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FROM: The Deputy Secretary

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COMMITTEE OF THE WHOLE - JANUARY 14, 1993

IBRD's Negative Pledge Policy With Respect to

Lending for Investment Projects

Statement by Mr. Peretz

The attached statement by Mr. Peretz on the above subject is being circulated at his request.

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COMMITTEE OF THE WHOLE : IBRD NEGATIVE PLEDGE CLAUSE (R92-214 AND R92-214/1)

1. Thank you, Mr. Chairman.

General introductory remarks

2. I welcome the proposals to offer a limited waiver of the Bank's negative pledge clause to countries in transition for public sector projects that generate income currency earnings.

3. We should remind ourselves we are talking about private sector lending of a kind that is absolutely normal when the investments themselves are in the private sector: that is project loans secured on the assets and income streams created by the investment projects. When the borrower is in the private sector there is no question of needing a World Bank negative pledge waiver. The issue of the negative pledge waiver only arises in economies where activities normally undertaken in the private sector will for a period continue to be in the public sector. Moreover, in those same cases, it is particularly important for the success of the transition process to mobilise private sector flows--and many of these flows will not come without the security of project assets and the use of escrow accounts.

4. At the same time we have to protect the financial position of the Bank, and its preferred creditor status. The Management's proposals are designed to meet both objectives. They will do so as long as the investment inflows and extra export earnings are truly incremental: that is, without the waiver neither the investments nor the export earnings would have taken place. With this protection I see no problem with the proposal in general. But there are a number of detailed points on the proposal that I would like to make.

Country Eligibility and Links with Macroeconomic Programme

5. I agree that to protect the Bank's financial standing, the Board must control the extent of any waivers given. The main protection is given by restricting the waiver to incremental project earnings. I also agree it should also only be available to countries in transition. I would prefer the Board to approve specific criteria country on eligibility rather than a case by case approach. I would oppose sectoral criteria. I would oppose case by case approval of waivers for particular projects. But I could go along with Board approval case-by-case of country eligibility. So long as the decisions are made on the basis of management proposals based on strict criteria.

This would be analogous to the procedure used to approved waivers in support of debt reduction operations.

6. While I think it appropriate for us to insist on a reform process being underway, I do not think it sensible to link the granting of a waiver to adherence to an IMF programme or, for that matter, necessarily to an active program of Bank adjustment lending. The relevant investment will normally be of a kind producing incremental revenues from export industries. Many of these operations will be able to perform successfully relatively independently of domestic macroeconomic developments.

7. In any case, I think we ought to be very cautious indeed about allowing the possibility of revoking a country's eligibility, once it is agreed. The result would be all too likely to lead to investors not investing at all, because of the uncertainty. Who is going to set off on a long process of negotiation of a loan if faced with the risk the country would no longer be eligible by the time it was agreed? A much better course, if there is a concern on this count, would be to make the initial period shorter, possibly as short as three years so long as it could be extended to five years later on.

Special purpose entities

8. Upgrading and rehabilitation projects will be an essential part of the transition process. These projects should provide incremental foreign exchange, and I am pleased to see that the waiver will also cover them. I suspect though in many such cases it may not make sense to have a separate legal entity receiving the incremental revenues. Think, for example, of an oil pipeline repair project. Would it really make sense to have one company operating the pipeline: and another responsible for repairs, and in some way receiving the extra income created by reducing leaks? The main safeguard for the Bank is the identification of incremental foreign exchange earnings, and the establishment of a lien over those earnings. The "special purpose entity" requirement seems in general a very cumbersome way to achieve this. At the very least I would hope Management will agree to consider sympathetically waiving this requirement, where there is good reason to do so. I can also see there may be cases where investors wish to route their loans in different ways, perhaps through intermediaries. So if there is to be a "special purpose entity" condition, I would prefer it to apply to the end beneficiary of the loan, even if the loan were to be routed through a financial intermediary. I see no reason why the waiver should not allow for a range of

possibilities of this sort, and would urge strongly that it should.

Privatisation

9. I welcome a general requirement for privatisation programme. However, I do not believe that there need be a requirement for the specific enterprise to be privatised, or in the process of privatisation.

Country of Lender

10. I welcome the relaxation of the restriction of the waiver to guarantees by ECAs in the country of the lender.