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825/3/8

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: The Finance Committee

DATE: April 9, 1981

FROM: Frank Vibert F.V.

SUBJECT: Energy Affiliate

Mr. Qureshi has asked me to distribute the final version of the paper on Expanded Energy Lending, which is due to be circulated to the Executive Directors on April 15. Please may I have any comments or suggested changes as soon as possible.

Cleared with and cc: Mr. Qureshi

04/10

cc: Messrs. McNamara, Stern, Golsong, Rotberg, Thahane, Gabriel, Wood, Lafourcade, Applegarth

cc: Mr. Chenery

FVibert/bw

4/10
1. Note the minor changes suggested.
2. OK for distribution to the Board if approved by Messrs. Stern + Qureshi.
[illegible]

April 2, 1981

MEMORANDUM TO THE EXECUTIVE DIRECTORS

SUBJECT: EXPANDED ENERGY LENDING - ENERGY AFFILIATE

SECTION I. INTRODUCTION

1. In August 1980 the Executive Directors discussed the paper entitled, "Energy in the Developing Countries". 1/ They recognized the desirability of expanding the Bank's energy lending program and endorsed the recommendation that the Bank should explore the establishment of an Energy Affiliate of the Bank to provide additional financing to promote energy self-sufficiency in the developing countries. Since then, informal consultations have been held with interested governments on various approaches to the formation of an Affiliate. This report has been prepared for consideration by the Executive Directors in the light of these consultations.

2. Oil-importing developing countries (OIDCs) face an acute problem in adjusting to high cost energy. Their current levels of energy use are low, but have to rise rapidly if momentum in their development process is to be maintained. Their consumption of energy in 1980 amounted to 13.7 million barrels per day of oil equivalent (mbdoe) and is expected to rise to 24.3 mbdoe by 1990, even to achieve modest growth objectives. In 1980, import bills for oil amounted to $74 billion (4.8% of GNP compared with 2.8% of GNP in 1978) and accounted for over 50% of the export earnings of countries such as Brazil and India. To reduce the current account deficits to sustainable levels relative to GNP and to obtain the quantities of energy required for acceptable rates of economic growth will require a reorienting of development strategies, including a reorientation of energy programs.

3. The key elements in the adjustment process as it relates to energy include:

- a strategy for energy development and energy use integrated into a country's overall planning framework and development objectives;

- a vigorous program of import substitution by developing all possible indigenous sources of energy including hydropower, coal and fuelwood, as well as the exploitation of any domestic oil and gas potential;

1/ Report No. 3076, dated July 11, 1980.

- a massive investment and savings effort to finance this increase in domestic energy production--average annual investments (in 1980 dollars) of around $40 billion will be needed between now and 1985 (including $5 billion for oil and gas) and more than $50 billion a year between 1986 to 1990 (including $7 billion for oil and gas) compared to less than $20 billion per year over the past five years;

- major conservation efforts including appropriate pricing policies to minimize consumption and maximize production, and measures to increase energy efficiency.

4. The international community has an important role to play in helping developing countries to carry out this adjustment process. Even with the incentives provided by pricing policies adjusted to reflect market scarcities and even with a maximum effort to mobilize additional domestic resources, self-help will need to be supplemented by external assistance. All forms of external capital will be needed.

5. Private capital and know-how have a major role to play. ~~In many countries~~ private direct investment has been vital both in exploring for and developing hydrocarbon resources (oil, gas, coal). The Bank's energy operations complement these private flows in a variety of ways: (See Annex 1 for a list of projects in which this has happened).

- by financing related infrastructure. In Thailand, for example, an engineering loan followed by an infrastructure project laid the foundation for the development of a gas find by Union Oil, and has also led to renewed interest in further exploration by private companies in the Gulf of Thailand;

- by altering perceptions of political risk. The Bank's "presence" requested both by the oil company and by the Government helped attract the participation of Gulf Oil and BP in oil exploration in Pakistan, for example, and several further possibilities are being considered involving other companies in other countries;

- by strengthening institutions that deal with foreign private investors. In Turkey, for example, a technical assistance component of a project is strengthening the General Directorate of Petroleum Affairs in charge of negotiating agreements with foreign oil companies;

- by accelerating pre-development activity. In Bolivia, for instance, Bank financing of feasibility studies and appraisal drilling is expected to advance the date when potential gas export projects will be at a stage where private capital can come in;

			Normal Frequency	Distribution[a/]
D.	LENDING OPERATIONS (contd.)			
	IVi.	Number of Lending Operations by Fiscal Year	Bi-monthly	Operating Departments
	IVj.	Meetings of Principal Aid Coordination and Country Review Groups by Fiscal Year (prepared by Secretary's Dept.)	Periodically	Operating Departments
	IVk.	IBRD/IDA Lending vs. Official Development Assistance Commitments	Annually	Regional Offices, DPS
	IVl.	Quarterly Report on FY79 Work Program of Regional Offices	Quarterly	Operating Departments
	IVp.	IBRD & IDA: Lending to Least Developed and Poorest Countries through FY84	Bi-monthly	Regional Offices, DPS
	IVq.	IBRD & IDA: Number of Lending Operations to Least Developed and Poorest Countries through FY84	Bi-monthly	Regional Offices, DPS
	IVr.	IBRD & IDA: Lending (Amount & Number of Projects) to French-Speaking Africa	Annually	PC
	IVs.	Program Lending and Local Cost Financing	Annually	PC
	IVt.	IFC: Investment Projects by Fiscal Year	Annually	PC
E.	COUNTRY AND SECTOR WORK			
	Va.	IBRD & IDA: FY79 Schedule of Economic Missions and Reports	Quarterly	Operating Departments, IMF, UNDP b/
	Vb.	IBRD & IDA: FY79 Schedule of Sectoe Missions and Reports	Quarterly	Operating Departments, IMF, UNDP b/
F.	BUDGET AND PERSONNEL			
	VI.	IBRD & IDA: Summary of Administrative Expenses FY68-79	Annually	Executive Directors (Budget Documents)
	VIa.	Summary of Fiscal Year Budget	Annually	Executive Directors (Budget Documents)
	VIb.	IBRD/IDA/IFC Monthly Report on Administrative Expenses	Monthly	PC, Controller
	VIc.	IBRD/IDA/IFC: Monthly Report on Authorized Positions and Actual Personnel on Duty	Monthly	Executive Directors
	VId.	Professional Staff by Department	Annually	PC, Personnel, Administrative Services
	VIe.	IBRD/IDA Regional Offices: Report on Professional Staff on Duty and Authorized Positions	Quarterly	All Departments
	VIf.	IBRD/IDA Central Projects Staff and Support Departments, and IFC Departments: Report on Professional Staff on Duty and Authorized Positions	Quarterly	All Departments
	VIh.	IBRD/IDA & IFC: "Professional" Staff on Duty and Promotions, by Nationality and Grade Level (prepared by Personnel)	Quarterly	PC, Personnel
	VIi.	IBRD/IDA & IFC: Recruitment, Terminations and Resignations for "Professional" Staff (prepared by Personnel)	Quarterly	PC, Personnel
	VIj.	Input/Output Data and Selected Measures of Efficiency by Fiscal Year	Annually	PC, Department Directors
	VIk.	IBRD/IDA Work Program and Administrative Costs by Region	Annually	President, Regional Vice Presidents

- by opening up new acreage for private investors and by providing assistance to the government in formulating a legal/contractual framework for private investors as part of Bank-financed exploration promotion loans. In Madagascar, for example, no exploration had taken place since 1975, but now 8 companies have expressed interest as a result of the Bank's project.

The Bank's activities along these lines has provoked rising interest by a number of large oil companies and indicates growing potential for operations involving associated investments by oil companies in the near future.

6. Private capital from commercial banks is also important in the financing of energy development projects. Here again, the Bank's energy operations are complementary by providing associated longer term financing, by strengthening domestic institutions, their management and their financial viability and by helping prepare their investment programs. This has been the practice in the power sector for many years and it will also increasingly be the case in hydrocarbons. In Thailand, for example, aside from direct investment by Union Oil, financing was mobilized from commercial banks and export credit agencies for a total of $330 million. Another similar recent example is in the case of the Bombay High development (where about $250 million has been mobilized).

7. There are other situations in which official capital may be critical. Certain types of projects, which are especially important to the poor--such as reforestation projects--are not attractive to private capital at all. Official capital may also be necessary in cases where the energy resource is thought likely to be sufficient only for supplying domestic needs. Such situations may not be attractive to private capital (particularly in low income countries) even though the prospective value to the domestic economy is very high. In hydrocarbon projects in low income countries where export earnings are possible, private capital may be attracted on an enclave basis. Even in such situations, the Bank may have a useful role to play.

8. Both the industrialized countries and the capital surplus developing countries have a vital interest in measures to stimulate the flow of external capital into energy investments in the OIDCs so as to:

- improve the balance of supply and demand in international energy markets, which is in the interests of oil producers as well as oil importers;

- support the efforts of oil importing countries to undertake the structural adjustments needed to resolve their balance of payments difficulties on a sustainable basis and avoid dislocation in international capital movements;

- achieve early restoration of acceptable rates of growth in oil importing developing countries and provide an important stimulus to more buoyant world-trading conditions.

9. The World Bank has already increased its emphasis on lending for energy so that it accounts for about 17% of the Bank's planned program for FY82-86. The $14 billion program envisaged is however considerably below the program considered to be feasible and desirable. An additional program of energy investments, for which the sources of external financing are not likely to be available, has been identified totalling a further $16 billion. It cannot be carried out within the present capital constraints of the World Bank because such a program would amount to 30% of the total Bank Group program, would thus upset the sectoral balance in Bank Group activities and lead to a weakening of the Bank's support for other key areas of the development process such as agriculture.

10. The means of securing additional financing to carry out this program can be sought in a number of ways. The alternatives were set out in an earlier paper to the Executive Directors. 1/ They included the possibility of a further increase in IBRD capital beyond the doubling involved in the General Capital Increase (GCI), possibly associated with the raising of IBRD's statutory limit on lending. Legislative action on the GCI is expected shortly and payments should begin in October. In these circumstances it would be difficult to seek a further increase in IBRD capital at the same time as action is being taken to implement the General Capital Increase. The creation of an Energy Affiliate has been suggested in part because the organization of a separate capital structure to mobilize resources for energy offers the possibility of moving ahead quickly in this high priority area and at the least cost to governments. Funding for a $25 to $30 billion lending program could be mobilized on the basis of budgetary outlays by all contributors of only $1 billion to $1.5 billion. The cost for any one subscriber would be small and in any event could be spread out over two or three years. Urgent action in this area is in the interests of the international community as a whole. The Affiliate could be organized to attract funds from capital surplus developing countries thus contributing to the recycling process. It would also provide a central focus specifically on the long-term capital requirements of the energy sector, and for increased efforts and new techniques to associate Bank Group lending with private capital. The program can be mounted at a minimum budgetary cost to OECD and OPEC governments and without creating a new bureaucracy.

11. The purpose of this report is to establish a basis for the start of negotiations on establishing an expanded World Bank Energy Lending Program. To this end, this report outlines, in a very preliminary fashion, the main features of an Affiliate around which negotiations might center and a draft charter be prepared. These suggested features of the Affiliate are likely to change in the course of further examination and detailed negotiations. Approval of the opening of negotiations would in no way commit individual governments either to the formation of an Affiliate or to participate eventually in it if one were formed. Negotiations would, however, enable a considered judgment to be made as to whether additional resources for energy investment by the World Bank in developing countries are needed and could be successfuly mobilized.

1/ "Possible Means of Financing an Expanded IBRD/IDA Lending Program", dated December 18, 1980.

SECTION II. THE PROGRAM TO BE FINANCED

12. The Scale of the Program. Against the background of the urgent need to expand energy investments in oil importing developing countries, an additional program of investments to be undertaken by the Bank, if the additional financial resources can be found to support it, has been identified. The program was outlined in the earlier paper, "Energy in the Developing Countries," and more recently, the expanded program was extended forward by one year. 1/ Although the bulk of the program is in oil importing developing countries, it includes investments in oil exporting developing countries for electric power, development of gas and other forms of energy since their policies and approach affect their consumption and exportable surplus. The desirable program in energy totals $30 billion over FY82-86, 2/ approximately $16 billion above the previously planned level.

Operational Program for an Energy Affiliate

	FY82	FY83	FY84	FY85	FY86	FY82-86
No. of Operations	75	80	100	100	100	460
Commitments ($ million)						
Expanded program	3,700	4,800	6,600	7,200	8,000	30,300
Present program a/	2,500	2,700	2,800	2,900	3,200	14,100

a/ As contained in, "Energy in Developing Countries", dated July 11, 1980.

13. A Catalytic Role. It is estimated that a program of this size will provide (on average) the financing for only about 10% of total investment needs of developing countries in the energy sector. A major objective of the program, therefore, is to serve as a catalyst to mobilize other financial resources both domestic and foreign. Annex Table II shows the co-financing associated with Bank lending to the energy sector in recent years. The growing importance of private sources of co-financing should be further accelerated as the expanded program in oil and gas gets underway.

1/ "Possible Expansion of IBRD/IDA Lending over Presently Planned Levels," dated November 14, 1980.

2/ About $4.5 billion of this program is for projects in the poorest countries not able to accept external assistance on the market-related terms on which the Affiliate will be able to lend. The question of how to find additional resources for the poorest countries is addressed in Section III below.

14. It is not only the project content of the program that is important from this perspective. The Bank's program of energy sector studies, being carried out in some 60 developing countries, will help provide a basis for an investment program in them and a framework for all potential lenders including foreign private capital.

15. The table below summarizes the expanded FY82-86 energy program as presently envisaged.

Sector Distribution of the Expanded Energy Program ($b)

	Proposed Program					FY82-86 $billion		FY82-86 Proposed Distribution Percent	FY82-86 Proposed Operations	
	FY82	FY83	FY84	FY85	FY86	Proposed	Present		No.	Percent
Electric Power	2.0	2.0	2.6	3.0	3.3	12.9	8.1	43%	135	29%
Oil and Gas										
Pre-Development	0.4	0.6	0.6	0.6	0.7	2.9	1.1	10%	120	26%
Development	0.7	1.0	1.6	1.9	2.0	7.2	3.2	24%	75	16%
Coal & Coal Gasification	0.1	0.5	0.6	0.5	0.6	2.3	0.9	8%	50	11%
Fuelwood & Biomass	0.2	0.3	0.6	0.4	0.5	1.8	0.6	6%	50	11%
Refineries & Retrofitting	0.3	0.5	0.7	0.8	0.9	3.2	0.2	11%	30	7%
Total	3.7	4.9	6.5	7.2	8.0	30.3	14.1	100%	460	100%

16. The comprehensive approach of the proposed energy program reflects the diverse energy situations that exist in oil importing developing countries. Some countries have a significant potential in oil and gas development (particularly to meet their domestic needs), while others have a natural resource base in coal or hydropower. In many developing countries, the dependence on scarce fuelwood is a major energy problem. Furthermore, there are important intra-sector "trade-offs" within a country which have to be taken into account in taking investment decisions in the energy sector. A broad approach is necessary not only for settling investment priorities within a sector, but also in order to draw up a coherent set of policies affecting energy end use, such as pricing, subsidies and conservation measures. The major objectives of the key components of the program are outlined below.

17. About 40% of the program is in electric power, although investment on this scale will only meet about 5-6% of investment needs in this area. Involvement in the power sector is crucial for the energy program, since significant opportunities exist for substitution of indigenous sources of

energy and no oil-fired generating facilities will be financed. About 45% of the power program will be for hydro generation, a further 20% for coal-fired thermal plants and the balance will be for the transmission and distribution. Investment in the power sector is also crucial for addressing pricing and efficiency issues.

18. About one-third of the program is in oil and gas. In the case of predevelopment activities, the dollar volume of lending envisaged is less significant than the number of operations because the program envisages a major financial contribution from the private sector, often in partnership with the host government. An important part of the predevelopment work in the oil and gas sector will be concerned with exploration promotion designed to increase the availability of new exploration acreage to private industry on reasonable terms. New entrants to international exploration such as medium-sized independents will be important participants in this area of the program. There will also be scope for new modes of involvement such as the technique of the "Letter of Cooperation," which seeks to provide a "presence" at the exploration stage and gives private investors more assurance in their operations. The financing of exploration and appraisal drilling is envisaged in specific situations where private capital is not attracted in sufficient volume. In the case of oil and gas development, willingness of the Bank to finance the infrastructure component makes it much more attractive for private oil companies to participate in the exploration/development stages.

19. About 10% of the program is coal. The coal program is designed to assist in roughly doubling coal output by 1990. Assistance is planned in coal exploration and preinvestment work; about 50% of the proposed program will finance coal mining and handling investments and a further 30% the associated transport infrastructure. All projects are expected to include a training/technical assistance component.

20. The provision in the program for fuelwood and biomass is modest compared to requirements. The fuelwood development program is aimed at the lower income countries of Africa and Asia where wood is still the primary source of energy for the majority of the population. While individual usage is small (the equivalent of less than 0.2 tons of oil equivalent per year) in aggregate terms, the use of fuelwood far outstrips supply and has led to serious deforestation problems and to a decline of agricultural production due to soil erosion and other factors. At current rates of planting (0.5 m. hectares per annum in recent years) projected demand for kerosene and other petroleum products will rise at 10-15% annually, providing additional balance of payments strain on the poorest countries. This can be forestalled. But it will require a five-fold increase in the rate of planting to 2.5 m. hectares per annum in the next two decades.

21. The program also has provision for involvement in the adaptation of refinery capacity and in industrial retrofitting as an important part of the overall focus on measures to improve energy efficiency and conserve fuel use. Investments in refinery operations will be aimed at improving the configuration of existing refineries, particularly their conversion capacity from fuel oil to light distillates and at ensuring the correct configuration of new investments.

22. Finally, an important dimension of the proposed approach to energy lending will be non-financial. The program of investments is intended to be fully integrated within each borrowing country's development strategy and in line with the Bank Group's overall support for that strategy. This integrated approach will encompass both lending activities and advice on relevant policies. The latter has come to assume a critical importance because energy policies have a major impact on many key aspects of the formulation of a country's development strategy.

SECTION III. SOURCES OF FINANCE AND CAPITAL STRUCTURE

23. The key financial issue in the design of an Energy Affiliate is how to mobilize the funds required in an environment where many governments that have traditionally been sources of development finance are under intense pressure to minimize increases in budgetary expenditures over the next few years. The most feasible approach, under these circumstances, is for the bulk of the resources mobilized by an Affiliate to take the form of borrowings on market terms. Budgetary expenditures would be minimized by asking governments to support the Affiliate mainly through guarantees (i.e., callable capital) as well as through direct lending on market terms. Cash outlays in the form of paid-in capital would be kept to the absolute minimum.

24. If this basic design concept is accepted, three questions immediately arise: (a) how much capital in total (including both paid-in and callable) is needed in order to assure the Affiliate's capacity to borrow the sums it requires on reasonable terms; (b) what is the minimum volume of paid-in capital needed to achieve an acceptable financial position for the Affiliate in the early years while it is building up its own earnings base; and (c) what arrangements can be made to finance operations in countries which are not creditworthy for borrowings on market terms? Each of these questions may be considered in turn.

Total Capital Requirements

25. The question of total capital requirements has been discussed with the investment bankers who act as underwriters for IBRD bond issues. As is well known, the Articles of Agreement for the IBRD limit its loans outstanding to the total of its subscribed capital and retained earnings--a ratio of 1 to 1. It appears probable that a newly established Affiliate could operate with a higher ratio of lending to capital. The precise ratio would depend in part on the proportion of the capital subscribed by countries whose guarantees are highly regarded by the markets. Views on prudent limits also, of course, differ from market to market. Depending on the composition of the capital, a legal limit on lending to capital of 2-1/2 to 1 could be acceptable to the markets, but it would be a matter of financial judgment as to how far and how fast the Affiliate could move in that direction.

might be considered

26. Approximately $25 billion of the Affiliate's $30 billion lending program for FY82-86 would be in countries that are currently regarded as creditworthy for IBRD borrowing. (Arrangements for the $4.5 billion of lending to "IDA only" countries are considered below.) A total capital of $10-15 billion ~~is proposed~~ as a basis for negotiations. It may be conservative, but this conservatism is justified by the fact that the Affiliate would be a new institution, unfamiliar to the markets. Moreover, it seems desirable to seek a capital base that would be clearly adequate to support the lending envisaged for the first five years. If a $10-15 billion capital base were to prove to be more than adequate to support a $25 billion lending program, the interval prior to a replenishment decision would simply be longer.

Paid-In Capital Requirements

27. Because the loans committed by the Affiliate will only be disbursed gradually over a period of years, it will take some time for it to build up its own sources of revenue. Paid-in capital is required to provide a source of income in this start-up phase. The figures in the table below show various indicators of the Affiliate's financial position in the initial years on the basis of three alternative assumptions about the volume of paid-in capital: $1.0 billion, $1.5 billion, and $2.0 billion. In each case, the capital is assumed to be paid-in over three years and all released for use in operations. The decision as to which of these scenarios represents the prudent minimum objectives for the Affiliate in the early years is, of course, a matter of judgment. However, while actual income losses can readily be explained to investors for the first two or three years, thereafter it would be desirable to show a positive net income rising to significant proportions in the fourth or fifth year.

	FY82	FY83	FY84	FY85	FY86
Net Income					
$1.0 billion paid-in	(53)	(36)	(18)	25	73
$1.5 billion paid-in	(49)	(13)	23	79	132
$2.0 billion paid-in	(39)	18	69	136	201
Interest Coverage Ratio					
$1.0 billion paid-in	0.47	0.89	0.97	1.03	1.07
$1.5 billion paid-in	0.54	0.96	1.04	1.10	1.13
$2.0 billion paid-in	0.63	1.06	1.13	1.19	1.21
Debt Service Coverage Ratio					
$1.0 billion paid-in	0.47	0.89	0.97	1.03	1.20
$1.5 billion paid-in	0.54	0.96	1.04	1.10	1.27
$2.0 billion paid-in	0.63	1.06	1.13	1.19	1.36

28. In the light of this analysis, it is suggested that the negotiations might commence on the basis that 10% of the subscribed capital would be paid in, that is, $1.0 to $1.5 billion out of a total of $10 to $15 billion. Since payments would be made over three years--say, $300 to $500 million per year--the budgetary implications for subscribing members would be modest.

29. Lending to the Poorest Countries. It was mentioned earlier that in the FY82-86 period, some $4.5 billion of energy projects had been identified in countries not creditworthy for IBRD lending (countries receiving assistance only from IDA).

30. Resources set aside for energy lending in IDA current plans are around $0.7 billion for the period FY82-83 (the last two years of the IDA6 replenishment period) and might amount to $1.5 billion in the seventh replenishment period FY84-86. The central issue in considering expanded energy lending in the poorest countries is how the remainder (say, $2.25 billion) of the $4.5 billion is to be financed.

31. An Affiliate could not adopt lower standards of creditworthiness than the IBRD without jeopardizing its own ability to borrow at reasonable cost. It should be emphasized that the problem is only to a minor degree one of income risk. Even if it were possible to subsidize interest rates on loans to the poorest, the portfolio risk would still be unacceptable.

32. The possibility of insulating feasible projects in non-creditworthy countries using an enclave project technique has been considered. It is quite clear that, while enclave financing may well be utilized for some of the oil and gas production projects, such projects are likely to be a very small share of the proposed lending for energy.

33. In the final analysis, the question of energy lending to the poorest turns on whether additional concessional resources can be provided. The amount of additional resources required is small in relation to the total program; however, it is crucial for the poorest countries. They cannot attract capital from private lenders; they have no alternative sources of assistance. Within IDA's resources there is some scope for the redirection of assistance to the poorest. A small additional amount for energy lending in "IDA only" countries might become available by substituting energy projects for other types of projects in IDA's current lending plans for these countries. Some additional co-financing from other official sources of concessional funds should be possible. All of these and other possibilities should be further explored in the course of negotiations.

SECTION IV. ORGANIZATION

34. Staffing and Management. Preliminary consultations have indicated differences on how an Affiliate should be organized. The need for a link with the Bank is accepted, but views vary on the precise extent of the link. Whatever the final decision regarding the form of the link, it is important to recognize the advantages to the developing countries of an integrated approach.

35. First, it would facilitate a quick startup of expanded lending operations. The Bank has a long-established expertise in such areas as the power sector, and more recently has established a core staff for lending for oil predevelopment and development and is expanding its forestry staff. On this foundation, the expanded program of energy investments could be undertaken without delay. The existing form of organization would ensure that intra-sector considerations are fully taken into account, as well as the many linkages that exist with other sectors such as transportation. Furthermore, the policy objectives of energy lending could be framed in the light of the Bank's regular program of economic and sector studies and be fully integrated into the dialogue with borrowing countries on their overall development objectives as well as the Bank's supporting program of lending. It would be extremely difficult and time-consuming to establish a comparable capacity in a substantially autonomous Affiliate.

36. Finally, and perhaps most importantly, it would reconcile the need to provide a central focus for energy lending with the need to maintain the Bank as an integrated development institution.

37. The World Bank's role as a development institution is to help developing countries, on a country-by-country basis, and in the light of their particular development objectives, to formulate optimal development strategies. The approach to energy issues has a central place in this development dialogue between the Bank and its borrowers. Subjects which have traditionally formed the core of the Bank's dialogue with borrowers--domestic and external resource mobilization, investment priorities, etc.--are all affected by the energy outlook, as are the size and the sector distribution of the Bank's lending program to particular countries. Removing energy from the Bank's dialogue with member countries would seriously weaken the Bank. The Bank needs to be maintained as an integrated development institution in order to carry out its role effectively.

38. The Board of Governors and Executive Directors. Although it is believed that an Affiliate should be integrated with the Bank, it could have its own Board of Governors, in which all powers of the Affiliate would be vested, and its own Board of Executive Directors responsible for the general operations of the Affiliate, as well as exercising such powers as are delegated to them by the Board of Governors.

39. The most efficient system would be for the Governors of IBRD, who are ex officio Governors of IDA, and the IFC, to act also, ex officio, as Governors of the Affiliate to the extent that their governments participate in it. Similarly, the Executive Directors of IBRD, who act, ex officio, as Executive Directors of IDA and IFC, would also act, ex officio, as Executive Directors of the Affiliate.

40. The Governors and, to the extent of the powers delegated to them, the Executive Directors would decide the overall operational, financial and other policies of the Energy Affiliate. An ex officio system of representation would help assure that the policies of the Energy Affiliate would be fully consistent with the policies of the Bank Group and the Bank's general approach to development issues.

41. The composition of shareholdings, the relative importance of sources of direct financial support, and the pattern of voting in the Energy Affiliate might differ from that in IBRD. These differences (following the precedents in IFC and IDA) could also be accommodated by Governors and Executive Directors of IBRD acting ex officio in the Energy Affiliate.

42. Voting. The voting structure of an Affiliate should be consistent with the objective of attracting the support of investors and rapidly establishing a sizable borrowing capacity for the Affiliate in financial markets. However, the connection between subscriptions to the capital of the Affiliate and votes need not, ~~and should not,~~ be a rigid one. For example, forms of financial support other than subscriptions to its capital, such as direct lending to the Affiliate, might be recognized in the voting system, and there are non-financial considerations, such as the need to ensure appropriate representation for developing countries, which should also be introduced into the voting structure.

V. SUMMARY AND RECOMMENDATIONS

43. This paper has outlined an Affiliate which could fulfill three major functions:

- mount a comprehensive program of support for energy investments fully integrated into the reoriented development strategies made necessary by high-cost energy;
- serve as a catalyst to mobilize additional finance for this purpose from all sources and, in particular, private capital;
- act as a lender of last resort to finance about 10% of sector investment needs for those investments which cannot be undertaken by private capital.

44. The financial structure outlined holds out the promise of mobilizing the additional resources required at a minimum cost in terms of government outlays. The benefits to the international community in terms of improved balance in international energy markets, and a smoother approach to the long-run structural adjustments needed in developing country economies would be large.

45. It is therefore recommended that negotiations should be started to explore in detail the expansion of the Bank's Energy Lending Program and the formation of an Energy Affiliate to provide the financing required. For this purpose, Governors of countries whose financial strength would provide a significant part of an Affiliate's capital foundation, if one were eventually to be formed, would be invited to designate Deputies to carry out negotiations. In addition, in order to secure broad representation in the negotiations, developing country Governors with the largest representation in Board constituencies not otherwise represented by a developing country representative would also be invited to designate Deputies. The Deputies would prepare a report and recommendation for consideration by Executive Directors who would, if appropriate, forward a report to the Governors.

46. A decision to start negotiations would not prejudge the eventual recommendation of Deputies and Executive Directors as to whether the Energy Program should be expanded or an Affiliate established. Nor would participation in the negotiations by any individual country commit that country to participate in an Affiliate if one were eventually to be set up. Moreover, as in the case of IDA, membership in any Affiliate could be expected to grow over time. Provision would need to be made to allow for the possibility that not all countries might be in a position to become members at the outset in the light of budgetary or other considerations.

Robert S. McNamara

Att. Annex I. Oil and gas projects approved or under preparation with private oil companies.
Att. Annex II. World Bank Lending and Co-financing in the Energy Sector.

OIL AND GAS PROJECTS APPROVED OR UNDER PREPARATION WITH PRIVATE OIL COMPANIES

PRODUCTION AND DEVELOPMENT

Country	Project Description	Oil Company Involved	Project Financing ($ Mil) Oil Company	Other Private	Government	Bank	Total	Estimated Incremental Production	Remarks
Thailand	Development of gas field and associated infrastructures	Union Oil	300.0	330.0	77.0	107.0	807.0	50,000 bdoe	Union Oil is financing the development of the field. The Bank is financing a share of the transportation and distribution.
Pakistan	Oil exploration. Letters of cooperation signed with Gulf & BP and in preparation with Shell.	Gulf BP Shell	not applicable						Bank presence based on a letter of cooperation with no financial involvement in exploration but willingness to consider assistance in financing development.
Sudan	Development and distribution	Chevron	72.5	123.5	20.0	20.0	236.0	10,000 BD	Financing development of Chevron discovery for domestic markets. Financing plan not yet definite.
Ivory Coast	Development of newly discovered offshore oil field	Phillips/ AGIP/SEDCO	120.0	60.0	60.0	60.0	300.0	50,000 BD	Sources of financing of Ivorian share are being sought. The proportion of "Other Private" and "Government" share may be different in final financing plan.
Senegal	Appraisal drilling	Possibly Chevron, Elf, Montenay, Wintershall and others		25.0		5.0	30.0	-	Bidding documents for acreage go out in September. Financing contingent on bidding, available early 1982.
Tanzania	Oil exploration	Shell	15.0	-	-	5.0		-	Loan to Shell Tanzania with guarantee arrangement by which Government covers political risk and Shell (Hague) commercial risk.
Argentina	Exploration and development sub-projects to be financed through development bank	Local Argentinian firms	-	-	-	100.0	100.0	NA	Local Argentinian firms usually operate exploration and development projects in association with foreign oil companies.
Chad	Production, transport and refinery	Conoco Chevron Shell Exxon	11.0	10.0	-	10.0	31.0	2,000 BD	This project was to be a joint venture of the Bank and Conoco, Chevron, Shell and Exxon. Other financing included $30.0 million shared by IFC and the Islamic Development Bank and $10.0 million bilateral aid. Project is in abeyance due to political situation in Chad.
Tunisia	Miskar offshore gas development	Elf Aquitaine	22.5	400.0	127.5	41.0	591.0	50,000 bdoe	Project deferred because of availability of gas from Algeria.

EXPLORATION PROMOTION 1/

Honduras	These exploration promotion projects consist of all or some of the following components: reconnaissance seismic work, review of geological data, technical assistance to governments and national oil companies, and preparation of bidding documents.	3.0	Expected date of bidding is early '82. Selecting consultants.
Somalia		6.0	Expected date of bidding is early '82. Selecting consultants.
Liberia		5.0	Expected date of bidding is fall '81. Seismic survey underway.
Guinea Bissau		6.8	Expected date of bidding is fall '81. Seismic survey underway.
Madagascar	30 companies responded. 9 met bidding deadline.	12.5	Negotiations underway with AGIP, Occidental, Amoco, Mobil, Cities Service, Monterief, Texaco, Union, Elf Aquitaine.
Congo	Exxon, Elf, Hydro Congo about to sign.	5.0	The Government of Congo sold aeromagnetic survey for US$2.3 million to Exxon. Government soon to complete agreement which will grant concession in the areas where survey was flown.
Mali	10 bought prospectus; contract signed with Esso.	8.0	Project under preparation.
Mauritania	Phillips, Mobil, Chevron and Total negotiating.	2.9	6 bought offshore prospectus; 10 bought onshore prospectus

1/ Additional exploration promotion projects under consideration in Ghana, Kenya, Equatorial Guinea, Caribbean Region, Panama, Nepal and Papua New Guinea.

Nationalities of Oil Companies

Union Oil	- American	SEDCO	- American
Gulf	- American	Elf Aquitaine	- French
BP	- British	Total	- French
Shell	- Dutch	Monterief	- U.S.
Chevron	- American	Wintershall AG	- German
Phillips	- American	Montenay	- French
AGIP	- Italian	Mobil	- U.S.
Exxon/Esso	- U.S.	Texaco	- U.S.
Occidental	- U.S.	Cities Service	- U.S.

March 6, 1981

ANNEX II

WORLD BANK LENDING AND CO-FINANCING IN THE ENERGY SECTOR, FY77-81

Bank Group Lending for Energy (US$M)	FY77	FY78	FY79	FY80	Estimate FY81	Total FY77-81
Electric Power	951.5	1,146.2	1,354.9	2,392.3	1,270.0	7,114.9
Oil & Gas	150.0	-	112.4	385.0	784.2	1,431.6
Coal & Coal Gasification	-	-	-	72.0	180.0	252.0
Fuelwood & Biomass	-	6.2	31.8	82.3	322.3	442.6
Refineries & Retrofitting	-	-	58.0	29.0	223.0	310.0
TOTAL	1,101.5	1,152.4	1,557.1	2,960.6	2,779.5	9,551.1
Number of Operations	18	21	27	44	39	149
Memo: Loans and Credits for Energy with Co-financing (US$M)	770.5	507.2	979.6	2,270.0		
Number of Operations	12	12	18	29		

Co-financing by Source (US$M)	FY77	FY78	FY79	FY80	Estimate FY81	Total FY77-81
Official						
Bilateral	188.3	251.1	201.0	593.4	510.0	1,743.8
Multilateral	213.0	268.3	144.2	744.1	616.9	1,986.5
Export Credit	129.5	81.7	215.4	2,121.3	1,000.1	3,548.0
Private	363.0	88.0	126.9	749.7	1,204.9	2,532.5
TOTAL	893.8	689.1	687.5	4,208.5	3,331.9	9,810.8

Co-financing by Sub-Sector (US$M)	FY77	FY78	FY79	FY80	Estimate FY81	Total FY77-81
Electric Power	779.8	689.1	559.5	3,814.9	1,775.9	7,619.2
Oil & Gas	114.0	-	44.5	376.5	366.0	901.0
Coal & Coal Gasification	-	-	-	5.7	480.0	485.7
Fuelwood & Biomass	-	-	6.5	6.7	259.0	272.2
Refineries & Retrofitting	-	-	77.0	4.7	451.0	532.7
TOTAL	893.8	689.1	687.5	4,208.5	3,331.9	9,810.8

Co-financing by Source and Sub-Sector (US$M)	Official	Export Credit	Private	Total FY77-81
Electric Power	3,165.9	2,710.5	1,742.8	7,619.2
Oil & Gas	106.5	481.5	313.0	901.0
Coal & Coal Gasification	380.0	100.0	5.7	485.7
Fuelwood & Biomass	22.2	-	250.0	272.2
Refineries & Retrofitting	55.7	256.0	221.0	532.7
TOTAL	3,730.3	3,548.0	2,532.5	9,810.8

Note: The figures in this table underestimate the extent of the association of private finance with Bank Group lending for oil and gas because they do not include private financing of developments made possible in conjunction with a Bank Group loan but not included in the narrow definition of the project. For example, not included in these amounts is about US$300 million for the cost of production facilities financed by Union Oil in conjunction with the Thailand Natural Gas Pipeline II project. Nor do the figures include, for example, private sector investments undertaken as a result of Bank financed oil exploration projects. The figures also do not include co-financing data for 33 small pilot fuelwood components in area and rural development projects, for 4 projects containing small biomass components, or for small components for retrofitting in industrial and DFC projects.

SVPOP
3/16/81

3/14/81

The Proposed Expansion of the World Bank's Energy Program

Background

An era of low cost energy has ended. All countries, industrialized and developing, face a difficult economic adjustment process but the problems are particularly acute for oil-importing developing countries (OIDCs). Their current levels of energy use are low compared to industrialized countries (the per capita consumption of the 1 1/4 billion people in the low-income countries is less than 200 kg of coal equivalent per year, and that of the 800 million people in the middle-income countries is about 1,000 kg of coal equivalent compared with over 11,000 kg per year for the US. Growth in their energy use is an invevitable and essential part of their development process.

To achieve just modest growth objectives, the consumption of energy in all forms which in 1980 was equivalent to about 11.1 million barrels a day oil equivalent (mbdoe) in the OIDCs will rise to about 20.5 mbdoe by 1990. Imported oil, even with vigorous substitution efforts, will still comprise an important part of this total. But imports of oil, which were 4.5 million barrels a day (mbd) in 1980 could be held to about 6.4 mbd by 1990 if the domestic energy production of the OIDCs is expanded rapidly.

The costs for the oil importing developing countries of the higher energy prices are already staggering. Their import bills for oil amounted to $50 billion in 1980 and accounted for over 50% of the export earnings of countries such as Brazil and India. In the short run the strains of the adjustment process show particularly in the balance of payments -- for the poorer countries the import bill means postponing a wide range of essential investments, for the middle income countries it means increased borrowing and a growing debt burden. In the longer run the adjustment process is not simply a balance of payments problem but a much broader process involving a reduction in consumption, from what it otherwise would have been, and a major reorientation of development strategies.

There are four key features of this longer run adjustment process as it relates to energy:

- the formulation of a strategy for energy development and energy use. This strategy must become an integral part of a country's overall development objectives.

- a vigorous program to reduce dependence on imported oil by developing all possible indigenous sources of energy. In some developing countries there is a significant potential for meeting a part of domestic energy needs from present or potential domestic oil and gas reources but in many cases the emphasis will need to be on other sources of energy, such as coal, hydropower and fuelwood. Any program to reduce rapidly the dependence on imported oil will also require appropriate changes in the legal framework and in incentives to attract private capital to the maximum extent feasible.

. a massive investment and savings effort. To increase domestic energy production average annual investments (in 1980 dollars) of around $40 billion will be needed between now and 1985 and more than $50 billion per year between 1986-90 compared to less than $20 billion per year over the past five years. Investments in energy will account for around 30% of total investments in developing countries in this decade.

. major conservation efforts, including appropriate price policies and measures to increase the efficiency of energy use.

Many developing countries are formulating appropriate programs but they need help -- technical and financial. Private capital and knowhow, including private direct investment, will have a central role to play, particularly in such areas as exploration for and development of oil, gas and coal resources. But not all sector activities or countries can attract private capital. Consequently, official assistance -- bilateral and multilateral -- must play an important complementary and catalytic role. For instance:

. Private capital for rapid development of hydro capacity is available, but often only on the basis of projects appraised by the World Bank and in association with Bank financing.

. Potential high returns of particular projects may be offset by the perception of adverse country economic and political risks. The extent of such risks can be reduced for private investors by World Bank participation as was done, for example with Gulf Oil and BP in Pakistan and with Shell in Tanzania.

. In low income countries, with little or no ability to borrow on the private capital markets, official financing is essential to their energy investment programs.

. The World Bank can provide the necessary assistance in developing appropriate pricing policies to spur conservation, to strengthen weak institutions, to reorient incentive structures and to help prepare the basis for attracting private external capital and knowhow to investment opportunities.

. Experience from the World Bank's energy operations shows that assistance in the preparation of geological and other data as a basis for soliciting bids for exploration investment proposals attracts substantial private interest to areas where none existed before.

The need for external support of programs to provide the long-term capital required by the energy sector is urgent.

The Significance for the Industrialized Countries

The extent to which the oil-importing developing countries are successful in increasing their energy self-sufficiency will have important

effects on the industrialized countries, including the United States, because:

- an important and growing source of pressure on world oil prices can be relieved;

- the resulting relaxation of balance of payments strain in developing countries will free foreign exchange for the imports of goods from industrialized countries and accelerate a return to the more bouyant world trading conditions associated with past periods of growth in industrialized economies;

- there is a political dimension which cannot be ignored. The adjustment policies described above involve immediate sacrifices in already low consumption standards, delays in the attainment of longer run development objectives and a switch in investment priorities away from such basic areas as health and education. Such changes are difficult to achieve even in countries with secure political traditions. They could impose immense strains on countries where the political structure is fragile. Economic assistance could be a very low cost investment contributing to political stability.

The World Bank's Expanded Program for Energy Lending

In response to the growing need for financial and technical assistance in energy the World Bank has increased its emphasis on lending for this sector (see attached list of typical projects) and has identified an additional program of high priority investments which could be undertaken if the necessary financing can be found. The total program amounts to $30 billion over the five years FY82-86 (an increase of $16 billion over presently planned levels). The program would increase production of all types of energy in developing countries, strengthen conservation programs and help to attract private capital and private technical knowhow to energy projects in the developing countries.

The expanded program would serve three main objectives:

(i) as a vehicle for an integrated approach to the reordering of development priorities in developing countries so that energy investments and energy sector policies can be framed in the context of overall development objectives;

(ii) as a catalyst to mobilize financial resources, from private and public sources. Private external capital in particular will need to be attracted, and key features included in the program such as sector studies, institution building, and legislative reform will provide a framework for other lenders and enhance the opportunities for private investors;

(iii) as a source of financing of 'last resort'. The program itself will meet only about 10% of sector investment needs. It will be crucial, however, for financing those investments which private capital will not undertake including investments in infrastructure, such as gas pipelines investments which in many cases are essential for the employment of private funds.

This program cannot be carried out within the present capital constraints of the World Bank without upsetting the sector balance of Bank operations and without significantly weakening the Bank's support for other key areas in the development process such as in agriculture. Therefore, additional financing is needed.

The additional financing to carry out this program can be sought in a number of ways. One approach would be to increase the capital subscriptions of the Bank, with or without a paid-in portion. An alternative would be to raise the authorized limits on lending by the Bank, i.e., the "gearing ratio" could be changed. A third approach, the creation of an Energy Affiliate has been proposed, because it holds out the promise of mobilizing a maximum volume of loanable funds at the least cost to government budgets and because agreement on it might be feasible faster than for the alternatives.

The financial structure envisaged for the Affiliate recognizes the budgetary constraints faced by the industrialized countries, and involves minimum outlays from government budgets. The cost would be small to any individual participating country and it would be spread over several years. For example, for the US it might amount to $80 million per year for three years starting in FY83 to support $25 to $30 billion of commitments. The market-oriented structure of the Affiliate would enable it to raise the needed funds on world capital markets including direct borrowings from capital surplus oil producers.

This initiative deserves to be examined expeditiously and in detail. Of the many demands facing industrialized countries in the international fora where 'North/South' issues are discussed, this initiative perhaps alone clearly serves the national interests of industrialized countries as well as benefitting the developing countries.

OIL AND GAS PROJECTS APPROVED OR UNDER PREPARATION WITH PRIVATE OIL COMPANIES

PRODUCTION AND DEVELOPMENT

Country	Project Description	Oil Company Involved	Project Financing ($ Mil) Oil Company	Other Private	Government	Bank	Total	Estimated Incremental Production	Remarks
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Argentina	Exploration and development subprojects to be financed through development bank	Local Argentinian firms	-	-	-	100.0	100.0	NA	Local Argentinian firms usually operate exploration and development projects in association with foreign oil companies.
Chad	Production, transport and refinery	Conoco Chevron Shell Exxon	11.0	10.0	-	10.0	31.0	2,000 BD	This project was to be a joint venture of the Bank and Conoco, Chevron, Shell and Exxon. Other financing included $30.0 million shared by IFC and the Islamic Development Bank and $10.0 million bilateral aid. Project is in abeyance due to political situation in Chad.
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EXPLORATION PROMOTION 1/

Honduras	These exploration promotion projects consist of all or some of the following components: reconnaissance seismic work, review of geological data, technical assistance to governments and national oil companies, and preparation of bidding documents.		3.0	Expected date of bidding is early '82. Selecting consultants.
Somalia			6.0	Expected date of bidding is early '82. Selecting consultants.
Liberia			5.0	Expected date of bidding is fall '81. Seismic survey underway.
Guinea Bissau			6.8	Expected date of bidding is fall '81. Seismic survey underway.
Madagascar		30 companies responded. 9 met bidding deadline.	12.5	Expected date of bidding is Jan. '81. Negotiations underway with AGIP, Occidental, Amoco, Mobil, Cities Service, Montcrief, Texaco, Union, Elf Aquitaine.
Congo		Exxon, Elf, Hydro Congo	5.0	The Government of Congo sold aeromagnetic survey for US$2.3 million to Exxon. Government soon to complete agreement which will grant concession in the areas where survey was flown.
Mali		10 bought prospectus; contract signed with Esso.	8.0	Project under preparation.
Mauritania		Phillips, Mobil, Chevron and Total	2.9	6 bought offshore prospectus; 10 bought onshore prospectus

1/ Additional exploration promotion projects under consideration in Ghana, Kenya, Equatorial Guinea, Caribbean Region, Panama, Nepal and Papua New Guinea.

Nationalities of Oil Companies

Union Oil	- American	SEDCO	- American
Gulf	- American	Elf Aquitaine	- French
BP	- British	CFP	- French
Shell	- Dutch	SAGA	- Norwegian
Chevron	- American	Wintershall AG	- German
Phillips	- American	Montenay	- French
AGIP	- Italian		

March 6, 1981

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

815/3/6

TO: Mr. Martijn J.W.M. Paijmans

DATE: January 14, 1981

FROM: Moeen A. Qureshi

SUBJECT: Energy Affiliate

I refer to your memorandum of December 31, 1980. I welcome your suggestion that, at the appropriate time, AOP should assist in the preparation of specific proposals concerning the organization, staffing and compensation for the proposed energy affiliate. We are not yet at that stage. At present we are still in the very preliminary stage of exploring alternative approaches to the organization and structure of an affiliate which would find general support amongst the Bank's membership. In the informal meeting that was held in November, the Group asked that we present a number of alternative modes of organizing and linking the affiliate with the Bank. A draft paper has been prepared (attached). I would very much appreciate having your views on this note.

As you will see from that note, we are far from having any definitive ideas at this stage, although we clearly have preferences. In any event, all we shall do at the forthcoming meeting of the Energy Group is to take account of the views expressed as background for the submission of a paper to the Board. This paper will also sketch out alternative approaches together with our preferred solutions. Once we receive a mandate from the Board on the approach to be adopted, then it would be quite opportune to begin working out the nitty-gritty organizational aspects and in that task the contribution of AOP would, of course, be most useful.

cc: Mr. McNamara

Attachment

MAQureshi:gmb

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

815/3/5

TO: Mr. Robert S. McNamara

DATE: January 12, 1981

FROM: Mahbub ul Haq, Director, PPR

SUBJECT: Energy Affiliate

1. This paper raises complex questions about the objectives and organizational form of the proposed new energy affiliate which have not been fully thought through. While six alternative organizational structures are presented in the draft paper, it is clear that the favored one is number (i), advocating complete integration of its staff and management with that of IBRD. The pros of this alternative are drawn out in great detail; the emphasis is generally on the cons of other alternatives.

2. The crucial question is: will this organizational form ensure additionality of resources? Specifically, will it attract participation of OPEC with additional funds and direct lending? Prima facie, there is no reason why it should. The paper assumes that financial structure and management structure can be delinked. But this assumption is hardly proven. There is no reason why OPEC should not set up their own separate energy institution if they cannot exercise much influence on management in a Bank energy affiliate.

3. Another reason for thinking in terms of an energy affiliate is that it may permit innovative policies: not only financial but also technical assistance; not only loans but also equity participation; and so on. By complete integration, we gain some advantages but we also forego the flexibility a new institution with a new charter can develop.

4. Some other questions that alternative (i) will raise:

(a) why treat only energy this way? why not agriculture, which involves about as much lending as energy?

(b) why assume a 2:1 ratio for an untried energy affiliate while downplaying it in the overall paper on the Bank sent to the Board recently? why not change the overall gearing raio of IBRD?

5. When the draft paper is revised, we would suggest that it should first set out the main objectives that an energy affiliate should serve, e.g.

- more lending for energy;
- ability to raise additional resources for energy lending;
- maintenance of an integrated approach to energy and general development issues; and
- ability to reach the poorer countries and the poorest groups within them.

We should then discuss various organizational forms which can best serve these objectives. These organizational alternatives should be made attractive both to new sources of finance (OPEC) and existing contributors to the Bank. This would require reversing the sequence of discussion and bringing financial and organizational structure close together. We should also be conscious that the establishment of an energy affiliate is being viewed in much of Third World and G-77 as a test case of how far the World Bank can accommodate the accumulating pressures for change in its structure, at least in its new windows.

cc: Mr. M. Qureshi
Mr. Stern (o/r)
Mr. Chenery

30

FORM NO. 75
(9–78)

THE WORLD BANK

ROUTING SLIP	DATE: January 9, 1981

NAME	ROOM NO.
Mr. Robert S. McNamara	E-1227
01/12	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
X	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

FROM:	ROOM NO.:	EXTENSION:
Moeen A. Qureshi	E-1241	73665

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Moeen A. Qureshi

DATE: January 8, 1981

FROM: Y. Seyyid Abdulai YSA

SUBJECT: Energy Affiliate

You may recall that when we discussed the setting up of the Informal Meetings on the Energy Affiliate, I wanted to know the criteria for the selection of the small group of countries for these meetings. You told me then the desire was to invite a few countries that were prepared to play a strong leadership role in the establishment of an Energy Affiliate.

This matter has been receiving considerable attention within the Nigerian Government and Nigeria had earlier informed me of the Government's desire to be part of the Informal Group because of the belief that the Energy Affiliate would be an important source of assistance to African countries.

Nigeria this week appointed a new Minister of Finance, and yesterday I received a call from the Permanent Secretary of Finance informing me that it has been decided that Nigeria should do all she can to work for the early establishment of the Energy Affiliate and should let the Bank know of her desire to participate in the deliberations of the Informal Group, beginning with the February meeting.

I would appreciate receiving a response on this matter at an early date.

YSA:cl

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

815/3/4

TO: Members of Finance Committee DATE: January 9, 1981

FROM: Frank Vibert F.V.

SUBJECT: Next Meeting on Energy Affiliate

Mr. McNamara has asked that this revised set of papers be distributed for the meeting of the Finance Committee set for 10:30 a.m., Monday, January 12.

cc: Mr. Chenery

815/3/2

REVISED
1/8/81

ENERGY AFFILIATE

Transmittal Note

In my note summarizing the meeting of November 24, circulated to you earlier, I referred to several areas of consensus in the discussions on the energy affiliate so far:

-- the need for a comprehensive approach to energy investments based upon a lending program broadly of the scale and composition identified by the Bank;

-- the desirability of the affiliate being designed to tap market sources of finance as well as being able to borrow directly from surplus countries.

The discussion also identified certain areas for further discussion. Of particular importance were questions relating to: the structure of voting in the affiliate; the extent of the organizational link between the affiliate and the Bank; and

the ways in which the affiliate could assist the poorest countries. In order to facilitate further discussion of these issues, I undertook to have notes prepared by the staff on each of these topics. These are now attached together with a note outlining those elements of the proposed affiliate about which there already appears to be something of a consensus.

I hope that at our next meeting, scheduled for February 2 and 3, 1981, it will be possible to explore the views of those present on the remaining issues. A suggested agenda for the meeting is attached.

Attachments: 1. Agenda
2. Discussion notes on-
#1 Energy Affiliate--Elements of a Proposal
#2 Organization
#3 Capital and Voting Structure
#4 Concessionary Lending

1/7/81

Meeting on Establishment of Energy Affiliate [1/]
February 2 and 3, 1981 Washington, D.C.
Agenda

1. Outline of Main Features of the Affiliate

Preliminary discussions have suggested a consensus on several major features of the Affiliate. A note has been prepared outlining these areas.

2. Organization of the Affiliate

A note has been prepared outlining alternative approaches to the organization of the Affiliate.

3. Capital and Voting Structure

A note has been prepared examining the extent to which the voting system might be directly linked to the distribution of capital subscriptions and the various techniques which can provide for appropriate modifications.

4. Lending to the Poorest Countries

A note has been prepared on how countries can be assisted that will not be able to borrow from the Affiliate.

5. Other Issues

Are there other issues which participants would like to discuss at this time?

1/ The meeting will take place in the Bank's Headquarters in Room E 1244, starting at 10:00 a.m. on Monday, February 2, 1981. The meeting will resume on the following day, Tuesday, February 3, 1981 at 10:00 a.m.

1/7/81

Discussion Note #2.

ORGANIZATION OF THE ENERGY AFFILIATE

Introduction

In discussions with governments so far, there has been widespread acceptance of the need for the Energy Affiliate to have a link with the Bank. Different views, however, have been expressed about the precise extent of that link. Accordingly, the analysis below outlines various different forms a link might take. It is the purpose of this analysis to highlight some of the questions that need to be considered in arriving at a consensus on this issue.

What is involved in an "Integrated" Approach ?

The key question is how the staffing and management arrangements for the affiliate can best provide a strong focus on energy matters while still assuring an "integrated" approach to energy and general development issues. Since the assessment of alternative staffing and management arrangements will depend to a significant extent on how well those arrangements can be reconciled with an "integrated" approach, it may be helpful at the outset to consider just what such an approach involves.

(i) Advice on Energy in the Context of Overall Development Strategies

The World Bank's role as a development institution is to help developing countries, on a country-by-country basis, and in the light of their particular development objectives, to formulate optimal development strategies. Over the past few years, energy has come to assume a central place in the overall dialogue between the Bank and its borrowers on their development objectives and strategy for several reasons:-

- because of its importance in their balance of payments prospects;
- because expanded investment in domestic energy production requires that additional domestic resources be mobilized, thus implying a need to increase domestic savings;
- because the higher real price of energy necessitates a re-ordering of investment priorities, reflecting changes both within and across sectors in the relative costs of factors of production and in comparative advantage;
- because pricing policies in the energy sector have a key role in the necessary adjustment of relative prices throughout a country's economy;
- because the pattern of relative prices and subsidies will have a major effect on the ability of developing countries to mobilize additional domestic savings from the public and private sectors in order to close the much larger resource gaps many of them now face.

While recognizing the critical role of energy in the near term, the Bank has also been urging borrowers to maintain a long run perspective on basic development objectives. Returning to paths of faster income growth, raising the productivity of the poor and meeting other goals, such as increased food self-sufficiency, should not be forgotten in the effort to cope with near term problems.

As a consequence the Bank can best assist and advise developing countries in formulating their development strategies by taking a comprehensive view of the effects of high cost energy on the domestic economy and by keeping the long term perspective in view. Subjects

which have traditionally formed the core of the Bank's dialogue with borrowers--domestic and external resource mobilization, investment priorities, etc., are all affected by the energy outlook, as are the size and the sector distribution of the Bank's lending program to particular countries. Conversely, meaningful assistance in energy can best be undertaken in the context of the country's general planning framework. The size of the energy investments to be undertaken, the nature of these investments, and the associated requirements for planning assistance cannot be framed without taking account of the full range of consequences for other sectors, and for the country's investment program as a whole. It is to give full recognition to these interconnections that the Bank has stressed, along with others, the need for an 'integrated' approach.

(ii) Advice on Project Design The interconnections that are central to a dialogue on a country's development strategy also apply to some aspects of the preparation of specific energy projects. Fuelwood projects, for example, cannot be satisfactorily prepared without taking account of a country's objectives in land use and the agricultural sector as a whole. There may also be important interconnections with the transportation sector, for example, in coal mining projects. The contribution which the government can reasonably be expected to make to meet its share of project or program costs will depend on the country's general budgetary situation, and on an assessment of its budget priorities. Similarly, external borrowing may have to be limited as part of prudent debt management and, in that context, choices made as to the allocation of borrowed funds between energy projects and other projects.

Current World Bank Staffing and Management Pattern

The Bank's current plan for energy operations in FY82 involves about 200 full-time professional staff in direct lending activity (i.e. project preparation, appraisal and supervision), and the equivalent of about 170 full-time professional staff in non-project work. Of the staff mainly involved in lending activity about 85 individuals are centrally-organized in the Energy Department, which deals with all Bank lending for oil and natural gas projects as well as having some advisory staff for electric power lending. A further 25 staff are also centrally located; for example, coal and industrial projects (refining; retro-fitting) are dealt with by the Industrial Projects Department. The remaining (approximately 90) staff/involved in direct lending work (mainly for electric power, including the supervision of the large portfolio of power projects) are located principally in the projects departments of Regional Offices. These arrangements are noted in the organization chart attached as Annex 1.

Non-project work is of two main types. First, there is general economic, sector and advisory work. While it is exceedingly difficult to quantify the proportion of country economic and advisory work that is devoted to energy topics, a conservative estimate is the equivalent of 60 man-years. This 60 man-years is made up of staff inputs from the part-time involvement of a large number of programs staff as well as input from projects staff. Secondly, there are several activities (e.g. Legal, Controller's, Treasurer's) carried out by support departments, which may absorb the equivalent of 110 man-years.

The management of the Bank's energy lending and advisory work is ultimately based upon individual country assistance plans which are prepared by the Regional Offices. Project preparation and appraisal activities are managed on a day-to-day basis by the projects department concerned, which may

either be part of the Regional Offices or the Central Projects Staff, depending on the sub-sector involved. General economic and advisory work is normally the responsibility of Regional Offices, though support may be provided by the Central Economics Staff. All operational work, whether project or program related, is supervised by the Senior Vice President - Operations.

Organizational Issues to be Considered

Against this background it is apparent that the proposed arrangements for the staffing and management of an Energy Affiliate need to be considered from several points of view:

"integrated" advice: are the arrangements such as to permit a comprehensive view to be taken, with energy lending viewed in the context of overall investment priorities and resource availabilities?

project design: are the arrangements such as to assure that linkages among the various sectors are properly taken into account?

duplication of staff: to the extent activities are now done on a part-time basis (e.g. by country economists; by support staff), would it be necessary to duplicate staff in order to permit the Energy Affiliate to operate autonomously?

impact on Bank effectivess: to the extent activities now undertaken by the Bank are withdrawn and handled separately by the Energy Affiliate, is this likely to have any significant impact on the effectivness of the remaining Bank operation?

In the light of this perspective, alternative organizational arrangements for the affiliate, which have been suggested by governments, are discussed below. Since the arrangements for
/the staffing and management of the affiliate are to a large extent independent of the arrangements for the affiliate's Board of Directors and Governors, the additional considerations relating to the Boards are discussed later in the paper.

Alternative Modes for Organization of Staff-Management

For the purposes of this discussion of alternative organizational arrangements for the affiliate, distinctions are made in the analysis between:

staffing arrangements - the extent to which the existing organization of staff support would be maintained or reorganized within an integrated or more autonomous affiliate;

management arrangements - the extent to which the affiliate would have its own management and the way in which it would relate to the Bank's present management structure; and between;

project work - the staff involved in the preparation, appraisal and supervision of energy projects;

program or lending work - the staff involved in lending relations with the country, general country economic and sector work; and,

support activities - the staff involved in supporting services such personnel, legal, operations evaluation and finance and accounting.

In the six alternatives discussed below, three provide for different degrees of integration of the Affiliate's management within a common staffing structure; and three provide for substantial autonomy for the Affiliate.

Alternatives Based Upon Common Staffing

(i) Complete Integration:

One mode of organization for the affiliate would be the complete integration of its staff and management with that of IBRD. An example of this mode is provided by IDA. IDA raises its finances from sources different from IBRD, it lends on terms different from those of IBRD and the countries to which it lends are only in the case of "blend" countries also receiving assistance from IBRD. Nevertheless, IDA shares the same staff and management as IBRD. This has served to ensure that IDA applies the same development strategy, the same country economic judgments and the same financial and economic criteria to the projects it finances as IBRD, which have, in turn, been an important factor in the financial

and political support given to IDA.

Complete integration of the affiliate's staff and management would continue the way in which the energy program is currently operated and ensure an integrated approach to energy lending. A further important advantage of a fully integrated approach is that it would facilitate a quick start up of expanded lending in energy. In this connection it is tentatively estimated that the expansion of the energy lending program could require increases in full-time equivalent staff of 200 and in consultants of 40 staffyears in the start up period. Such increases in a single sector of activity are very large even for an organization of the Bank's existing size, experience and exposure in recruiting markets. Recruitment and absorption problems might be more difficult for an autonomous affiliate. Moreover, in a largely autonomous organizational structure the current base of staff would have to be extracted from its present organizational structure and reconstituted with resulting reduction in the effectiveness of present staff in the reorganization period. When combined with a simultaneous introduction of significant numbers of new staff, the impact would delay the timely build up of the expanded energy program objectives.

Not only could an integrated organization facilitate a quick start on expanded lending operations but it could also assist the affiliate to establish its borrowing capacity rapidly. Investors will look to the affiliate to apply sound financial and economic criteria to its projects; they will also look to the creditworthiness criteria it applies to borrowing countries. The Bank has established standards in both areas which have provided an important part of the foundation for its borrowing. An integrated approach applying the same standards and relying on the same staff assessments could significantly assist the affiliate in launching its own substantial borrowing program.

Two variations of this approach are set out below. They both involve maintaining integrated staffing arrangements for the Affiliate, but with new management arrangements. The new management arrangements could be limited to projects work or extended to cover not only the projects work but also the program or lending work and possibly some of the support activities. These possibilities are discussed in the second and third alternatives below.

(ii) New Management Structure for Projects Work

The purpose of new high level management direction would be to give senior focus to all energy projects work and energy sector policy issues. A new Energy Projects management could supervise the existing structure of centrally organized projects staff, and also the projects staff that are regionally organized. For this purpose, a Vice President Energy Projects would be appointed, reporting to the Senior Vice President, Operations. In other respects, there would be no change. For example, the program work involved in energy lending would remain as presently organized and managed. Since the existing staff structure could remain in place, existing arrangements for coordination between projects and program work would remain intact at all levels. In particular, lending decisions relating the size of lending in energy to the overall size and composition of country lending programs would continue to be the responsibility of the Regional Departments. Support activities would also remain unaffected.

(iii) New Management Structure for Energy Projects, Lending and Support Activities

The second alternative described above would give a central focus to projects work. A further possibility would be the creation of a senior manager with responsibility for supervising and giving central focus not only to the energy projects work but also to those involved in program and lending work in energy as well as possibly some of the support activities. Staffing arrangements would remain fully integrated within the Bank's present structure.

Both alternatives (ii) and (iii) aim to capture the benefits of common staffing arrangements for the energy program. The difference compared with the Bank's present approach involves new senior management for part or all of the work. Each of these first three alternatives aims to avoid the problems of ensuring coordination with the Bank which could arise with separate management and staff for the Affiliate. Each of these three alternatives would preserve an integrated approach to energy lending. Each would ensure that the Bank would continue to be able to take a comprehensive view of the energy situation in advising developing countries on their development strategies as well as ensure that assistance and lending undertaken in the energy sector was framed in the context of the country's overall development objectives and investment program. A separate organization would both weaken the Bank's ability to give meaningful advice on development strategy as well as have an adverse impact on the quality of energy lending itself. The issues involved in a separation of the Affiliate's staff and management are discussed next.

Alternatives Involving Independent Management and Staffing

(iv) Full Separation

At the opposite end of the spectrum from an Affiliate completely integrated with the Bank, would be a fully separate affiliate. Under such an arrangement the Affiliate would have a completely separate staff and management.

It would be organized to carry out independently the full program of energy investments with staff of its own to cover all the projects and program work and a full range of support activities. An Affiliate organized in this way would take time to mount a sizeable volume of operations and to establish its presence in capital markets. Furthermore, this arrangement would almost certainly involve a significant degree of duplication of staff with the Bank. This would apply particularly to staff involved in lending and support activities but it would also apply to the projects staff. For example, it would be necessary for the Bank to retain expertise in energy issues and retain projects staff needed to undertake supervision of the existing portfolio of energy projects. There would also be a question as to whether the Affiliate should undertake support activities of the range developed by the Bank; for example a research program or operations evaluation staff.

More important, the removal from the Bank of responsibility on an issue of central importance for the development strategy of its member countries would seriously weaken the role of the Bank itself. This alternative would so reduce the effectiveness of the Bank that it is not considered further. Two variations are set out below. Both envisage some staff and activities shared in common with the Bank in order to attempt to try to provide a mechanism for coordination.

(v) Substantial Autonomy with Some Shared Support Services

Under this alternative, the affiliate would share some support services with the Bank but the staff involved in both energy projects and lending work would be separately organized and the Affiliate would have its own management structure headed by an Executive Vice President. Coordination at the management level between the Affiliate and the Bank would be at the level of the Executive Vice President of the Affiliate reporting directly to the Senior Vice President of the Bank for Operations.

This alternative would involve the disengagement from the present structure of the Bank of most of the energy projects staff, with the possible exceptions of some involved in forestry and agricultural related lending.

As a result of the separation of energy lending work, arrangements would need to be put in place to ensure that whatever economic work on energy issues was undertaken in the affiliate (including that undertaken in connection with energy sector reports) would be fully taken into account in the Bank's country economic work. Economic and program staff in the affiliate would similarly have to be fully aware of the work in the Bank on the development strategy for each country and the Bank's place in it. There would also have to be close coordination between the program staff involved in lending decisions and relations with borrowing countries in the affiliate and those in the Bank.

As far as support activities are concerned, the borderline between separate or common support services could obviously be varied. For example, the affiliate might have its own separate staff for borrowing operations, legal work and personnel recruitment, while other services, such as Controllers, Operations Evaluation and Development Policy staffs and Treasurer's operations would remain in common with the Bank.

While the sharing of some common support services between the Bank and the Affiliate could be arranged without difficulty the removal of lending functions from the Bank's present management and staffing structure would make the necessary degree of coordination between the Bank and the Affiliate very difficult to achieve in practice. Although the arrangements outlined in this alternative are broadly patterned after the IFC, the nature of the operations would be very different in character. The support given to the private sector provided by the IFC is fairly distinct in nature and is moulded to fit as a largely self-contained activity within the role articulated for the private sector by developing countries. By contrast, decisions in the energy sector have ramifications across all other sectors and the separation of staff and management dealing with energy lending would make a coordinated approach to development lending most difficult.

(vi) Part Separation of Staff and Activities

This alternative would involve the separation from the Bank's structure of a nucleus of the projects staff involved in energy, for example those at present organized in the central Energy Department and responsible for project work in oil and gas. Other projects staff and the lending staff would remain within the Bank./ Possibly, some support activities, such as finance could also be separated out while others would remain. The affiliate would have separate management, headed by an Executive Vice President or President, and would contract to the Bank for those services where the staff would remain integrated within the Bank.

This alternative would also raise severe issues of coordination. For example, contract arrangement would become a problem area unless the affiliate were adopting policies and procedures identical to those of the Bank. Moreover, a partial separation of projects staff would be inconsistent with the comprehensive

approach to energy lending which appears generally desired.

Although there are points of connection between the choice to be made on the organization of the affiliate's management and staff and the choice on the organization of its Boards of Governors and Directors, the two choices are largely independent of each other. For example, it would be consistent with any of the alternatives mentioned above for the affiliate to have its own Board of Directors. The question of the structure of the Board of Directors and Governors is considered below.

The Board of Governors and Executive Directors

In the preliminary discussions which have taken place it has been a general assumption that the affiliate would be established as an institution, legally and financially separate from the Bank. It would have its own Board of Governors, in which all powers of the affiliate would be vested, and its own Board of Executive Directors responsible for the general operations of the affiliate, as well as exercising such powers as are delegated to them by the Board of Governors.

In broad terms, two different arrangements could be envisaged in relation to the Governors and Executive Directors. In one arrangement, the Governors of IBRD, who are ex officio Governors of IDA, and the IFC might also act, ex officio, as governors of the affiliate. Similarly, the Executive Directors of IBRD, who act, ex officio, as Executive Directors of IDA and the IFC, could also act, ex officio, as Executive Directors of the affiliate. In an alternative arrangement, in order to reflect different voting strengths in the affiliate, the Executive Directors of the energy affiliate could be appointed and elected separately from Executive Directors in IBRD. This second alternative would not preclude a particular country, or group of countries, choosing to be represented on the Boards of the energy affiliate by the Executive Director who also happens to be the Executive Director of IBRD.

There are two main considerations applying to these alternatives. One of them - the need for an integrated approach to energy issues, has been discussed earlier in this note. The Governors, and to the extent of the powers delegated to them, the Executive Directors will decide the overall operational, financial and other policies of the energy affiliate. An ex officio system of representation would help assure that the policies of the energy affiliate would be fully consistent with the policies of the Bank Group, and framed within an integrated approach to development issues. Were a separate Board to be decided upon, other means would have to be devised to assure the necessary degree of integration and consistency. The other major consideration is the relationship between the Boards of the affiliate and the affiliate's structure of voting. A possible approach to voting in the affiliate is treated in a separate note. However, for the purposes of this discussion it is relevant to recognize that the composition of share holdings, the relative importance of sources of direct financial support, and the pattern of voting in the energy affiliate may differ substantially from that in IBRD. This raises the question as to whether such differences, particularly in voting structure, could easily be accommodated by Governors and Executive Directors of IBRD acting ex officio in the energy affiliate.

In this connection it should be noted that when the Governors and Executive Directors of IBRD are acting ex officio in their IDA (or IFC) capacity, their voting power corresponds to the voting structure in IDA (or IFC).[1/] This precedent shows that differences in voting strength can be accommodated within an ex officio system of representation. Only if the differences which might arise between voting strength in IBRD and

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1/ All the votes which a Director is entitled to cast are cast as a unit.

in IBRD and voting strength in the affiliate would be of such a different order of magnitude would it appear desirable to move from this (and the IFC) precedent. 1/

1/ Table showing voting strengths of Executive Directors in IBRD, IDA, and IFC is attached. (Annex 2)/

VOTING POWER (%) 1/

	IBRD	IDA	IFC
Directors Appointed by:			
1. United States	20.99	18.29	23.89
2. United Kingdom	7.07	6.51	6.20
3. Germany	4.81	6.63	5.44
4. France	4.80	3.48	4.34
5. Japan	4.79	6.56	4.19
Elected Directors:			
6. El-Naggar (Egypt)		-	-
Bahrain	.11	-	-
Egypt, Arab Rep. of	.51	.55	0.55
Iraq	.33	.25	0.31
Jordan	.13	.21	0.11
Kuwait	.93	1.05	0.78
Lebanon	.12	.22	0.08
Maldives	.07	.19	-
Pakistan	.75	.90	0.76
Qatar	.17	-	-
Saudi Arabia	1.59	2.24	1.54
Syrian Arab Republic	.21	.26	0.19
United Arab Emirates	.37	.44	0.34
Yemen Arab Republic	.10	.22	0.07
Sub-total	5.38	6.53	4.73
7. Drake (Canada)			
Bahamas	.14	-	-
Barbados	.11	-	-
Canada	3.06	3.21	3.45
Dominica	.07	-	-
Grenada	.08	.20	0.05
Guyana	.12	.25	0.10
Ireland	.41	.27	0.43
Jamaica	.23	-	0.22
St. Lucia	.08	-	-
Sub-total	4.30	3.93	4.25
8. Ray (India)			
Bangladesh	.40	.57	0.42
India	3.18	3.04	3.26
Sri Lanka	.33	.41	0.34
Sub-total	3.91	4.02	4.02

1/ Authorized shares

VOTING POWER (%)

	IBRD	IDA	IFC
9. Looijen			
Cyprus	.14	.25	0.13
Israel	.52	.31	0.56
Netherlands	2.14	1.86	2.39
Romania	.61	-	-
Yugoslavia	.68	.57	0.51
Sub-total	4.09	2.99	3.59
10. De Groote (Belgium)			
Austria	.80	.57	0.87
Belgium	2.03	1.12	2.27
Luxembourg	.15	.22	0.13
Turkey	.51	.60	0.54
Sub-total	3.48	2.51	3.81
11. Wang (China)			
China	1.70	2.33	0.72
Sub-total	1.70	2.33	0.72
12. Lundström (Sweden)			
Denmark	.75	.89	0.82
Finland	.65	.50	0.70
Iceland	.13	.21	0.11
Norway	.72	.83	0.78
Sweden	1.06	2.22	1.17
Sub-total	3.30	4.65	3.58
13. Ragazzi (Italy)			
Greece	.32	.38	0.33
Italy	2.79	2.39	3.15
Portugal	.43	-	0.39
Sub-total	3.54	2.77	3.87
14. Zain (Malaysia)			
Burma	.23	.33	0.22
Fiji	.11	.23	-
Indonesia	1.12	.98	1.24
Lao People's Dem. Rep.	.10	.23	-
Malaysia	.63	.37	0.68
Nepal	.11	.23	-
Singapore	.18	-	0.32
Thailand	.47	.41	0.50
Viet Nam	.27	.30	0.27
Sub-total	3.21	3.08	3.32

VOTING POWER (%)

	IBRD	IDA	IFC
15. McLeod (New Zealand)			
Australia	1.81	1.34	2.02
Korea, Republic of	.44	.29	0.44
New Zealand	.58	.26	0.62
Papua New Guinea	.14	.25	0.12
Solomon Islands	.07	-	-
Western Samoa	.08	.20	0.05
Sub-total	3.11	2.34	3.25
16. Abdulai (Nigeria)			
Botswana	.09	.20	-
Burundi	.12	.25	-
Equatorial Guinea	.09	.21	-
Ethiopia	.11	.23	0.09
Gambia, The	.09	.21	-
Guinea	.13	.26	-
Kenya	.22	.31	0.21
Lesotho	.09	.20	0.06
Liberia	.14	.25	0.12
Malawi	.12	.25	-
Nigeria	.86	.43	0.95
Seychelles	.07	-	-
Sierra Leone	.12	.25	0.10
Sudan	.26	.26	0.26
Swaziland	.10	.21	0.07
Tanzania	.19	.31	0.18
Trinidad & Tobago	.25	.29	0.25
Uganda	.18	.31	0.16
Zambia	.38	.38	0.25
Zimbabwe	.29	-	-
Sub-total	3.87	4.81	2.70
17. Muns (Spain)			
Costa Rica	.10	.21	0.08
El Salvador	.11	.21	0.08
Guatemala	.11	.22	0.09
Honduras	.10	.21	0.07
Mexico	.92	.85	1.02
Nicaragua	.10	.21	0.07
Panama	.13	.19	0.11
Spain	1.29	1.12	1.44
Suriname	.11	-	-
Venezuela	1.09	-	1.20
Sub-total	4.06	3.22	4.16

VOTING POWER (%)

	IBRD	IDA	IFC
18. Razafindrabe (Madagascar)			
Benin	.10	.23	-
Cameroon	.14	.26	0.12
Cape Verde	.07	.20	-
Central African Rep.	.10	.23	-
Chad	.10	.23	-
Comoros	.07	.20	-
Congo, People's Rep. of	.10	.23	-
Djibouti	.08	-	-
Gabon	.13	.23	0.11
Guinea-Bissau	.08	.20	-
Ivory Coast	.21	.26	0.20
Madagascar	.14	.26	0.13
Mali	.12	.25	-
Mauritania	.10	.23	0.08
Mauritius	.13	.25	0.11
Niger	.10	.23	-
Rwanda	.12	.25	0.09
Sao Tome and Principe	.07	.20	-
Senegal	.19	.31	0.16
Somalia	.12	.25	0.09
Togo	.12	.25	0.10
Upper Volta	.10	.23	0.08
Zaire	.40	.40	0.42
Sub-total	2.91	5.38	1.69
19. Blanco (Bolivia)			
Argentina	1.33	1.57	1.38
Bolivia	.14	.27	0.12
Chile	.40	.44	0.42
Paraguay	.09	.21	0.06
Peru	.32	.32	0.33
Uruguay	.21	-	0.19
Sub-total	2.50	2.81	2.50
20. Constain (Colombia)			
Brazil	1.52	1.58	1.70
Colombia	.39	.44	0.38
Dominican Republic	.12	.22	0.09
Ecuador	.17	.24	0.15
Haiti	.12	.25	0.09
Philippines	.53	.55	0.57
Sub-total	2.84	3.28	2.98

VOTING POWER (%)

	IBRD	IDA	IFC
21. Khelil (Tunisia)			
Afghanistan	.16	.26	0.15
Algeria	.70	.48	-
Ghana	.30	.36	0.30
Iran	1.59	.51	1.63
Libya	.50	.26	0.49
Morocco	.40	.44	0.42
Oman	.12	.21	0.09
Tunisia	.20	.30	0.19
Yemen, PDR	.16	.28	-
Sub-total	4.12	3.10	3.27
Representation Undetermined			
Kampuchea, Democratic	.14	.26	-
South Africa	1.00	.29	1.11
St. Vincent	.07	-	-
Sub-total	1.21	.55	1.11
Grand Total	100.00	100.00	100.00

Discussion Note #3

Revised
1/7/81

Capital Structure and Voting Arrangements

In the discussions so far on the energy affiliate there has been widespread support for establishing an institution capable of mounting a comprehensive program of energy investments covering the entire energy sector along the lines of the program identified by the Bank totalling $30 billion over FY82-86. There has also been general support for the idea that in order to finance this program the affiliate should be designed to tap finance available in the market. In addition, the new institution should provide encouragement for direct borrowings from capital surplus countries.

A capital structure appropriate for a market oriented institution has also been outlined in these earlier discussions and there appeared to be general acceptance of its principal features:

- the backing for the affiliate's borrowings would be provided by capital subscriptions totalling about $10-15 billion;
- a small part of this capital backing, amounting to about $1.5 billion would be paid-in and the balance would be callable only if the affiliate could not meet its obligations to bondholders;
- subscriptions might be stretched over a period of two or three years to minimize the budget impact on subscribers which would in any event be small (less than 1 % of estimated development assistance budgets on average).

The affiliate's borrowing capacity will be crucially affected by the quality of the guarantees provided by subscriptions to its capital. From this perspective, while it will be important for investors that developing countries that are potential borrowers from the affiliate subscribe to a part of the capital of the affiliate as evidence of their commitment to its success, the major part of subscriptions will need to be provided by the industrialized countries and capital

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The affiliate's borrowing capacity will be crucially affected by the quality of the guarantees provided by subscriptions to its capital. From this perspective, while it will be important for investors that developing countries that are potential borrowers from the affiliate subscribe to a part of the capital of the affiliate as evidence of their commitment to its success, the major part of subscriptions will need to be provided by the industrialized countries and capital

surplus developing countries.

Against this background, one view expressed on the voting structure in the affiliate has been that, while there need be no firm link between subscriptions to its capital and voting rights, the arrangements should not diverge too far. A point of departure for exploring this issue is provided by two generally accepted principles -- namely, that the voting structure should be representative of all major interests, and also that the structure should help the affiliate achieve the strongest possible financial support. This note, therefore, starts by examining the relationship between voting structure and financial support. It identifies the major interests that need to be taken into account in designing the affiliate's voting structure. The note continues with a discussion of several illustrative voting patterns and the various voting techniques that might be involved in them.

The Voting System and Financial Support

While there will be many factors entering into investors' judgment on the quality of the obligations of the affiliate, one of the more important factors affecting investor confidence will be the question of operational "control." This concern relates not only to the identify of shareholders having the major voting power, but also more generally to whether the system is likely to be conducive to sound financial management by the affiliate. The confidence of investors on this point will affect both the size of the market open to the affiliate and the terms on which finance can be obtained. Investors in surplus countries, who may be approached for direct borrowings, will be equally concerned with the security of their investments and the financial soundness of the affiliate. In this regard, they share identical concerns with the market.

Because investors tend to be reassured if the holders of voting control also have a major financial stake in the affiliate they are likely to take a keen interest in the nature of the link between the voting system and subscriptions. Subscriptions to capital provide the strongest evidence of commitment to the financial viability of the affiliate.

Capital subscriptions do not provide the only point of connection between the system of voting and the financial concerns of investors. Although a willingness to provide risk capital is perhaps the most convincing indication of commitment to sound financial operations, major creditors also acquire, by virtue of their creditor status, a clear stake in the financial integrity of an institution. It might therefore be consistent with a market-based institution, if the system of voting control were to assign a part of the voting power to major creditors. One of the techniques considered below ("floating votes") does precisely this.

Thus, while financial considerations suggest that the borrowing prospects of the Energy Affiliate may be enhanced if there is a clear connection between voting rights and capital subscriptions, they also suggest that modifications to take account of other financial factors such as creditor status could be acceptable as well. In addition there are non-financial considerations such as the need to provide for a balanced representation of interests in the voting structure that also may suggest the desirability of departing from a rigid connection between subscriptions and voting power. The nature of these interests is examined next.

Interests to be Represented

In preliminary discussions there have been references to the industrialized countries and capital surplus developing countries as the major providers of capital to the Affiliate. There has also been reference to the need to ensure a significant place for other developing countries, many of whom will be borrowers from the Affiliate.

Two questions arise about the distinctions among groups of countries. First there is the question of how far, if at all, they should be formalized in any system of voting and representation in a market based institution. Categorization of membership may lead to rigidities and be seen to detract from the businesslike nature of an international institution. Furthermore, they can become dated with the passage of time. A second question relates to whether these interests are likely to find appropriate representation in the voting structure in a system where there is an important connection between voting and capital subscriptions.

This second question refers partly to the developing countries that are likely to be borrowers from the Affiliate. As mentioned above, it is anticipated that these countries will subscribe to the capital of the Affiliate and thus would acquire voting power through their subscriptions. However, for the smaller, poor borrowing countries capital subscriptions could be a significant financial burden, even though the paid in portion of capital subscriptions may be small. Their position may need to be protected by such techniques as the allocation of membership votes.

This question also refers to the position of capital surplus developing countries. While the industrialized countries might be looked to as the source

of the major part of the affiliate's guarantee capital, the capital surplus developing countries may wish to provide an important part of their support in the form of loan capital. Techniques to ensure appropriate representation of interests that may support the affiliate in forms additional to guarantee capital could therefore be important and are included in the discussion which follows on illustrative voting structures.

Alternative Capital and Voting Structures

In order to seek further guidance on these points. Two alternative capital and voting structures are outlined below. The examples are purely illustrative and are intended to highlight some of the key issues. It should be emphasized that the groupings illustrated are for the purpose of simplifying the discussion and not to suggest that these, or any others, should be treated as formal distinctions in the actual voting arrangements. The groupings obscure important potential shifts in the relative positions of individual countries (compared with their position in IBRD) in a capital and voting structure that, it is hoped, will reflect current economic realities.

Case I. This example assumes that industrialized countries would subscribe the majority of the affiliate's capital and have a majority position in the voting structure. It shows the industrialized countries providing the majority of the affiliate's capital, while at the same time illustrating substantial participation by capital surplus developing countries. Subscription votes are distributed in proportion to countries' capital subscriptions and membership votes are assumed to be a little over 10% of total votes. The main innovation in this voting structure as compared to the current IBRD pattern is that the capital-surplus oil-exporting countries have a significantly higher share of total voting power, and the industrialized countries a significantly lower share.

Case I: Hypothetical Subscriptions and Voting Power

	Industrial Countries (OECD)	Capital-Surplus Developing Countries a/	Other Developing Countries	Total
Capital Subscriptions ($b)	9.0	4.2	1.8	15.0
Subscription Votes b/	600	280	120	1,000
Membership Votes	20	5	100	125
Total Votes	620	285	220	1,125
% of Total	55%	25%	20%	100%
Memo Items:				
Voting Power				
- IBRD Present Pattern	62%	5%	33%	100%
- IMF Calculated Quotas	69%	7%	24%	100%

a/ As defined in World Development Report 1980 to include: Kuwait, Qatar, Saudi Arabia, United Arab Emirates, Libya, Iran and Iraq.

b/ The total number of subscription votes is set arbitrarily at 1,000 for all the illustrations to facilitate comparisons. Actual subscription votes would depend upon the subscription price per share.

This type of voting structure would be readily accepted in the financial markets. The subscription burden on the developing countries could be further reduced - as compared to the figures shown - by increasing the number of membership votes and reducing the proportion of capital subscriptions assumed to come from this group of countries. The system of membership votes could follow that of the IBRD. Alternatively, another example is provided by the system in the Asian Development Bank where such votes account for a fixed proportion (20%) of total votes, equally distributed among all members. This means that the number of membership votes is adjusted whenever there is an increase in subscribed capital.

Case II. This example illustrates parity between the subscriptions of the industrialized countries and the capital surplus developing countries. Taking account of other developing countries, the industrialized countries are in a minority position which would be accentuated in the voting structure if membership

votes were introduced.

Case II

	Industrial Countries (OECD)	Capital-Surplus Developing Countries	Other Develop-ing Countries	Total
Capital subscriptions ($b)	6.0	6.0	3.0	15.0
Subscription Votes				
- Number	400	400	200	1,000
- % of total	40%	40%	20%	100%

This example raises the question of whether the composition of capital illustrated would meet the wishes of potential investors in the affiliate's bonds. There is also the question, given differences in their stage of development, as to whether it would be a reasonable expectation for capital surplus developing countries to subscribe to the capital of the affiliate in equal proportions to the industrialized countries.

A technique relevant to the first concern, and possibly of more general relevance, would be the provision for qualified majorities in the affiliate on major issues - for example those involving the interpretation of, or changes to the Articles of Agreement of the Affiliate or those involving major financial issues such as increases in capital. At the same time it should be recognized that there would be a risk to the sound running of the affiliate if qualified majorities were extended to cover issues related to more routine financial or lending operations of the affiliate.

The second concern might be addressed by drawing a distinction between the current capacity of the capital-surplus countries to provide cash support to the affiliate and their longer-run capacity to share the risk of the affiliate's obligations to creditors. One way of doing this would be to consider a system allowing for variations in the proportion paid in depending on whether a participant wishes to emphasize its contribution to the affiliate's cost-free resources or the

guarantee portion. Since the paid-in portion would be of particular value to the affiliate, a larger number of votes might be accorded to subscriptions with a larger paid-in portion. This could be done inter alia by establishing two classes of subscription votes, one corresponding to the paid-in portion of subscriptions and the other corresponding to the guarantee part. Alternatively, two different classes of shares allowing for different proportions of paid-in capital could be established with different votes accorded to each.

Balance in the voting system could also be achieved through a system of floating votes. Under one approach, a certain proportion of votes (say 20%) might be set aside to be distributed from time to time to major creditors. Under another approach, the proportion of floating votes a country might be eligible to receive could be set in relation to the country's normal share of votes.

It was mentioned above that this type of modification to a straightforward connection between capital subscriptions and votes might be desirable in order to recognize support given to the affiliate by major creditors. There has been limited application of such a system in the IMF.1/ Such a system would involve a determination from time to time of major creditor status as measured by borrowings outstanding or credit agreements arranged and there are further questions about such a system which would have to be considered in detail at a later point such as what type of action would confer floating votes (access to market, permission to use a currency, direct official lending, etc.) and whether voting power conferred in this way should be exercisable over the full range of decision-taking in the affiliate or on limited issues.

1/ In the IMF, in accordance with its Articles of Agreement, the voting power of members is adjusted only in the case where the decision is to be taken to waive any of the conditions for the use of its resources or to declare a member ineligible to use such resources because it is using them in a manner contrary to the purposes of the Fund.

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9

Mr. McNamara

OFFICE MEMORANDUM

815/3/1

TO: Mr. Moeen A. Qureshi DATE: January 5, 1981

FROM: Saad S. El Fishawy

SUBJECT: UNITED ARAB EMIRATES: Energy Affiliate

On December 13, I met in Abu Dhabi first with Sheikh Ahmed Khalifa Al-Sweidi, the Adviser to the Amir (although he is no longer Minister of Foreign Affairs, he remains, by all accounts, most influential), and then with Mr. Nasser Al-Nowais, the Director General of the Abu Dhabi Fund.

In my meeting with Sheikh Ahmed Khalifa, I explained to him the proposal of the Energy Affiliate and he expressed his support for it.

In the meeting with Mr. Al-Nowais, I went in detail over each of the main topics involved in the proposal, viz.: the program to be financed, means of financing, capital structure, organization and distribution of shares and voting. I summarized the variant points of view expressed by the participants at the meeting held on November 24, 1980. I also handed Mr. Al-Nowais copy of the Note by the Chairman on that meeting. I indicated the next steps envisaged and outlined the timetable planned. I explained to Mr. Al-Nowais that the membership of the preparatory committee was limited to a very small number of the Bank's membership. I promised to keep him abreast of the progress made on the proposal. I also mentioned that before the finalization of the proposal, there would be a meeting of deputies of certain member countries.

01/05

cc: Messrs. McNamara
Stern o/r
Chaufournier

ElFishawy/rh