

PLANNING AND FINANCING OF PROJECTS IN ETHIOPIA

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1. INTRODUCTION

The intention of this paper is to outline the main points which should be considered when planning a project. The paper is based mainly on the experience gained by the author in undertaking projects when working in the Ministry of National Community Development and Social Welfare, Awash Valley Authority, Planning Commission Office and Technical Agency. As to the procedure of how to go about each item, the Planning Commission Office has recently prepared a manual entitled "A Guide to Project Planning in Ethiopia" which, it is hoped, will be published soon for general use.

2. PLANNING

Planning has been defined in many ways, but most authorities agree that it is, in essence, an organised, conscious and continual attempt to achieve specific goals. Economic Planning involves the economizing of scarce resources to achieve defined goals. Development Planning embraces change in the economic and social institutional framework in the process of securing an acceleration in the rate of economic and social progress. A shorthand statement of development planning's primary goal is "**change plus growth**".

Development planning includes subnational and multinational regional planning. Subnational regional planning may mean planning for one region, or planning for a series of regions covering an entire country. Multinational regional planning may refer to planning for an economic region which extends beyond the boundaries of one country. It may also refer to planning for one or more economic sectors of two or more countries. Or it may refer to the co-ordination of national plans or the setting of integrated targets for the economies of several countries which are members of an international regional organization.

Our Government considers it desirable to formulate comprehensive economic programs both for public and private sectors as a framework for our economic development activities and these programs take much of their physical form through the execution of individual projects. Since capital and skilled labour are relatively more scarce in our country (as in the case of all developing countries) it must be put to the most effective uses.

3. PROJECT PLANNING

The purpose of project planning is, therefore, to achieve the above-mentioned end by making as sure as the circumstances permit that the project is technically sound, that it will provide a reasonable economic and where appropriate, financial return, that its objectives cannot be achieved in some less costly way and that it fits in with the overall economic objectives of the country.

Although in a highly abstract sense planning may be thought of as a process in which a broad macro-economic framework is established and then filtered down to sectors and finally to individual investments, in practice this never happens. Instead, planning is characterized by a "top down, bottom up" process. The "top down" aspect includes:

- a) the definition of major objectives
- b) the definition of plan size
- c) the making of broad allocations among sectors and
- d) the degree of comprehensiveness

The "bottom up" process includes:

- a) sketching of development prospects for each sector
- b) the setting of production targets in fairly specific terms for the period of the plan
- c) the generation of specific projects and programs
- d) the estimation of costs
- e) the specification of a policy framework and the administrative means within which projects and programs will be carried out.

A project passes through various stages from the time it is first identified as potentially attractive, to its preparation, and eventually to the time it goes into operation.

3.1 Project Identification involves a preliminary determination of the nature, size and scope of potential projects and the establishment of their possible priority in the country's development program.

As mentioned earlier, on the basis of the National Development Plan which shows priority sectors and indicates areas which require action, projects could be identified through:

- a) The Planning and Programming Units of the Ministries, Agencies, Financial Intermediaries such as the Agricultural and Industrial Development Bank (AIDB), Ethiopian Tourism and Hotel Investment Corporation (ETHIC) and by private investors;
- b) The World Bank Economic Missions, which, in exploring possibilities, may note and bring to the Government's attention projects that appear to deserve priority for investigation or execution;
- c) Specific project identification missions undertaken by the Ministries, Agencies, private investors (domestic and foreign), or by International Organizations such as the World Bank/IDA staff, FAO/IBRD Co-Operative Program, FAO or UNESCO;
- d) The World Bank field office established in East Africa to advise member-countries on all aspects of project identification;
- e) Sector studies undertaken by Ministries, Agencies, Financial Intermediaries, Private Investors (domestic and foreign) or through consultants or International Organizations of the United Nations;
- f) UN Special Fund Studies;
- g) Bilateral and/or Multilateral assistance.

At this stage of project identification, it is advisable to notify financing institutions about the project in order to obtain their reaction and possibly their assistance in the preparation of the project and also to enable them to follow up the project.

Once a project is identified a prefeasibility study should be carried out to avoid unnecessary wastage of resources in carrying out a complete feasibility study. Such a study could be carried out by the ministries or agencies concerned alone or with external assistance as indicated above.

3.2 Project Preparation usually refers to "feasibility study" which consists of a more detailed study of a project which has already been identified. The aim of a feasibility study is to provide all the information necessary to determine whether and how a particular project can be carried out in accordance with sound

principles and at a cost which compares favourably with the contribution it can be expected to make to development.

A feasibility study of a project includes preliminary investigations and reports concerning the general layout and design and the estimated cost of the project, economic and financial justifications, the time required for its construction, the organization and management aspect of the project. Project preparation does not normally include the further detailed engineering which would be required in order to invite tenders.

3.3 Planning of feasibility studies includes:

- 1) Specifying the information which has to be gathered;
- 2) Defining the studies needed to provide such information;
- 3) Establishing the necessary priority among the phases of the investigation;
- 4) Defining how those studies can best be financed, organized and presented;
- 5) Preparing the appropriate terms of reference;
- 6) Selecting an appropriate consultant for the studies, or study group within a Ministry, for example;
- 7) Supervising the study.

Feasibility studies on some agricultural and industrial projects are at present being carried out by the Ministries and Agencies through their planning and programming units in cooperation with the operative departments. However, feasibility studies concerning sizeable projects — especially engineering projects — are still undertaken by International Consulting Firms.

I should point out that by far the greater number of failures in carrying out public sector projects and programs at a reasonable cost and in reasonable periods of time are traceable to inadequate project selection and preparation. We are not yet fully aware of the necessity of selecting soundly conceived projects with potentially high yields, defining their scope with clarity, estimating their national currency and foreign exchange requirements with a sufficient degree of accuracy and laying down realistic schedules for their execution.

3.4 Terms of Reference for a Feasibility Study of a Project — The terms of reference for feasibility studies should be carefully worked out specifying the objectives and the scope (what the consultant shall and shall not do), method of approach, timing, staffing, costs. These should be augmented by appropriate legal clauses. The terms of reference may be initially drafted by the Ministry or Agency sponsoring the project, with the assistance of the Planning Commission Office where needed, and then revised with the assistance of International

Organizations such as FAO, FAO/IBRD, IBRD, etc., or other organizations from aid-giving countries which may be involved in the preparation of a project. International Financing Institutions such as the World Bank usually assist developing countries in preparing terms of reference for consultants. It is of utmost importance that terms of reference for a study be carefully handled so that the consultants know precisely what is required, and thus subsequent disappointments and litigations with them may be avoided.

3.5 Selection of Consultants — Once the terms of reference are prepared for a study, selection of the right type of consultants will follow. The selection of a consulting firm for a particular assignment should begin with the preparation of a reasonably sized list of firms claiming expertise in the field. The list may then be shortened by detailed studies of each firm's experience and capabilities until four or five remain. In cases where the project is to be financed subsequently from International Financing Institutions such as the World Bank, it is necessary that the client submit to the financing institution the final list of consultants before invitations for proposals are sent out so that the financing institution may satisfy itself that the firms are qualified to perform the work. Invitations should define the objectives of the undertaking and stipulate the conditions under which the work is to be performed. It should be clearly indicated that financial terms are not desired at this stage, that selection will be made entirely on the basis of qualifications to perform the work and not on price. Consultants should furnish, as part of their proposals, estimates of the time required both in the field and in the home office to comply with the terms of reference, as well as the names and qualifications of those who would comprise the team.

Proposals when received should be carefully analysed and compared with respect to plans of approach, schedules, the amount of time to be spent in the field and home office, experience and capabilities of personnel to be assigned, the quality of supervisory leadership to be supplied, attention to be given by supervisory leadership to be furnished, attention to be given by principals of the firm, facilities of the home office and the assistance, if any, that may be available from others. Familiarity with the language and customs of the country in which the work is to be performed should be given due consideration. After selection has been made of a firm considered to be best qualified for the assignment, negotiations should be opened in order to agree upon the financial terms of the contract.

The firm selected should submit a statement of its estimated costs and proposed remuneration and be ready to justify the items involved. If the proposed financial terms appear reasonable a contract should be entered into: if they appear too high, efforts should be made to reach a mutually satisfactory agreement. If this is not possible, negotiations should be terminated and opened with the firm next in line.

When the International Financing Institution such as the World Bank makes its selection, the names of firms to be asked for proposals are usually submitted to the beneficiary for comment and statement of any objections before the invitations are sent out.

As the consultants become advisor to and representative of the client, there should be no conflict of interests between the two. Consultants must work in the best interest of their client, even at times to their own financial disadvantages. In engaging consultants for any purpose the client entrusts his interests to the judgement and integrity of the consultants. All this points to the necessity of keeping the relationship between client and consultants on a high ethical and professional basis. In general for the reasons given above, it is not recommendable to engage consultants from the institution, firm or country which will subsequently finance the project or supply the required equipment.

3.6 Contract between the Client and a Consulting Firm — After a consulting firm satisfactory to the client has been chosen, it is necessary to see that the responsibilities of the consultant are clearly set out in his contract with the client and that he is fully employed in carrying out those responsibilities. It is essential that the section describing the services to be performed, the sequence of work, the information to be supplied by the client and the terms of payment should be prepared by someone with a considerable knowledge of these matters. To achieve this, it is necessary to agree on terms of reference for inclusion in the contract and to insure that the consulting engineer is aware of the full implications of the terms and conditions of his employment. It is also necessary to give to the consulting firms sufficient power and discretionary rights to exercise their responsibilities and carry out the terms of their contract.

3.7. Training of Local Professionals during the preparation of a Feasibility Study of a Project — When carrying out feasibility studies through consulting firms, it is of utmost importance that the client assigns to the consultants, to the extent possible, professional people for the duration of the study so that (1) young local experts gain experience and training in undertaking such a study, and (2) they follow the matter closely for subsequent actions after the consultants have completed the study and left the country. This aspect seems to be overlooked by most of the Ministries and Agencies, but it is one of the most effective ways of training (and building up) local experts.

3.8 Steering Committee to Supervise the Progress of a Feasibility Study From past experience, we have learnt that it is most convenient to set up a steering committee right from the initiation of the preparation of a feasibility study of a project. The steering committee may be composed of representatives of the client, the consulting firm who will undertake the study, the institution which will subsequently finance the project and the Ministries and Agencies concerned.

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The purpose of the steering committee will be to review the progress reports that will be submitted by the consultants and to advise on the next steps to be taken. This is a very good procedure for raising and clarifying all questions, in the process of the preparation of the project. It is also advantageous to all concerned — the client, the consultants and the financing institutions since most points will be discussed and agreed upon prior to the submission of the final report. It will avoid disappointments and litigations after the study has been completed and the final reports forwarded. This will also facilitate the appraisal of the project by financing institutions because they will have followed the project closely through their representatives in the steering committee. International Financing Institutions such as the World Bank support such a follow-up of project procedures and they are willing to assist in this kind of activity.

3.9 Appraisal of Projects - In general, project appraisal has to answer three main questions, which involve the investigation of the project from six different points of view.

The first of these questions is: is the project properly designed and planned? To answer this question, the project must be examined from four different points of view, namely, the technical, the managerial, the organizational and the commercial.

The second question is: whether the goods or services to be produced by the project are needed by the economy for consumption or for export, or whether it is better to produce the goods or services at home than to import them? Whether the economic soundness of the project is fully justified? In order to answer this question, the project must be investigated from the economic point of view.

The third question is: is the proposed method of financing the project appropriate, and (where relevant) are the earnings prospects satisfactory? This requires an examination of the project from the financial point of view.

The relative importance of these different aspects varies considerably according to the type of project involved, as is shown in the following paragraphs, in which the six aspects are discussed in turn.

3.10 Technical Aspect — The technical side of the investigation concerns the appraisal work done by engineers and similar specialists. In the technical appraisal of a project, the basic question is whether the project is sound from a technical and engineering point of view. Some of the technical aspects of the project which are considered during the appraisal would include the proposed scale (size) of the project, process technology, the types of processes or equipment to be used, the location of the project, its layout and design and the availability of the various factors of production, products to produce and timing for the implementation of the project.

The appraisal will examine carefully the estimated capital and operating costs made for the

proposed project to ensure that these have been realistically prepared and include sufficient contingencies to take care of unforeseen engineering costs and the risk of inflation.

There are some types of projects, particularly railroad and highway construction, in which the commencement of work need not be delayed until all the detailed engineering has been completed. In such cases, there may be a substantial margin of error in the estimate of the work to be done, and in particular of the amount of earth and rock to be moved. Allowance must be made for these uncertainties in estimating the cost.

3.11 Economic Appraisal The economic appraisal is concerned with the economic costs and benefits of the project and with the problem of allocating resources so as to maximize the benefits to the country as a whole.

The chief objective of the appraisal of the economic aspects of a project is to determine whether the project is of sufficiently high priority from the view point of the national economy of the country concerned to justify investment in that project. This judgement is greatly eased when a general review of the economy of the country has already been carried out by the Government itself in the preparation of an economic development program, in which case both the study and the program must be evaluated. To determine whether the proposed scheme represents the most economical project, the costs and benefits of the best alternatives must also be estimated. In transportation projects, this may mean comparing the net benefits of railways and highways; in power it may involve comparing the net benefits of a series of small thermal plants to be constructed over a number of years with those of a large hydro-electric plant to be constructed at one time.

It is important to consider in such an investigation, the project's benefit-cost analysis or internal rate of return. Such economic evaluation looks only from the social point of view, excluding the private investment point of view which is the object of separate analysis under financial evaluation which is described below in a separate paragraph. The economic rate of return is obtained by discounting the estimated economic costs and benefits of the project over its life to find the rate of discount which equalizes their present worth. Such calculation of the internal rate of return or **social** (or national) benefit-cost analysis employs "accounting" or "shadow" or "economic" costs and prices external to the organization or firm. The other standard method which could serve the same purpose is the Net Present Worth Analysis. To calculate the net present worth of any project, it is necessary first to project the estimated income likely to be earned during each year of the estimated life of the project and similarly the expenditure, both capital and current. The total expenditure in each year is then subtracted algebraically from the revenue and the resulting net cash flows in each are discounted back to the present using the estimated opportunity cost of capital.

In addition to the direct benefits that a project generates, there are other questions which will normally be examined such as the project's effect on employment, its contribution to the Government's revenue through taxation, its effect on the balance of payments, on the foreign exchange earnings or savings.

3.12 Commercial Aspect The Commercial aspects of project appraisal entail a review of all arrangements for buying and selling. In the construction phase, this aspect of the appraisal involves an investigation of the proposed arrangement for buying the materials needed to construct the project. To obtain imported goods, international competitive bidding is advisable. For the operating phase an investigation is required into the proposed arrangements for obtaining the raw materials and the power and labour needed to operate the project, as well as to market the product.

3.13 Financial Aspect The financial appraisal considers the costs and benefits of a project in terms of actual receipts and expenditures, including repayments of debts, in order to assess the self-liquidating character of the project, the adequacy of its incentives, and its impact on Government finance.

The fundamental purpose of financial analysis is to determine whether the enterprise, to construct and operate the project, and the project itself, is financially sound and, if it is not, whether and how it can be made so. All the information gathered on the other aspects bears on the financial analysis which usually examines two aspects of finance. The first is the amount of money required to bring the facility into operation and the sources from which that money is to be obtained. The appraisal investigates whether additional funds are available and on what terms.

Secondly, the appraisal is concerned with the probable operating costs and revenues, prospective liquidity, and financial rate of return in the operating phase. Projections of future operating costs and revenues are needed to determine, for a non-revenue-earning project such as a flood control project, what the recurrent financial burden of operation and maintenance will be and for a revenue-earning project such as an irrigation, power or water supply project, what the financial return on investment will be and whether the client has sufficient working capital. In the light of these projections, a judgement has to be made about the soundness of the financing plan and the need, if any, for additional financial assistance.

The final analysis that has to be carried out in the financial aspect of the appraisal is the calculation of the **private** rate of return or benefit-cost analysis, employing actual market costs and prices. In private benefit-cost analysis the enterprise is generally concerned about maximizing the difference between benefits and costs, valuing each in terms of market prices, after taking into account any indirect taxes and subsidies there may be and after deducting direct taxes.

3.14 Management Aspect In general, the appraisal of management is an art and not a science and the investigator has to rely on his personal judgement, based upon his own experience of men and affairs. The shortage of management experience and ability is one of the main difficulties standing in the way of economic development in many countries. This is caused by the limited concept of the role of management in some countries, where it is not understood that management has much more to do than simply to keep a plant running.

3.15 Organizational Aspect Closely related to the question of management is the question of the sort of organizational structure best suited to carry out the project successfully. One of the problems which has to be investigated here is the extent to which responsibility and authority should be centralized or delegated. This, of course, is intimately related to the scale of operations, and to their geographical extension.

In the construction phase, the critical question usually is how much outside help will be needed. In some cases such as electrical power, the process of construction is almost continuous with one project starting just as the other is finished. Thus a substantial power system will have its own design and construction department, familiar with its needs and problems, which will normally carry out the work related to construction, although it may call on consultants for help in very large projects or those with unusual engineering aspects.

4. FINANCING DEVELOPMENT PROJECTS

4.1 Source of Financing — After the appraisal of the project has been undertaken on the basis of the feasibility study and the project has been found suitable for financing, the project can be financed from local and/or external sources.

Common sources of financing for development projects in Ethiopia are:

Government Budget

Local Banks

Contribution from people

Bilateral and Multilateral arrangements
International Financing Institutions such as
IBRD, IDA, African Development Bank.

Local resources are very limited and since engineering projects are usually expensive, such investment costs can seldom be met entirely from local budgets. Consequently, engineering projects are normally financed by loans, credits or grants. Most of our development projects are financed by loans or credits from the World Bank and, therefore, I should say a few words about the Bank's procedure for the negotiation of a loan and about its lending policy.

4.2 General Lending Policy of the World Bank Group Bank/IDA — Should the World Bank be invited to finance a project, it will undertake an intensive investigation and appraisal of the project. If the project is considered suitable for financing, the potential borrower must begin formal negotiations. Since many of the problems should have been settled during the course of the project appraisal, these negotiations can usually be brief. Once agreement has been reached, the loan or credit agreement and all supporting documents, together with the recommendations of the President of the Bank, are presented to the Bank's Executive Directors for their appraisal.

After approval by the Board the agreement can be signed, but it usually only comes into effect upon the fulfilment of certain prescribed conditions including furnishing satisfactory evidence to the Bank that the agreement is binding upon the borrower.

In most major respects the operating policies of the Bank and IDA are identical. Both institutions lend only for projects or programs which are of high priority for the borrowing country's economic development, which are economically and technically sound, and which have satisfactory prospects of being carried out and operated successfully. The two institutions apply the same methods and standards in determining for what purposes loans or credits should be extended and in deciding what conditions need to be established to assure that these purposes will be achieved. In addition, the Bank and IDA try to help borrowing countries to improve their economic management and to increase the productivity of their resources. This objective is sought through analysis of the long-term development problems of a country and its development strategy and through evaluation of the policies being followed and planned.

The fundamental difference in the operating policies of the two institutions is in the terms of their financing. The Bank lends on a long-term basis and at more or less conventional rates of interest; IDA lends on still longer terms and levies no interest charge as such. IDA's Articles state that one of the purposes of the Association is to provide finance "on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans", thereby supplementing the Bank's activities. IDA was set up specifically to assist countries whose balance of payments' prospects do not justify the borrowing on conventional terms of as much capital as they can effectively use. Such countries, however, are not regarded as eligible for IDA assistance if their lack of repayment capacity is attributable to their own mismanagement of their economies. Because of IDA's favourable terms, such credit is normally employed to finance infrastructures with high social but low financial returns such as roads, schools, hospitals, etc., while IBRD loans are used to finance productive (quick-yielding) projects.

Conditions of financing of international institutions and donor countries are indicated in Table I. The table gives the types of loans or credits that we receive. Conditions as well as interest rates are not

fixed — they change from time to time for various reasons, such as policy of the donor country, the money market and the type of project proposed for financing, etc.

5. PROJECT SUPERVISION AND FOLLOW-UP

While the loan or credit for the project is negotiated with the financing institution, a project office, or company, as the case may be, is established to be responsible for the implementation and supervision of the project. After the financing aspect of the project is settled, terms of reference are prepared by the project office for a detailed engineering study, the appropriate consulting firm is selected for the purpose and a contract signed for the consulting services. Once the detailed engineering study is completed, tender documents are prepared, a contractor selected and implementation starts after signing the contract document. (The consultants who undertake the detailed engineering study prepare the tender and contract documents for the implementation of the project.) Usually, the consultants who prepare the final design also undertake the supervision in cooperation with the client.

It is, I think, in order to mention here that project planning, preparation and execution could be undertaken more efficiently employing the Critical Path Method or Project Evaluation and Review Technique (CPM or PERT)* which is a method whereby the policy to be adopted in carrying out a project is represented by a graphical model in which the times necessary for the constituent parts are inserted, the model is analyzed, the sequence(s) of times which determine the total projection extracted and the times available for all constituents calculated. Comparison of actual times with available times enables control to be exercised in the performance of a project.

If the project is financed by international financing institutions, they like to make sure that all the above are carried out according to standards acceptable to them and everything must be undertaken only with their approval. During implementation of the project, it is required that records be kept and submitted to them. Such reports are supplemented by periodic visits to the project by the staff of the financing institution. These visiting staff members examine the work being done, scrutinize the accounts of the borrower, observe the use and maintenance of goods and equipment purchased with the loan or credit proceeds, and satisfy themselves that the management and administration of the project are satisfactory.

During these missions, it is possible to discuss the problems that have arisen in the course of implementing the project and to explore possible solutions. Changes in project specifications may be found necessary and can be mutually agreed upon. Also, the obstacles to successful accomplishment of the project can be reviewed, and steps needed to overcome them can be discussed and decided upon.

* Project Oriented Planning Scheduling and Control Technique by Hailu Ycmanu, Zede, EDEA No. 4, January 1970.

TABLE 1 TERMS OF LOANS AND CREDITS FOR FINANCING DEVELOPMENT PROJECTS IN ETHIOPIA.

Donor Countries and Financing Institutions Listed according to volume of Loans or Credit Granted in recent years	Grace Period	Repayment Period	Maturity Period	Interest rate	Local Currency Financing	Tied Loan or Credit	International Competitive Bidding Permitted
	in Years	in Years	in Years				
World Bank loan	5	20	25	7-7½% + commitment charge of ¾%	No	No	Yes
IDA credit	10	40	50	No interest charge but commitment charge of ¾%	No (mode of financing depends on type of project)	No	Yes
USAID							
Soft loan (PL480)*	10	21	31	2.6%	Depends on the type of project: yes for agriculture	Yes	No
Soft loan	10	30	40(50)	First 10 years = 2%; remaining years = 3% or free of interest but commitment charge of ¾%	Yes	Yes	No
USSR	1	12	13	2½%	No	Yes	No
Germany	7	18	25	3%	Yes	No	Yes
Yugoslavia	—	6-12	6-12	3%	No	Yes	No
Czechoslovakia	—	6-12	6-12	3%	No	Yes	No
Italy		10-13	10-13	3-6%	Yes	Yes	No
Sweden finances:							
a) in association with World Bank/IDA	10	30-40	40-50	Without interest but commitment charge of ¾%	Yes	No	Yes
b) without association with World Bank/IDA	10	15	25	2%	Yes	No	Yes
Netherlands		10	10	6½%	No	Yes	No
United Kingdom	0-7	18	18-25	No interest	No	Yes	No

* (PL480) is tied to the purchase of cotton

During the operation of the project, reappraisal of the project at appropriate intervals of time is necessary and normally it is built in the project in order to determine whether the project is being operated as planned or not, and to take corrective measures if required.

6. CONCLUDING REMARKS

A project which can be interpreted to mean a proposal for a capital investment to develop facilities to provide goods or services, passes through various stages, as has been noted, from the time when it is first identified as potentially attractive until it goes into operation. The greatest number of failures to carry out projects at a reasonable cost and in reasonable periods of time are traceable to inadequate project identification and preparation. As pointed out earlier, resources, capital, skilled labour, foreign exchange, etc., are scarce in our country (as in any developing country) and therefore we should give paramount importance to proper project planning in order to avoid unnecessary wastes of scarce resources and achieve the maximum benefit for the

economy of the Nation. Such an endeavour can be achieved only through the active participation of professional people such as the engineers and architects who play an important role in the identification, preparation and implementation of projects in both the public and private sectors. In this respect, the challenge is great and much is expected from us to contribute to the development of this Nation.

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