the Department of the Treasury emphasized the importance placed on the development policies of the Bank by the U.S. management system. The Department criticized our draft for discussing the U.S. management system in terms of a loan-by-loan review, although it conceded that such review was an important and key process. The Department felt that our draft report concentrated very narrowly on the appraisal by NAC of technical and other aspects of individual loan operations. This apparently was interpreted by the Department to be a duplication of the work of the Bank staff. The Department also stated that our draft report had overlooked the large influence the United States has had on the general development policies of the Bank.

The role of the U.S. representative in the Board of Executive Directors is to see that the Bank's general development policies, internal procedures, and overall lending results are consistent with broad U.S. policy goals; and one of the methods of accomplishing this role is through the review of proposed projects on a loan-by-loan basis. In this way the Bank's members can ascertain whether the Bank is following established policies and whether policies on unacceptable practices need to be clarified.

Our review of U.S. management included an analysis of individual loan proposal documents, as well as the available documentation on the U.S. management review of these loan proposals, to determine what elements of the loans were questioned during the review and whether, in our opinion, other aspects should have been questioned. Our analysis showed that questions were raised by NAC relating to Bank policy, such as, financing of local costs, procurement practices, and questionable use of IDA funds; but in many instances we found no evidence that action was taken to resolve these questions.

We did note, regarding the Department's comment that the United States had had a large influence on the general development policies of the Bank, that NAC had frequently discussed Bank policy in the Staff Committee meetings. As might be expected, determining the extent to which the United States was able to influence Bank policy would be a difficult, if not an impossible, task since much of the evidence would not be documented and the basis for revisions in Bank policy would be subject to interpretation. To add to this difficulty, we were denied access to the minutes of the Board of Executive Directors' meetings. A Department official stated that the Department was aware of U.S. influence, but it was difficult to show evidence of this influence in most instances.

The Department also objected to the implication in the report that the Bank was unaware of the management and administrative problems noted in our review of the loan proposal documents or did not make them known to the United States and other members of the Bank. The Department stated that neither implication was true, the material on which GAO observations were based was from the Bank's own careful analyses of the borrower's capabilities and problems, as contained in the loan documents distributed to the Executive Directors. Further, the Department was of the opinion that it would be a grave shortcoming for the development institution to refuse to lend to other than ideal borrowers, because it was the objective of such institutions to use the lending process to accomplish administrative and management improvement.

As pointed out by the Department, the United States was aware of the existence of these problems; but we found no evidence that they were discussed during the loan review process. The use of the lending process to improve some management and administrative problems has merit. However, when such problems endanger the success of the project or cause delays, particularly when there is evidence that the same problems have existed in prior loans and have not been corrected, we question the reasonableness of granting loans before actions are taken to correct, or at least improve, the conditions. We believe that there are ways to correct these problems. For example, technical assistance loans are granted for many different purposes; therefore, similar loans could be made to provide assistance to resolve these management and administrative problems.

MINIMAL U.S. FOLLOWUP OF PROJECT IMPLEMENTATION

Once financing for a project is approved by the Bank's Board of Executive Directors, the United States essentially leaves implementation and evaluation up to the Bank staff. Monitoring of implementation is sporadic and informal; regular independent evaluative reporting to member governments on efficiency of operations, success or failure of World Bank and IDA projects, results achieved, etc., is virtually nonexistent.

The project is actually carried out by the borrower; but the Bank staff follows implementation of the project. The Bank reports that it disburses portions of the loan as they are required, either directly to suppliers or to the borrower. The Bank staff also checks the specifications of goods supplied and supervises the tender and award process for contracts. The Bank receives periodic progress reports from borrowers and sends staff members to the borrower's country to check periodically on the progress of projects.

The U.S. Executive Director does not receive the progress reports submitted by the borrowers. He does regularly receive notification when the Bank staff visits are to take place, but he does not see their findings. The Executive Director receives periodic reports showing the status of loan disbursements and repayments, procurement data under the loans, and certain other information. He does not receive, nor do other U.S. Government officials participating in the work of NAC receive, any regular substantive reporting on actual project performance, operational efficiency, problems and weaknesses, and the like. In some cases, when the Bank President submits a project proposal to the Board of Executive Directors which is a follow-on of an earlier Bank project, the documentation will include information on the earlier project. This information includes comments on project performance, problems and weaknesses, etc.

INTERNAL AND EXTERNAL BANK PROJECT EVALUATION

Although some review functions are performed, there has been no systematic independent evaluative audit of the operations of the Bank and IDA for use by member countries. The internal and external reviews of the operations of the Bank and IDA are described in the following sections.

Independent financial audit

In accordance with the Articles of Agreement and bylaws of the Bank and IDA, an independent firm of commercial auditors annually audits Bank and IDA accounts.

Joint Audit Committee

The Joint Audit Committee, established in 1970, consists of five Executive Directors who are appointed annually on the basis of seniority as Executive Directors. The Committee nominates, for consideration by the Executive Directors, a firm of private auditors to annually audit Bank and IDA books; discusses the scope of examination and its results with the auditors; and reports their conclusions and recommendations to the Executive Directors. The Committee also discusses the scope of the internal auditor's examination and its results.

Office of Internal Audit

The internal auditor, who reports to the Bank's Vice President of Finance, determines that the accounts and records of the Bank and IDA are maintained in accordance with established policies and procedures and in conformance with generally accepted accounting principles. He also determines that the system of internal control is adequate to safeguard the assets and to insure the accuracy and reliability of the accounting data.

Operations Evaluation Unit

This unit, established in September 1970 in the Programming and Budgeting Department reports to the Department's director. The group is responsible for the evaluation of the effectiveness of Bank and IDA operations and emphasizes projects which have become operational. To determine how policies and procedures might be improved, the group's first assignment was a study of the impact of the Bank on the development of Colombia after 1949, when the first loan was made to that country.

Lack of independent evaluation of management efficiency and program results

Although the above audit and review functions may provide management with worthwhile information, the Executive Directors do not receive sufficient evaluative information on the operations of the Bank and IDA to insure that the funds contributed by their respective governments are being used efficiently and effectively to accomplish the objectives. Such information should be provided by a review group established completely independent of the management of the Bank and IDA, and this group should report directly to the Board of Executive Directors.

It should be remembered that, although the Bank and IDA are international entities, they were created by governments of nations. They derive their authority from the agreements authorized by these governments, draw their power from funds provided by these governments, and exist solely to fulfill the plans and hopes of these member governments as expressed in the charters or articles of agreement of the institutions. As such, they are accountable to their member governments for the efficient accomplishment of their statutory purposes. The operational interface between the Bank and IDA and the member governments takes place through the Board of Directors, not the Bank presidency. At present, the Board of Directors has no effective source of information or means for evaluating Bank and IDA operations except through the Bank management. To completely fulfill its responsibility to the member governments, the Board needs an independent means of review and evaluation, responsive to the Board's needs and direction and reporting directly to it.

Treasury Department officials informed us that, although there was no independent systematic review and evaluation of World Bank and IDA activities, there were other indications that they relied upon in judging the soundness of the Bank's operations. They said that the Bank's loans were being repaid on schedule, the Bank has consistently shown a profit on its operations, and the Bank has succeeded in raising funds on the world bond market. These are noteworthy considerations. We believe, however, that other elements need to be considered which bear more directly on the operations of the Bank from a developmental viewpoint. These officials said that their judgment also stemmed from informal contacts with the Bank staff and infrequent reports coming to their attention that Bank projects had run into trouble.

INSPECTOR GENERAL OF INTERNATIONAL FINANCE

In September 1970 the Secretary of the Treasury, in reorganizing the Office of the Assistant Secretary for International Affairs, appointed an Inspector General for International Finance. The Inspector General directs and conducts reviews, evaluations, and inspections of the international financial programs and operations of the Treasury Department to ascertain the effectiveness of their administration and knowledge of the international economic and financial policies of the United States. However, we understand that, to date, no formal reports have been issued.

The establishment of this position is a constructive effort on the part of the Department of the Treasury and, if properly implemented, will improve the U.S. oversight of the operations of the international financial institutions.

U.S. EMBASSIES AND AID MISSIONS NOT EFFECTIVELY USED AS SOURCES OF INFORMATION ON BANK AND IDA ACTIVITIES

Officials of NAC member agencies have held that primary sources of information for evaluating Bank and IDA activities are the U.S. Embassies and AID Missions in the various countries. However, our review at selected Embassies and AID Missions indicated that very little information on Bank and IDA activities was actually provided to Washington.

We visited the U.S. Embassies and/or AID Missions in Argentina, Brazil, Paraguay, Korea, Malaysia, the Philippines, Taiwan, Kenya, Tanzania, Uganda, India, Nepal, and Pakistan and found the following conditions relating to Bank and IDA activities.

No instructions or guidelines

No instructions or guidelines had been provided for furnishing information to Washington on Bank and IDA activities. Instructions had been issued by the State Department and AID for providing information on the activities of ADB, IDB, and the United Nations Development Program.

Bank and IDA loan documents received late or not received at all

The Embassies and AID Missions had very little knowledge of the details of Bank and IDA projects. The preliminary data on proposed projects and the formal loan documents were generally received after the loan had been approved or were not received at all.

Minimum of voluntary reporting

There were no requirements for reporting on Bank and IDA activities and very little information had been voluntarily forwarded to Washington.

Minimum of project monitoring

We found that project implementation was seldom monitored and completed projects were seldom evaluated unless AID had jointly financed the project with the Bank or IDA.

Some U.S. officials expressed concern about the political implications of unilateral monitoring and evaluating of the activities of an international organization. We assured these officials that we were not considering a regular, intensive review of a project.

Meaningful information could be provided

Many of the Embassy and AID Mission officials expressed the opinion that they could provide meaningful information to Washington on Bank and IDA activities. Some officials cited instances when their comments could have contributed to improving a project.

For example, an AID technical advisor in one of the countries stated, after visiting a Bank ranching project, that one of the ranches was in a location that was less desirable for ranching than other areas in the country and therefore would require concentrated management and bush clearing to make it a successful project.

An Embassy official in another country said that he could provide several significant points on Bank and IDA loan proposals which, he felt, had not been considered fully. He cited a tea scheme and a flue-cured-tobacco scheme as examples. The points he mentioned were: (1) resettling large numbers of families and solving the social problems inherent in such a move, (2) providing qualified extension workers which were in short supply, and (3) forming cooperatives which had a history of weaknesses in the country.

A further example was presented by an AID official in a third country. In referring to an IDA credit to help finance the construction of, and the purchase of equipment for, academic buildings and student hostels, he stated that:

> "*** the USAID should make a particularly critical review of the proposed projects which appear to possess the typical weakness of being largely a construction effort with relative small emphasis on technical assistance and which may well result in the establishment of institutions which will continue to provide *** [the country] with an increasingly large number of badly educated, incompetent, unemployable engineers. It is indeed unfortunate that this mission did not have the

> opportunity to review and comment upon the proposal before its actual approval by the World Bank in Washington this past June 1970 ***."

Although the Bank and IDA finance projects in sectors in which neither the Embassies nor AID Missions have the necessary expertise for technical evaluations, the Embassies and Missions would be in a position to recognize and comment on significant problems that were not technical. Often the Embassies and the AID Missions do have personnel with the expertise in the fields in which the Bank and IDA are financing projects and therefore could recognize technical problems.

Agency comments and GAO analysis

The Department of the Treasury agreed that it needed to receive more substantive information on proposed projects earlier but pointed out that recent changes had facilitated its review and allowed it to better judge policy implications. These changes include a separate section in the Monthly Operational Summary listing the new projects, a considerable expansion in the amount of information being supplied in the summary, and an informal arrangement for receiving information in advance of the Notices of Intention to Negotiate.

We found that the recently revised Monthly Operational Summary would permit easier identification of new projects and that the expansion in the amount of information appeared to be of value in identifying policy issues. The other items in the system for obtaining earlier information on projects include a Notice of Intention to Negotiate and a Status of Negotiations. These items generally contain only a minimum of information--name of the borrower, loan amount, and purpose of the loan--and do not appear to be sufficiently detailed to identify issues or assess the soundness of proposed projects.

The Department agreed to implement the proposal that guidelines be established for the review and evaluation of loan proposal documents, but it felt that a checklist would not substitute for experience and judgment in assessing the soundness of proposed projects.

Our draft report did not suggest a checklist, but rather guidelines or criteria to insure that the major elements were considered in reviewing proposed projects and yet were unrestricted so that NAC members could consider additional elements. We agree that experience and judgment are very important factors in assessing the soundness of proposed projects, although guidelines or criteria also seem to be essential for a uniform review process, particularly when inexperienced loan reviewers are involved.

The Department agreed that some further development was needed in reporting from the U.S. Missions. However, the Department felt that the draft report overemphasized the reporting aspect and did not recognize the extent to which U.S. Missions were able to influence projects in the development stage. The Department pointed out that this influence was exerted through close and regular coordination, in many countries, among representatives of multilateral and bilateral aid organizations and by the U.S. Missions in getting together with World Bank appraisal missions. The Department stated that the Missions' contributions were reflected in Bank loan documents even though they might not report to Washington and might not be in a position to review the actual documents in time to provide comments.

Our review at selected U.S. Embassies and AID Missions showed very little close coordination between U.S. and Bank representatives. The coordination that did take place was general in nature and not related to specific proposed projects. We were told that in some instances Bank missions had visited countries without the Embassies' and AID Missions' even being aware of their presence.

The Department agreed in principle with the need for an independent review body but felt that it should wait and see how effective the recently established Operations Evaluation Unit would be as a substitute for an independent review body.

In our opinion, there are no alternatives to an independent review. Having reviewed two of its reports, we believe that the Operations Evaluation Unit is a worthwhile tool for management. Since this unit is responsible to the Bank's management, it would not accomplish the objective we are seeking--an independent means of reviewing and evaluating the Bank's operations and activities that would provide the Executive Directors with sufficient information to determine whether or not funds were being used efficiently and effectively.

All member agencies of NAC commented on a draft of our report. The Department of State commented that the observations and recommendations in the draft report dealt with problems which had concerned it for some time. The Export-Import Bank of the United States felt that the draft report represented a useful study of the role of NAC in reviewing and evaluating Bank loans.

Several of NAC agencies thought that the draft report underestimated the amount of influence the United States had had on Bank development policies and activities. They also felt that the report should recognize that some improvements had already been made and that others were underway. These comments have been recognized in the appropriate sections of the report.

OVERALL CONCLUSIONS AND RECOMMENDATIONS

To successfully manage a member's participation in an international organization, the member needs a system for adequately appraising information on activities to be undertaken by the organization, for following the implementation of those activities, and for independently evaluating the results of specific undertakings. The objective of such a system would be to provide basic data on how efficiently and effectively the activities of the organization were being carried out. This, in turn, would provide the basis for improving the programs and operations of the organization and justifying continued financial support.

Although improvements have been noted, such as the earlier receipt of more substantive information on proposed projects, the Department of the Treasury, in our opinion, has not yet developed a fully functioning system for managing U.S. participation in the Bank and IDA and for assessing the organizations in carrying out their objectives. The current internal U.S. system of management needs strengthening in the following areas:

- --Although the formal NAC loan review was established to determine the U.S. position on proposed loans, it was unstructured and uneven and was performed without firm guidelines or criteria against which to assess the soundness of proposed projects.

- --Loans brought before NAC for review are in the final approval stages and, according to some officials involved in the NAC review process, there is little chance that the Bank would be willing to make changes. Any questions on the loans would have to be resolved with the Bank during the so-called informal review stage. However, the information available during the informal review stage appeared to be insufficient to assess the soundness of a loan. Treasury officials maintain that, if a question is raised concerning a certain undesirable aspect of a loan, it is likely that that aspect will not appear in a future loan.

U.S. Embassies and AID Missions supplied little information on Bank and IDA projects because they had received no instructions or guidelines on providing such information.

--Questions raised at NAC Staff Committee meetings on proposed Bank and IDA financing did not appear to have been fully resolved, although these loans were recommended for approval.

--Once financing for a project is approved, the U.S. representatives essentially leave implementation and evaluation up to the Bank staff. Monitoring of implementation by U.S. officials is sporadic and informal; regular independent evaluative reporting to member governments on efficiency of operations, success or failure of projects, results achieved, etc., is virtually nonexistent.

Bank documents made available to the United States by the Bank showed that, in several instances, loans had been proposed when the borrowers' organizations had unresolved management and/or administrative problems which later delayed the execution of the projects and may have had detrimental effects on the projects. Treasury officials said that it was Bank strategy to work with the borrowers in correcting these weaknesses as the projects progress. Nevertheless, the continuance of these weaknesses in loans to the same borrower over time indicates a need for increased vigilance over the loans by the U.S. Executive Branch.

Further, we noted the following trends in the operations of the Bank and IDA which were considered of significance to the United States as a participating member.

--It has been suggested that, in meeting targets for committing new funds, project planning may have suffered--this might explain, in part, the increased slowness with which projects are implemented and funds are disbursed. The problem of delayed disbursements appears to have existed for a number of years, as evidenced by the continuous increase in the undisbursed balance of loans from $1.2 billion on June 30, 1963, to $4.1 billion on June 30, 1972.

--Because of the slow project implementation--as measured by gross disbursements--and the rapid growth in principal and interest payments and commitment charges on older loans, the Bank in recent years has not been a significant factor in the net transfer of resources to developing countries.

Recommendations

To improve management of the U.S. participation in the Bank and IDA, we recommend that the Secretary of the Treasury arrange for:

--The routine receipt of more substantive information before receipt of the formal loan proposal documents on projects to be financed by the Bank and IDA. With this information, many of the questions raised during the NAC review could be resolved with the Bank prior to the final approval stage, when the Bank would be reluctant to make changes in the project and loan agreements.

--The development of instructions that stipulate the desired depths and parameters of the U.S. appraisal process on proposed projects to guide U.S. officials and technicians in making their appraisals. These instructions should include a clear statement of policy regarding the appraisal of the economic and technical aspects of the projects.

--The development of instructions to U.S. Missions to furnish available information to Washington on Bank and IDA activities, including loan requests from would-be borrowers and problems in implementing approved projects. Problems which the U.S. Executive Director might want to call to the attention of the appropriate Bank staff should be pointed out.

We recommend also that the Secretary of the Treasury instruct the U.S. Executive Director to propose and actively seek a continuing independent evaluation of the operations and activities of the Bank and IDA in order to provide the Executive Directors with sufficient information to determine whether funds are being used efficiently and effectively. Such information should be provided by a review group completely independent of the management of the Bank and IDA. It should be of appropriate size and competence and should report directly to the Board of Executive Directors.

MATTERS FOR CONSIDERATION BY THE CONGRESS

Because of congressional interest and concern over the increasing levels of U.S. participation in the international financial institutions and the lack of control that the United States has over the funds provided, we believe that this report should be particularly useful to the Congress.

The Congress should consider having the U.S. representative to the Bank and IDA propose a program of continuing independent reviews of the development activities of the Bank and IDA which would provide the Treasury Department and other agencies in the executive branch with adequate information to determine whether funds are being used efficiently and effectively.

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EXPORT-IMPORT BANK OF THE UNITED STATES

WASHINGTON, D.C. 20571

CABLE ADDRESS "EXIMBANK"

April 7, 1972

Mr. Oye V. Stovall, Director
International Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Stovall:

This is in response to your letter of March 8, 1972, to Mr. Kearns, who is presently away on official business, requesting comments on the draft GAO report covering selected aspects of U. S. participation in the IBRD and IDA. Our general reaction is that the proposed report represents a useful study of the role of the NAC in reviewing and evaluating World Bank loans. The following observations are offered in respect to the major issues identified and examined.

There may be some merit in attempting to develop more specific guidelines for the review process but we believe it is neither feasible nor desirable for the NAC to verify in detail all of the financial, economic, and engineering work done by the Bank's staff of technical experts. Since the NAC is primarily concerned with policy considerations the member agencies should not be required to duplicate the basic work done by the IBRD's professional staff except to insure that the Bank's loan proposals and practices are consistent with policies established by the Board of Directors and are not prejudicial to the interests of the U. S. This is not to say that the U. S. will not be interested in the quality of the IBRD's analysis and the administration of its loan portfolio. The problem as we see it, however, is not that the staff work of the Bank is deficient or lax but rather the extent to which the U. S. can exert its influence on management to adopt policies for the staff to implement which coincide with our view of how the Bank should operate.

Since the IBRD's loan operations are primarily within less developed countries, it is to be expected that its borrowers are frequently unable to meet tests normally applied in the more advanced countries. The lag between disbursements and authorizations is probably due in part to the inherent nature of the infrastructure projects financed by the Bank as well as to the inadequate absorptive capacities of borrowers. On balance it is our impression that the IBRD has been aware of the need for improvements in the administrative capacity of its borrowers. The pace at which borrowers should be required to achieve a higher degree of competence and the extent to which it should be made a condition of continued loan assistance is one of the most difficult aspects of development banking. It might be worth noting that in some instances we have felt that the Bank may have actually continued too long in providing assistance to borrowers which had reached a level of administrative and financial competence enabling them to seek funds from more traditional sources of financing.

Eximbank has been particularly concerned that the U. S. has not obtained a larger share of procurement from projects financed by the World Bank in recent years. We have called the attention of the NAC to the apparent reluctance of the IBRD to require potential borrowers to investigate more fully the availability of other sources of financing before agreeing to consider applications. This is most troublesome in respect to self-liquidating projects in such fields as power, telecommunications, and industry in countries which can attract appropriate financing from bilateral institutions.

We do not take exception to the recommendations of the GAO report but suggest that the text be revised and updated to more adequately take account of recent steps which have been taken and the continuing efforts being made to improve the coordination of interagency positions within the NAC context and to improve opportunities for U. S. suppliers to bid successfully on World Bank projects. Further mention should also be made of the role played by the U. S. Executive Director's Office in communicating U. S. views to the Bank's management as well as providing more information to the NAC agencies on the Bank's operations. In any event Eximbank will of course cooperate to the fullest extent possible with any procedural changes that may be adopted as a result of the GAO's examination.

Sincerely,

Don Bostwick
Executive Vice President

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

ANDREW F. BRIMMER
MEMBER OF THE BOARD

April 7, 1972

Mr. Oye V. Stovall
Director
International Division
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Stovall:

Thank you for giving us an opportunity to read the draft of your report, "U.S. System for Appraising and Evaluating World Bank and International Development Association Projects."

Our staff has reviewed the document, and I am sending along a copy of a memorandum commenting on some specific points.

The principal suggestion I have concerns the general characterization of the NAC review of IBRD loan proposals as a "rubber stamp". In my judgment, this unduly minimizes the significance and effectiveness of the review process.

In recent years, the NAC has been giving more attention to IBRD and IDA proposals than it once did. This has not necessarily been reflected in abstentions or negative votes being cast by our Executive Director. As your report recognizes, the Executive Director has been instructed on many occasions to express criticisms of various aspects of particular loan proposals both in Board meetings and in bilateral discussions with the management and staff of the Bank. While it is difficult to measure the impact of these comments, I know that management has taken them seriously. The frequency with which the Executive Director has been instructed to make critical comments has increased with the expansion of the lending operations of the Bank and IDA in the past few years. Earlier, when the Bank was authorizing far fewer loans and could be much more selective, NAC reviews were less likely to give rise to instructions of a critical nature. I hope that you will reconsider the description of the NAC reviews as a "rubber stamp" operation.

I would agree that the present procedures in the NAC could be improved, but it should also be recognized that some improvements have already been made and others are underway.

Sincerely yours,

Andrew F. Brimmer

Andrew F. Brimmer

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 4, 1972

To Mr. Bryant

From Reed J. rvine

Subject: Comments on GAO Report on "U. S. System for Appraising and Evaluating World Bank and International Development Association Projects."

In[1] the discussion of the NAC review process which begins on page 29, the description of the three levels in the NAC is not correct. This should be revised to point out that there are four levels, the highest being the Council composed of Cabinet-rank officials. Meetings at this level are quite infrequent, and most of the matters considered by the NAC are not referred to the officials occupying the highest level. The second level consists of the Alternates to the Council members. A great many of the matters considered by the NAC are brought to the Alternates for decision, including votes on individual loan proposals for the weekly telephone polls. The Alternates meet from time to time to resolve policy issues, not merely those that have "stalemated" the Staff Committee. The Staff Committee carries out the review of individual loan proposals and does the ground work that is often required for the policy decisions made at higher levels. The fourth level is the Working Group. Such groups are organized to carry out technical work on specific problems. They report to the Staff Committee. It is not correct to say that the representatives on the Staff Committee are the officials in charge of the office of economic development in the various agencies. The Federal Reserve representative does have responsibility for the developing countries, but this is the exception rather than the rule.

In the bottom paragraph on page 30,[1] it is said that votes are taken if there is disagreement in the Staff Committee. This is misleading. All proposals are voted upon even if there is not disagreement at the Staff Committee meetings. The matters to be voted upon are reported to the officials in each agency who are authorized to clear the votes. Normally this would be the Alternate or someone designated to act for him, not the NAC principal.

The description of the loan review process on pp.[1] 31-32 is not quite correct, and does not do full justice to the procedures. It should be pointed out that each agency involved in the review process brings different interests and skills to bear on each proposal. While it cannot be denied that there would be something to be gained by laying down firm guidelines and criteria for the review process, it should be remembered that such a list would not be an adequate substitute for the experience and judgment of those reviewing the loans. The description of the review process would be more balanced if it pointed out that the loan documents are reviewed by specialists who are quite adept at spotting objectionable features and potential problems. I believe that it would be desirable to list what

Treasury, AID and Federal Reserve submitted as items that the reviewers look for in reading the loan documents. I would suggest deleting the fact that Treasury added to its list "as an afterthought." If you ask a person to describe what is to him a routine function he will in all probability overlook certain actions precisely because they are things he does without thinking.

In discussing on p. [1] 33 the fact that loans are recommended for approval even though questions may be raised with respect to them, it should be indicated that the questions raised were not necessarily of such a serious nature as to justify rejection of the loan. It is frequently necessary and desirable to raise questions and ask that they be discussed with the management or staff ofthe bank in order to make them aware of the type of concerns we have. Hopefully, they will bear these concerns in mind in devising other loan proposals in the future. This deserves to be pointed out in the discussion on p. 33.[1]

[See GAO note 2.]

The present procedures do not provide an adequate basis for evaluating the probable success or failure of loans made by the IBRD and IDA, but it should be noted that the IBRD has had a generally excellent reputation in project development. As the Bank greatly expands the scale of its lending, it may be desirable to scrutinize its activities more carefully. The suggestion for more review of performance under loans that have been made in the past and greater use of the expertise available in our embassies is a good one, however.

The source of the figures in paragraph 3 of page 57[1] is not identified, and the figures are different from the data provided in the annual report of the IBRD, except for the increase in disbursements in FY 1971. This should be clarified.

I think that too much emphasis is placed on the amount of net capital transfered tothe borrowing countries by the bank and IDA. It is a mistake to think that there can be a substantial increase in the net transfer year after year when the funds are being loaned, not granted. What is important for the purposes of development is not the size of the net transfer but the total amount ofcapital that is placed at the disposal of the borrowing country and the efficiency with which that capital is utilized. If it is utilized well, it will not only earn enough income to repay the loan but will bring benefits of increased employment and productivity to the borrowing country that will enable it to raise income levels. The section on pp. 57-59[1] does not provide a balanced discussion of this problem. I would suggest either dropping it or expanding it. Since it is not really relevant to the subject of the report, dropping it might be preferable.

DEPARTMENT OF STATE

Washington, D.C. 20520

April 28, 1972

Mr. Oye V. Stovall
Director, International Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Stovall:

I have been asked to present the views of the Department of State and the Agency for International Development on the draft report of the GAO on the World Bank Group, in response to your letter of March 8, 1972.

As the draft report points out, there is a long-standing philosophical dispute over how much control member governments should try to exercise over the policies of international institutions. Most member governments of the World Bank Group tend to leave their Executive Directors a great deal of latitude in dealing with Bank management. The U.S. Government has chosen not to follow this formula. The NAC mechanism described in the draft report was devised as a means for the various Executive Branch agencies with an interest in the operations of these institutions to make their views known to the Secretary of the Treasury before he issues instructions to the EDs. The informal contacts mentioned in the report have the same general purpose: to make the Bank management and staff aware of, and hopefully responsive to, U.S. Government policies and concerns related to the operations of the Bank.* The Bank's staff is extremely competent and we share the Bank's stated objective of furthering the economic development of less developed countries, so the Bank's relationship with the US Government is generally a harmonious one. It goes without saying, however, that the Bank has to take into account many other considerations as well, and that even the most dynamic and detailed U.S. representations to the Bank on issues of concern to the U.S. do not guarantee a Bank policy decision to our liking.

*Unless otherwise specified, references to the Bank also include IDA.

This is the context within which the U.S. Government input into the World Bank Group's policies must be considered. We share the GAO's concern that our contribution be as effective as possible, while recognizing that one of the fundamental characteristics of multilateral aid is a certain insulation from the individual policies of donor governments. Most of the observations and recommendations contained in the draft report deal with problems about which we have been concerned for some time. My intention in the remarks which follow is to discuss the report's recommendations as they affect the Department of State and AID, particularly in the light of developments since the draft report was compiled.

Perhaps the most difficult problem the Executive Branch has to contend with is early warning on Bank projects. No formal procedures could completely guarantee that the Executive Branch had enough information, at an early enough stage in each project, to eliminate all risk of having to disagree with a finished loan document. Loans are simply too complex and detailed for this to be possible. But we have devoted a great deal of attention to improving the existing operating procedures. Our efforts perforce rely heavily on increased informal contacts between desk officers in State and AID and their counterparts in the Bank. In addition, procedures for a more detailed and formal NAC review of the Bank's monthly operations summary have recently been instituted. We have been working with Bank management on procedures for flagging potential problems in upcoming loan proposals.

We hope that increased attention to and awareness of the early warning problem will reduce still further the already low incidence of serious policy difficulties with Bank proposals. It is neither practicable nor desirable, however, to try to duplicate the job of the Bank staff in providing the basic analysis of loan projects.

Problems which remain in spite of our best efforts to root them out early must be dealt with - formally or informally - by the Board of Directors. The U.S. Executive Director has on occasion withheld support from loans which did not meet the economic standards the US Government expects of World Bank Group projects. A negative vote or an abstention is a serious move, to be undertaken infrequently, with good reason, and only after careful consideration. The U.S. Executive Director is usually instructed to express our reservations or comments on given aspects of a project orally at the Board meeting if the NAC does not find them sufficiently strong to warrant withholding support from a project. Properly used, both the voting power and the formal remarks in Board meetings at the Bank are appropriate tools for conveying to the Bank management our views on issues of concern to the U.S. Government.

The draft report contends that no explicit list of criteria is used in appraisal of Bank projects by the NAC agencies. This allegation is misleading. Reviewing officers in State and AID do not, and should not, attempt to duplicate the work of the Bank staff in providing the basic analysis of loan projects. Their more general review, however, does regularly take into account a wide range of factors. The following paragraphs describe the most important of them.

State and AID officers make a unique contribution to the NAC review process in three respects. They supply a first-hand knowledge of the countries involved; they also have direct experience of the requirements and problems of lending for different types of projects; finally, they bring to bear foreign policy considerations. Although multinational institution loan projects cannot - and should not - be subject to the political criteria of member nations to the same degree as bilateral aid, the State Department must make sure that US support for a given project, or the withholding of that support, is consistent with overall US foreign policy objectives.

The other criteria which State and AID officers look for are concerns shared by all the NAC agencies. Loan projects are expected to meet certain general tests of economic feasibility: they should have a satisfactory financial, economic, and/or social justification; they should include adequate followup provisions (e.g., requirements for management reform, technical assistance provisions, reports to be made to the Bank); they should be harmonious with the borrowing country's development plan, if there is one; they should be adequately coordinated with other donors involved in the same country and sector.

State and AID reviewing officers also consider how the institutions' policies are being applied in the case of individual proposed commitments. There are a number of such policy considerations, e.g. giving emphasis to the employment aspects of loans where possible, the mix between hard and soft loan funds, and availability of alternate sources of financing.

NAC agencies are ordinarily concerned about Bank assistance to facilities for the production of commodities which are in worldwide oversupply and examine particularly carefully the economic benefits to the borrowing country, the country's ability to produce the commodity at worldwide competitive cost, and the potential impact of the project on the world market.

The NAC agencies also examine projects for certain features more directly related to US economic interests. Unsettled debt arrearages or expropriations and procurement rules which discriminate against US suppliers are among the most important concerns in this area.

This is not an exhaustive list. Special considerations may come up with any particular loan project which would call into question US support for the project - or which would override a less-than-ideal score on the above criteria. These have included such concerns as the ecological effects of a project, for example.

The draft report raises the question of instructions to U.S. overseas posts on Bank and IDA activities. In my opinion, the field missions are more active than the draft report indicates. Most AID missions have regular and close working relations with resident World Bank representatives in their countries. Where there are no resident World Bank representatives, World Bank appraisal missions usually make it a regular practice to call on AID missions to exchange information. Washington often receives, either formally or informally, summaries of these meetings. In posts where there is not an AID mission, the task of providing useful information to Washington about World Bank projects devolves upon the embassy. It should also be mentioned that for those countries for which consortium or consultative group arrangements exist, these arrangements provide an effective mechanism for broad coordination among donor countries and the Bank.

The question of appropriate instructions to U.S. overseas Missions covering reporting on World Bank and IDA activities is being carefully reviewed. It should be noted, however, that in keeping with the multilateral nature of the World Bank and IDA it would neither be feasible nor appropriate for each member country independently to evaluate the implementation of the projects of those institutions. The GAO auditors themselves appear to recognize this point.

A more practical approach is that suggested in the report, which recommended the strengthening of the Bank's and IDA's own evaluation procedures. As you may know, an evaluations group responsible to management has recently been established in the Bank. The GAO's recommendation that the Secretary of the Treasury urge the Bank to set up an independent evaluations unit responsible to the Board of Directors is a proposal well worth exploring.

The above remarks, and the recommendations to which they alluded, have to do with U.S. Government consideration of specific loan projects. The report makes no mention of the Bank's series of policy papers initiated recently with the active encouragement of the U.S. Government. We believe that this is a serious omission. These papers are circulated for Board discussion; they have been an important, and generally productive, vehicle for U.S. input into Bank policies. There are three general types of policy papers: the sector study (e.g. industry, power, population); the indicative planning paper (such as the recent projections for the 1974-78 period); and the operations evaluation report (one so far, on electric power projects financed by the Bank). These papers are discussed in considerable detail within State and AID and subsequently at the NAC. The salient points made in these discussions are then written up for the U.S. Executive Director to use in Board discussions. These points can be incorporated into Bank policy, and can represent a far more lasting and significant U.S. contribution to that policy than would be possible if our attention were confined to specific loan projects.

I understand that other agencies of the National Advisory Council will be sending you separate letters commenting on the draft report.

Sincerely,

Richard W. Murray

Richard W. Murray
Deputy Assistant Secretary for
Budget and Finance

THE ASSISTANT SECRETARY OF COMMERCE
Washington, D.C. 20230

MAY 8 1972

Mr. Oye V. Stovall
Director, International Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Stovall:

This is in reply to your letter of March 8, 1972, which invites Department of Commerce comments on the draft GAO report entitled, "U. S. System for Appraising and Evaluating World Bank and International Development Association Projects."

We believe the GAO report addresses important questions of U. S. policy-level relationships with the Bank and IDA, and we welcome the report's efforts to identify areas in which improvements might be made. We agree with the central observation of the report; i.e., that more specific criteria and guidelines be developed to assist U. S. officials charged with formulating and articulating U. S. policies concerning the operations of international financial institutions.

As the report points out, the National Advisory Council is responsible for this role, and it is helpful to have the report's assessment of how relevant NAC procedures can be strengthened. However, it must be recognized that United States policy objectives are not static, and they may on occasion be at variance with those of other members of the international financial institutions. Hence, whatever the machinery for formulating and implementing them, it is in the nature of international organizations that U. S. views will not always prevail.

With respect to the issue of efficient project implementation and the report's suggestion for an independent evaluation system, I believe that considerable further analysis is necessary before a firm recommendation can be advanced on this issue. There is, I believe, an identity of interests on the part of Bank/IDA management, the U. S. Government, and other member governments in effective and economical project design and implementation. And, in this regard, the report states, "membership in an international organization presumes a certain willingness on the part of member nations to rely on the internal management of the organization for effective, efficient and economic implementation of approved programs and activities."

It is for this reason that the U. S. has attempted to ensure that senior Bank officials are fully conversant with U. S. development and related policies and, similarly, that the U. S. has encouraged the Bank to retain the highest caliber professional staff.

Nevertheless, delays and problems are inevitable whenever large, complex projects are undertaken in developing countries. It would, of course, be helpful to be better informed about such developments. As the report notes, Bank personnel spend a considerable amount of time abroad, and it is my understanding that project implementation problems are fully documented in the resulting staff mission reports. Such information is made available to Executive Directors and to members of the Bank's several consortia and consultative groups. There is no reason that this type of information could not be provided to policy-level officials on a more systematic and timely basis as the report suggests. I believe this approach would be preferable to the creation of the proposed new monitoring machinery.

Also, as regards early notification of emerging difficulties, steps are being taken to provide early warning on loan proposals raising difficult problems before Bank-borrower negotiations are far advanced. The recent improvement of the Bank's "Monthly Operational Summary" is a practical step in this direction.

The role of U. S. overseas posts is covered in one of the GAO recommendations. It should be noted that U. S. posts are now provided with explicit instructions from Washington to follow up with the local borrowing agencies regarding bidding opportunities for United States exporters in advance of Bank approval of its project loans and to report such information in detail to Commerce for dissemination to United States exporters.

This is a separate "early warning system" which was developed 16 months ago under sponsorship of the NAC agencies and the Office of the U. S. Executive Director as an endeavor to alert United States businessmen in a timely fashion to opportunities presented by World Bank projects. Implementation of this system is the responsibility of Commerce and U. S. Foreign Service posts. We believe that the result is a useful step toward an improved United States supplier position under World Bank and IDA lending operations.

Sincerely,

HB Scott

Harold B. Scott
Assistant Secretary for
Domestic and International Business

THE DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

June 6, 1972

Dear Mr. Stovall:

The attached memorandum contains the Treasury Department's comments on the draft GAO report entitled, "U.S. System for Appraising and Evaluating World Bank and International Development Association Projects." I would like to call your attention particularly to certain of the points made in greater detail in the memorandum itself.

First, the draft report concentrates very narrowly on the appraisal by the Executive Branch of technical and other aspects of individual loan operations. In so doing, the report may miss the forest for the trees. An essential feature of multilateral assistance is that member governments delegate much of the technical preparation and analysis of projects to the proven competent staffs of the international financial institutions. Hence it is not the role of the United States or other governments to duplicate the staff work of those institutions.

It is the role of the U.S. representative in the Bank's Executive Board to see that the Bank's general development policies, internal procedures and over-all lending results are consistent with broad U.S. policy goals. This requires a greater focus on (a) over-all policies of the borrowing country, how sound they are and where the project fits into their development plans, and (b) whether the loan for a project is within certain U.S. policy parameters such as fair international bidding, non-substitution for other reasonable financing, adequate prospects of repayment and likelihood of benefit to the people of the borrowing country.

The loan-by-loan analysis and review process is, nevertheless, a key one, and the United States Government devotes considerable time and effort to it. However, what the draft report has missed is the large influence we have had on general development policies of the Bank. For example, the shift in Bank lending toward sectors emphasizing job creation and social infrastructure took place with leadership from the United States, as did Bank moves toward establishing an ex post loan evaluation mechanism and a Board-level country review process. By pooling the combined judgments of the member countries on policy issues as well as scrutinizing individual loans, we can do more than we could hope to do individually.

While loan-by-loan review continues to be important, a number of major changes in procedure have been made recently that enable the U.S. Executive Director and the representatives of other member governments to given greater emphasis and attention to Bank policy issues than would be possible by concentrating attention on specific loan projects. I believe the narrow project-oriented approach in your draft report, if accepted as the major U.S. role in participating in the Bank, would be a step backward and inadequate.

Second, the draft report reaches conclusions about the over-all effectiveness of the World Bank. These conclusions are based exclusively on GAO examination of internal U.S. procedures for participation in the World Bank. This provides no basis for GAO judgments on the over-all effectivenss of the World Bank itself. The Bank has, of course, stood the test of over twenty-five years of successful operations, and continues to enjoy the support and confidence of its developed and developing member countries, of the private capital markets in which it borrows, and of other qualified observers in the field of development finance. [See GAO note 3.]

Third, we have felt it necessary to comment substantively in our memorandum on many matters simply because they were treated in the draft report. Many of these subjects, however, have no relevance to the quality of Executive Branch management; some others lie in areas where GAO can at most add another opinion but has no special expertise; and still others are clear attempts to comment directly on the work of the World Bank that are inappropriate by GAO's own definition of its proper role. I believe the report would benefit from extensive deletions of matters not essential to the appraisal of Executive Branch management of our participation in the international financial institutions.

Sincerely,

John M. Hennessy
Acting Assistant Secretary
for International Affairs

The Honorable
Oye V. Stovall
Director, International Division
United States General Accounting Office
Washington, D. C.

Attachment

TREASURY DEPARTMENT COMMENTS ON DRAFT GAO REPORT, ENTITLED "U. S. SYSTEM FOR APPRAISING AND EVALUATING WORLD BANK AND INTERNATIONAL DEVELOPMENT ASSOCIATION PROJECTS"

DIGEST OF TREASURY COMMENTS

-- Treasury has been adapting and improving the management of its participation in the Bank, just as the Bank itself has been adapting and improving its operations in the light of the expansion of its role and responsibilities.

-- Treasury therefore welcomes constructive suggestions that contribute to its on-going review of ways to continue to assure that funds are being used efficiently and effectively. The Bank has operated with efficiency and effectiveness and won high marks of confidence and approval not only from the U. S., but from other participating governments, private capital markets around the world and expert independent observers as well.

-- GAO's main premise is defective and its main conclusion misleading. GAO examination of internal U. S. procedures for participation in the World Bank provides no basis for GAO judgments on the over-all effectiveness of the World Bank itself. Such judgments would in any event go beyond what GAO itself has said is the appropriate scope of examination of U. S. participation in the international financial institutions.

-- Inter-agency review of loan projects is not a "rubber stamp" activity; use of the term reveals a limited understanding of the review process.

-- The World Bank continually seeks to help borrowers improve administratively and managerially; GAO mistakenly implies that loans should only go to "ideal" borrowers.

[See GAO note 2.]

-- Technical suggestions offered for improvement of U. S. oversight of World Bank activities are generally acceptable.

TREASURY DEPARTMENT COMMENTS ON DRAFT GAO REPORT, ENTITLED "U. S. SYSTEM FOR APPRAISING AND EVALUATING WORLD BANK AND INTERNATIONAL DEVELOPMENT ASSOCIATION PROJECTS"

I. General Comment

The draft report rests on a faulty premise, as a result of which it is led to a principal conclusion that is at best subject to great misinterpretation, that is not adequately supported in the underlying document, and that is contrary to the views of many seasoned, independent observers.

The defective premise on which the draft report proceeds is that it is possible to reach a conclusion on the overall efficiency and effectiveness of a major international institution such as the World Bank through a narrow, technical and over-simplified appraisal of the internal U. S. Government mechanism for evaluating the Bank's loan projects. The detailed points cited in the GAO draft report neither bear on the overall effectiveness of the Bank nor provide any basis for questioning the fact that the Bank is indeed moving at an increasing pace toward meeting its intended objectives. There are, on the other hand, a number of independent checks and indicators not referred to in the draft report that do permit one to feel satisfied with the effectiveness of the Bank and to conclude that it is making continued progress toward carrying out its objectives.

The merit of the draft report is not rescued by the fact that it makes several subsidiary recommendations that are generally constructive, although breaking little new ground. If the draft report intended simply to suggest that there are ways of improving the Executive Branch's oversight of the operations of the Bank, we would have little to quarrel with. In fact, this has been one important aspect of our activities and we, therefore, welcome those GAO suggestions that bear on this. Judgments on the overall effectiveness of the Bank, however, go beyond what GAO itself has said is the appropriate scope of examination of U. S. participation in the international financial institutions. To stay within its mandate, the report should confine itself to the effectiveness of Executive Branch mechanisms, and not of the Bank itself.

II. Comments on the Digest

The Digest speaks of U. S. appraisal of proposed projects. The U. S. role is, contrary to the statement in the report, not a "restricted" one. The United States, like other countries, places important responsibility on the management of the institution.

It would be contrary to the very objectives of efficiency and effectiveness about which the GAO expresses concern, as well as prejudicial to the accomplishment of our objectives in multilateral institutions, if we were to substitute our own activities for the general activities of management. This does not mean to say, of course, that there are not areas where further development of the U. S. role is desirable.

The Digest goes on to characterize the inter-agency review of proposed loans as a "rubber stamp operation" and to state that all projects proposed are assured an affirmative vote. The term "rubber stamp operation" is a repetition of a worn-out quote that appeared several years ago. Its use reflects a limited understanding of the aims of the review process. The inter-agency review has focused not only on loans themselves but also, and perhaps more importantly, on policy problems arising out of the review of loans. Whether the United States renders an affirmative vote or not in relation to a particular loan, it is clear that U. S. views on the policy issues that emerge from individual loans are not a "rubber stamp" in relation to the evolving activities of the institution. Just as a point to mention in passing, there have been several recent occasions where the U. S. has found it desirable to vote other than affirmatively. This, however, is incidental to the major comment and the major actions taken by the U. S. with respect to the policies and operations of the World Bank and IDA, both evolving out of the formal and informal mechanisms of inter-agency review.

In the sections dealing with need for vigilance over operations, reference is made to the dearth of information on implementation of projects. Again, we agree that there is room for more information. However, as has been pointed out to the GAO, the implementation of previous projects in the country is discussed in each new loan proposal.

The reference to borrowers who have unresolved management or administrative problems carries the implication that the Bank was unaware of such situations or did not make them known to the United States and other member governments. Neither implication is true. The material on which the GAO's observations was based was drawn from the Bank's own careful analyses of the borrower's capabilities and problems, as contained in loan documents distributed to the Executive Board. The fact that the Bank has usually been most successful in helping borrowers overcome management and administrative problems is ignored. For a development finance institution, it would be a grave shortcoming to refuse to lend to other than "ideal" borrowers. The objective of such institutions is to use the lending process to bring about the administrative and management improvements that will enable borrowers to operate successfully on their own in the future. The examples used in the draft report to illustrate the point about administrative problems of borrowers only serve to highlight the failure of the report to understand this aspect of the World Bank's relationship to the total process of development.

In discussing several additional points under the general topic of vigilance over World Bank operations, the Digest carries a possible implication that the Executive Branch has been unmindful of those additional points or of avenues of improvement. Such an implication would be wholly incorrect. For example, the Executive Branch has paid extremely close attention to the debt service problems of some of the recipient countries. Indeed, we have pioneered with the Bank by influencing it and working with it in this area. The Bank's studies are universally regarded as definitive on the debt service problem, and it is the principal source of factual information in this field.

The GAO seems to be lacking some guidelines of its own in criticizing Bank lending to certain countries because of a shortage of concessional funds and at the same time criticizing, in what we consider an unjustifiable manner, a relatively low level of net transfers of resources to the developing countries. There are problems of accuracy, of consistency, and of concept in this foray by the GAO into the field of general development economics.

The inference drawn by GAO that project planning might have suffered because of the increase in commitments is not based on factual analysis. The relationship between loan commitments and disbursements can vary for a variety of reasons, including new areas of lending where the lag in disbursements are understandably longer, and, of course, where there has been a rapid increase in the level of loan commitments in general. In any event, the Bank and we are mindful always of the need to remove obstacles to effective disbursement while maintaining sufficient safeguards on the integrity of financial operations.

[See GAO note 2.]

III. Comment on GAO Recommendations

Earlier Receipt of More Substantive Information. We agree with the intent of the recommendation but it should be so worded as to recognize that this is in fact an ongoing activity. We have moved over the last several years toward obtaining more substantive information earlier in the project preparation stage. In so doing, we have built on the existing system of providing information to the Executive Directors. This system basically consists of a Monthly Operational Summary listing all proposed projects in the pipeline, a Notice of Intention to Negotiate informing Directors that a project has reached the state of preparation that allows negotiation and a Status of Negotiations reporting that negotiations have been substantially completed.

Until recently, the Monthly Operational Summary consisted of a compilation of about 20 pages identifying potential projects in most general terms (power, roads, etc.). New projects were lumped together with old ones under the country concerned.

About 16 months ago, an early warning system was established within the Executive Branch whereby new projects in the Monthly Summary were referred to our overseas posts, which were instructed to follow up with the local borrowing agencies in order to develop information relevant to procurement possibilities for U. S. exporters. A steady flow of such information is now received.

Other changes include a separate section listing new projects and a considerable expansion in the amount of information being supplied, resulting in a document of over 50 pages. These changes facilitate our review and allow us better to judge whether projects have policy implications for the United States. The principle has been established that any Executive Director who has doubts about proceeding with a lending proposal should bring his concerns to Bank Management.

In addition, we are establishing informal arrangements whereby we will receive notice at least 30 days before Notices of Intention are to be issued. These arrangements are designed further to assure that we have accurate information in sufficient detail early enough to identify issues and to affect the Bank's processing of loans.

Development of Instructions for Loan Appraisal. We doubt that a check list of criteria can substitute for experience and judgment in assessing the soundness of proposed projects, but nevertheless, will undertake to implement this suggestion. It should be emphasized that what is involved here is not the absence of existing guidelines among the various agencies, but only their codification and formalization.

Instructions Regarding Field Reporting. We agree that some further development is needed in areas of reporting from the field. We would caution the GAO on the wording of this recommendation so thatit is not construed to mean that the field is expected to do in depth audits or otherwise uneconomically duplicate the work of the Bank, or build up large staffs for this purpose. We assume that what is sought is for the field to be alert to activities and information relative to projects and to communicate this information to Washington.

As indicated above, U. S. missions in the field are informed at an early date regarding prospective World Bank projects.

We believe that your draft focuses too much on reporting and does not really understand the procedure whereby, and the extent to which, U. S. missions in the field are able to influence projects in the development stage. There is close and regular coordination in many countries among representatives of multilateral and bilateral aid organizations, often in the form of regular meetings under the chairmanship of a resident IBRD or UNDP representative. Furthermore, our missions make it a practice to get together with World Bank appraisal missions. They are thus in a position to contribute to and influence the early stages of Bank consideration of its lending. One important interest in the field is in coordination of U. S. and World Bank programs in the country in which they are located and in encouraging its economic development through the most effective use of Bank resources. Their inputs are reflected in Bank loan documents even though they may not report to Washington and may not be in a position to review the actual documents in time to provide comments.

Follow-up Implementation of Projects. So long as it is clear that the kind of follow-up contemplated (a) can be accomplished on a sample basis; (b) may take different forms; and (c) does not require U. S. duplication of the work of the Bank staff, we have no problem with this suggestion, which has a relationship to the recommendation on reporting from the field. We do, however, feel that there is more adequate follow-up by U. S. missions in the field than the report indicates -- as a result of the field coordinating arrangements mentioned above and through other measures. There is also a need for the draft report to face up to the implications of a declining U. S. presence in development efforts abroad, including size of U. S. missions.

Independent Review and Evaluation Body. We are sympathetic with the GAO view on this proposal; surely the function is an important one that must be performed. Nevertheless, the Bank only recently established an evaluation group responsible to Management and has begun to cirulate its reports to the Board. The first such report entitled "Operations Evaluation Report: Electric Power" was discussed in the Board on April 4, 1972. We felt that the study was an excellent beginning but a consensus as to the usefulness of this effort has not yet developed in the Board. We anticipate further discussion of this Group's work in July. We will re-examine this recommendation after further experience with the approach. You also might give thought to whether there are not alternative ways of accomplishing this purpose.

Interests of the United States. We doubt that the Secretary needs to be reminded to assure that the interests of the United States are protected.

IV. Policy Areas of Concern

There follow our comments, in somewhat greater detail than offered above in regard to the Digest, on the five questions raised as warranting furtherinquiry by the Executive Branch. We agree that these are important (but rather obvious) questions; the report needs to acknowledge, however, that we and the Bank staff do carefully follow developments in these areas.

Debt Service Burden. The mounting burden of external public debt of many developing countries has been of concern for many years and the subject of much work, both within the Bank and elsewhere. For example, in 1969 we asked the Bank and Fund to prepare studies on this subject -- which they did. The Bank study, among other things, concluded that there are only four countries that have accumulated such large amounts of debts and whose development is likely to such a prolonged process that they may encounter serious and protracted debt service difficulties unless large amounts of external assistance are available to them on concessionary terms. These four countries are Ceylon, Ghana, India and Pakistan -- all primarily IDA countries and not the recipients of much IBRD lending in recent years. The Bank, in fact, keeps a very close watch on the creditworthiness of individual borrowers and is not prepared to make IBRD loans to countries which lack sufficient creditworthiness. It makes both IBRD and IDA loans to a number of countries, called "blend" countries. While several small IBRD loans in 1968 might have been made as IDA credits if IDA funds had been available, they were made to blend countries that had sufficient creditworthiness to bear the burden of the more conventional IBRD terms for the small amounts involved.

Lag in Disbursements. As the report is aware, the Bank last year made an exhaustive review of disbursements. We believe the Bank made a good case for its position that a decline in its disbursement rate was due to the six specific factors mentioned in your report, as well as to the fact that during a period of rapid buildup of lending there will be a temporary increase in the pipeline of undisbursed funds. The Bank projects IBRD disbursements in the vicinity of $2 billion a year by the mid-70's, by which time the recent build-up in lending will have had its full effect upon the disbursement rate. Nevertheless, we agree that the disbursement rate should be watched and will follow it closely.

Small Net Transfer. Over a period of time a fairly stable level of lending at commercial rates of interest and with maturities of 15-25 years (the IBRD situation in the 60's) reaches a point of small or even negative transfer of funds. This was true of the 1966-70 period, will not be true of the years immediately ahead because of the recent build-up of loan commitments, but will eventually again be true. We do not regard this as a source of concern but rather as a description of the capital flow process. It should not be a source of concern, since Bank lending is for productive projects which yield over time an economic return very substantially in excess of loan repayments. In any event, the size of the net transfer is merely one aspect of the debt service burden about which we have already commented.

It should also be pointed out that the discussion on net transfer from the Bank to developing countries rests on an inaccurate method of estimating such transfer. In order to accurately measure the net transfer to "developing countries", repayments from the now developed countries must be excluded. This gives a net transfer series in the last five fiscal years of: [See GAO note 4.]

	IDA	IBRD
1967	337	$154 million
1968	311	142 "
1969	246	136 "
1970	131	167 "
1971	222	269 "

[See GAO note 5.]

To summarize, the whole concept of net transfer is one which can easily be misunderstood. Bank and IDA lending is for productive projects which yield over time an economic return very substantially in excess of the loan repayments. A negative net transfer, accordingly, may merely mean that a country has been successful in its development efforts.

[See GAO note 2.]

[See GAO note 2.]

V. Shortcomings of GAO Approach to Project vs. Policy Issue.

It would have been useful if the draft report could have provided some thoughtful appraisal of an appropriate over-all strategy for U. S. participation in institutions such as the World Bank. Instead, it has concentrated in an extremely narrow manner on the appraisal of the individual loan operations and the examination of technical aspects of particular loans. Such an approach is myopic and completely overlooks the breadth of policy problems that must be addressed.

The role of governments in international institutions, as reflected in positions taken in Executive Boards, is primarily that of establishing the policies which guide the institutions in their activities rather than of second-guessing them on technical points. We are rarely in a position, for example, to say that the technical assistance or other solutions negotiated between the Bank and borrower to overcome Bank-identified management or administrative problems will not work, but we do know that the Bank often holds up projects for months or even years while it is insisting upon certain conditions. Under such circumstances, we have every reason to rely on its technical judgments.

One way to affect policy, of course, is on a case by case basis through discussion of individual operations. We do carry out such case by case review. This is not, however, necessarily the best way or only way of controlling policy in the case of an expanding Bank making 150-200 loans per year already and with perhaps 500 more in the pipeline and more than 500 being supervised. Under such circumstances, proper control depends upon the establishment of clear policy guidelines disseminated to all staff. A primary objective of our review of lending operations in the Executive Branch is to establish their consistency with Bank policies we helped to establish, as well as their consistency with our own policy objectives.

In this connection, the point should be made that the relationship between Bank Management and Executive Board is an evolving one. The Bank has greatly expanded its lending activities since 1969. As a result, the amount of time spent by the Board in loan review expanded but the time spent on individual loans decreased. Governments came to realize that Board discussions were too involved with details of lending operations and not enough with the wider policy issues underlying these operations. An ad hoc Committee, accordingly, was established to obtain the views of Executive Directors as to how Board procedures and the role of governments should evolve in the light of the new situation.

Views varied, but there was a general consensus on three points: (1) the amount of time spent at Board meetings on consideration of specific projects should be reduced by concentrating individual loan discussion on policy issues; (2) the time saved should be used for discussion of general policy and country development program issues; and, (3) the information provided Executive Directors on the work of the Bank should be expanded. Some of the Directors carried their interest in streamlining Board consideration of projects to the point where they advocated that a significant fraction of proposed lending operations be approved without discussion on a "no objection" basis. We did not favor this approach.

As a result of this exercise, the Board decided upon three significant innovations, namely:

(a) Preparation of sector program papers to serve as a basis for Board review of the Bank's lending policies for projects in each major economic sector. The purpose is to provide guidance to Bank staff in negotiating projects in the sector.

(b) Recasting of documentation for lending operations to put them in a broader context, including significant features of the Bank's lending strategy for the country, and the relationship of the particular project to the strategy. This change was designed to shift emphasis in Board discussions from technical and factual matters to policy issues and significant problems.

(c) Reviews by the Executive Directors of the economic development prospects and programs of some of the major recipients of Bank Group financial support.

We believe that these innovations put the U. S. in a position where it can make a far more significant contribution to Bank policy than would have been possible if our attention continued to be confined to specific loan projects. This was the purpose of the reform. We have, accordingly, spent a good deal of time and effort in responding to these papers. A U. S. position on each policy paper is developed within the NAC, and our Executive Director is instructed in writing as to what positions should be taken in Board discussions. These points can be incorporated into Bank policy and represent a lasting U. S. input into Bank policy.

As you can see from the above, we believe that the basic approach in your draft report would represent a step backward towards the period when member governments would largely limit their role to a review of lending operations. In our view, the report fails to come to grips with the implications of greater reliance upon the multilateral approach to foreign assistance and fails to focus on the type of appropriate government controls over policy that such an expanded World Bank role demands.

Attached is an annex which contains further comments on specific parts of the report and corrects miscellaneous factual or interpretation errors that appear in it. [See GAO note 6.]

GAO notes:

1. Page numbers refer to pages of the GAO draft report and may have changed in the final report.

2. Deleted comments relate to matters in the draft report which are omitted from the final report.

3. We did not review the Bank's operations and so stated in the scope section of the draft report. Our position with the Department of the Treasury has always been that we have no authority to directly audit Bank and IDA operations. However, we could not ignore certain trends in the Bank's operations which we considered of interest in managing U.S. participation.

4. Repayments from the newly developed countries were not included in our computations.

5. Greece, Israel, Portugal, Spain, and Yugoslavia were not included in our computations of net transfer of resources.

6. Annex section of comments have been deleted since they are in effect a restatement, in more detail, of the points made in the basic comments.

OFFICIALS RESPONSIBLE FOR ADMINISTRATION OF U.S. PARTICIPATION IN THE WORLD BANK AND THE INTERNATIONAL DEVELOPMENT ASSOCIATION

	Appointed or commissioned
SECRETARY OF THE TREASURY:	
George P. Schultz	June 1972
John B. Connally	Feb. 1971
David M. Kennedy	Jan. 1969
Henry H. Fowler	Apr. 1965
ASSISTANT SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS:	
John M. Hennessy	Feb. 1972
John R. Petty	May 1968
Winthrop Knowlton	Aug. 1966
U.S. REPRESENTATIVE TO THE BANK AND IDA BOARD OF EXECUTIVE DIRECTORS:	
Robert E. Wieczorowski	Nov. 1969
Covey T. Oliver	Nov. 1968
Livingston T. Merchant	July 1965
OTHER MEMBERS OF THE NATIONAL ADVISORY COUNCIL ON INTERNATIONAL MONETARY AND FINANCIAL POLICIES:	
Secretary of State:	
William P. Rogers	Jan. 1969
Dean Rusk	Jan. 1961
Secretary of Commerce:	
Peter G. Peterson	Feb. 1972
Maurice H. Stans	Jan. 1969
Cyrus R. Smith	Mar. 1968
Alexander B. Trowbridge	June 1967
President and Chairman, Export-Import Bank of the United States:	
Henry Kearns	Mar. 1969
Walter C. Sauer (acting)	Aug. 1968
Harold F. Linder	Mar. 1961

	Appointed or commissioned
Chairman, Board of Governors of the Federal Reserve System:	
Arthur F. Burns	Dec. 1969
William McChesney Martin, Jr.	Apr. 1963

U.S. GAO, Wash., D.C.

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