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TECHNICAL, FINANCIAL, AND ADMINISTRATIVE ASPECTS OF
WATER SUPPLY IN THE URBAN ENVIRONMENT IN THE AMERICAS

AVAILABILITY OF INTERNATIONAL FINANCING AND
PRINCIPAL POLICIES AND CRITERIA APPLIED WITH RESPECT
TO WATER SUPPLY SYSTEMS

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TO WATER SUPPLY SYSTEMS

The sole purpose of these brief notes is to give summary information on the existing sources of international public financing for water supply systems^{1/} and on the principal policies and criteria applied in considering loan applications in this field. On both points, however, only those general factors considered most important will be mentioned, and no attempt will be made to describe, much less analyze, exhaustively all possible factors and aspects involved.

1. Sources of international public financing for waterworks

For the American countries there are, in the main, four institutions now in existence that provide international financing for programs of economic and social development: the International Bank for Reconstruction and Development, the International Monetary Fund, the Export-Import Bank of the United States, and the Development Loan Fund of the United States. Two of these institutions, however, do not provide financing for waterworks.

The International Monetary Fund considers only applications for investment relating to the establishment or the expansion of private companies, mainly industrial ones (in other words, processing, manufacturing, mining enterprises).

The International Bank for Reconstruction and Development does not, as a general rule, consider loan applications for works - like waterworks - that are not directly reproductive, that is, that do not produce or directly contribute to bringing about an increase in the national product. The distinction between "directly reproductive" or "not directly productive" works might lead to a long discussion that

^{1/} The reference to "waterworks or water-supply systems" will be understood to refer only to water supply for household consumption.

is not relevant here. But a few brief explanatory remarks on these terms are necessary. In the first place, there is no exact formula that makes it possible to say what kind of works are "directly reproductive" and what kind are not, and the evaluation has to be based on simple practical considerations. In the second place, the fact that works of a certain kind are considered "not directly reproductive" does not imply that they are not considered to be necessary, or even that they should not have an appropriate priority in national plans. The foregoing concept is linked, rather than to the "value" or the justification of the works, to facts quite alien to the nature of such works: (a) the international funds available for granting financing are limited, and (b) the countries' capacity for assuming debts is also limited. Therefore, the elimination of certain types of works from the field of operation of international institutions -such as the International Bank for Reconstruction and Development- is based mainly on the belief that since the available funds are limited, it is more advisable to utilize them in projects that will bring about a direct increase in production and in an expansion of the countries' capacity for assuming debts, and that will, in turn, make it easier for the lending institution to obtain more funds in the capital markets.

The Export-Import Bank of the United States accepts applications and has granted loans for the installation, expansion, and improvement of waterworks. There are, however, two limiting factors with respect to any financing that may be obtained from the Export-Import Bank. The loans of this institution cover only the importation aspect of the investment projects, and, moreover, they should be tied in with purchases that may be made in the United States. In other words, financing can be obtained through the Export-Import Bank only to cover the dollar expenditures that will have to be made for purchases in the United States under the investment program.

The Development Loan Fund of the United States also accepts applications and has granted loans for waterworks. The dollar loans of this institution, like those of the Export-Import Bank, are granted to finance expenditures abroad, but the purchases may be made in any country. In general, the loans from the Development Loan Fund are reimbursable in the currency of the borrowing country. Later, this Fund will grant loans in local currencies.

Both the Export-Import Bank and the Development Loan Fund grant loans to governments, government agencies, political subdivisions, and private firms. The Export-Import Bank also grants financing to United States exporters who thus are in a position to extend credit to their purchasers for the sale of equipment.

Neither the Export-Import Bank nor the Development Loan Fund is legally obliged to require guarantee by the government of the borrower's country. Nevertheless, in the case of loans for waterworks, in which the borrower is a municipality, a guarantee by the national government will surely be required because, as a general thing, domestic laws forbid cities to enter into contracts, independently, for loans in foreign currencies.

Although there is no set rule on the subject, the granting of loans for waterworks by the two aforesaid institutions will be facilitated to the degree in which such works not only are greatly needed, but also have some industrial use. The weight given to this factor in granting or refusing a loan will depend on various factors, but perhaps the most important is the opinion of the financial institutions on the general capacity of the country in question to incur debts. If it is believed that the limit of such capacity to incur debts has, in general, been reached, there will surely be a greater tendency to reject applications for waterworks loans that do not have, at least to a certain degree, an industrial use.

Another source of financing, in the future, for works of this kind will be the Inter-American Development Bank. Early this year representatives of the American republics negotiated and drafted an agreement providing for the establishment of the Bank. At present, the Agreement is in process of acceptance or ratification, and it is expected that in a few months it will enter into force and the Bank will start operations. According to the terms of the Agreement, there is nothing to prevent this Bank from granting financing for works of social capital, which is what water-supply systems are.

The Inter-American Bank will start with resources both in United States dollars and in currencies of the other American republics, which will be paid by the member countries as contributions for its capital. The institution will be able to grant financing to governments, government agencies, political subdivisions, and private enterprise for investment projects in the American countries. The general rule is that the product of the loans of this institution may be used to make purchases in any country, though certain possible limitations are foreseen. According to the provisions of the Agreement, the loans in foreign currency that are granted may be used, save for special cases, only to cover the part of the cost of the project that should be met in foreign exchange. One provision of the Agreement that should be stressed is that which enables the Inter-American Bank to facilitate financing by giving its guarantee to loans that are obtained chiefly in private capital markets. The Agreement provides that this guarantee may be granted for the placing of loans both in foreign capital markets and in those of the borrowing country. This type of operation may be most useful, especially for projects, such as water-supply systems, that might often be sent up on reasonable bases of returns and of self-financing and that, in such conditions, and with the guarantee of an international organization, might have easier access to private capital markets.

The Inter-American Bank may grant loans without requiring a guarantee from the government of the borrower's country. The Bank will also operate a separate fund for special operations, for the purpose of granting financing under conditions and terms that will make it possible to deal with special circumstances that arise in specific countries or projects. With the resources of this fund, loans will be granted that it will be possible to repay in the currency of the country in which the project is carried out.

2. Policies and criteria applied in considering loan applications

The various factors that financing institutions take into consideration in studying any loan application can be classified under two headings:

factors relative to the general situation of the country to which the loan is to be made, and factors connected with the specific project for which the financing is requested.

A. General Situation of the Country

When any financial institution considers a loan application, it analyzes the credit rating of the borrower's country, that is, its general ability to service additional amounts of foreign debt. The concern of such institutions to protect their interests and make certain that their loans will be repaid is unquestionably the main reason for considerations of this kind, but it is not the only one. That motivation certainly cannot be very important, for example, in the case of institutions that make loans repayable in local currencies. The public institutions that provide international financing have to consider the influence that their policies and activities have on the economic development of all the countries with which they have dealings, and an analysis of the credit rating of a country also has as an objective to evaluate the advantages of the use of funds in a specific credit operation in the light of considerations of general economic development.

The principal factors that are taken into account to appraise the credit rating of a country are: (1) the present relationship, and that which might be expected in the foreseeable future, between the amount of the annual service on the foreign debt that the country must pay and its current foreign-exchange revenues; (2) the present outlook for foreign-exchange revenues; (3) the present degree of economic stability, including the rate of inflation; (4) the balance of payments situation and the foreign-exchange policy; (5) the effectiveness of the development programs and policies; (6) the experience to date as to the manner in which the country has met its debt-obligations in the past; and (7) its political stability.

There is no rigid formula, nor can there be one, for evaluating the factors listed, and those factors that can be measured statistically--such as the proportion of the debt service and the rate of inflation--certain rules are generally applied that have only a practical conventional basis. Further more, the credit rating criteria that an institution applies will unquestionably be influenced by the way that it obtains its funds. Thus, if the institution must go to the private capital market to obtain its funds, it will surely tend to apply stricter criteria, than those that would be applied if such funds were obtained from public sources. Likewise the appraisal of the general situation of the country, on the one hand, and that of the project for which financing is requested, on the other, are not two independent aspects. The considerations on the credit rating of the country in question will be influenced by the nature and the merits of the specific project proposed and, vice versa, the opinion held on the general situation of the country will condition the analysis of the merits of the project.

As has been said, the fact that the waterworks may not be considered to be directly reproductive means that the general factors stated above are given great weight in determining whether or not financing will be granted in projects of this kind. Thus, it might be that, while a financial

institution does not as a general policy eliminate waterworks from its field of operation, it does refuse a project of this kind in specific countries for reasons allied to the general economic situation in the country. To the degree that the total debt service in a country is high in relation to its foreign-exchange revenues, that the outlook for an increase in such revenues is unfavorable, that the balance of payments situation is tight, that the inflation rate is high, financial institutions will surely tend not to grant financing for waterworks so that, within the limited capacity to incur debts that is attributed to the country, preference may be given to works of other types. On the other hand, if the general situation is satisfactory, not only is the door open for works of this kind, but the conditions that are imposed with respect to the project itself will probably be less strict.

B. Factors relative to the specific loan proposal

One of the important reasons why in some cases a greater use is not made of existing available sources of financing is that often there is a lack of projects and specific loan proposals that have been well prepared. A vague application that is not backed by sufficient background material will surely not be received with interest. On the other hand, if the application shows that the project has been carefully studied and that all the important problems have been analyzed as far as data and information make reasonably possible, there will be a greater tendency to give the proposal further consideration.

When a loan application is received, financing institutions make a preliminary analysis of it so as to decide whether or not it deserves major consideration. If the preliminary decision is favorable, a mission is usually sent to study the project in the field, and additional background material thought necessary to judge the proposal more in detail is requested. There is no uniform or predetermined procedure for presenting a loan application for an investment project. Nevertheless, the basic factors that are considered in appraising any loan application follow.

Purposes and nature of the project. When a loan application is submitted, it should be accompanied by a specific and detailed description of the type of work proposed, whether it is a new installation, the expansion of an existing one, or the modernization or improvement of one. The location of the works and the area and the population they will serve should be given in detail. There should be included an estimate of the population of the area in question and the anticipated water consumption for, let us say, the next twenty years. Together with the estimate, the capacity of the proposed waterworks should be indicated. The loan application should give in detail the nature of the sources of the water that will be used, the construction that is proposed, and the kind of materials and equipment that will be purchased. There should be a statement giving the specifications of the materials and equipment that are required (capacity, operating costs, price, etc.) and of the construction work planned, including the reports, plans, and engineering designs that are needed.

The cost of the proposed investment should be broken down and presented with costs in local currency and costs in foreign currency, with an explanation in each instance of the items to which such costs refer.

Economic justification of the project. The loan application should include a presentation of the significance of the proposed works, the need that they meet, and their effect on the economic and social development of the country. For example, the way in which -and, as far as possible, the degree to which- the proposed waterworks will contribute, in the area they cover, to lowering the death rate, reducing the incidence of disease and strengthening the labor force, lowering the absentee rate of workers because of illness, and improving the health and social environment of the community in general -all of these are factors that it is useful to present in the loan application. Special stress should be given to the industrial use, if any, of the proposed works, as well as to any indirect influence on the economy of the region.

But, in addition to the justification of the works from the point of view of the needs that they will meet and the results that are expected from them, the financial institutions will be interested in analyzing their justification from the point of view of the efficiency with which the works will be constructed, operated, and administered and of the soundness of the loan with respect to the present and future financial status of the borrower and his ability to meet the service on his debts.

Administration of the project. The financial institution will be particularly interested in the effectiveness with which the funds will be used. This includes not only the initial stage of construction, but also the management and future administration of the enterprise or agency receiving the loan. If it is expected that the administration will be efficient, it is possible to apply less strict criteria with respect to other factors. The financial institution will therefore be interested in knowing the administrative structure and the borrower's legal authority.

Consequently, the loan application should explain the structure and the legal nature of the agency, corporation, or enterprise that wants to take the loan, including the form and the degree of its relationship to the central government. If it is a dependency of the government, there should be an explanation of the degree of autonomy it has, the extent to which the administration of the agency has responsibilities to other government dependencies, the jurisdictional areas of different agencies that might have a say in matters connected with the project, etc. In general, the financial institution will be interested in knowing not only the legal responsibility of the borrower, but also all the factors that have anything to do with the adoption of decisions that will necessarily have an influence on the administration and management of the project.

Another aspect that the financial institution will doubtless analyze is the quality and competence of the personnel who will manage the project.

In this sense, all the factors relating to the possibility of obtaining and keeping competent personnel will be analyzed: salary levels, degree of responsibility and rank of the staff in comparison with those of other agencies, stability of the posts, existing possibilities for advancement, etc.

Often the lack of a competent and responsible administration, one with authority, is a serious obstacle to the obtaining of loans. In such cases, the changing of such circumstances might be a prerequisite that should be provided for in the project.

Financial aspects of the project. Unquestionably, the financial institutions are particularly interested in making sure that the proposed project is financially sound and that the borrower will be in a position to take care of the service of the debt.

Hence they will want to know the present financial condition of the borrower and the total indebtedness that he has assumed in the past on which he is now making service payments. Surely they will want to know, too, the facts about income, expenditures, and financial results of the enterprise in the last few years. As for the proposed project, it will be necessary to submit all the background material that will make it possible to appraise, as far as possible, the future development of the financial situation of the borrower. It will be necessary to give in detail all other sources of financing that the borrower hopes to count on to cover the total of the planned investment, as well as to estimate the degree of surety that such funds will effectively be available.

An estimate for several years should be made, even though only tentatively, of the revenues expected from the works planned. Moreover, an estimate should also be made of the operating costs of the works in the immediate future, including amounts sufficient for service on the debts, to pay for repairs and maintenance of equipment and structures, and even to meet the normal needs for expansion.

This touches on a problem that Dr. A. Wolman has very wisely stressed in his paper ^{1/} with respect to which he cites the opinion of Eugene Black, President of The International Bank, that public services should, by charging high enough rates for their utilization, receive sufficient revenues to meet their financing needs.

In the consideration of loan applications by financial institutions that lend money for water-works, the fact that the project shows that all possible measures have been taken to operate the service on an economical basis of self-financing, will certainly be a favorable factor. From the immediate point of view of the financing granted, the reason for the foregoing would be that in such conditions, in general, a sounder financial

^{1/} Dr. Abel Wolman, "Technical, financial, and administrative aspects of water supply in the urban environment in the Americas."
(Document CD11/DT/1).

situation is achieved and there is more certainty as to the ability of the borrower to repay the loan. But this is not the most important factor on which the aforesaid criterion is based. Waterworks, like other public services, require a considerable investment, which in large part must and can be taken care of with national resources: local labor and national materials. For this purpose it is essential that the utilization of those resources be released from other uses, and the collection of high enough rates for public services is one of the most effective ways of achieving that release and transferring them so that the expansion plans for such services may be carried out. As we have said, the international public financing institutions base their policies partly on general considerations of economic development, and the adoption of reasonable charges for the utilization of public services may be one effective way of bringing about an increase in the total national savings of the different countries.