UNDP and the "Pre-investment Vacuum"

by Brian Johnson [1]

Technical Assistance and capital investment are generally thought of as distinct concepts, though the former is widely recognised as often being an important component of the latter. The description "pre-investment" as a category of development-enhancing activity has, however, always been problematic. "Pre-investment" as used to describe a broad range of activities, first cropped up in UN development jargon in the mid-1950s. As a concept, it rapidly gained currency in development institutions beyond the technical assistance-providing UN specialised agencies. The reason for this is not hard to divine. During the public aid burgeoning of the late 1950s, the excess of available resources over feasible-looking projects was very evident, and this "gap" was to continue throughout the 1960s, in some sense persisting today.

But the idea of evolving separate and specialised institutions for pre-investment and investment had little to do with the widely perceived pre-investment gap. It emerged from the _political_ requirements of one particular agency: the UN Special Fund (after its 1965 merger with the Expanded Programme of Technical Assistance, the UN Development Programme). In a recent monograph[2] K. W. Taylor, who was until recently chief of the Development Finance Service of UNDP, has described some of the results of the political compromise which produced the UN's pre-investment agency. General Assembly resolution 1240 (XIII) which created the Special Fund, was the bargaining outcome of the poor nations' desire to create SUNFED (Special United Nations Fund for Economic Development, which was to be a recipient-controlled development fund into which all nations would pay a percentage of their GNP each year), and the rich nations' unwillingness to contribute a multilateral aid scheme on such a scale and under such conditions. The functions of the Special Fund had, therefore, to be clearly differentiated from

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[2] _The Pre-investment Function in the International Development System_, K. W. Taylor, Carnegie Endowment Occasional Paper No. 8, October 1970. A shorter and more accessible version of this paper appeared as an article in _International Development Review_.

conventional technical assistance, at the insistence of the poor countries, and from capital investment, at the insistence of the rich. The final form of words of the compromise established a fund to create "...conditions which would make...investment either feasible or more effective".

How feasible has it proved in practice to separate, within the multilateral aid system of the UN, the function of preparing the ground for capital, from the actual provision of capital? When discussing the capital-attracting performance of the UNDP's Special Fund projects it is important to realise that only about one third of the funds so far allocated have been to pre-investment in the narrow sense of the term, i.e. to projects whose objective is to identify opportunities, and prepare specific proposals for capital investment. The remaining two thirds of the UNDP s Special Fund resources have been fairly evenly divided between the establishment or support of training institutions and research-related projects. Both of these two latter activities can be (and are) represented as pre-investment in the sense that they pave the way for indigenous management and support for capital investment projects. Yet their effectiveness cannot be measured by any yardstick, as can, to some extent at least, the one-third of the Programme devoted to survey-type projects, whose results may be expressed in the form of an investment yield on a pre-investment input.

As Taylor points out, the follow-up results of UNDP's "survey sector" have not been very impressive. So far, roughly $800 million spent on basic infrastructure, agricultural and natural resource surveys has directly stimulated about $2.1 billion in "follow-up" money. If one regards UNDP's $800 million as "seed money" (which Administrator Paul Hoffman does, at least for public relations purposes), then clearly this 5 for 2 yield is unconvincing. It is even less so when one realises that this return has been achieved by a very high yield on a few projects, a large number of survey project reports having attracted nothing but dust.

A brief examination of the sources of the $2.1 billion of investment follow-up goes far to explain the reason for this state of affairs. More than two-thirds of this sum has been directly provided, or stimulated by the World Bank Group, through Bank loans, IDA credits, 'joint financing' organised by the governments. At the same time, only 24 per cent came from official and private bilateral sources, which it must be remembered, account for almost 90 per cent of total external capital flows.

World Bank predominance in this investment follow-up has not occurred simply through inertia or by chance. The link between UNDP's Special Fund Sector and the Bank Group was a close one from the start. From the earliest days of the Special Fund, an informal arrangement has existed between the Bank and the UNDP whereby the Bank gives the UNDP the "right of first refusal" to finance its pre-investment surveys costing in excess of $100,000, the government of the recipient country having submitted a formal request for such assistance. Clearly this procedure, which operates in the case of two-thirds of the UNDP's survey-type projects that have yielded fruit, requires nothing but paper-processing by the UNDP, even though its results are set forth on UNDP's promotional literature as a major demonstration as to the effectiveness of the Programme and the efficacy of the pre-investment concept.

What about the other, and much larger, group of the UNDP's survey-type projects which have yielded very little identifiable fruit? Significantly, these were almost exclusively carried out by the UN Specialised Agencies, whose approach Taylor characterises as "more technically oriented than investment oriented, which has led to the production of massive technical reports which are 'unbankable', i.e. which are almost totally devoid of the financial data and analyses that they are needed for investment decision". Taylor argues that the UNDP has not succeeded in filling the "pre-investment vacuum" primarily because of "functional and professional failure to carry the required pre-investment to the final stage, that is, to produce fully bankable reports and feasibility studies in a form suitable for investment decision. Curiously, however, Taylor never questions the basic validity of the concept of separating pre-investment from investment at a certain arbitrarily defined stage.

Surely the relevant question that must be asked is, if a compromise between rich and poor nations over the SUNFED had not been necessary, would the pre-investment function ever have been separated from investment? Surely, too, the only people who can supply the answer are those responsible for making the loan or credit commitments - the bankers themselves, whether public or private, national or international. In the light of Taylor's paper, I have discussed the question of separating the preparation of a lending proposition from the banking decision with a number of individuals in a variety of walks of banking. In each case, the answer was unequivocal and the same. The decision as to what is a 'bankable proposition' can only be made by a bank. Furthermore, as every bank, whether in the public or private sector, has its own characteristics and requirements, it is generally infeasible even for banking institutions with similar operations, character and clientele to prepare loan proposals for one another. In the case of consortia, agreement as to 'bankability' is arrived at by a process or negotiation in which all parties participate actively.

All this is not to deny that UNDP has had, and continues to have, an important role as an independent provider of surveys, e.g. of mineral deposits, for countries that prefer not to trust alternative (bilateral or Paris-club multilateral) sources of help. Much was made of UNDP's potential in this area in its earlier days. Clearly there have been cases in which this was a government's initial motivation in going to UNDP for a resource survey. But this type of broad-gauge operation, which UNDP continues to be well-equipped to sponsor, cannot readily be combined with the very specialised business of finding the funds, and establishing the terms, for exploitation of the investment opportunity. Appraisal of the political future of the government (or country) concerned is at least as important in 'bankability' studies as technical knowledge of the economic potential of the land or the people. This is not a role for which the UNDP is politically suited. UNDP can, however, having revealed the extent and quality of a natural resource, play a vital advisory role in helping a developing country make choices between different types and terms of external finance, as indeed between different alternatives for the channelling of domestic savings.

In practice the UNDP's specifically capital-attracting function has been, and, in my view, is bound to be, the victim of power realities which were glossed-over by General Assembly resolution 1240. The current tendency for the pre-investment function to merge with the investment function is the result. UNDP's failure to produce a supply of 'bankable' studies in its collaboration with agencies other than the World Bank, has led the Bank to develop its own direct relations with individual Specialised Agencies of the UN (UNESCO, FAO, WHO) on a bilateral basis, and with impressive results. Moreover the World Bank's 'bilateral' arrangements with other multilateral agencies produces feasibility studies which are not made available to other sources of finance, such as the regional development banks. Unable to get or accept a "finished product" ready for financing from the UNDP, and without access to the Bank's bilaterally-arranged feasibility studies, the regional banks have chosen to finance and carry out their own pre-investment work.

All of this may be seen as a World Bank drive for hegemony with the multilateral development system. But equally it may be seen as the logical outcome of bankers' refusal to take anyone else's judgment but their own as to the security of their depositors' money. What are the implications of this trend for the future activities of UNDP? One possibility is that the present tendency for the UNDP to finance studies which are "second stage" or even "third stage" follow-up on the broad-gauge findings of earlier survey projects will continue, and that small-scale UNDP projects shaped around a perceived financing possibility, will proliferate. Although the survey-type share of UNDP-financed activities has been declining gradually over recent years, this trend of "probing towards bankability" has maintained a considerable degree of momentum. The growth of pre-investment activities by regional banks and other financing institutions has not so far produced any noticeable shrinkage of UNDP-financed activities in this area, though there are signs that this will be happening in future.

Yet the problem remains that the UNDP's results - excluding World Bank follow-up - are dismal in relation to resources expended.

Various remedies have been suggested. Principally they concentrate on involving the World Bank and the regional development banks more in the UNDP's project selection and preparation process. I do not believe that such proposed remedies for the UNDP's "pre-investment vacuum" would help. Indeed I see danger in a protraction of confusion as to the possible role of UNDP in directing resources to specific projects and offering its politically pale blue flag as a background to what will, in many cases, be distinctly dark blue terms for financing. Naturally both donor governments and individual investors would be delighted for the UNDP to play a greater intermediary role in organising follow-up finance. But this could so easily in practice mean persuading recipient countries to accept terms of lending or investment heavily in favour of the financier. If you cannot serve God and Mammon, can you play Minerva and Panarus?

Finally, it must be observed that any attempt to define separate technical assistance, pre-investment and investment functions contains an element of unrealism. There is a strong capital content in many, if not most, UNDP training and research, as well as survey projects, in that the local counterpart contribution and the UNDP foreign exchange input purchase significant capital installations in the form of buildings and equipment. The fact that the average cost of each of a number of UNDP-financed training centres is not more than $2.5 million, whereas a single IDA credit for a school system may run to $40 - $50 million demonstrates difference of scale but scarcely of type as between capital aid and technical assistance.

Any discussion of appropriateness of roles for international agencies must return to the central question of their political power relationship to one another, to which functional divisions will always be subordinate. The fact of the matter is that UNDP <u>does</u> have a different political character and "flavour" both from the specialised agencies individually, and the World Bank and regional banks. Its peculiar blend of donor country financial control through the voluntary nature of their contributions, recipient country orientation (through the Third World majority on the Governing Council) and Eastern European liaison and affiliation dictates that this should be so.

Today UNDP's new scale is beginning to give this unique character a chance to assert itself. The Programme's present $240 million in annual contributions may well grow to a level of over $500 million annually in the next four or five years. Can a new order of magnitude give this "pre-investment" programme a gravitational field which will alter its present relationship to the development banks and other providers of capital aid? My reasons for doubting this possibility are not altered by the UNDP's prospective expansion. Banks and companies will still insist on control of the allocation of their depositors' or shareholders' money. It therefore seems to me particularly important that UNDP should concentrate on its task of promoting the multilateral exchange of knowledge, skills and technical equipment between the

First, Second and Third worlds, which is the one role to which it is uniquely suited.

Other activities, which the UNDP may also be uniquely placed to supervise in future should gradually be added. UNDP should prepare itself to vet, upon request, national development plans in relation to regional and global considerations. This must mean taking environmental and ecological considerations into account. Another area of activity for which UNDP is potentially uniquely equipped is that of giving international financial priority to training and research on global problems. Oceanic, atmospheric and soil pollution, urban studies and general systems research are some of the areas to which UNDP should direct research, training and public attention, in addition to its current invaluable work in building socio-economic infrastructures that can cope with capital development.

All of these activities could, if necessary, be labelled pre-investment, since they are, or should be, the pre-condition to future investments in development in all three worlds. Given the foreseeable distribution of power and resources among international agencies, they would all be more fruitful areas for the UNDP's attention than concern over a pre-investment vacuum which must, of necessity, be filled by the investors of capital themselves.