

that the task of promoting small industries lies primarily with national development agencies, or at least with agencies that are strongly and extensively represented in the field, since a local presence is necessary for assessment in personal terms of the degree of entrepreneurial commitment, assistance in working up an idea into a viable proposition, assistance in the acquisition of basic business skills, such as book-keeping, and early warning when the small business man's vulnerability to short-term problems is getting him into difficulty. Compared with national development banks concerned with the promotion of medium and large-scale industries, agencies for the promotion of small industries have been relatively little used by the major international lenders as financial intermediaries, because of a prevalent assumption that their main need is technical assistance. Yet such agencies do need financial support in the performance of their role, in association with technical services, which suggests that a Commonwealth Investment Bank could fulfil a useful purpose in a relatively neglected field of international development cooperation.

General Purpose Borrowing

47. The needs in relation to general purpose borrowing are not confined to those countries which are sufficiently creditworthy to go to the market. In addition to helping creditworthy countries to organise their borrowing as cheaply as possible, a Commonwealth Investment Bank could play a useful role in helping countries to assess and compare the true worth of the services offered by commercial banks and other private intermediaries, even in countries of limited borrowing capacity.

Other Areas Considered

48. The other areas that we have considered fall mainly under the heading of invisibles. In particular, we have looked at three areas in which it is frequently argued, notably in the context of Unctad debates, that the dominance of developed countries imposes an unnecessary strain on developing countries' foreign exchange resources. These are:

- (a) insurance;
- (b) shipping;
- (c) tourism.

We do not believe that simply building up developing countries' capacity in these three areas provides an adequate solution to the problems that arise. In insurance, we see no easy way of avoiding the cost of re-insuring in one of the established insurance markets. Both in shipping and in tourism, we note that considerable efforts have already been made, and that in the light of experience many developing countries are now re-considering their policies. We would draw attention to the possibility of expanding the functions of the CFTC in these fields, to assist developing countries in making discriminating use of the facilities that are available, but we are not convinced that the problems are primarily financial, or that a financial intermediary could make a significant contribution to their solution.

IV. THE TASK OF ESTABLISHING THE BANK

49. A bank capable of responding to the needs identified in the two

preceding sections would have to possess the following characteristics:

- (a) a high degree of operational flexibility;
- (b) knowledge of, and a determination to work with, a wide range of other financial institutions;
- (c) a capacity to sustain an uncompromisingly business-like image while remaining sensitive to the developmental aspirations of its principal clients;
- (d) a professional command of some highly specialised skills.

The performance of its intermediary role requires above all that it should avoid the tendency which is sometimes attributed to existing international development agencies, of imposing their own operational preferences instead of trying to respond to the preferences of their clients.

50. To establish and run a bank with these characteristics will impose far greater demands both on its backers and on its staff than would the establishment and running of a more or less self-contained operational agency. Even if the charge that existing development agencies tend to impose their own preferences is open to challenge, it is certainly true that they find it easier to operate in situations in which they retain a controlling position. Our aim in this section is to provide a realistic assessment of some of the principal difficulties to be overcome, which we see as lying in five main areas:

- (a) the time-scale for establishing a Commonwealth Investment Bank;
- (b) staffing;
- (c) relations with member countries;
- (d) relations with non-member countries;
- (e) commercial and financial risk.

In the concluding section, we make specific suggestions concerning the structure of the Bank, which we think would go some way towards resolving these difficulties. But we do not think that they can be totally eliminated, or that they should be glossed over.

Time- Scale

51. Experience suggests that the establishment of a new financial institution tends to take longer than expected. Our view, and the view of those whom we have consulted, is that it might take two years to build up the staff of a Commonwealth Investment Bank to a level at which it would be capable of operating effectively, and that it might require a further period of between three and five years before it had built up a sufficient volume of business to be fully self-supporting and capable of expanding its operations purely on the basis of its own record. During this initial period, it will require special support from its members, though we do not think this support should be continued indefinitely. We have given a tentative estimate of administrative costs during the preliminary two-year period, before the Bank has begun to earn a normal income, in Annex X. These administrative costs would have to be financed by, and would for an intermediate period absorb, the

interest on the Bank's capital, which during this period will presumably be held in the form of time deposits and other liquid assets. However, as the Bank begins to do business, it seems inevitable that in the early stages, before it has established the sort of reputation required for the performance of its intermediary role, direct lending from its own resources will figure more prominently in its operations than is ultimately envisaged, and for this it will need extra backing on a temporary basis.

52. We have identified two major respects - the incorporation of a soft window and the provision of venture capital - in which the Bank may have to reconsider its position once it is securely established. Furthermore, we have suggested above that a transitional period will be required before the Bank can develop its intermediary role. There is clearly a danger that in the process of establishing itself the Bank could become committed to practices which would impede a subsequent review of these issues, and which might therefore prevent it from functioning as intended. The phasing of the Bank's transition from one stage to another will need to be carefully thought out in advance, and precautions taken against the onset of operational rigidity.

Staffing

53. The Bank will be granted authorised status by HM Treasury,¹ and will gain acceptance from the commercial banks with which it will need close relations, only if it is seen to be run by people with the experience and qualifications that the performance of its functions requires. Staff of the required standing will not be easy to find, and to attract them will require the payment of internationally competitive salaries. Apart from the crucial question of the appointment of the chief executive, we see three main staffing needs which may be difficult to fulfil:

- (a) a specialist in UK exchange control;
- (b) at least one first-class foreign exchange dealer, and eventually a team;
- (c) several bankers with experience of putting projects together in developing countries, especially in the natural resources sectors.

We do not think these problems are insuperable, especially as we do not envisage a large staff, perhaps twenty to twenty-five professionals in the fourth year (see Annex X). However, there are two requirements for their solution:

- (a) that the Bank should be seen to have the substantial backing, preferably as shareholders, of a number of private banks with established reputations in the City of London;
- (b) that the governmental shareholders should recognise the overwhelming importance of recruiting the best staff possible, not necessarily ruling out non-Commonwealth citizens in specialist positions.

¹ In this paragraph, it is assumed that the Bank would be located in London - cf. para. 77 below.

54. The key to effective staffing, as indeed to many other aspects of the Bank's development, is the appointment of the chief executive. We assume that the need to make this appointment on the basis of personal quality and professional qualifications will be widely recognised, and that political considerations will enter only to the extent that there are certain obvious minimum conditions of acceptability that need to be met.

Relations with Member Countries

55. We have suggested that the Bank will require some form of special support in its early years. It would be alien both to the spirit and to the substance of our proposal to expect that support to come exclusively or even primarily from Commonwealth developed countries. A question arises, therefore, concerning the extent to which the political will exists, on the part of Commonwealth developed and developing countries alike, to give the Bank effective support in its initial funding. The answer to that question depends partly on the amount of support required. In the next section, we suggest that it would be possible and indeed desirable to establish the Bank with an equity and loan capital structure which imposes a relatively small burden on its members.

56. There are two other respects in which the attitude of countries considering the possibility of participating in a Commonwealth Investment Bank needs careful assessment. First, does the potential utility of the Bank constitute a sufficient inducement to member countries to bring business to it in the early years of its development? In our view, this question has at least as significant a bearing on the ability of the Bank to establish itself as the question of funding. Secondly, will the Bank's need to attract business provide a sufficient assurance that it will endeavour to meet its members' requirements, without the imposition of political controls? To establish itself as a credible mobiliser of external capital, the Bank will need considerable freedom of action. Political controls, while superficially seeming to bring it more closely into conformity with members' requirements, could frustrate it in the performance of its principal function.

Relations with Non-Member Countries

57. In some respects, notably in the syndication of loans, the mobilisation of export credits, and procurement, to confine the Bank to operations in Commonwealth countries might be unduly restrictive. At the same time, the case for the Bank as a Commonwealth institution rests on a belief that the Commonwealth relationship is advantageous to all its members, including its developed country members. This case will be strengthened if the generally desirable principles of freedom to seek procurement from the cheapest source of supply and to explore all possible sources of capital are tempered with some measure of Commonwealth preference, but it will not be easy to strike the right balance, and even less easy to translate that balance into watertight legal provisions.

Commercial and Financial Risk

58. A bank which is primarily concerned with the financing of projects in the productive sectors depends essentially for its income on the profitability of the enterprises that it supports. For certainty of repayment, it depends on the strength of the security that it can take. It will of course seek the normal assurances of appropriate guarantees and other forms of

security in its operations. But it should not seek special protection in respect of any risks inherent in the projects which it finances, and should be steered away from the temptation to rely on government guarantees as the main element in its own creditworthiness. If a significant proportion of the enterprises supported by the Bank fail, it, too, will have failed, and its shareholders will stand to lose their equity stake. We believe that this risk should be faced, as a necessary discipline in the Bank's operations. We do not believe that the areas of need which we have identified require an institution which is set up to make losses.

59. For an institution which both borrows and lends on essentially commercial terms there is, however, a more general risk relating to the creditworthiness of borrowing countries. Indeed, the question arises whether operations on such terms are appropriate to some of the poorer Commonwealth countries with particularly difficult development tasks. In this connection, we consider that the case for a bank of the type that we envisage rests partly on evidence which suggests that even in the poorest countries there are projects offering the potential of high economic returns, but which are held up by problems of assembling the needed financial, technical and managerial package. Probably all countries resort to borrowing on commercial terms in addition to assistance received on concessionary terms. By helping to ensure that such borrowing would be undertaken on the most favourable terms and conditions, and that the projects financed would be effective in earning or saving foreign exchange, a Commonwealth Investment Bank would in fact strengthen the creditworthiness of the borrowing country. This would not be sufficient in itself to guard against the possibilities of balance of payment and debt-servicing difficulties in borrowing countries. However, on the assumption that Commonwealth countries would value the services provided by a Commonwealth Investment Bank, it would be important that they should protect the Bank's own ability to borrow by avoiding default on their debt service liabilities to the Bank.

V. RECOMMENDATIONS

Functions of a Commonwealth Investment Bank

60. We propose the establishment of a Commonwealth Investment Bank with the following principal functions:

- (a) to take a financial participation in and to assist the efforts of Commonwealth countries to diversify and enlarge their sources of external capital;
- (b) to assist Commonwealth countries in the identification and preparation of projects, especially projects in the productive sectors, and in the mobilisation of finance for such projects;
- (c) to assist Commonwealth countries in organising the capital structure of projects on a sound financial basis, especially projects in which governments or public enterprises are major participants;
- (d) to assist Commonwealth countries in the identification of and negotiations with suitable foreign partners in the promotion of joint ventures;