Disbursing World Bank Loans

When the World Bank was founded it was charged with a duty that was new in international finance; it had to ensure that the money it lent was well spent. The author describes how it discharges this duty in disbursing loans—a procedure which applies equally to credits granted by its affiliate, the International Development Association.

Norman G. Jones

THE ARTICLES OF AGREEMENT of the World Bank require it to ensure that the proceeds of any loan are used only for the purpose for which the loan was granted, with due attention to economy and efficiency. They also provide that the borrower shall be permitted by the Bank to withdraw the proceeds of the loan only to meet the expenses of the project as they are actually incurred. There are similar provisions in the Articles of Agreement of the Bank's affiliate, the International Development Association (IDA).

The policy of supervising projects to be financed out of the proceeds of loans and credits is thus clearly laid down in the charters of both the Bank and the Association. It was decided that this supervision could be exercised most effectively by controlling disbursements and supervising the physical development of the project.

A New Responsibility

In the period between the two World Wars, international loans were usually granted without any provision for supervision; the proceeds of a loan were generally paid out to the borrower immediately, without any provision for control over the way the money was spent. It is hardly surprising that the proceeds of loans were sometimes spent wastefully or that they gave out before the project was completed. This was the historical background against which it was intended that the Bank's procedures should stand out in sharp contrast.

To carry out the directive contained in its charter, the Bank procedures require loan funds to be set aside in an account on its books, to be paid out only as borrowers establish that funds are needed for a specific payment necessary for goods or services for the project which the Bank has agreed with the borrower. Although new as applied to development loans, such precautions are not new in banking practice; they are similar to those connected with documentary letters of credit issued by commercial banks throughout the world. They not only carry out the basic objective but also provide a means of knowing that the supplier is paid, that the cost of the goods or services is reasonable, and that the goods are in due course actually shipped to the borrowing country.

The "List of Goods"

During the negotiations for a loan the Bank agrees with the borrower not only the amount of the loan, but the goods and services which the loan will finance. On the basis of these discussions a list, which is known as the "List of Goods," is agreed with the borrower. This list does not go into detail, but merely summarizes the various parts of the project and allocates to each the amount of the loan to be applied. A typical List of Goods for a loan for a hydroelectric power project might consist of five categories:

Category A: Civil Works Construction of Dam and Power House

Category B: Mechanical and Electrical Equipment for Power House

Category C: Distribution Equipment and Substations

Category D: Supply and Erection of Transmission Lines

Category E: Consulting Engineering Services (A portion of the loan may be shown as "Unallocated," or "Contingencies.")

The effect of this List of Goods is that the borrower has a number of accounts against which he can draw, and the amount allocated to each category cannot be exceeded except by agreement with the Bank. The amounts allocated to each main category are normally based on an estimate of the cost of the project and, as the borrower at the time of negotiations will usually have placed few if any contracts, revisions of the List of Goods are often necessary. These are made by a simple exchange of letters between the Bank and the borrower.

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A List of Goods drawn up in this way forms the basis of the Bank's supervision of disbursements and assists the Bank to judge whether the goods which the borrower proposes to purchase are appropriate to the project, and whether the prices charged are reasonable.

A recent study of Bank and IDA disbursement policy recommended that instead of using a document entitled "List of Goods" the Bank and the borrower should agree on a document entitled "Allocation of Loan Proceeds." This change is in process.

Requests for Withdrawals

The actual way in which payments are made depends on the circumstances. While the gen-

eral lines of the Bank's disbursement system are now firmly established, new problems are constantly met, and the Bank tries to be flexible in its approach and to work out with the borrower a satisfactory solution in line with normal commercial and financial practices.

During the loan negotiations the Bank's disbursement procedures and requirements are explained to the borrower's representatives, and after the loan has been signed a disbursement letter is sent, together with samples of application forms and a memorandum describing in detail how each type of application for withdrawal of funds should be prepared. During the negotiations the borrower is also given an explanation of the Bank's procurement policies and requirements for reporting progress.

Withdrawals from a Loan Account may be made only against a formal application submitted by the borrower in accordance with the Loan Agreement. With one exception, which will be discussed separately below, disbursements are made only against documentation normally used in commercial letter-of-credit transactions, such as suppliers' invoices, bills of lading, and so on. The system provides the Bank with information about the goods and services on which loan funds are expended and reduces the burden of making detailed checks on the spot. It also enables the Bank to ensure that contracts which are too small to require approval before the contract is awarded are placed in member countries and that the goods are appropriate.

This kind of disbursement, against full documentation on the basis of a List of Goods, is particularly advisable when the Bank is involved in joint financing with other lending agencies. It not only minimizes the possibility of two agencies paying for the same thing, but often leads the other agencies to place greater reliance upon the Bank as primary administrator.

The process has another virtue. There are certain member countries of the Bank that have been unable to release all or part of their 9 per cent subscription to the Bank on a convertible basis, but have indicated that all or part of their remaining subscription might be released to finance exports from their own territories purchased under Bank loans. Whenever the Bank becomes aware of such transactions, it invites the government in question to release such funds.

Methods of Payment

When it comes to the actual making of the payment, the Bank has four established disbursement procedures. They are not in the least complicated, as they follow normal commercial practices. The Bank can either reimburse a borrower for expenditures already made or, at the request of a borrower, make payment direct to a supplier on the borrower's behalf. On occasion the Bank, if it so agrees, can issue either its qualified or its irrevocable agreement to a commercial bank to reimburse that bank for payments made under an approved letter of credit.

Under the first procedure for reimbursement, the application must normally be supported by a copy of the supplier's invoice, evidence that the supplier has been paid, and evidence of shipment, normally a bill of lading.

Under the second procedure, the application by the borrower is very similar. It must be supported by a copy of the contract or pur-

chase order, a copy of the supplier's invoice, and in due course, once again, by a copy of the bill of lading showing that shipment has been made. The point to note here is that the World Bank does not act as a commercial bank and consequently cannot undertake to make payment on a specified date or against documents presented by the supplier; it can act only on the basis of applications received from the borrower.

The third and fourth procedures are used when a supplier requires a borrower to open a commercial letter of credit in his favor and the commercial bank in the supplier's country is unwilling to confirm the credit without some security. The paying bank first makes a written request to the borrower asking for either the Bank's irrevocable or its qualified Agreement to Reimburse. The borrower then submits a formal application authorizing and requesting the Bank to issue its Agreement to the commercial bank concerned, and requesting the Bank to reimburse the commercial bank for payments made by it under the credit. If the Bank approves the application, it issues its Agreement to Reimburse direct to the commercial bank. As payments are made under the credit, the commercial bank requests reimbursement direct from the Bank.

When the Bank gives its irrevocable Agreement to Reimburse to a commercial bank, this is a "special commitment" covered by the Bank's Loan Regulations, and a special commitment charge of ½ of 1 per cent is made. If only a qualified agreement is requested and issued by the Bank, however, no additional charge is made, since in the event of the borrower's right to make withdrawals under a loan agreement being suspended or canceled the Bank is not obligated to reimburse the commercial bank for any payments made by it subsequent to the date of such suspension or cancellation.

There is one exception to the rule that disbursements are made only against readily available commercial documentation. This occurs when, because of the type of goods and services to be financed, it is not practicable from an administrative point of view to require the borrower to furnish documentation—for example, in loans where the construction work is being carried out by an agency of the borrower by force account or day labor and the amount of the loan is fixed as a percentage of the total estimated cost of the project. In loans of this type the application is merely supported by a certified statement by the borrower of the total amount that has been expended on the project. These expenditures, however, are always subject to a check at a later date by Bank staff on project supervision missions.

Summing Up

While the way in which the Bank makes disbursements of its loans may appear to be more of technical than of general interest, it in fact casts a good deal of light on the nature and extent of the Bank's responsibilities, and even on its constitution and standing as an international organization. It shows how much more far-reaching its responsibilities are than the primary one of providing finance.

There is now a good deal of experience to suggest that those wide responsibilities are recognized and that the procedures that flow from them are acceptable. To date the Bank and IDA, using these procedures, have disbursed

more than the equivalent of $8 billion in some 40 currencies on over 500 loans and credits. In doing so they have worked with hundreds of commercial banks and suppliers of goods throughout the world. The fact that investors and others consider the Bank to be a "sound institution"—in large part because of its control over disbursements—indicates that the procedures are sufficiently restrictive on borrowers. The fact that no borrower, bank or supplier, has raised a serious objection to the efficiency of the procedures indicates their effectiveness in enabling borrowers to draw down the funds as needed.