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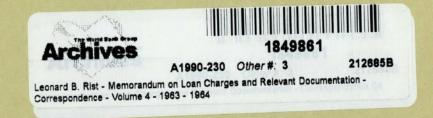


THE WORLD BANK Washington, D.C.

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L.B. Rist: memorandum on Joan changes and relevent Documentation 1963



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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

DECLASSIFIED Date: 11 15 2013

CONFIDENTIAL

FPC63-8

FROM: The Acting Secretary

July 18, 1963

NOTICE OF MEETING

BANK FINANCIAL POLICY

The attached memorandum dated July 18, 1963 from the President will be considered by the Committee on Financial Policy at a meeting to be held in the Board Room at 10:00 a.m., Tuesday, July 30, 1963.

Distribution:

Members of the Financial Policy Committee President Vice Presidents Department Heads

BANK FINANCIAL POLICY

1. On February 12 the Financial Policy Committee discussed the staff paper (FPC 63-5) outlining various courses which the Bank might follow with respect to dividends, loan charges and reserves. At the close of that meeting I undertook to put forward some specific recommendations and suggestions for consideration by the Executive Directors. I do so in this memorandum which consists of four parts:

- A. Financial Policy Proposals Previously Discussed (p. 1)
- B. Recommended Financial Policy (p. 3)
- C. Proposed Changes in Lending Policies (p. 8)
- D. Proposed Expansion of Technical Assistance Activities (p. 15)

A. Financial Policy Proposals Previously Discussed

2. After careful consideration, I have come to the following conclusions concerning the various proposals discussed at our earlier meeting; these conclusions are, I believe, consistent with the tenor of the comments made by the Committee and with the general consensus concerning each of the alternatives discussed:

(a) <u>Payment of Dividend</u>. On balance, the arguments against payment of a dividend appear to me more compelling than those in support of a dividend. In particular, I am impressed by the possibility that such action might impair the Bank's reputation as a developmental institution and that at least some part of the funds paid out as a dividend would be with-drawn from the stream of funds available for development

purposes. It is significant, I think, that even among the developed countries, which would be the recipients of the bulk of any dividend distribution, there is no strong support for paying a dividend.

- Loan Charges. The Bank's present loan charges are both low (b) and reasonable. I believe that the arguments against any substantial reduction in those charges, particularly the effect of the reduction in increasing the spread between the cost of borrowing from the Bank and of borrowing in the private market, are persuasive. However, those arguments are applicable primarily to the interest rate (including the commission); they do not apply with equal force to the commitment charge made on the undisbursed portion of Bank loans. In view of the size of Bank earnings, I believe it would be reasonable to cut the commitment charge in half, from 3/4% to 3/8%, and to apply the reduction to existing as well as to new loans. This would result in an estimated decline in the Bank's net earnings of about \$5 million next year and probably somewhat more thereafter. The benefit of the reduction would be realized by our most recent borrowers, almost all of them less developed countries.
- (c) <u>Transfer to IDA</u>. I am convinced that a direct transfer of a portion of the Bank's net earnings to IDA at this time would adversely affect the Bank's standing in the financial communities of the world. Primarily for this reason, but

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also for other reasons expounded during the Financial Policy Committee discussions, I believe this course of action would be unwise and I am opposed to it.

(d) <u>Reserves</u>. For the immediate future at least, I believe that there is no need to continue to put all of the Bank's net income into reserves. Unless and until there is an adverse change in relevant circumstances, (i) I favor continuing the l% commission included within our loan charges (which pursuant to the Articles of Agreement must be allocated to the Special Reserve); but (ii) I believe that the Supplemental Reserve need not be increased beyond the June 30, 1962, level (\$476 million). My proposal with respect to net income subsequent to that date is contained in paragraph 4.

B. Recommended Financial Policy

3. In considering what affirmative recommendations I should make to the Executive Directors concerning the use of Bank net income, I have reviewed with the staff the general course of the Bank's operations thus far. This review has left me with the following principal impressions:

(a) The Bank's effectiveness in the development field is attributable largely to its dynamic approach to development problems, to its periodic reappraisals of the impact of its own operations and to its readiness and ability to evolve new policies and new tools appropriate to new situations. If the Bank is to continue to be a forceful agent of economic development, this adaptability to changing conditions must be preserved.

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(b) The situation now facing the Bank is different and in some respects considerably more difficult than it was ten, or even five, years ago. We have many new members, most of them lacking the institutional structure, and relatively inexperienced in the techniques, necessary to carry forward the development process. To lend money wisely in such countries involves a much greater investment of human skills than in countries with a longer experience of development administration. In other countries in which the Bank has been operating for some time, difficulties of a different character are arising. One is the rapid increase in the external debt service obligations of these countries in relation to the increase in their capacity to repay. Another is the fact that, in a number of countries, many of the more obvious and more easily manageable investment projects -- the large power plants, the highway, railroad and port expansion schemes, the big irrigation projects -have already been or are being financed. 1/ Moreover, such basic projects cannot be fully productive unless they are accompanied by modernization of agricultural practices,

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^{1/} By June 30, 1963, the Bank had made loans aggregating \$2,338 million for electric power, \$2,268 million for transportation and \$330 million for irrigation and flood control. In addition, IDA had extended credits of \$57.7 million for power, \$247.3 million for transportation and \$113 million for irrigation and flood control.

soundly based industrial growth, better and more wide-spread education and training programs, etc. In many countries, development in these latter sectors is not keeping pace. Formidable problems of appraisal, planning and management are involved, requiring a more intensive promotional effort and more flexible organizational and financial techniques than are required for the more conventional fields of Bank lending.

(c) If, in the face of these difficulties and of a rising volume of repayments on outstanding loans,^{2/} the Bank is in the future to make as large a net contribution towards meeting its members' development needs as it has in the past---and certainly this should be a minimum target--we will have to add new dimensions to our lending and greatly intensify our technical assistance activities. It is in the fields of agriculture, industry and education, in particular, that this more forward-looking approach by the Bank is needed. For a number of reasons, we have in the past done less than we might in these areas. Because of the very real practical problems presented by any effort to provide assistance to small farmers, for example, we have tended to concentrate

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^{2/} Repayments on outstanding loans (including repayments by borrowers to investors holding maturities of Bank loans) amounted to \$244 million in 1962-1963. Assuming new lending at the rate of \$700 million a year, repayments are estimated to amount to \$335 million by 1965-1966 and to \$415 million by 1969-1970.

our activities in the agricultural field on the large schemes --irrigation, flood control and land clearance--which fit most readily into our lending pattern and supervisory arrangements. 3/ In the field of industry, the scope of the Bank's direct financing has been substantially limited by the guarantee requirement of its Articles.4/ In the field of education the Bank has heretofore not operated at all. In many of our member countries, however, these three areas have or are coming to have at least the same economic priority as infrastructure projects. In my judgment, our activities in these areas must now take on new breadth and depth. I have in mind particularly that we should now be prepared to lend for new projects and for new purposes in these three fields and that, in appropriate instances, our loans should be made on terms different from those which have characterized our lending in the past. I also believe, as noted above, that we must intensify our technical assistance in these fields.

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^{3/} Of the total of some \$529 million of the Bank's loans in the field of agriculture, \$380 million or 71% has been for large agricultural schemes of this kind.

^{4/} Out of total lending of \$6,986 million as of June 30, 1963, \$1,127 million, or about 16%, has been in the industrial field, including loans to development banks.

4. I have given considerable thought to what our financial policy should be in order to enable us to embark on the broad program of expansion implied by the proposed new approach with confidence that the Bank's financial standing will not be impaired. My conclusion and affirmative recommendation is that we should retain all Bank net earnings for use in Bank operations. As a method of doing so, I propose that we allocate the Bank's net income, after provision for the Special Reserve, for the fiscal year 1962-1963 (and for subsequent years as well, unless and until conditions change), to a new "Earned Surplus" account. On this basis we would be justified, in my judgment without prejudice to the Bank's standing as a sound financial institution, gradually to adopt the more enterprising approach which I believe is now desirable and even necessary.

5. The two succeeding sections of this memorandum, sections C and D, summarize the changes in our lending policies and in our technical assistance programs which I propose. Should we embark upon the recommended course, other appropriate new initiatives will no doubt suggest themselves as we proceed. In any event, I wish to emphasize that the succeeding paragraphs, while describing in broad outline the paths which I believe that the Bank should now prepare to follow, are not a detailed blueprint. If the general approach is approved by the Executive Directors, some of the steps indicated could be taken without delay. One would require an amendment to the Bank's Articles of Agreement (see paragraph 8). The pace at which other steps could be taken, particularly where technical assistance is involved, would depend upon our

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ability to recruit adequate skilled personnel. The manpower implications of the proposed new approach are substantial. We shall therefore have to proceed cautiously and to feel our way, to assure that there is no reduction in the quality of the Bank's performance.

C. Proposed Changes in Lending Policies

Loans with Longer Periods of Grace and Amortization

6. Several types of projects, although they are of substantial importance for development, have their impact upon economic output only over a very long period. The Bank has not normally financed projects of this type, largely because its usual loan terms are not appropriate for such financing. I believe that, where necessary, we should now be prepared to lengthen the maturities of our loans up to perhaps 40 years, and to provide for periods of grace up to perhaps 10 years. Loans of this character, at the standard Bank interest rate, would facilitate the financing of the following types of projects among others:

(a) Long-term Agricultural Improvement Schemes. As already stated, I believe the Bank needs to put much more emphasis than heretofore on schemes for improvement of agricultural production. Such schemes have a direct impact on the living standards of a large segment of the population in many of the Bank's less developed member countries and often provide a necessary base for further industrialization. In some cases, improvement of agriculture will require primarily large-scale land clearance and colonization

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schemes. In most cases, it will require a program on a broad front to improve the agricultural practices of individual farmers and, through storage, farm-to-market roads and other means, to facilitate their access to markets. It may call for assistance in meeting the financial requirements following upon a program of Land redistribution. Frequently, it may mean that local agricultural development and finance institutions will have to be strengthened, in somewhat the same way as we have supported local development finance companies in the field of industry. In any event, a combination of extensive technical assistance (see paragraph 17) and of financing on very long term is normally likely to be necessary. I believe we should put ourselves in a position to provide such financing.

(b) <u>Pioneer Industries</u>. A number of the less developed countries are still overly dependent on exports of raw materials or of unprocessed agricultural products. It would usually be beneficial to the economies of such countries to achieve diversification through building up suitable industries which will generally be based to a large extent on local raw materials or agricultural products. Often, however, such industries, although sound over the long term, will be slow-yielding at first and are therefore not likely to be attractive to investors in the absence of some kind of "leverage." In such cases, Bank financing on the terms

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indicated (and even with initial interest capitalized) may be the means of launching a basic industry of national importance and sustaining it until it reaches its full potential.

(c) <u>School Building Programs</u>. This is a field in which IDA has operated but the Bank has not. In many countries which are so creditworthy that they do not qualify for IDA assistance, there are pressing investment requirements for educational facilities which, in my judgment, should be eligible for Bank financing. The availability of loans on the terms proposed would facilitate such financing.

7. I do not suggest that lengthening the period of amortization is appropriate only for financing new kinds of projects; it is appropriate as well in the case of loans for some types of projects which the Bank now finances. Varying maturities of up to 40 years could prove useful in the case of a number of more conventional projects which have an economic life well in excess of the 25-year period which is the longest provided for amortization under our existing practice.

Loans to Established Private Industrial Enterprises without Full Government Guarantee of Repayment

8. A second major change in our lending policies, which I believe we are justified in making in the context of the proposed new program, is to extend long-term loans to private shareholder-owned industrial enterprises (and in some cases to local development finance companies) in the less developed countries without full government guarantee of repayment. I have in mind primarily substantial enterprises whose shares

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are publicly held and which have an established record of earnings. I would expect that the recipients of such loans would in most cases be companies which are domestically owned, wholly or in substantial part. In my judgment, the Bank should be in a position to meet the needs of such enterprises for foreign exchange to carry out projects of modernization and expansion, where these needs cannot be met by IFC or by any local industrial finance institution. Bank support for projects of this character has in the past been inhibited by the guarantee requirement of the Articles of Agreement. On the one hand, private shareholderowned enterprises are often reluctant to seek a government repayment guarantee and, on the other, governments often find it politically or constitutionally difficult to give such a guarantee. Accordingly, I recommend that we now seek an amendment to the Articles of Agreement which would authorize the Bank, in appropriate cases and up to a specified limit, to make loans without the requirement of a full government guarantee of repayment.

9. These non-guaranteed loans would have the following characteristics:

(a) They would normally have a lower limit of, say, \$2.5 million; a lower limit of this kind is necessary to preclude the possibility of a flood of applications. Projects requiring financing in smaller amounts should, I believe, continue to be handled by local development finance corporations and by IFC. Moreover, I would expect that a local development finance company would generally be identified with projects for which non-guaranteed loans are made by the Bank, and

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that sometimes IFC as well would participate in the financing.

- (b) In place of the presently required government guarantee of repayment, we would require in connection with these loans an assurance, from the central bank or the government, as appropriate, of convertibility of interest and principal payments by the borrowing enterprise.
- (c) Because of the additional risk involved in making loans without government guarantee, and in order to avoid giving recipients of such loans an unfair advantage, the interest rate would be higher than the Bank's normal rate, perhaps 6¹/₂-8% as compared with the Bank's present lending rate of 5¹/₂%.
- (d) The total amount of such loans would be limited to the aggregate amount of the Bank's Earned Surplus and Supplemental Reserve, in order to make clear that we are not using our capital or borrowed funds for this purpose.

10. It is not possible to forecast with any degree of certainty how many opportunities there will be for making loans of the kind described in the preceding paragraphs or how soon opportunities will present themselves. A type of case I have specifically in mind is that of enterprises in need of a combination of loan and equity financing in amounts beyond the ability of IFC to undertake out of its own limited resources or even in conjunction with capital which it is able to mobilize from private sources. In such situations, the combination of a non-guaranteed loan by the Bank and an equity investment by IFC (and possibly others) would enable the two institutions, together, to assist much larger

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enterprises than IFC alone has been able to finance. As indicated above, there are also likely to be cases not involving equity financing where a Bank loan would be desirable and where a waiver of the government repayment guarantee would be the critical factor in making negotiation of such a loan feasible. Moreover, in the case of loans to private borrowers, whether industrial enterprises or local development finance institutions, even where a government guarantee could be obtained it would often be more consistent with the Bank's objectives, and more appropriate for and useful to the borrower, for the Bank to provide the financing without such a guarantee.

11. For all these reasons, I believe that the Bank should be authorized to make non-guaranteed loans to private enterprises within the limit suggested in paragraph 9(d). Such authorization would provide the Bank with a new tool of major importance for the fulfillment of its basic development purposes. If the Committee agrees, I will promptly present for the consideration of the Executive Directors a proposed report to the Board of Governors recommending the necessary amendment to the Bank's Articles of Agreement.

Maintenance Import Loans

12. A third change which I believe would be desirable in the Bank's lending policies is that we should be prepared, in addition to our normal project loans, to make available, in appropriate cases, long-term financing for the import of components and spare parts for industry generally or for some particular segment of industry of special importance to the given economy.

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13. What I have in mind here is that, in some of our less developed member countries, the expansion, modernization and maintenance of industrial undertakings is hampered not so much by unavailability or insufficiency of industrial credit or capital as by a foreign exchange shortage.2/ Where the growth of industry is so impeded, the Bank should, I believe, be prepared to consider making a long-term loan to the government, the proceeds of which would be sold against local currency to industrial enterprises for the purchase of imported equipment or parts required to increase their production. To help assure that the foreign exchange would be employed to fullest advantage, its use might be limited to the purchase of specified categories of imports or to approved import programs to meet the needs of designated industries or types of industry. Moreover, eligibility to purchase the foreign exchange proceeds of the loan might be limited to particular industries of developmental importance or, for example, to export industries generally. Use of the proceeds would not be tied and the Bank would expect procurement to be made in the most favorable markets.

14. This device is admittedly not free from difficulty. It would be important to assure that the foreign exchange proceeds of our loan were

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^{5/} For example, the report of our recent mission to India (SecM63-75) comments that "The inadequate and erratic supply of imported materials, components and spares is the most obvious and immediate restraint on industrial output. The most effective form of external assistance to India in present circumstances would be an increase in general purpose aid not tied to procurement of particular commodities or in aid that can be used to finance imports of materials, components and spare parts for industry and agriculture. "The problem is, of course, not confined to India, but exists in a number of other countries as well.

not simply being substituted for amounts that would in any event have been allocated to the industrial sector, and that they were in fact additional resources. Moreover, the technique is clearly not appropriate for every country where the industrial sector is suffering from a foreign exchange shortage; for example, it should not be made available to the government of a country whose foreign exchange shortage is due, not to lack of resources or of savings, but to inappropriate economic and financial policies or to a prevalent habit of cacheing local capital abroad. Even with these limitations, however, I believe the technique could prove to be a significant aid to the development of the industrial sector in a number of countries.

D. Proposed Expansion of Technical Assistance Activities

15. The Bank's technical assistance activities have expanded substantially over the last few years and I believe that, quite apart from the new lending approaches suggested above, our advisory work will have to continue to grow.⁶/ However, the need for a broadening and intensification of our technical assistance program will become far more urgent if we add the proposed new types of financing to those in which we have heretofore engaged. Many of the new kinds of projects to which I have suggested our financing should now extend will require considerable

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^{6/} The Bank's expenditures for "Services to Member Countries" in 1952-53 amounted to \$214,344, compared to \$2,830 million in 1962-63. In addition, the Bank absorbed substantial indirect overhead and supervisory expenditures for these services as part of its regular administrative budget.

pre-investment work in order to bring them to the point of financing, and some of them are also likely to require considerable technical and managerial assistance during the course of construction and operation. It will not be easy to recruit persons with the requisite skills, but this very difficulty underlines the importance of starting promptly. 16. Since the greatest single obstacle to Bank and IDA financing is the limited number of soundly planned projects ready for financing, project preparation is clearly the principal field in which we should intensify our technical assistance. The primary technique for this will be the expansion of our program of project and sector studies, which is of special importance for the newer and least experienced of our member countries. In addition, the Economic Development Institute is organizing itself to undertake additional training courses in project evaluation. Beyond these steps, however, I believe we must be prepared, through long-term assignments of our own technical staff and through use of outside consultants, to provide advisers to member governments for substantial periods to help them in the process of translating promising ideas into properly prepared projects. This is important for the conventional types of projects which the Bank has heretofore financed, and it is even more important in the case of some of the more enterprising types of projects to which I believe our help should also be extended in the future.

17. In the broad field of agricultural improvement, for example, the Bank and IDA will not be able to invest money effectively unless our members are given a great deal of assistance in organizing and running

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extension services, agricultural credit institutions, production and marketing cooperatives, and the like. I do not suggest that the Bank can or should provide or finance all the help of this kind that may be needed in connection with Bank and IDA projects, but we should, I think, take an initiative in identifying and analyzing the needs for skilled personnel and in arranging for and coordinating the provision of technical assistance to meet those needs. In many cases, this may mean that, in addition to providing the services of our own staff, the Bank will have to bear part of the cost of technical services provided by outside firms or other institutions.

13. In the field of industrial development, I believe there is similar need for expansion of the Bank's technical assistance activities. For one thing, if we are to continue to increase our lending through local development finance companies, we must organize ourselves to provide more help in finding staff for such companies and in providing training for their officials. For another thing, we should, I am convinced, be more active in helping to establish and develop industrial estates for medium-size and small enterprises and to bring these enterprises into contact with modern technology and management methods. And, finally, I think we should be prepared, in appropriate and probably isolated cases, to share with private investors the cost of studying the feasibility of particular industrial investments where the industrial project to be studied seems likely, if proven sound, to be suitable for subsequent Bank or IFC financing.

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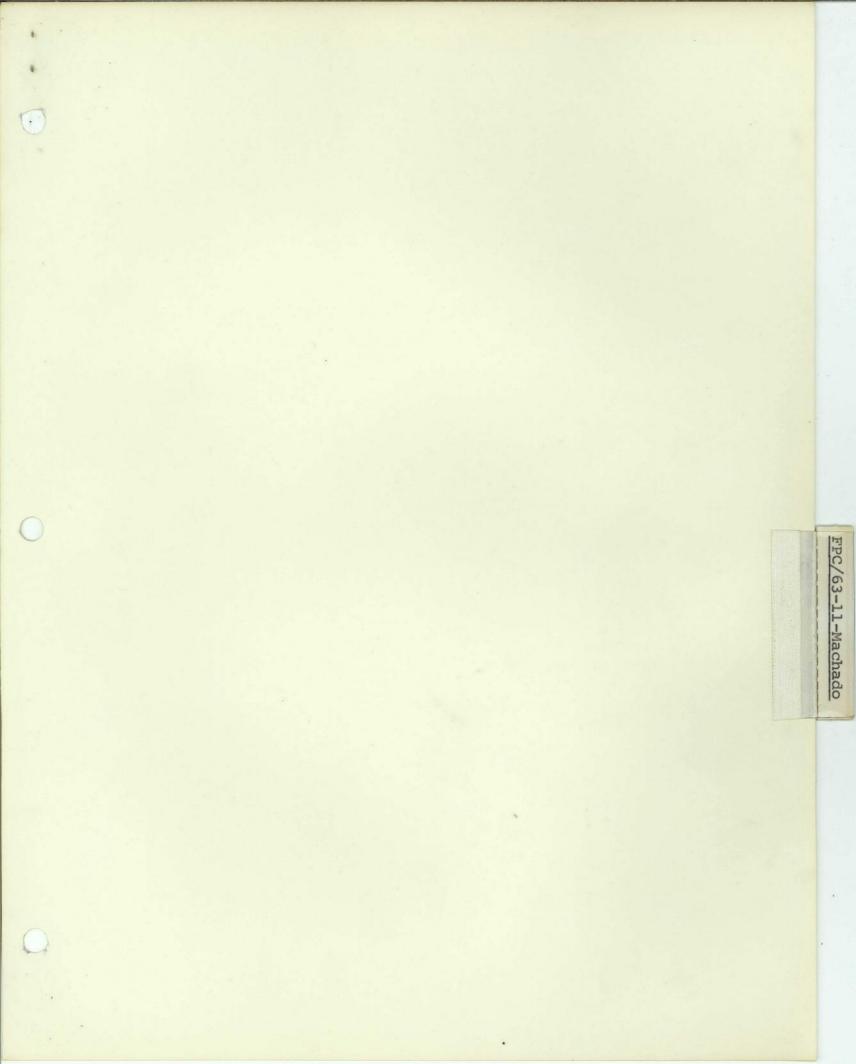
19. Finally, I believe that it would be both appropriate and desirable for the Bank to undertake an extensive program of technical assistance in the field of education. Based on the advice which I have received from Dr. Harvie Branscomb, who has been serving as Educational Consultant to the Bank, I have concluded that, instead of establishing a program of grants in the field of education at this time, our initial approach should be to supplement IDA credits and Bank loans for educational facilities with the provision of expert services and technical advice in such fields as educational planning, teacher training, modernization of teaching materials and techniques, and improvement of school administration and of school design and construction. Help in these and related matters is certain to be a concomitant of, and often a prerequisite to, effective capital investment in the educational sector. The Bank and IDA, between them, are likely to become a major source of external capital for educational investment purposes. It is Dr. Branscomb's conclusion, with which I concur, that by combining Bank technical assistance with Bank/IDA financing activities, our program in the educational field will be able to function with increased scope, flexibility and initiative. 20. By emphasizing in our initial approach the provision of services and advice in fields related to and facilitating our financing activities, rather than a foundation-type program of educational grants, we will avoid serious administrative complications and the establishment of a possibly undesirable precedent. Nevertheless, we should, in my judgment, be prepared to consider grants for a few especially important educational projects in cases where, considered on their merits, there are special and

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persuasive reasons for Bank support. One example of the kind of project I have in mind is the International Institute for Educational Planning, which the Bank has already agreed to support. Other projects may suggest themselves to us as we gain further experience in this whole field of activity. However, each such case should, I believe, be considered on its own merits and not as part of a pre-defined grant program.

* * * * * * *

21. I sincerely hope that both the proposal to widen the Bank's horizons and the related recommendation that, with that end in view, earnings in excess of Special Reserve requirements be retained within the Bank for its own operations will commend themselves to the Executive Directors. My own view is that the program herein advanced will, if adopted, add greatly to the Bank's effectiveness in accomplishing its task of assisting with advice and finance in the development of its member countries.



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FPC63-11

CONFIDENTIAL

August 2, 1963

*Memorandum of Meeting of Bank Financial Policy Committee on "BANK FINANCIAL POLICY" (Report FPC63-8), Tuesday, July 30, 1963, at 10:00 a.m.

1. There were present:

Chairman

Executive Directors and Alternates acting as Executive Directors

Alice Brun John C. Bullitt Jose Camacho (Alternate) Reignson C. Chen Otto Donner John M. Garland A. K. Ghosh (Alternate) Joaquin Gutierrez Cano Fernando Illanes Ismail Khelil (Alternate) Ali Akbar Khosropur (Alternate) Pieter Lieftinck Luis Machado F. Oellerer (Alternate) D. B. Pitblado A.F.W. Plumptre Gengo Suzuki J. Waitzenegger (Alternate)

Management

Geoffrey M. Wilson

Alternates not acting as Executive Directors

H. Abramowski Lempira E. Bonilla Erle Cocke, Jr. L. Denis Hudon M. Kumashiro Sergio Siglienti Eino Suomela A.J.J. van Vuuren

Staff

M. M. Mendels A. Broches Robert W. Cavanaugh Richard H. Demuth Mrs. Shirley Boskey Lyell Doucet

*This memorandum consists of staff notes of the discussions in the Committee and is not an approved record.

Distribution:

Members of the Financial Policy Committee President Vice Presidents Department Heads

J. Burke Knapp

2. The Chairman proposed that the Committee's initial discussion of the Financial Policy paper (FPC 63-8) should take the form of general and preliminary comments on the paper as a whole, rather than focusing on particular points. Certainly no effort should be made to arrive at any decisions. Probably many Directors had not yet received full instructions from their countries and also there was the handicap of Mr. Woods' absence. Mr. Woods had a great personal interest in the paper and would hope that Directors' views would not become fixed before he had an opportunity to make his own exposition of the reasons behind the proposals. However, Mr. Woods had wanted the meeting to proceed in his absence. He intended to read the transcript and reports of the proceedings.

3. Mr. Pitblado said that the views he would express were personal; he had not yet received views from London. The paper was extremely important and contained a number of far-reaching suggestions. The paper as a whole, and particularly a number of its details, would require a great deal of discussion and clarification before conclusions could be reached. It was addressed not only to the question of the creation and disposition of Bank income but also the Bank's future role. He agreed with the line which the paper took on loan charges, and with the suggestion on the commitment charge. He agreed with the paper's position on dividends. He did not think payment of a dividend was desirable for the general purposes of the Bank, although it was true that the Articles contemplated that possibility, just as they contemplated the possibility of reduction of the commission. He would comment later on the question of a transfer of funds to IDA.

If, as the paper implied, the Bank's income was going to increase, 4. Mr. Pitblado said the question was whether it should all be put into reserves. Mr. Woods' recommendation was that it was not necessary to continue to do so. Whether it was desirable to continue to build up the Supplemental Reserve at a modest rate or to cut it off at the present level and put future Bank net earnings into an "Earned Surplus Account," as the paper recommended, was a point to be discussed. It was not clear to him what the significance of the proposal would be. As he understood it, the "Earned Surplus Account" would not be used differently from the existing Supplemental Reserve, which was in principle used fully in Bank operations. The paper did not suggest any different use for the proposed new account except that the aggregate of this account and the Supplemental Reserve should serve as a ceiling on the volume of any loans made to private enterprises without government guarantee. If his understanding was correct, the proposals in the paper would not go very far to solve the problem of the use of the Bank's net income, except to continue the present policy of keeping the income within the Bank. The policies recommended were not policies of financial imprudence; they did not suggest that the earnings curve would be any different in future. Lengthened periods of repayment and longer grace periods would not reduce earnings. The proposed loans to private enterprise, if prudently made, would in fact increase earnings. Technical assistance expenditures were likely merely to absorb some of the increases in earnings which were expected from year to year. Thus, Mr. Pitblado doubted that the paper in the longer term resolved the problem of the use of the Bank's net income except, as he had noted, by a continuation of present policies. This was not necessarily a criticism of the paper, but it was a point to be made.

5. On the development of lending policy, Mr. Pitblado thought the paper contained much of value and interest. He agreed that the Bank should adopt more flexible policies concerning maturities and grace periods, that it should be prepared to do more in the agricultural field and more for pioneer industries and school buildings. In his view, maintenance import loans would meet a need revealed in a number of operations, particularly in the consortia.

Concerning technical assistance, Mr. Pitblado thought there was general 6. agreement that more should be done in this field, in what the paper described as a dynamic and evolutionary way. But he thought it necessary to exercise caution. It was important that technical assistance activities be entirely geared to the Bank's basic purposes as an international, intergovernmental institution. The Bank's primary purpose, after using the funds which governments had made available, was to attract money from the private sector for use in development. Its success had been due not only to the flexibility to which Mr. Woods had drawn attention but also to the soundness of its practices and to the fact of its keeping its activities under control and related to its lending. Mr. Pitblado noted that the paper had recommended against a foundation-type program of educational grants. He agreed; indeed, he thought that the Bank ought not to have a foundation-type program in any area. The Bank should not regard its earned surplus as a large private institution might look on parts of its surplus which it was prepared to use for general purposes. While he favored greater activity in the technical assistance field, he thought that some of the extension suggested in the paper would take the Bank rather a long way into areas in which it had no special expertise and in which other international institutions had the major international responsibility. For example, the proposed assistance in organizing and running agricultural extension services seemed to go a long way into the operating field. The same might be said of the proposal to help in development of industrial estates. In the educational field, advice in teacher training and educational planning had been suggested. Here, too, he doubted that the Bank as such was the right international organization to take a lead. It might equally be suggested that the Bank should reorganize the health, individual, political, religious, social and other habits in its member countries. For these reasons, he thought any extension of technical assistance into the fields proposed should be done

with caution and with an eye to keeping a very close link to the Bank's activities in its primary field of development lending.

7. Returning to the earned surplus, Mr. Pitblado commented that he had thought about, but did not believe he really favored, a different approach: that the earned surplus, instead of being made really indistinguishable from reserves, should be used in extended ways under the authority of the Governors or possibly under the authority of appropriate modifications of the Articles. However, proposals for modification of the Articles should be approached with extreme caution. Once a particular amendment was suggested, many others could be advanced, not only in the area of guarantees, but in other policies of the Bank. The proposal in the paper for amending the Articles to authorize non-guaranteed loans to private industrial enterprises seemed to Mr. Pitblado to raise a number of questions, although he would not want to say at present that he was opposed to it. This was one of the areas as to which the Directors would want to learn more of what Mr. Woods had in mind. On the face of it, it would not seem that many projects which ought to have been financed by the Bank had been seriously held up by the guarantee requirement. Moreover, it had occurred to him that if the Articles were to be amended as proposed, that would open up the whole question of the relationship between the Bank and IFC: it had been this very provision which was one of the main reasons for the creation of the latter as a separate institution. The making of non-guaranteed loans was entirely within IFC's competence. Even supposing that IFC might in the future be restricted by lack of resources (and he thought this had not thus far been a limiting factor), if the Bank were to modify its practices and to use its funds for IFC-like purposes, why should it not also modify its practices by using its funds for IDA-like purposes? He supposed it would be feasible to contemplate modifications of the Articles which would enable movement to be made in both directions. Perhaps the time was not propitious. Perhaps it was right to proceed with expansion of the Bank's activities in the various ways indicated in the paper, which would mark a very important move forward, leaving the problem of net earnings to be considered again from time to time as things moved on.

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8. Mr. Donner said he had been much impressed by the basic ideas underlying the paper and by the paper's approach. He agreed with Mr. Pitblado that the paper presented two kinds of problems; one was concerned with the general reappraisal of Bank policies in the light of experience and in relation to changing circumstances. While he welcomed such a general reappraisal and felt it necessary, he felt that the conclusions drawn from that reappraisal by the paper could have been much broader. For example, Mr. Machado had suggested the possibility of guaranteeing local currency loans raised by the less developed countries themselves. In earlier discussions of IDA-type operations, Bank financing in the field of health had been proposed. And Mr. Illanes had spoken of the possibility of underwriting losses under compensatory financing schemes in the field of foreign trade. All of these proposals should be discussed.

Mr. Donner said that at the February meeting of the Financial Policy 9. Committee, two alternatives had been discussed: one was to transfer net earnings directly to IDA, and the other was to develop IDA-like operations inside the Bank. None of the changes in lending policies proposed by the paper would significantly increase the amount of development capital for countries in need of assistance on lenient terms. The only suggestion in this direction was the proposal to reduce the commitment charge, and this would cut into current earnings by no more than \$5 million. The proposal to extend the periods of grace and amortization would not make a significant contribution in this direction. He was not taking a position as to whether any such change in the Bank's policies was advisable; much could be said for it. At present, he was concerned only with the balance of payments impact of the proposed type of loans. He had asked the Economic Staff to put together some tables indicating the burden on borrowing countries if they received (a) a conventional IBRD loan, (b) the proposed type of loan with a longer period of grace and amortization but at the Bank's normal rate of interest, and (c) a standard IDA credit. The new type of loan would pile up large payments obligations for the future: the burden during the first 10 or perhaps 20 years would be low but thereafter there would be a larger foreign exchange burden. Thus the only countries which might expect to benefit from the proposed new type of loan were those which might hope to be over the development hump within 10, 15 or 20 years. But for those countries whose balance of payments and development prospects were not as bright, the day of reckoning would merely be postponed. Some relief would be provided for the time being, but at the cost of burdening future years even more. Any type of IDA-like operations would be designed particularly for those countries which lacked any substantial creditworthiness for conventional credits. But among that category of countries, most of the newly independent countries in Africa were definitely not likely to benefit from the proposed new kind of lending, and indeed the number of less developed countries anywhere which were likely to be over the hump in 10-20 years was not large.

10. As far as loans to established private industrial enterprises were concerned, Mr. Donner noted that it was proposed that these carry interest of $6\frac{1}{2}$ - 8 per cent. He assumed that the repayment schedule would be determined by the nature of the project - a conventional amortization period. That kind of loan would not only fail to take account of the limited debt service capacity of the less developed countries but would eat very heavily into that

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capacity. The foreign exchange burden of interest and amortization from the very first year would be considerably higher than the burden of an IDA credit, or even of a standard IBRD loan. Maintenance import loans would apparently not carry special terms; therefore that type of loan would likewise not contribute to easing the foreign exchange burden of recipient countries. Accordingly, Mr. Donner concluded, the proposals did not take a significant step toward developing practices inside the Bank which could be considered as IDA-like operations.

11. Mr. Donner said that, like Mr. Pitblado, he could see little difference between the proposal to establish an earned surplus account and the existing practice: resources to be carried under the heading of "surplus" would be available for lending operations. Those who believed that surplus earnings in their totality should remain in the Bank might be satisfied with the proposal. However, Mr. Donner thought there were a number of implications in the proposal which had not been fully evaluated. The press might begin to comment adversely on the Bank's earnings situation. Governors of the less developed countries might likewise comment, and parliaments in the industrialized countries, considering their own balance of payments situation in relation to the demands for development assistance, might decide to withdraw or withhold approval of the use of the 18 per cent portion of their subscriptions in Bank operations, and devote it to purposes they considered more important. It would be unfortunate if this should occur, but it might. Therefore, he thought the problem of dealing with surplus earnings, if indeed it was clear that they were surplus, was urgent.

12. With regard to the suggestions for a new approach to lending policies, Mr. Donner favored the general line of the paper, and its position that there was a good case for making loans with longer periods of grace and amortization, for non-guaranteed loans to private enterprise, for maintenance import loans, and so forth. However, like Mr. Pitblado, he would like to hear about these proposals in greater detail. He wondered whether loans at $4\frac{1}{2}$ per cent to be repaid over an extended amortization period in foreign exchange were appropriate terms for improving agriculture in the African states or for industrial activities of a pioneering character in Asian or Latin American countries. Similarly, he questioned whether loans at $5\frac{1}{2}$ per cent and repayment in foreign exchange were the type of capital aid that should be considered for school construction. He agreed that these activities deserved to be helped. But he was not yet convinced that the proposed type of lending was the proper means. It was his understanding that organizations which already operated in these fields did so on softer terms. He had in mind, for instance, the Inter-American Bank, which used the trust fund from the United States Government for assistance in this area: its interest rate was low and it permitted partial repayment in local currency.

13. With regard to the fostering of established private industrial enterprise, Mr. Donner agreed with Mr. Pitblado's comments. He and, he thought, many of his colleagues had welcomed the instances of financing of local development banks by IFC and the Bank, jointly. He hesitated to accept the concept that in order to operate in the same field of private industrial enterprise, a new organizational approach was now necessary. He was particularly reluctant to believe this in view of the difficulty IFC had encountered in employing even the limited resources at its disposal. Moreover, he wondered in which less developed countries established private industrial enterprises with a proven record of earnings were likely to be found. These were likely to be characteristic of the more advanced among the less developed countries, with rather sophisticated administrations, and he questioned whether the government of such a country would be willing to give a convertibility guarantee for a 10-year period for a loan carrying $6\frac{1}{2}$ - 8 percent interest, and thereby further burden its already overburdened balance of payments. Moreover, he wondered whether the influence which the government might exercise over the private enterprise by reason of a transfer guarantee would be any the less than it would be if that government gave a full repayment guarantee. With all these considerations in mind, he would welcome further discussion of these points.

14. Mr. Donner referred to the proposal of the paper, based on Dr. Branscomb's advice, that the Bank should not embark on a program of educational grants as envisaged earlier, but should instead make conventional loans and extend its technical activities in this field. For himself, he felt that the Bank's venture into the educational field thus far had been disappointing. He believed it would be useful if, before going any further in that field and changing the direction of what originally had been suggested, a closer look was taken. As he recalled it, a study was supposed to have been submitted to the Board for discussion. He thought it would be well if this were done. The primary criterion for lending should in every case be the particular country's needs. If it appeared that in a particular country at a particular time schools were the most urgent investment priority, they should be financed. But he would hesitate to announce that the Bank was generally prepared to make conventional, or more or less conventional, loans for purposes so far afield from economic infrastructure. Moreover, as he had commented earlier, he doubted that loans on conventional terms were appropriate for such purposes.

15. Concerning the proposed expansion of technical assistance, he did not doubt that the Bank could be very useful in this field, but he also believed that the Bank was strongest where it had experience and experts of its own, and where other agencies did not operate. He would be sorry if in the Bank's eagerness to give technical assistance, because it could afford to do so, it began to duplicate the work of other organizations. For example, he thought UNESCO was already doing what was necessary in the field of assistance to education. The Bank was not in a position to judge whether schools in a given country did or did not have the proper textbooks or whether teaching techniques were appropriate, or to advise countries on how to build up their educational systems. The best the Bank could do would be to engage experts from existing organizations and rely on their knowledge. The Bank's experiences in the Tunisian case should serve as a warning. Thus, while he was very much in favor of an extension of technical assistance, he felt the Bank should keep in mind the limitations on its activities in that field. He concluded by noting that all of his observations had been made on a personal basis.

16. Mr. Khelil said that he welcomed the paper, as an attempt to adapt the Bank's financial and lending policies to the real needs of the developing countries. The countries he represented had long felt the need of such an adjustment and had urged a more flexible approach to their development problems. Only by broadening the limits of its activity in the light of the requirements of the developing countries and changing conditions could the Bank continue to fulfill its task and be a forceful agent of economic development. So far only a limited number of countries had had recourse to the Bank's facilities; others had been handicapped by lack of institutional structure, of human skills, and by the increase of their debt-service obligations. So far also only a limited category of projects were considered eligible for financing; these had been related to infrastructure, being more obvious and more easily manageable. In the proposed new approach, Mr. Woods suggested enlarging the number of countries which might benefit from the Bank's facilities, on the one hand by lengthening maturities of loans up to 40 years and periods of grace up to ten years and, on the other hand, by broadening and intensifying the technical assistance program both at the pre-investment stage and at the stage of construction and operation. Mr. Khelil thought this would be a substantial incentive to economic development.

17. Mr. Khelil noted that the paper also proposed broadening the scope of projects eligible for Bank financing, to include modernization of agriculture, projects aimed at industrial growth, maintenance imports and school building programs. He applauded particularly the proposed extension of activities in the agricultural field. He hoped that loans would also be extended to investments in tourism where development of tourism was given high priority, and to general imports of essential equipment whether or not integrated into specific projects. In this last, he had particularly in mind agricultural and public works equipment. Economic development aimed at improving the well being of people, but that goal was often forgotten as development plans became more concerned with quantitative objectives such as production and investment. Economic development ought also to extend to improvement of social standards, not merely material conditions. Accordingly, he thought that sanitation and housing programs should also be eligible for Bank financing. Mr. Khelil noted that the paper did not specify the part of the project which could be financed. He thought a

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new approach was warranted here, too: loans should cover not only the cost of equipment required for a project but also imports of raw materials and semi-finished products necessary for its execution. Financing for equipment expenses was becoming more readily available on terms approaching direct long-term credits, but financing for raw materials and semi-finished products was still limited. He also thought it desirable to enlarge the concept of foreign exchange cost, to include every expenditure in hard currency made for execution of a project. He referred with approval to Mr. <u>Machado's memorandum</u>, proposing Bank assistance to developing countries in mobilizing local currency for local development projects. The Bank should also help to establish capital markets as a means of strengthening investor confidence and improving the investment climate.

18. Mr. Plumptre said his remarks would be made on a personal basis although he believed they would probably command the support of his authorities. He welcomed the paper, which he considered forward-looking, imaginative and constructive. He fully agreed with the points made in Section A, concerning the dividend, loan charges, the IDA transfer and reserves; he thought Mr. Woods' position was quite right at the particular time. At the same time, so far as concerned the possibility of a transfer to IDA, it did trouble him that there should be, within two closely related institutions, a problem in one of how to deal with excessive amounts of income and a problem in the other of inadequacy of funds. He thought it likely that the IDA replenishment would fall short of what could very usefully be used. However, he did not differ from the position expressed in the paper, which was related to the present time and present circumstances.

19. With regard to Section B, Mr. Plumptre reiterated what he had said about the general gist of the paper: it summarized a dynamic and an imaginative approach to be backed by the accumulating hard cash of the Bank. He did have some reservations and questions about particular issues, which he would mention in relation to Sections C and D. With respect to the concept of "earned surplus" in this section, he liked the phrase and could accept its application as suggested later in connection with the non-guaranteed lending operations. However, it was not clear to him whether the concept of "earned surplus" and the attribution of income to "earned surplus" was meant to permeate the rest of the activities summarized in Sections C and D or was instead essentially tied to the single outlet of non-guaranteed loans.

20. Mr. Plumptre commented, respecting Sections C and D, that he agreed with Mr. Pitblado and Mr. Donner that if the Bank entered in a substantial way the fields discussed in those sections, it would be going into areas already occupied by other institutions in some way and to some degree. He had in mind, for example, the Expanded Technical Assistance Program of the United Nations, the U.N. Special Fund, UNESCO, FAO, ILO, and possibly other specialized agencies of the United Nations. These bodies and programs had been set up by governments to do particular jobs; their rights and prerogatives were guarded with some jealousy not only by the permanent staffs of the organizations but also by the various departments of national governments which took a very active interest in them. He thought it perhaps the main deficiency of the paper that it was silent on this issue, which he should have liked to have seen discussed. He was not concluding that merely because there were other agencies in these fields the Bank should immediately relinquish all interest in them. He was suggesting, however, that the Bank must move cautiously and perhaps slowly to achieve its best results and that it would also want to have clearly in mind where its strengths and where its weaknesses lay, what were its capabilities and what its limitations. His question was really whether the Bank could and should attempt to collaborate with these bodies and agencies or should ignore or circumvent them. His own disposition was to feel that to the maximum extent possible attempts should be made to collaborate with bodies of this sort. The Bank, having its own sources of funds, was in a position to move forward irrespective of the wishes and good will of the other agencies in the field, but he was sure it would create problems in national capitals if that were done. Moreover, the mere fact that the Bank need not rely on annual contributions from governments put upon it some international responsibility. Mr. Plumptre said that, like others, he was strongly in favor of expanding judiciously the Bank's technical assistance activities; his comments about collaboration with other international organizations were pertinent here. He found the references to agricultural improvement in paragraph 17 rather ambitious for the Bank, and he was immediately reminded of the extent to which FAO had already established capacities and expertise in that field. He fully realized that some of the U.N. specialized agencies were not the most efficient or most operationally satisfactory bodies in the world. He was well aware that there were difficulties in dealing with them, and that they were not always as rigorous as national treasuries would like in their organizational and other arrangements. Nevertheless, over the years these agencies had accumulated a large body of valuable expertise which the Bank should draw on as it could.

21. Mr. Plumptre said that he shared with other Directors worries relating to the Bank's getting into educational operations; construction of schools was quite different. He appreciated that it was not feasible to consider school construction without having views upon the general educational structure of a country, and the kinds and location of schools required. These broader considerations did enter in. It was a matter of degree. He shared the apprehensions voiced by other Directors about the nature of Bank activity in this general area. 22. Turning to Section C, Mr. Plumptre said he welcomed the suggestion of greater flexibility in the terms of Bank lending; the Bank should be considering longer-term loans and longer grace periods. However, he would like to see developed a clearer rationale than could be put forward in a brief paper of the sort of situations to which the more lenient terms might be applicable. He had heard loans on longer terms and with longer grace periods justified on four different types of grounds, some of which seemed to have more validity than others. Sometimes they were related to balance of payments considerations, sometimes to the earning life of the assets that were being financed. He thought both these considerations had merit. Sometimes they were related to the fact that the borrower was in a relatively weak position, so although the productivity of the investment was considerable, the borrower himself was not able to mobilize the results of the increased productivity. He was less sure that this was a good reason for longer terms and longer grace periods. It was also sometimes suggested that because the loan was a poor one or unproductive even in a broad sense, lending terms should be more lenient; in that situation the right answer was that the loan should not be made, in the interests of both borrower and lender. He hoped there would be evolved for discussion a more clear rationale as to what was in mind in regard to these longer-term loans and grace periods.

23. Mr. Plumptre thought the paper had not clearly explained what was meant by a long-term agricultural improvement loan as compared to any other sort of agricultural improvement loan. Here a more refined definition would be desirable.

24. Concerning the proposal related to pioneer industries, Mr. Plumptre said he had a favorable reaction to that proposal, particularly in relation to those underdeveloped countries which had a shortage of natural resources but no shortage of population. However, industrialization was a field full of pitfalls. One was the danger of excessive protectionism to support an industry which particular leaders happened to favor; another appeared in the paper, where it was suggested that the working up of local raw materials had some special validity or desirability. Industrialization should be developed on the basis of all the economic considerations. The fact of availability of a particular raw material should not take precedence over other economic considerations. For example, it did not follow that the Canadian North and Venezuela should become world iron and steel centers because iron ore was found there. Nor did it follow that elementary cotton spinning and weaving ought to be carried out primarily in those countries which grew cotton. In short, he thought the possibility of working up raw materials a dangerous criterion, and regretted to see it in the paper.

25. As for loans without guarantees, Mr. Plumptre agreed with the proposals but, like Mr. Pitblado, wondered whether the way to achieve the objective was through amendment to the Bank's Articles or through a strengthening of IFC. He had no strong views as to the path to be followed, but would like to see further discussion of the latter possibility. If the conclusion were ultimately that amendment of the Articles was the desirable course, he would have no difficulty in supporting that approach. 26. Mr. <u>Plumptre</u> was glad to see the section on maintenance import loans included in the paper. Many Bank loans, and perhaps even more IDA loans, were in essence balance of payments supporting operations. It was desirable for the Bank and IDA to be able to take this action openly wherever appropriate, rather than apologetically and in an effort to attach the loans to particular projects. He realized that there were serious dangers of abuse in that area. But by and large he thought the Bank should recognize, as the paper seemed to do, that it was in the balance of payments support business.

27. Mr. Plumptre concluded by saying that although he had raised a number of critical points, he wished to make clear that his general reaction to the paper was a very favorable one.

28. The Chairman said that although he was deliberately not intervening in the discussion very much, he would like to reply to Mr. Plumptre's question as to how far the earned surplus concept permeated the rest of the paper. It did permeate the rest of the paper; paragraph 4 of the paper was meant to . make that clear. The whole concept of a new and more enterprising approach, as reflected in the proposed series of measures mentioned in the paper, would be fortified if net earnings were retained in the Bank in the form of earned surplus or otherwise. Mr. Pitblado asked for further clarification. He could see that the Bank would be fortified if it were going to enter into operations which were financially less sound. If it were not going to enter into operations of that character, it did not need fortification. The Chairman said he had not suggested that the new activities would be less sound, but rather that the area of activity would be broader and more enterprising. Mr. Pitblado replied that he had difficulty with that concept. Mr. Donner inquired how establishment of the earned surplus account would facilitate the making of maintenance import loans. The Chairman replied that at the present stage all he would like to say was that the management felt that the strengthening of the Bank's financial resources through the retention within the Bank of net earnings would facilitate an expansion of activities in many different directions, as outlined in Sections C and D of the paper. He would prefer postponing any more detailed statement until the rest of the Directors had an opportunity to make their general statements. Mr. Donner said he agreed that the accumulation of further earnings strengthened the Bank. His point was that he felt that any of these proposed new activities, with the exception of those in the technical assistance field, could have been carried out by the Bank in the past. Maintenance import loans would not cost the Bank anything, that is, would not reduce its earnings. Loans to private industry would enhance earnings. In fact, nonguaranteed loans to established private enterprises with an established earnings record might even be better risks than some of the guaranteed loans. Longer periods of amortization and grace would to some extent reduce turnover of the Bank's capital but would in no way affect its earnings. The Chairman replied that the discussion might later come back to some of the points raised.

29. Mr. Lieftinck said that the paper contained many suggestions which deserved the Directors' full consideration. He agreed with Mr. Pitblado that it left doubt in several respects concerning the thoughts and intentions of management, although this should not be considered an impediment to discussion. He regarded the meeting as providing an opportunity for giving first reactions; he was confident that the management would later clarify its concepts and intentions. With particular reference to the concept of an earned surplus account, Mr. Lieftinck said it was not clear to him what function the account was intended to perform, and what was the relation between the creation of the proposed fund and the new policy approach outlined in the paper. He would refer to this difficulty later.

30. On the proposal for the accumulation of Bank income, Mr. Lieftinck agreed with the position taken by the management with respect to payment of a dividend, for reasons he had explained in earlier discussions. With regard to loan charges, he thought the Bank should be extremely cautious before changing these, although on this point he was flexible. He felt that although there might be an argument in favor of cutting the commitment charge in half, as the paper proposed, the Bank should be mindful of the true function of that charge, namely, to put pressure on borrowers rapidly and diligently to draw down the loans. It should carefully weigh the pros and cons of a reduction in the commitment charge in that light. He still doubted the need to maintain the traditional formula for the Bank's loan charges: the market rate plus one per cent plus one-quarter of one per cent. His doubt did not apply to the two components of the market rate and the one per cent commission. He thought the Special Reserve should continue to grow; he did not consider it adequate at present. However, he was less sure of the merits of the one-quarter of one per cent element of the loan charges. This had always been justified as necessary to cover the Bank's administrative expenditures. But in view of the fact that the Bank had an initial capital on which it did not pay interest, that it had accumulated earnings which added to its earning capacity, he was openminded with respect to the possibility of dropping the one-quarter of one per cent. He would add that the Bank's loans should, however, not become unduly cheap and perhaps thereby cause distortion of investments; he was not sure that the abandonment of the one-quarter of one per cent would in any event have such a consequence.

31. Mr. Lieftinck said he would not restate his position on a possible transfer to IDA; this was already well-known to the Board and management. He did, however, want to say again that he was strongly in favor of continuing to build up reserves, perhaps at a somewhat lower rate; he referred again to his flexibility with respect to the Bank's loan charges. There were two main reasons why he thought reserves should continue to grow. One was because of the risks involved in Bank loans; the other was that it was desirable to continue to provide the Bank with an increasing amount of cheap money for its operations. In his opinion, this would assure that the Bank's loan charges would not have to rise even if temporary market conditions caused its borrowing costs to go up steeply (although in principle he would be inclined to follow the long-term trend of the market). He found somewhat surprising the rather abrupt statement in the paper, with respect to the adequacy of the Supplemental Reserve, that a level of \$476 million was sufficient. At the same time, the paper later indicated that actually the Bank would go on building up reserves, not only the Special Reserve but also the Supplemental Reserve, except that the name of the Supplemental Reserve, beyond the \$476 million level, would become the "earned surplus account." He had already indicated that the true function of the new account was not very clear to him.

32. Concerning the rest of the paper, which he thought the most important part, in that it dealt with changes in policies, it was Mr. Lieftinck's opinion that the Bank should be extremely cautious in changing its policies to such an extent and in such a manner that instead of remaining a true bank, as it had been in the past, it would gradually change into a development assistance fund. He thought the Bank should remain a true bank governed by sound banking principles. By that he meant, to give one example, that it should maintain a sound relation between the average maturities of its loans and the average maturities of its borrowings. Perhaps some modification of this principle would be justified depending on the nature of a particular institution's capitalization, but as a general rule the principle should be carefully observed. There were many other possible illustrations of what he would consider operating on sound banking principles. He would like to see the recommendations of the paper weighed from that point of view, to determine whether the proposals would carry the Bank into a sphere of activities that would no longer be consistent with good banking principles.

33. Mr. Lieftinck said he was fully aware that there were many needs in the less developed countries, that the Bank should have an open mind concerning those needs, and that it should carefully consider what it was in a position to do to help to meet them. However, it should also be realistic enough to recognize that it could not meet every urgent need in the field of development and development assistance. For that reason he thought there should be kept in mind the distinction between the Bank on one hand and IDA and IFC on the other; the Bank should not embark on IDA-type or IFC-type financial activities. He was not against reconsideration, from time to time, of the Bank's practices; indeed he thought the time had come for such a reappraisal. Moreover, he favored a certain amount of flexibility. But he reiterated that the Bank should continue to operate as a Bank and not as an IDA or IFC institution. The problem of a rapidly accumulating reserve had a bearing on the amount of flexibility the Bank could adopt: the stronger it was financially the greater the margin for expansion of operations. But certain limits should be set. He could conceive of setting aside part of future net income for special purposes, admittedly not purely Bank activities, but considered to be within the margin of flexibility which the Bank could afford. Similarly, he could conceive of continuing to build up the Supplemental Reserve with part of net earnings, 50 per cent, 55 per cent, 75 per cent, whatever was considered to be sufficient to back the Bank's truly banking activities. The remainder might be set aside in

a special account, to be called, say, the "general development assistance grant and loan account." This would allow the Bank to embark on certain activities which, although useful and important, were "fringe" activities from a true banking point of view. All technical assistance expenditures, for example, might be charged to the general development assistance grant and loan account. The Bank's budget already separated administrative expenditures from expenditures for assistance to member countries. By charging technical assistance expenditures to the proposed special account there would be, in effect, a limit set to what the Bank would spend on these "fringe" activities. He was greatly in favor of increasing the Bank's technical assistance, but he also agreed with those Directors who had taken the position that technical assistance should be related as closely as possible to financing activities. The proposed new account, which would be expanded considerably each year, could be used for other purposes as well. Special loans might be made out of the account, perhaps something like those suggested in the paper. As to these he would like to reserve his position because he had difficulty with a number of the proposals. Nevertheless, he was sure there would be a range of possible financing on more lenient terms than the Bank had to specify for its normal operations. He could conceive of projects in the field of agricultural development; perhaps also of industrial development, although here he had considerable doubt; and in the field of education where special loans with longer maturities and with a lower interest rate could be beneficial.

34. Mr. Lieftinck said that one of his principal objections to the suggestions of management with respect to extension of lending operations was that it was proposed to make concessions with respect to maturities only; he wondered why the proposals did not include the possibility of making loans cut of special funds on easier interest terms. He could not conceive of a long-term agricultural credit, even one for 40 years, carrying interest at 52 per cent. He doubted that sound agricultural borrowers willing to pay such a high rate of interest could be found; in the agricultural field, interest had to be much lower. He was also surprised to find that with respect to industrial loans the management was considering interest considerably higher than the Bank's normal interest rate. There were a number of specific problems here which he did not want to discuss at present. Referring again to his suggestion for a general assistance grant and loan account, Mr. Lieftinck said he did not have in mind that the account would be confined to grants and normal loans; its main purpose ought to be the making of special loans on easier terms -- not as lenient as IDA credits, but for projects closely related to the Bank's normal operations which increased the effectiveness of those operations. That criterion would of itself restrict the type and number of such special projects. In his view, all the problems and difficulties of entering into fields occupied by other institutions would be minimized if the Bank's special operations were confined to making its own primary activities more fruitful and more effective. Presumably the fund in the account would produce earnings and he proposed that that income be used for grants in the field of technical assistance, and perhaps for other purposes. Mr. Lieftinck added that he found the

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paper prepared by Mr. Machado very constructive. He was not in a position to give it his support at present, but he thought it touched the heart of a problem, perhaps of the problem, in the special field; it should receive most serious consideration.

35. The <u>Chairman</u> asked what were the Directors' wishes on the meeting schedule. It was apparent that the general exchange could not be concluded by the end of the morning. He wondered whether the Committee would want to resume in the afternoon or Thursday morning. It was agreed that the meeting would resume at 10:00 a.m. on Thursday, August 1.

36. Mr. Garland thought the paper raised some fundamental issues for the Bank and incorporated some quite important and constructive suggestions. Because of their far-reaching implications, and because there had been such little time to study the proposals, he thought it reasonable that the meeting should confine itself to a preliminary examination of the paper and to exploring personal reactions. He thought first attention should be given to the question of reserves. The paper suggested that the Supplemental Reserve not be increased beyond the June 30, 1962, level of \$476 million. It was true that this suggestion was made "for the immediate future" only, that the Special Reserve appropriation would continue, and that the "Earned Surplus" account would be in the nature of a third reserve account. He would agree that the Bank could very well taper off the appropriations to Supplemental Reserve. Nevertheless, he believed it would be unwise, for presentational reasons, to refrain from making, even for the time being, some additions to the Supplemental Reserve, however much these might be reduced in comparison with the practice in recent years. The paper mentioned the possibility of an adverse change in relevant circumstances. Mr. Garland said he would prefer to anticipate that possibility and make provision for it annually, rather than to suspend further allocations to reserves entirely until the adverse circumstances occurred. A suspension might well be misunderstood, particularly in view of the additions to membership, the contemplated expansion of Bank activities into fields somewhat more experimental than heretofore, as well as the growing debt-servicing problem of members generally. Perhaps it would be useful to look at these problems in more detail and if the staff also circulated a revision of the reserve ratio projection given in R62-110.

37. As to the payment of dividends, Mr. Garland said he had noted the view expressed in the paper; he was not in a position to contest its conclusion on this point. As to loan charges, he remained unconvinced; in particular he was not convinced by the arguments against a reduction in commission. As to a transfer to IDA, the countries he represented had previously not found the idea very attractive, and had seen some dangers in it. In the present context, however, he did not believe that the idea should be summarily dismissed. The view expressed in the paper concerning a transfer to IDA was addressed to a transfer at this time. He assumed that even if the Directors accepted that view now, the possibility would not be dismissed for all time; it might be reconsidered in future in some more appropriate context.

38. The recommendations on financial policy seemed to Mr. Garland to approach the Bank's future problems in the right spirit. It was appropriate, at this stage of the Bank's development, that some new initiative be suggested. All the recommendations had to be considered very carefully. He could appreciate the eagerness of management for some prompt decisions, particularly in view of the forthcoming Annual Meeting, but he thought it most important that adequate time be allowed for governments to assess the proposals fully and comprehensively. The manpower implications mentioned in the paper were likewise very important; it would be wise to adopt the suggestion in the paper that it was necessary to proceed cautiously. The proposed changes in lending policy were particularly interesting, Mr. Garland said. A fuller, more quantitative description was needed, however, to make clear what they would involve. Extension of the repayment period was proposed "where necessary." He wondered whether this might not tend to become the norm for lending to less developed members. If so, taken together with the other proposals, this might have implications for the future availability of funds for new lending. Some of the proposed new types of loans could take the Bank far into the IDA and IFC fields and possibly, in the case of school building projects, deeper into local currency financing. The proposals needed to be investigated very fully and, he believed, applied fairly selectively.

39. Mr. Garland said he was not happy about the proposed extension of Bank financing to school buildings. He believed that educational projects which fell properly within the Bank field of lending should be associated very closely with developmental projects. An agricultural training school or a school set up to service an industrial estate would, in his view, be very much more suitable for Bank lending than school buildings justified merely in terms of the general contribution made to development by improving educational facilities.

40. Mr. Garland thought the proposal for maintenance import loans had merit. It was true that it represented some qualification of the project loan principle on which the Bank operated, but he would not object to it on that ground if the loans were strictly selected, and provided as far as possible for international competition. Justification for such loans could be found in a number of different situations and for countries at various stages of development; some degree of flexibility could consequently be given to the loan arrangements. He had, however, grave doubts about the proposal for loans without government guarantee, and wished to reserve his position on this suggestion until he had received more comprehensive comments from his governments. His authorities had already raised two points: (a) the paper did not provide a sufficient basis for reaching decisions on the various proposals, particularly on those concerning loans without government guarantee, and a detailed paper describing more fully the scope and implications of these suggestions should be submitted to the Board and thus to member governments; (b) his authorities were anxious to know what was likely to be the effect of the proposals on the Bank's ability to mobilize capital on commercial terms. The reaction of capital markets, particularly

Wall Street, to the Bank's "new look" would be most important, and should be one of the considerations governing the Board's reaction to the proposals.

41. Mr. <u>Garland</u> agreed that expansion of technical assistance activities could reasonably be contemplated, on a gradual basis, depending on the availability of suitable staff, and confined within areas which did not overlap those of other international institutions except as might be mutually arranged. It was important to avoid any unnecessary duplication of international functions and activity. He stressed this point because the proposals seemed somewhat ambitious, and their cost would mount fairly rapidly. He assumed that technical assistance would for the most part be financed from the Earned Surplus account, and would therefore be kept under reasonably close review. Extended technical assistance represented one of the few increases proposed in current expenditure, as opposed to capital expenditure. It was therefore, at least in part, an alternative to other ways of using the Bank's surplus income. He was, however, not convinced that it had been established that this was a better alternative than proposals previously discussed.

42. As to education, Mr. <u>Garland</u> said that until he had an opportunity to read Dr. Branscomb's report he would reserve his position. He believed, however, that Bank activities in that field should be closely associated with development and productivity. He was extremely doubtful of the desirability of going into the field of educational operations, and he did not contemplate with very great enthusiasm the prospect of the Bank and IDA becoming a major source of external capital for educational investment. On the other hand, he would not necessarily object to a cautious and hardheaded advance into education, in close association with the proper functions of the Bank, and in close cooperation with other international agencies concerned.

43. The Chairman commented that there was in fact no Branscomb report. Dr. Branscomb had prepared a series of working papers at various stages in his consideration of the problem and in his capacity as a consultant to management. Had the end product been a positive proposal, Dr. Branscomb would have been asked to prepare a report in support of the proposal. The Directors would recall that the possibility originally in mind was a ten million dollar fund along the lines of a foundation operation. Since the conclusion had been negative, no such report had been prepared. He was sure that Dr. Branscomb would not wish to have his working papers regarded as a report. Dr. Branscomb had since severed connection with the Bank. The Chairman inquired whether the Directors would be interested in hearing an oral report from Dr. Branscomb. Mr. Chen suggested the possibility of a resume of the working papers. Mr. Pitblado thought it might serve the purpose as well if the Directors received a longer and more reasoned paper setting out the management's views, which had only been touched on here in the present paper, rather than a specific account of what Dr. Branscomb had done. Very likely a number of points would be made by Directors on the proposals in the field of education. It might be helpful to have a rather

full statement of the management's views. Mr. Donner concurred in Mr. Pitblado's suggestion. Last year the Board had decided that Dr. Branscomb should prepare recommendations as to how the Bank might move into the educational field and make grants of ten million dollars a year. Now it appeared that this proposal was to be dropped in favor of technical assistance in the educational field, and with financing of school buildings on much the same basis as applied to other bank projects, although with somewhat extended amortization and grace periods. This called for a fuller discussion. It was likewise desirable to have a more comprehensive presentation of the reasons underlying the recommendations for non-guaranteed loans to industry and some indication of the possibilities in the field of agricultural schemes and pioneer industry schemes. The Chairman agreed that it would be more useful to focus on the present proposals, rather than past history. A paper would be prepared, elaborating the conclusions set forth in the present document concerning education.

44. Mr. Machado thought the paper was the best thing that had happened to the Bank since the formation of IFC and IDA. The fact that self-examination and self-criticism was possible, with Directors invited to suggest ways in which the Bank might continue to be helpful to its members, was a sign that the institution was alive. He commended Mr. Woods' vision, courage and initiative. Whether the Directors agreed or disagreed with the paper, its recommendations were clear, it was thoughtful and looked to the future. He thought the presentation of the paper very timely in view of the forthcoming Governors' meeting, which would offer a useful opportunity to discuss various approaches to the Bank's future activities. He therefore hoped it would be possible to crystallize some thinking on the paper before September. For the moment, he assumed that what was wanted was an expression by each Director of his general views on the various points made in the paper.

45. Mr. Machado thought it appropriate to consider the Bank's future policies. As he had said before, the Bank was running out of clients. There was no further reconstruction work to be done for the time being. Formerly undeveloped countries on the continent of Europe no longer needed assistance. Even among the less developed countries, some had reached a stage of development which might in the future make it unnecessary to look to the Bank for assistance. Moreover, other specialized agencies had come into being and were beginning to take on some of the work that formerly the Bank had to do. It was therefore proper to consider what new activities the Bank might undertake in the future if it were not to become obsolete.

46. Turning to the paper, Mr. Machado was glad to see that Mr. Woods had reversed his earlier position on payment of a dividend, and that he was of the opinion that there should be no transfer of funds from the Bank to IDA, since this would not increase the over-all amount of funds available for development. In Mr. Machado's view, the real problem was to find new funds and ways of raising them for the large development task remaining to be done. He likewise agreed with the proposed disposition of the recurrent question of the amount of the statutory commission, that is, that the one per cent commission should be retained as the single source of future increases in reserves. 47. Mr. Machado commented that the name "Supplemental Reserve" was misleading. It made persons outside the Bank, and even some in the Bank, think that \$476 million was idle, whereas the funds in the Supplemental Reserve, whatever their amount, were actually put to work in loans by the Bank. Perhaps by changing the name on the balance sheet this impression would be corrected. Perhaps new questions would arise, but at least the funds would remain available for Bank operations.

48. Mr. Machado agreed with the general recommendation that amortization and grace periods should be lengthened, although he would not go so far as the paper seemed to suggest, allowing 50 years or 40 years where 20 would do. In some cases, particularly loans for agricultural development, the nature of the loan itself called for a longer amortization period, up to the time when returns on the investment could reasonably be expected. On the other hand, he agreed with Mr. Lieftinck that the amortization period should not be extended where this would not be justified, merely to provide easier money. This would not be a service to the country, and might be a disservice to the Bank, especially in the light of the new U.S. tax proposals. It was also necessary to take account of the fact that a lengthening of the amortization period might make sales out of the Bank's portfolio more difficult.

49. Regarding the loan charges, Mr. Machado said he had told Mr. Woods that he did not agree with the recommendation to cut the commitment charge in half. That charge was in line with the practice of other institutions. It served as a kind of insurance against the possibility that the Bank's interest rate would rise between the time the loan was signed and the time the funds were drawn. He did not think the present rate was excessive. The primary purpose of the commitment charge was to encourage countries to use the funds placed at their disposal by the Bank. He in fact favored a commitment charge for IDA credits. He thought it was a disservice to IDA to make no charge for credits, making funds available whenever the borrower wanted them, and without any obligation on its part to use them or any stimulus to use them. Perhaps instead of a flat rate regardless of the number of years required for the project being financed, a sliding scale, like the IMF's, might be adopted, say one-half of one per cent for the first year, three-quarters of one per cent the second year, with subsequent increases until the funds were drawn. The staff might consider whether such a scheme might not expedite disbursements.

50. Turning to the proposal to increase the Bank's activities in the field of technical assistance, Mr. Machado said increased technical assistance was badly needed. He thought the proposal to increase project preparation work very constructive. The field of long-term agricultural projects was one in which the Bank could be of great assistance. He assumed that more details would be supplied later. He approved the proposal to make maintenance import loans, particularly in countries where industries had been established and where obsolescence of equipment and the necessity of replacing parts actually diminished industrial returns. He agreed that pioneer industries should be encouraged. Most of the less developed countries were producers and exporters of raw materials. Anything that could be done to assist them in the industrial development of their raw materials would enhance their balance of payments position, enable them to earn foreign exchange, and contribute to their development.

51. Concerning the recommendation to go into the field of education, Mr. Machado was sure that the Bank would not try to compete with UNESCO or with any of the existing institutions. He envisaged that the Bank would offer to assist in high priority educational projects where there was need for financial assistance which could not be met otherwise.

52. With respect to the proposal for loans to private industry without governmental guarantee, Mr. Machado thought there were two points to be considered. One was that an amendment of the Articles would be required. This did not disturb him, if it was absolutely necessary. He believed that Mr. Woods had in mind that soon IFC's capital would be insufficient by itself to meet the needs of private industry in the less developed countries, and that he was preparing to make it possible for the Bank to participate to a greater extent in IFC transactions. Aside from the difficulty and the inconvenience of modifying the Articles, Mr. Machado thought this a good move. IFC had made a great impact in the field of developing industry in the less developed countries; while the early transactions might not have been ideal, the operation had been profitable both for IFC and for the less developed countries. He would rather approach parliaments for a change in wording than for additional appropriations. However, he would suggest to the staff that perhaps a good deal of what was intended could be done without amending the Articles. The Articles permitted the Bank to accept a central bank guarantee as well as a government guarantee. The Bank had always insisted on parliamentary approval, but nothing prevented it from accepting a central bank guarantee of repayment instead; the proposal in the paper contemplated a central bank convertibility guarantee. For that matter, the Articles also now authorized acceptance of a guarantee from an agency comparable to the central bank; a country could create such an agency if it did not exist. Thus perhaps the matter could be handled without going to parliaments for funds or for a change in the Articles.

53. Mr. Machado thought there was one serious omission in the paper: the Bank should do something in the field of public health and sanitation. He referred to the discussion, at the time of creating IDA, of the possibility of eliminating malaria from Central and South America for a relatively modest investment and through cooperation with United Nations health organizations and the various regional health organizations. Perhaps the staff might want to consider this field. The other matter omitted in Mr. Woods' paper, which Mr. Machado had dealt with in a paper of his own, distributed at the end of the preceding week, was the need to help the less developed member countries to solve the problem of supplying the local currency financing to carry out Bank projects. The foreign exchange component, which the Bank met, represented in most cases less than 50 per cent of the cost of a project. When a country which did not have the means and lacked a capital market was required to put up in four or five years an equivalent amount in local currency, it could do so often only at the cost of essential items in its local budget. He hoped his colleagues and the staff would study his paper. Perhaps his solution was not the best one. But the problem existed and seriously affected members' economies and the progress of development.

54. At 12:55 p.m., the meeting was recessed, to reconvene on Thursday, August 1, at 10:00 a.m.



Mr. Geoffrey M. Wilson

John Duncan Miller

Commitment Charge

Mr. Rist Will you think about it too. G.M. W. 25/10

This did not come up at Williamsburg so I did not bring it up. But I noticed reading (since I got back) the Board discussion of September 17 that Miss Brun (page 3) said that "the commitment charge functioned as a penalty on borrowers who did not carry out their projects within a reasonable time. But it was also a burdensome payment for those borrowers whose projects had to be carried out over a number of years". This provides a justification for a suggestion I was going to make.

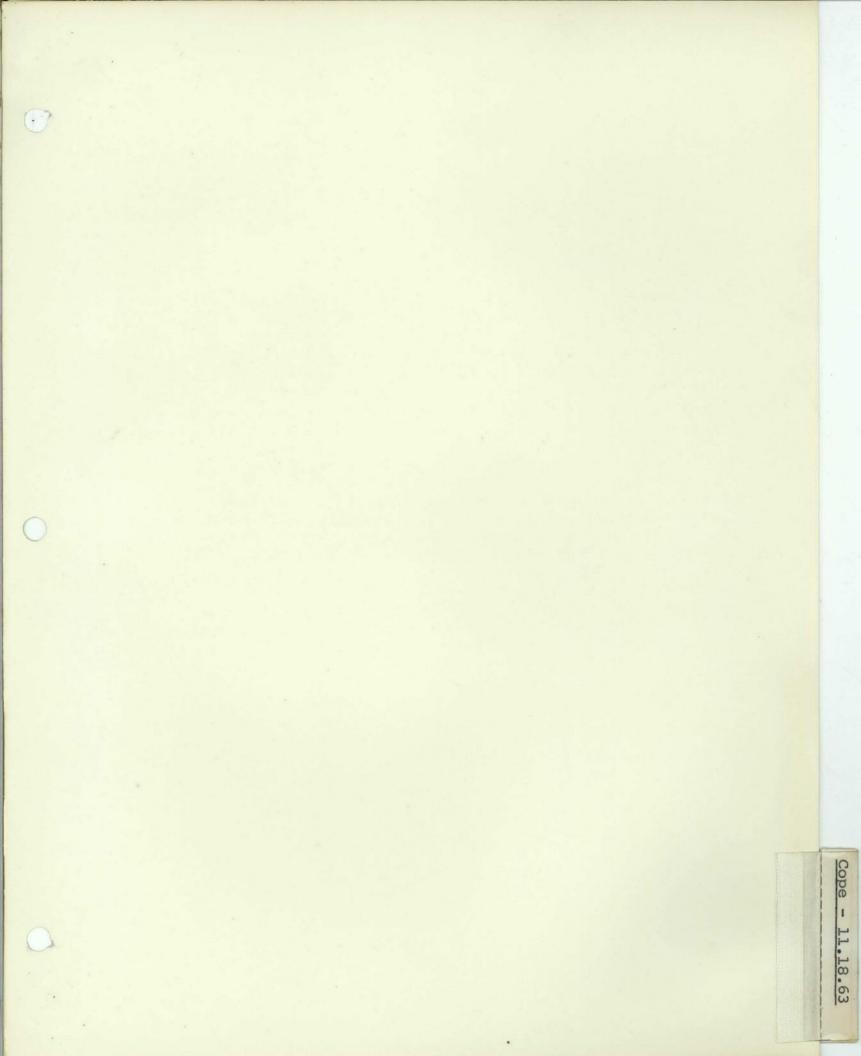
Could we not, at the time of negotiating the loan, also negotiate the commitment charge on the basis of estimates as to when the funds will actually be needed. I would suggest charging only a nominal (1/4%) rate up to the time when it is estimated that a drawing will be made; 1/2% for the first three months after the estimated date; 3/4% for the second three months; and 1% after that.

This would encourage borrowers to carry out projects in a reasonable time but would not penalize those who have to sign a loan for a large project and know that they cannot use much of the money for two or three years.

We would not have to make provision for disbursements before the first date the money can be drawn so it would be no hardship for us. At the moment we are charging borrowers some \$12 million for money they have not had and that, in many cases, we have always known they could not have used yet.

October 21, 1963

Commitment Copy chape



Loans to countries with established market credit

Nov. R. 63 Cope

feepaper

1. For some considerable time the Bank has been making loans to certain of the more developed countries among its membership who have been able to establish their credit, but who have been unable to meet all their legitimate needs for imported capital in the market.

2. On each occasion, the Bank, mindful of the Articles of Agreement, has taken care that the country in question was making due efforts to borrow in private markets, and could not obtain the money elsewhere on reasonable terms. With the Bank's lending rate at 5-1/2%, however, the more creditworthy of the Bank's borrwers had little incentive to borrow in private markets where the net cost of borrowing was seldom below this figure, and frequently considerably above. In these circumstances the problem of avoiding competition with the market is a real one.

3. From time to time, Executive Directors have raised questions whether the Bank was justified in continuing to lend to these countries, even though it had ample resources. Doubts have been expressed as to whether the countries in question were really making every effort to raise money in foreign private capital markets themselves.

4. It so happens that it is these countries who have also been very restive at the insistence of the Bank on its conventional "project approach". Bank staff has also been skeptical of the value of a detailed project appraisal in some of these countries. The time and labor necessary to appraise a project and follow it up is hardly justified if the Bank is unable to exercise any significant influence on, or make any appreciable contribution to, the project itself or the borrowing country's policies.

5. In these circumstances, I propose that for the small group of countries who have established their credit in foreign capital markets, the Bank should make loans at rates reflecting the market rating of their bonds, or at its standard rate (at present 5-1/2%), whichever is higher. The loans would give the Bank the right to call for bonds of a marketable type and would enable the Bank to market these bonds through the countries' own investment bankers as suitable occasion offered. These loans would normally be for general development and would not be linked to specific projects. In the remainder of this paper these loans are termed "market loans" to distinguish them from loans of the type now made by the Bank, which are termed "conventional loans".

6. The proposal would be applied to countries which were normally able to meet in the market a substantial part of their needs for external capital. The list would include such countries as Australia, Austria, Denmark, Japan, Norway, South Africa and Sweden. Other countries which have not yet established their credit in the market, but might shortly be expected to do so, would be borderline cases, and the new procedure might be applied to them in such a way as to encourage their entering the market. Countries coming into this second category might receive project loans rather than loans for general development. A blend of conventional loans and market loans might be used in some cases. The proposed procedure must not be applied so as to appear as a penalty for their having entered the market, but as providing an additional source of external capital.

7. Market loans would be made under a special form of agreement. They would have the following characteristics:

- (a) They would bear a rate of interest which would be agreed upon at the time between the Government and the Bank as reflecting the current credit standing of the borrowing country in external markets, allowance being made for the cost of offering the bonds publicly in due course. For example if the country's 5%, 20-year bonds were quoted at 94 to yield 5.5% to redemption, the Bank would lend (say) at 5.75%, the difference of 0.25% representing the amount required to amortize an assumed 3 point cost of marketing. The same result could be obtained by setting aside (say) 3% of the original amount as a reserve for selling costs. The market rating in New York would be given the predominate weight, since New York is in present circumstances the largest market for foreign issues, In determining the price, and incidentally the reserve for issue expenses, the Bank would consult with the government's bankers.
- (b) The Bank would have to be satisfied as to the purposes for which the loan proceeds would be used. In most cases the purposes would be defined as the general development of the country concerned, in which case the appraisal would be of the economy and of the development program of the government. In a few cases, there might also be a project which would call for the usual kind of appraisal.
- (c) In most cases the borrower would be the government, since direct obligations are normally more marketable than guaranteed obligations.
- (d) In the case of a loan for the government's general program of capital investment, disbursement would be made against the certification that the money had been, or would be, applied to expenditure of capital works. In this case, it would obviously be impracticable for the Bank to insist on competitive bidding. If there were a conventional kind of project, the disbursement basis would reflect the actual circumstances.
- (e) The currencies disbursed would be selected so as to facilitate the subsequent sale of bonds. Dollars would be the currency disbursed in most instances.

- (f) As in the case of conventional loans, the agreement in respect of a market loan would give the Bank the right to call for bonds at any time. The form of the bonds would conform to market requirements. The loan agreement could provide that bonds could be serial bonds or sinking fund bonds at the Bank's option, provided that the aggregate amortization schedule in the agreement was not exceeded. Provision would also have to be made for issuing bonds bearing a lower rate of interest than that provided in the market loan agreement, the difference being paid to the Bank as a service charge.
- (g) If and when the Bank was ready, it would call for bonds and offer them publicly through the borrower's regular bankers. In some cases the whole or a part of the issue might be placed privately either under a conventional type of participation agreement or by a sale of bonds. Contrary to present practice, the Bank would retain (any) profit resulting from a sale as well as bear the loss. This profit or loss might take the form of a difference in price, or, in the case of a profit, by the payment by the borrower to the Bank of a service charge.

8. The idea of the Bank providing a loan in a marketable form could be applied in conjunction with a conventional public bond issue. For example, suppose that in a country on the margin of being able to raise money on its own credit, there were a need for external financing of \$25 million. The borrower's bankers might feel able to raise \$10 million immediately and \$5 million in a year or two's time. In these circumstances, the financing might take one of two forms. One would be a public issue of \$15 million, of which the Bank would take \$5 million on underwriting terms, and a conventional Bank loan of \$10 million. The other would be a public issue of \$10 million, a market loan of \$5 and a conventional loan of \$10 million. Once the principle is accepted that the Bank can make loans or buy bonds on market terms, the actual technique can be flexible and be adapted to circumstances.

The question arises whether there are any provisions in the 9. Articles of Agreement which would prevent the Bank making market loans of the kind proposed. The "project" for which the market loan was granted (Article III, S.4(vii)) would in most cases have to be defined as the development program of the government in question. Requirements regarding the use of the proceeds of the loan (Article II, S.5) could be satisfied in such cases by the payment of the proceeds to the government for its capital expenditures. The provisions of Article IV, S.3(c) requiring exceptional circumstances to justify payments for local expenditures would not pose any particular difficulty. The 1% commission under Article IV, S.4 could form part of the interest payable under the market loan as in a conventional loan. As in the case of any other sale out of its portfolio, the Bank could sell the bonds in respect of the market loan only with the agreement of the member in whose markets the sale was to be made (Article IV, S.8),

10. The selling arrangements would give rise to a number of technical problems which would have to be explored with the SEC and with one or two representative New York houses before the scheme was launched. For example, when is registration with the SEC required? What is the role of the Bank in the registration process, and what are its responsibilities? Would the registration complications involved in marketing a guaranteed obligation in effect restrict market loans to governments?

Decisions involved in marketing the bonds arising under this 11. arrangement would not always be easy. Subject to Article IV, S.8 of the Articles of Agreement, the Bank would be free to sell at any time (otherwise its portfolio would be "frozen"), but it should undertake to consult with the borrower before selling, as it does on selling out of its present portfolio. There might be differences of view between the Bank, the borrower and its bankers on terms and on timing. A problem might arise when the borrowing country finds that the market is receptive to an issue and wants to raise fresh money rather than facilitate the placement of bonds under a market loan held by the Bank. This problem is analagous to that faced by the Bank at present when its desire to sell out of portfolio is restrained by the marketing plans of the borrower. As at present, the Bank would always regard the marketing of its own portfolio as subordinate to the encouragement of a member's resort to the market.

12. There is also the basic question as to whether, in principle, the Bank should adopt a system involving differential interest rates. To single out certain borrowers and make them pay more than the generality of borrowers might provoke the question as to whether the Bank should not apply a specially low rate to the poorer of the Bank's creditworthy members. The general question of interest rates is now being studied by a committee under Mr. Rist, and the committee will no doubt come up with views on this point.

13. This paper takes no account of the proposed U.S. tax on foreign issues of certain countries. While a tax of the kind proposed would not vitiate the proposal, it would be wise to await the passage of the tax legislation before committing the Bank to it.

S. R. Cope Department of Operations - Europe November 18, 1963 10. The selling arrangements would give rise to a number of technical problems which would have to be explored with the SEC and with one or two representative New York houses before the scheme was launched. For example, when is registration with the SEC required? What is the role of the Bank in the registration process, and what are its responsibilities? Would the registration complications involved in marketing a guaranteed obligation in effect restrict market loans to governments?

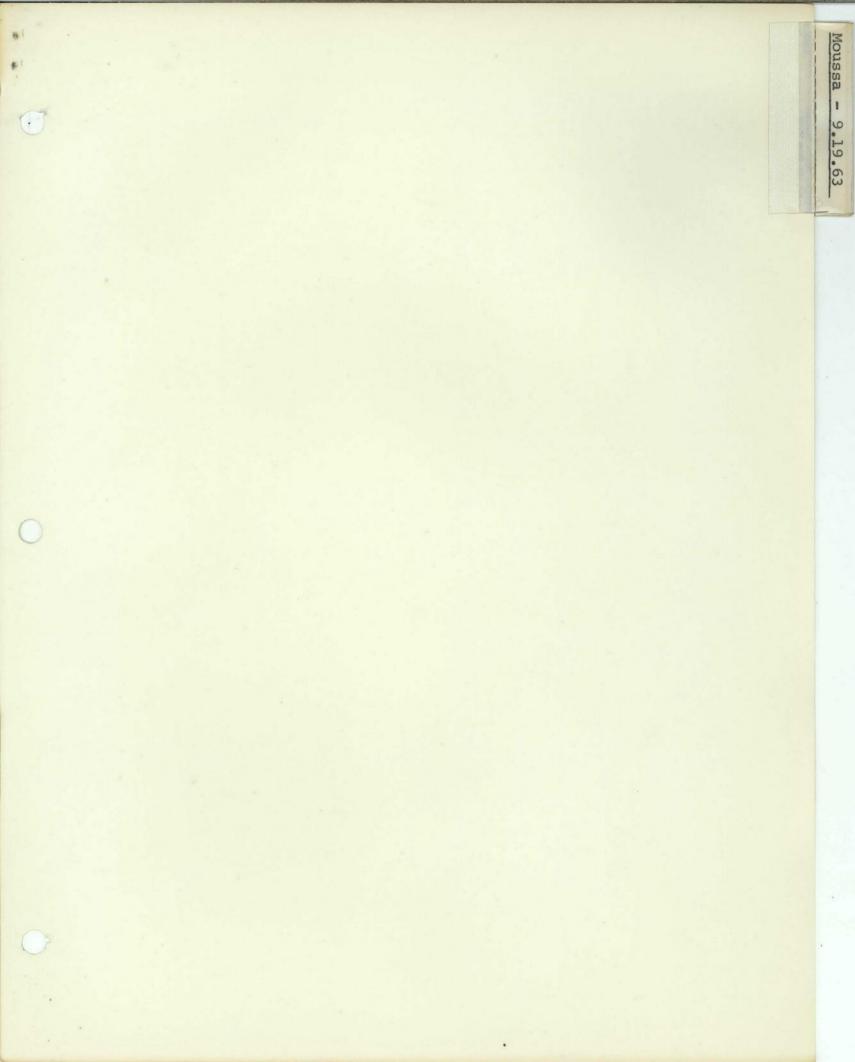
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> 5. R. Cope Department of Operations - Europe November 18, 1963



Loave charges

September 19, 1963

Mr. George D. Woods

Pierre L. Moussa

Bank Charges

house

1. The Bank Financial Policy memorandum of July 18, 1963, states "the Bank's present loan charges are both low and reasonable". This is, of course, true in the context of comparison with interest rates charged in the capital markets of the world. However, there is something to be said for a reexamination of our loan charges policies in view of the fact that we do not have as much IDA money available as we require.

2. If we had sufficient IDA money available we could offer a complete range of rates tailored to the different classes of countries - starting with charges at around the market rate for countries able to carry the corresponding debt burden - and, then, by varying the blend of Bank and IDA money, vary the costs of external capital provided by us from near market costs down to full IDA terms for countries which have only a very feeble creditworthiness. Unfortunately, we do not have enough IDA money. Consequently, if we maintain uniform Bank loan terms we may find ourselves lending at the same interest rate to countries which are quite highly industrialized with per capita incomes in the vicinity of \$1,000, and fairly poor countries. In other words, our first group of countries, which get only Bank money, is too comprehensive.

3. I would suggest, therefore, that we consider seriously making a distinction between countries like New Zealand, Norway, Finland or Japan, which would pay the present rate (or even a little more) and underdeveloped countries, for which the rate might be reduced by 1 to 1.5%. The criterion might be whether they are Part I or Part II countries.

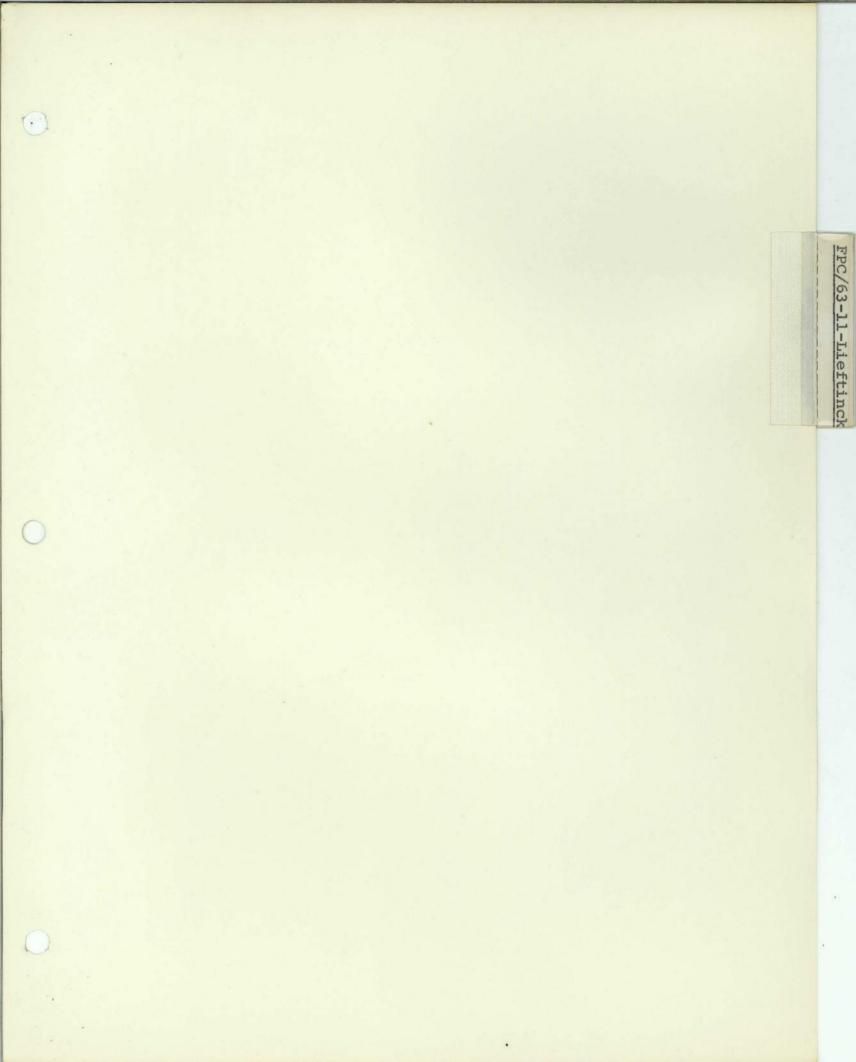
4. One of the advantages of this would be that, for the "blend" countries, everything being equal, the proportion of IDA in their financing could be reduced without increasing the total debt service burden.

5. The General Counsel informs me that the Articles of the Bank do not require uniform charges. Uniform charges, I believe, were imposed initially because it was thought that the members of the Bank would not accept any discrimination. However, the members of the Bank have now accepted (at least for IDA purposes) a differentiation between Part I and Part II members.

6. The principal objection to lowering the Bank's lending rate is that we would compete, or be felt to compete, with the private market. The objection does not appear to hold in cases where the Bank is lending to countries which cannot go to the market; there is then simply no competition.

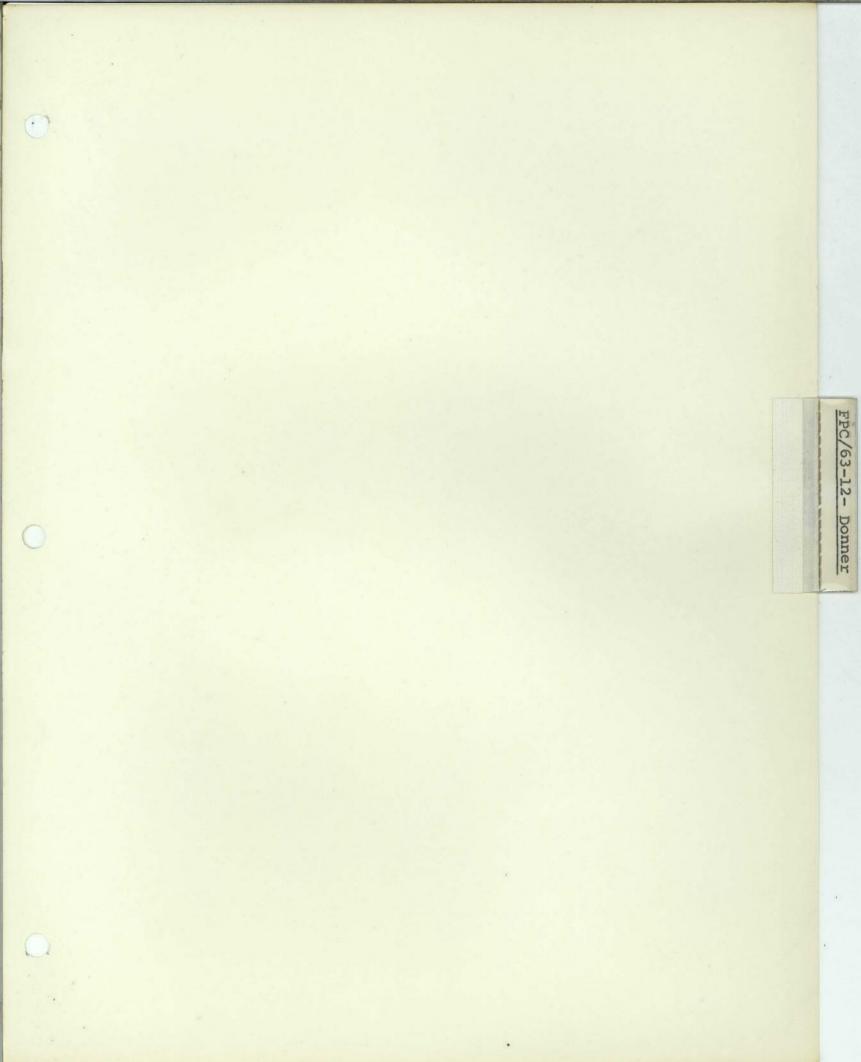
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cc: Messrs, Knapp, Wilson, Broches, Demuth, Cavanaugh



See FPC/63-11 (Machado)

above



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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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Date: 11 15 201050

FPC63-12

August 6, 1963

*Memorandum of Resumed Meeting of Bank Financial Policy Committee on "BANK FINANCIAL POLICY" (Report FPC63-8), Thursday, August 1, 1963 at 10:00 a.m.

1. There were present:

Chairman

J. Burke Knapp, Vice President

Executive Directors and Alternates acting as Executive Directors

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Helmut Abramowski Lempira E. Bonilla Erle Cocke, Jr. L. Denis Hudon M. Kumashiro Eino Suomela A.J.J. van Vuuren

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*This memorandum consists of staff notes of the discussion in the Committee and is not an approved record.

Distribution:

Members of the Financial Policy Committee President Vice Presidents Department Heads

The Chairman said that there were one or two points made during the 2. discussion on Tuesday on which he would like to comment, not by way of debate, but for the purpose of clarification. First, with respect to the proposed earned surplus account, he wanted to make clear that, as one Director had suggested this was essentially a change in nomenclature. The funds allocated to the new account would serve largely the same purposes as those hitherto allocated to the Supplemental Reserve. They would continue to be employed in the regular operations of the Bank, and they would strengthen the financial position of the Bank by improving its debt-equity ratio. The retention of the Bank's earnings in any form gave additional confidence to purchasers of the Bank's obligations. And since the Bank did not need to pay interest or amortization charges on the retained funds it gave the Bank a greater measure of flexibility in fixing its own interest and amortization charges on its own loans. The proposal to establish an earned surplus account reflected the management's judgment that the June 30, 1962, level of the Supplemental Reserve was in fact adequate, taken together with the Special Reserve and barring any adverse change in circumstances, to give the Bank reasonable protection against impairment of its capital through losses that might be suffered. The allocation of net earnings since June 30, 1962, to an account described as "surplus" rather than one labeled "reserve" would avoid giving the erroneous impression that the Bank still regarded its reserves as inadequate. Earnings would be retained in the Bank but would not be classified as reserves, since that might be taken to imply that the Bank still considered itself inadequately protected against losses. There was no intention of segregating the "earned surplus," any more than the Supplemental Reserve, for any special lending operations. He would rather say, to adopt Mr. Plumptre's phrase, that the increased financial strength of the Bank which would result from the retention of its earnings would permeate all of the other recommendations in the paper for bolder and more enterprising Bank activities.

The other point which the Chairman wished to clarify concerned manage-3. ment's intentions in the technical assistance field. Several Directors had expressed what he thought might be undue concern regarding the scope of the paper's technical assistance proposals. In particular, they had expressed the fear that in some fields the proposed activities might duplicate or compete with those of other international agencies, such as FAO or UNESCO. Section D of the paper had intended to make clear that the intention was to take on technical assistance functions not indiscriminately, but only to facilitate and give support to the investment activities of the Bank, IDA and IFC. That thought could be found, expressly or by implication, in each of the paragraphs dealing with technical assistance in the agricultural, industrial and educational fields. That criterion had always governed the Bank's technical assistance activities. There was no thought of any change in that respect. As for the avoidance of duplication of the efforts of other international organizations, the Bank had in the past endeavored to coordinate its technical assistance work with that of the other specialized agencies; here again there was no intention to change. If another organization was providing or could be persuaded to

provide the technical services needed to support projects in which the Bank was interested, so much the better. The paper had in mind instances where such arrangements would not be possible or where special considerations indicated the desirability of the Bank's taking the initiative after consultation with other organizations which might have an interest.

Mr. Illanes said he was glad to have the chance to comment on the 4. paper. He welcomed its broad outlook and timeliness in discussing the complex and changing problems faced by the Bank in dealing with threefourths of the Free World nations. He had been hopefully awaiting the proposed changes; in his opinion they were more consistent with the evolving role of the Bank and with present-day requirements of economic development. Whatever differences of opinion might be expressed about the specific measures proposed by the paper, it demonstrated the basic role of the Bank as the most important international agency in the field of economic development. Loans were not an end in themselves but a tool to permit sound and continuous growth for each country according to its needs, characteristics and potentials. This required flexibility and a full understanding of the economic and human factors, which affected all economic and social progress. The many complex problems besetting developing countries did not in general permit continuous growth, but rather produced advances and setbacks due to such circumstances as insufficiency of resources or errors in planning and execution of economic policies. Timely and generous aid by some of the developed countries had averted greater financial difficulties. Stand-by agreements with the International Monetary Fund had also played their part, as had banks and treasuries. But short-term credits required for effectiveness complementary support of long-term loans. The long-term loans proposed in the report for maintenance imports could in many cases complement the action of the Fund in the exchange field. He was in full accord with the measures broadly outlined in the paper, for they would enable the Bank to provide greater stimulus to the process of economic development. It was essential that the developing countries establish a balance between infrastructure projects and projects designed to increase or improve agricultural, industrial and mining production. An increase in agricultural productivity could not be achieved without simultaneous development in other sectors, particularly the industrial sector, or without technical improvements and a reduction in cost for the marketing and distribution of agricultural products. Most of the developing countries faced serious balance of payments difficulties. Therefore, if the Bank were to operate solely on the basis of conventional loans, the application of its present creditworthiness policy would have the consequence of denying access to its facilities to a great number of the countries most in need of financing for their development plans. IDA's resources were limited; IDA could not be a substitute for the Bank in all such cases. Mr. Illanes therefore regarded the proposal for loans which could be amortized over as much as 40 years and with a grace period of up to 10 years as deserving full support. He agreed that there was need to increase technical assistance, especially in the fields of economic planning, project preparation, education and administrative organization, all with the qualification emphasized

by the Chairman that this would not overlap the activities of other organizations. The expansion of the Bank's technical assistance in the areas over which it already extended, with broader programs and a greater number of participants, would in itself be of great benefit. Mr. Illanes endorsed the value of on-the-spot study and research in the fields of economic and educational planning and the others he had mentioned; methods of execution of projects varied considerably with the local and regional environments, as well as political, economic and social conditions. Moreover, the requisite changes in attitudes could not be brought about by training a few officials in each country; large-scale local and regional training was essential. In this connection, he suggested the possibility of establishing three-month training courses in selected countries characteristic of a group of nations within a developing area. The programs and operational facilities for such courses might be arranged by the Bank in cooperation with the governments concerned, universities or other centers for research and study.

While Mr. Illanes found himself in full agreement with Mr. Woods' 5. views, as set forth in the paper, he had a number of comments on specific points. The proposal to make long-term loans without government guarantee to private enterprises of medium or large size had both favorable and unfavorable aspects; these should be carefully analyzed. Without minimizing their advantages, both in adding to Bank earnings and giving greater stimulus to the operations of larger enterprises, he thought they raised certain problems. At present, resources for infrastructure projects and general facilities for a balanced growth of the agricultural, industrial or mining sectors of a developing economy were barely adequate. In the agricultural sector alone the needs were enormous. Private industrial enterprises of the kind described in the paper had easiest access to private capital markets, and any strengthening of the economies in which they operated would help them further in that respect. Such enterprises did not, therefore, seem to him to have a high priority claim upon already scarce resources. Accordingly, other means should be adopted to promote industrial enterprises, in his view. The possibility of other approaches should be explored by the Bank or, better still, by IFC. Mr. Illanes also referred to the problems incident to the entry of foreign private capital into the less developed countries. That problem raised juridical considerations and called for expert and impartial intervention to smooth over misunderstandings and to correct the erroneous concepts and prejudices which at present existed on both sides.

6. Mr. <u>Ghosh said he wished to associate himself with those Directors</u>, in particular Mr. <u>Plumptre</u>, who had praised the paper; it was far-reaching and very, very bold. His impression, after listening to previous speakers was that it was the consensus that there was need for much more IDA-type money than was available. This seemed to be the paramount need at present. He therefore hoped that, although it was the management's present view that the Bank's surplus earnings should not be channeled directly into IDA, that decision was not final, especially in view of the rather limited IDA resources available for the next few years. This matter might perhaps be reconsidered at a later stage.

7. With reference to the specific proposals of the paper, Mr. Ghosh said he welcomed the suggestion to reduce the commitment fee. This was consistent with the idea that the less developed countries should have a smaller burden of repayment, as far as possible. The proposal would reduce the cost of money to them. He therefore thought it an excellent move. He would, moreover, recommend that the Bank examine the possibility of reducing the one per cent commission, which was also a direct burden on borrowers. Since borrowers generally were underdeveloped countries, a reduction of the commission would help them significantly. This point might perhaps be examined in relation to the growth of reserves, particularly since so far there had been no need for the Bank to dip into its reserves.

Turning to the substantive aspects of the paper, Mr. Ghosh welcomed 8. the combination of proposals which would in effect make it possible for the Bank to make what might be termed impact loans of the type which it made immediately after the war to European countries -- long-term loans for the general development of the economy, for imports of raw materials, components, etc. It was extremely important to realize -- and the Bank should take the lead in this respect--that development of an economy could not be accelerated merely by assisting specific projects. Froject loans were important, but should be combined with loans made to develop the economy within the framework of a development program. The paper mentioned the possibility of financing import of components and raw materials required by industry where industry was not operating at full capacity. Another possibility was the import of fertilizers. If the Bank were to finance the import of fertilizers for a period of five years and also finance establishment of a fertilizer plant, this would insure an increase in the country's agricultural production. There would be an immediate increase by reason of the imported fertilizers; then in perhaps five years domestic production of fertilizers would make it unnecessary to look to imports. This type of lending could stimulate development considerably in the long run. He added that it was important to bear in mind that these long-term loans would not reduce the Bank's earnings, since it was proposed to make them at commercial rates of interest. At the same time, postponing repayment of capital would help underdeveloped economies significantly. In his opinion, wherever it appeared that the requirements of an economy were for over-all assistance in the balance of payments, that type of loan could be of very great importance.

9. Mr. <u>Ghosh</u> said he had had great misgivings concerning some of the technical assistance proposals but the <u>Chairman</u> had explained that it was not the intention to overlap the activities of the specialized institutions such as UNESCO and FAO. He thought the Bank should be careful to assure not only that its resources were not used in competition with those of other organizations but that they were used with greatest efficiency. The Bank might not be the best organization to provide technical assistance in

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certain fields in which it had no special expertise.

10. Concerning loans to private industry without a government repayment guarantee, Mr. Ghosh was impressed with the points made by Mr. Illanes. He was also somewhat concerned that the charging of a higher rate of interest to industry might impose a burden on the borrowing countries. Moreover, to the extent that governments would be required to guarantee convertibility, this might have certain implications which needed to be very carefully considered.

11. The Chairman noted that Mr. Ghosh had described the maintenance imports proposal as extending to the financing of raw materials. That was not the intention. The proposal was to finance, either for industry as a whole or for specific industrial sectors, capital equipment imports not identifiable with a particular project. Capital equipment would include components and spares for that equipment, but there was no thought of financing consumer goods components. Mr. Ghosh replied that in that case he would propose that consideration be given to enlarging the proposal. The sort of impact loans which the Bank made immediately after the war were even more urgently required today. Moreover, the Bank urged aid-giving countries to make funds available not only for capital equipment but also for financing development generally; it should itself set an example in that regard. He did not mean that the Bank should necessarily finance imports of all manner of things everywhere. It should decide where this activity was likely to do most good. If, for example, it appeared that the greatest need of an economy was a rapid increase in agricultural output, then the kind of coordinated financing he had described earlier could be very useful. The proposal in the paper was good, but it should go further in the same direction.

12. Mr. Plumptre said he supported Mr. Ghosh's suggestion that the Bank (and perhaps, even more, IDA) should consider favorably the inclusion of raw materials, possibly of fertilizers too, within the maintenance import category. If the Bank was going to give increased attention to agriculture, as the paper suggested, fertilizers would deserve consideration which might not otherwise be given to them. As far as raw materials were concerned, he had hoped that there was an accidental discrepancy between the footnote on page 14, referring to the comment made by the Bank's recent India mission report concerning the inadequate and erratic supply of imported materials, components and spares, and the paragraph in the text which omitted reference to "raw materials." Apparently the discrepancy was deliberate. He had a double interest in the matter. He was interested in trying to insure that the recipient countries received aid in the form in which they needed it. Experience in bilateral aid programs with India and certain other countries indicated an urgent need for what might be called balance of payments support. In response to urgent pressure from these countries, Canada had included a substantial raw materials element in its bilateral aid, being persuaded that this was important for the maintenance of industrial operations. The other element in his interest was that for a country such as Canada, the question of Bank and IDA financing of raw materials was quite

significant. As governments moved toward situations in which they were expected to contribute to replenishment, it became more important that they should feel that the funds put up had a reasonably good chance of being spent in their territories. Canada now received a certain proportion of Bank financing and IDA financing although a good deal less than many countries around the table. If industrial materials were included, the efforts which a person like himself could make to elicit and maintain support would be more effective. Thus from both points of view he hoped that the Bank staff would take a very serious look at Mr. Ghosh's suggestion.

13. Mr. Bullitt said his remarks, too, would be purely personal. He congratulated Mr. Woods on the very enterprising and thought-provoking paper under discussion. He welcomed the recognition that the Bank would have to add new dimensions to its lending and greatly intensify its technical assistance activities. Certain of the proposals in particular seemed to be areas in which the Bank group of institutions could well begin immediately to expand its activities many-fold, e.g., maintenance import loans and technical assistance in project preparation and industrial development. In emphasizing the desirability of moving ahead promptly in these fields, he did not mean to denigrate the possibility of doing so in other areas suggested. However, more thought and discussion might well be desired before the approaches suggested in the fields of agriculture and education were adopted. He thought Mr. Plumptre's comments with respect to further exploration with other institutions and agencies were particularly apt. Mr. Garland had felt that any educational activities should be closely related to development. These thoughts warranted further exploration. Maintenance import loans, however, seemed clearly desirable. He agreed with the proposals for greatly intensified technical assistance for project preparation. He had been very much impressed by the comments of delegation after delegation made at the recent meeting of the Development Assistance Committee in Paris concerning the need for greatly increased project preparation assistance if the flow of resources to developing countries is to expand. The Bank could perform an extremely useful and significant function if it could make increasing amounts of technical assistance in that field available not only for projects which it or its affiliates might finance but also for those which might be financed by other multilateral or national agencies. This assistance would be welcomed in itself as a means of increasing the number of projects which could be prepared for financing. Moreover, if the Bank were to provide it, it would serve to intensify international coordination of such activities. Technical assistance for industrial development could also be an important arena for Bank activities. Here again he would hope that the Bank would not have to restrict itself to projects which would be financed by the Bank group. Indeed, the Bank might well wish to become a focal point and a stimulus for technical assistance to all aspects of private manufacturing enterprises, including particularly the medium- and small-scale undertakings.

14. Although Mr. Bullitt felt that an expansion by the Bank group of institutions--he stressed "group"--of activities in the other fields indicated should be positively explored, he shared the hesitation of some of the Directors over the form in which it was proposed to do this. In effect, the proposal would have the Bank assume some of the functions carried out by IFC and IDA--although this might now be appropriate. Like some Directors, he was impressed by the statement that a direct transfer to IDA "at this time" would adversely affect the Bank's standing in the financial communities of the world. Although he thought it must be accepted that this was probably the case, he joined with some of his colleagues in stressing the words "at this time." He hoped that the proposals made in the paper would not preclude a re-examination of the question of the transfer to IDA at some later date. Like Mr. Pitblado, Mr. Bullitt thought that if an amendment of the Articles was in order, a modification of Article V, Section 14 might be considered, to make it clear that Governors could authorize a transfer of some portion of net earnings to IDA.

15. Concerning reserves, Mr. Bullitt agreed that the time had come to allocate earnings other than the commission to a new account rather than to the Supplemental Reserve. The title of the new account was less important than the conclusion that the Bank need not continue to accumulate supplemental reserves. As to the terms on which these funds and the amount represented by the existing Supplemental Reserve would be utilized, he would like to reserve judgment for the time being.

16. In Mr. Bullitt's view, the proposal to extend grace and amortization periods had many interesting aspects. He would wish to study these further. As Mr. Donner had pointed out, they also had certain drawbacks, in that countries' debt-service burden would be increased over the long run. As for the proposals to amend the Bank's Articles and permit non-guaranteed loans to private industry at interest rates of $6\frac{1}{2}$ to 8 per cent, he wondered whether that was really necessary to enable the Bank to stimulate private industrial enterprises. Aside from the fact, which the paper recognized, that IFC was already authorized to make such loans, he wondered whether the requirement of a government guarantee really did inhibit Bank operations in that area. He stressed the word "wonder," since this was a matter about which he would like to hear a good deal more. He thought it possible that governments might be reluctant to allocate scarce foreign exchange resources to such high-cost loans when they could obtain lower-cost loans by borrowing directly from the Bank. If this proved to be the case, the new proposal might have the effect of discouraging, rather than facilitating, Bank activity in the area in question. An increase in technical assistance, whether or not for Bank-financed projects, might achieve a more significant result. It would be interesting, Mr. Bullitt said, to have the views of the management as to the volume of non-guaranteed loans it would contemplate, and an indication of the extent to which, in management's judgment, IFC would be unable to meet the need. The latter point brought to mind a more general question which had not been discussed in the paper: the effect the new proposals would have on the over-all volume of Bank lending. He recalled that a paper distributed in connection with earlier discussions of the Financial Policy Committee projected Bank lending at the

rate of \$700 million a year. This might simply have been an illustrative projection rather than an indication of the management's judgment as to what the likely possibility would be. However, many persons had been disturbed by the sharp reduction in the Bank's lending in the last fiscal year. Perhaps this could be explained as a matter of timing, depending on whether a commitment was made late in one fiscal year or early in another. However, he thought all the Directors would hope that a significant expansion of Bank lending activity would be possible as a result of the discussion of the proposals in the paper, combined with an increased volume and a progressive softening of the terms of bilateral aid. It would be interesting to have the management's views on these questions.

17. Mr. Bullitt agreed that loan charges should continue to be determined as they were at present and that the one per cent commission should continue to be allocated to the Special Reserve. He was also persuaded that a dividend would from many points of view be undesirable. He favored the proposal to reduce the commitment charge. It was his impression that the charge did not greatly stimulate borrowers to draw down their commitments. There was sufficient stimulus in their need for foreign exchange. He would not, therefore, agree with Mr. Machado's suggestion that a graduated charge be imposed by IDA. However, he was concerned about the very large amount of undisbursed Bank loans, at present amounting to nearly \$1.5 billion. Concern was expressed at the DAC meeting at the increasing size of the pipeline of committed but undisbursed funds. As the communique issued at the end of the meeting reported, it was agreed to consider methods of reducing the pipeline through technical assistance or other means. Although he recognized that it was not the time to go into the matter in detail, since in his view the Bank's history had shown that a commitment charge was not effective in this respect, he wondered if a paper could be prepared giving management's views as to what might be done by aid donors as well as recipients.

18. In reply to Mr. Bullitt, the Chairman said that, as the Annual Report stated, the annual level of lending was an accident of the calendar very largely. In June 1962, for example, the Bank had made a loan of \$130 million to Mexico. Had that loan been made in July 1962, loans for the 1962 fiscal year would have been about \$750 million and for 1963 around \$600 million. Mr. Bullitt said the question would be what happened in the current year. If loans in fiscal 1964 were still at about the 1963 level, it would no longer be a swing, but a trend. Mr. Donner thought it would be useful if the Board could be given a forecast of the number and amount of loans expected to be processed before the Annual Meeting.

19. Mr. Waitzenegger said that he considered the paper a very important one which deserved careful consideration and might have very far-reaching consequences. More time was required to study all its implications. His remarks would be made on a personal basis. Insofar as the reappraisal of the Bank's lending and financial policies was concerned, he welcomed some of the suggestions in the paper. It was desirable to keep lending policies under active review, maintain flexibility, and revise policies as circumstances suggested. However, the Bank must be cautious and careful to take account, in any "improvement" of policy, of the Bank's reserve needs and the proper role of the Bank vis-a-vis other institutions.

20. Mr. Waitzenegger thought that the matter of funds for IDA underlay the discussion of Bank financial policy. The amount of the replenishment would be limited, while at the same time there was need for more financing on IDA terms. He thought, therefore, that in the not too distant future--perhaps even already -- the Board would be faced with three choices. The additional resources shortly to be contributed by governments could be regarded as sufficient. Or, on the other hand, an effort could be made to find supplementary resources in an amount beyond that which governments were prepared to commit. Perhaps a third approach was to introduce some IDA-like operations in the Bank. He was very doubtful about the latter possibility, and did not think it wise to go very far in that direction. Even if Bank terms were to be softened in some respects, he was not certain what the paper had in mind. He referred in particular to the proposal to extend the duration of loans to 40 years while retaining the Bank's normal rate of interest, at present $5\frac{1}{2}$ per cent. He doubted that that was really a softening of terms; in fact it seemed to him to be much more a hardening of terms from the standpoint of the balance of payments: the amount ultimately repaid under a 40-year loan with interest at $5\frac{1}{2}$ per cent would be much higher than the amount repaid on a 25-year loan. If these loans were being justified in terms of the economic life of the assets being financed, it was true that for industrial projects the life of the investment would be longer than 25 or 30 years. But this would be equally true for most infrastructure projects, apart from equipment itself, which normally had a much shorter life. He noted that the paper described the 40-year term as a maximum, presumably contemplating shorter periods where appropriate. His first reaction to the proposal was not one of approval. The proposal needed to be thoroughly reviewed.

21. On technical assistance, Mr. Waitzenegger thought he should reserve his position. He did not wholly approve the proposal. He was not opposed to some expansion of technical assistance. He fully supported technical assistance clearly related to projects and investments. He agreed with Mr. Bullitt's remarks on this point. In other respects, he felt that the proposal went too far. Assistance proposed in the field of education was not linked to projects. He doubted that the Bank should enter such fields as teacher training, improvement of school administration and so on. These were specialized areas. He was encouraged by the Chairman's statement that there would be full coordination with other agencies with responsibilities in special fields to avoid overlapping. A division of labor in these matters should be worked out.

22. Concerning loans without government guarantee, Mr. Waitzenegger said he had many reservations. The proposal raised the question of the proper role of IFC and of IFC's future. It might also create financial and other difficulties for the Bank. This, too, was an issue requiring careful study. He would welcome discussion on the point at some subsequent time.

23. Mr. <u>Waitzenegger</u> recognized that there was a place for educational financing. Perhaps IDA was the proper agency to provide it but he did not wholly exclude the possibility of Bank financing.

24. Concerning other aspects of the paper, Mr. Waitzenegger said his reaction was more positive. He favored the proposal to create an earned surplus account. He would not comment specifically on the other financial suggestions; he associated himself with the comments of Mr. Bullitt, particularly concerning the transfer to IDA. He thought there was merit in the proposals concerning agricultural and industrial loans. The Bank was already doing something, although not enough, in these areas, and he would not be opposed to some extension. He thought maintenance import loans would be useful, although perhaps, as he had commented concerning the education proposals, these should be done by IDA. He would put very precise qualifications on this activity, but he thought they had a role, if used cautiously. Here again careful consideration was called for. He thought more time was needed to study all the proposals and certainly some informal discussions should be had. He urged proceeding slowly; it was very doubtful that some of the steps indicated in the paper could be taken immediately.

25. Concerning Mr. Machado's paper, Mr. Waitzenegger said it should be given the same full consideration. His own quick reading suggested that the paper would raise very difficult questions. One which occurred to him was that it might not be easy to sell bonds where there was no transfer guarantee.

26. Mr. Suzuki commented that some months ago he had emphasized in a meeting of the Financial Policy Committee the necessity of considering possible expansion of Bank activities to enable the Bank to carry out the purposes for which it was created. Accordingly, he welcomed the paper. He agreed with the position taken in the paper concerning payment of a dividend, loan charges, transfer to IDA and reserves. On the matters discussed in Section B, his general impression was favorable, but he would reserve on details until he had a clearer idea as to how the proposal would be implemented. He would be particularly interested in the relationship between the proposed new account and Bank activities.

27. With regard to loans with longer periods of grace and amortization, Mr. Suzuki said that he was in general willing to support the proposal. He thought it might provide useful flexibility for certain agricultural projects. Another possible candidate was the case of those Part II countries precluded for creditworthiness reasons from receiving IDA credits. The proposal would enable the Bank to take account of their situation.

28. With regard to loans to established private industrial enterprises without full government guarantee of repayment, Mr. Suzuki said he had serious doubts perhaps more than serious doubts. He was, in fact, inclined

to be opposed to the proposal. He did not find the reasons convincing. It was said in the paper that private shareholder-owned enterprises were often reluctant to seek a government repayment guarantee and that governments often found it politically or constitutionally difficult to give one. Japan had had no difficulty with private shareholders when the Japan Development Bank was used as a channel between the World Bank and private industry. Moreover, he thought there was no reason why industrial enterprises in less developed countries should borrow without government guarantee when those in other countries had to obtain a guarantee.

29. Mr. Suzuki welcomed the proposal for maintenance import loans. During his visit to South Asia he had observed the difficulties which joint ventures--U.S.-Indian, European-Indian, Japanese-Indian--established under the Indian economic development program were encountering in getting foreign exchange allocations to buy components and spare parts; in consequence, some of the enterprises were operating at very low capacity, and some were thinking of closing. Operation at low capacity was not only a loss to the company but wasteful for the country. India was not the only case; the problem existed in other countries as well. The terms on which components and spare parts were imported also presented difficulties for heavily indebted countries. He could understand why the paper omitted reference to materials imports, notwithstanding the report of the mission to India. However, he thought there should be some flexibility; there might be cases in which it was desirable to finance materials as well. He did not think the facility should be confined to export industries; loans for the purpose stated should be available to any industries contemplated by a country's program.

30. Concerning technical assistance generally, he agreed with the paper. Like other Directors, he would be interested in the reasoning behind Dr. Branscomb's conclusions. He agreed that it was not desirable for the Bank to give foundation-like grants.

31. Miss Brun said that the suggestions in the paper warranted consideration, although they might undergo some change as a result of the discussions. Her remarks would be made on a personal basis. Section A of the paper recommended against most of the financial policy proposals previously discussed. She wanted to stress that some of her countries had favored the idea of a dividend, others had supported a reduction in the commission, and still others had not been unwilling to find a way for a transfer to IDA. She hoped that these proposals would not be wholly abandoned. She had doubts about the proposal to cut the commitment charge in half. The commitment charge encouraged the borrower to complete the project being financed without unnecessary delay; she would hesitate to yield on that point.

32. Miss Brun said that the problem was that as the Bank continued its operations, its reserves grew. At the same time, the need for financial support in the developing countries was also growing rapidly. All the

Directors felt that the means which the Bank had at its disposal should be used. However, many countries had limited ability to borrow on hard terms and it was becoming difficult to find conventional projects suitable for Bank financing. Against this background the paper suggested that the Bank should broaden its lending policy and make loans to projects which were of a more varied kind, not merely infrastructure projects. Moreover, it proposed no further increase in the Supplemental Reserve, instead employing future net earnings in the new kind of lending. This was one way to meet the problem. But she was not fully convinced that financing these new kinds of projects through long-term loans on normal interest terms would meet the most important needs of the less developed countries. Another approach might be considered. In the past, Bank lending had been on a very conservative basis; several projects might have been rejected for risk considerations. Perhaps thought might be given to departing to some extent from the present approach and to the financing of projects which would involve some risk. Obviously, there was a point of risk beyond which the Bank should not go. Miss Brun had in mind simply more liberal lending. This would in itself increase the amount of money lent without its being necessary for the Board to specify the particular kinds of projects to which loans might be made. Should such a change in lending policy be adopted, the Bank would need its reserves.

33. Miss Brun commented, with respect to the groups of projects mentioned in the paper, that FAO had more experience in the field of agricultural development than the Bank; should the Bank undertake to finance agricultural projects it would be well to cooperate with FAO. Similarly, in the educational field, UNESCO might be the right operational body.

34. Miss Brun was not too happy about the establishment of an earned surplus account. She thought the Bank could carry out its new policy without establishing a separate fund. She did not think it appropriate to stop accumulation of the Supplemental Reserve precisely at the June 30, 1962, level; she would prefer a more flexible arrangement. Whatever future policy might be, any loans proposed as a consequence of the new policy would be considered together with the Bank's loans; it was up to the management and the Board to keep the volume of any group of loans at a reasonable level.

35. As to technical assistance, Miss Brun referred to the clarifying comments made by the <u>Chairman</u>. She added that technical assistance was very important; the need for training was formidable in some countries. But she also agreed with other Directors that the Bank should be careful not to try to cover that field of technical assistance covered by other international agencies; in the technical assistance field, the Bank should restrict itself to projects in which it had a specific expertise. The Bank might well finance education. As to technical assistance in that field, the Bank might primarily engage in training and education of agricultural and craft personnel in support of its financial aid. But should the Bank want to engage in development of a general school system or training of teachers, that should be done in close cooperation with UNESCO. 36. Concerning the paper prepared by Mr. Machado, Miss Brun said the Board should be grateful to him for having emphasized a serious problem existing in many countries: the capital flight and the lack of domestic capital for investment. She did not think that the solution proposed was the right one. But if a solution could be found, it would go a long way toward improving the economic situation of those countries.

37. Mr. Camacho said he joined those who had praised the paper. Whatever looked toward keeping the Bank abreast of the times merited full support. Mr. Mejia, too, wished to express enthusiastic support for the paper. Mr. Camacho agreed with Mr. Machado's suggestion that the commitment charge be restudied and possibly established on a sliding scale between the dates of commitment and disbursement rising from perhaps less than 3/4 of 1 per cent initially. Whatever can be done to stimulate the developing countries to expedite investment of funds provided by the Bank would be helpful. The proposal to add new dimensions to the Bank's lending and to intensify technical assistance activities was supported by all the countries he represented. He placed special emphasis on the field of education. In the long run, this was the most productive of the Bank's activities. In conjunction with financing educational projects, technical assistance in the field of education should be increased whenever possible. Mr. Camacho understood the statement in the paper that loans should be made on terms different from those which had characterized Bank lending in the past to mean that loans would be made on terms more in accordance with the servicing capacity of borrowers. If a country had received a 40-year loan and subsequently its economic situation markedly improved, it could prepay and save interest. Joint loan/equity financing by the Bank and IFC would be in line with the growth of "financieras" in many countries. The question of guarantees in such operations would have to be studied; he did not believe that the problems would be difficult. He supported the proposition that the Bank needed to put much more emphasis on schemes for improvement of agriculture production, and that the terms for agriculture credits should be easier than those for other types of loans. Mr. Machado's paper should be studied closely. Mr. Camacho added that Mr. Mejia might wish to express his views on all these matters on his return.

38. Mr. Chen said that he would speak in a personal capacity. He thought the paper clear cut and constructive, and the subject one of vital importance. He agreed that the time had come for reappraisal and a more dynamic approach to development problems. He supported the position, for the present at least, that the Bank should neither pay a dividend nor make a transfer to IDA. He welcomed the proposed halving of the commitment charge. However, he favored the sliding scale proposed by Mr. Machado. The higher charge would penalize borrowers who were slow to draw down loans without justifiable cause; the availability of the lower charge would be an inducement to speed up completion of the project and save that much of the cost of the loan, small though the saving might be. He associated himself with Mr. Ghosh's suggestion that the commission also be reduced. 39. Regarding reserves, on sound banking principles Mr. Chen was inclined to agree with those Directors who had advocated that building up of reserves continue. With unsettled conditions in many parts of the world, the Bank should build up very substantial reserves, both Special and Supplemental, to provide against all contingencies and possible defaults. He had been glad to hear from the Chairman that the Bank's sound and conservative policy on reserves would be continued.

40. Mr. Chen supported the proposal that the Bank should be prepared to lend for new projects and new purposes in the fields of agriculture, industry and education. Hereafter agriculture should be given equal weight in lending. The majority of the less developed countries, especially the newer members of the Bank, were basically and traditionally agricultural economies. They needed financial assistance in the field of agriculture even more urgently than for industrial development. Reference was made in the paper to programs of land redistribution; he would give assistance for such programs his full support.

41. Mr. Chen thought the proposal to extend the period of grace and amortization was very constructive and would support it. However, he suggested that the proposed 40-year maximum for amortization and 10 years of grace might be too drastic an initial change when compared to the Bank's present terms. For the immediate future he proposed an experimental start with a maximum of 30 years for amortization and five to seven years of grace.

42. Mr. Chen associated himself with Mr. Ghosh and Mr. Plumptre in urging Bank financing of raw materials imports -- fertilizers for example. He was also impressed by the proposal concerning assistance to pioneer industries. This would help underdeveloped countries to raise both the quality and quantity of primary raw materials and would encourage the establishment of basic industries, which in turn would increase foreign exchange earnings. As to the proposed assistance for educational projects, Mr. Chen had some misgivings, having in mind possible overlapping with other international agencies, such as UNESCO. However, the remarks of the Chairman had clarified this matter. He felt strongly that instead of lending for school buildings the Bank should perhaps consider extending loans to housing projects as Mr. Khelil had proposed. Mr. Chen cited the high priority given to such projects by the Inter-American Bank in many Latin American countries. He supported, in principle, the proposal for loans to private industry without full government guarantee, but noted that it would have to be carefully studied. He also favored long-term financing of imports of components and spare parts and, above all, capital equipment for industry.

43. Mr. Chen said he fully supported the proposal to expand technical assistance. He also felt strongly that the project appraisal courses of the Bank's Economic Development Institute should be expanded. Concerning the statement in the paper on an educational grant project and on the recommendations of Dr. Branscomb, he would reserve comment until he had the opportunity to study the paper being prepared by the staff. He thought Mr. Machado's paper put forward a very constructive suggestion, which merited serious consideration. Such an undertaking by the Bank would undoubtedly encourage the flow of private capital. However, he called attention to the possible inflationary implications of the proposal and thought account should be taken of these before the Bank decided to embark upon any such venture.

44. Mr. Gutierrez Cano said the paper was both timely and pertinent. His comments would be made in a personal capacity. He agreed with the view expressed in the paper that the payment of dividends was undesirable: it would tend to reduce the Bank's future lending capacity. He did not, however, completely share the view that the Bank's loan charges were low and reasonable. The interest rate was one of the most important factors in the Bank's activities, having great influence on the borrowing capacity of countries in need of foreign financing. He had considered the arguments in favor of maintaining a close relationship between the Bank's rate and that of the private capital market. He nevertheless thought that a more flexible interest policy would contribute greatly to the maintenance of the creditworthiness of borrowing countries. A reduction in the commitment charge would be, in his opinion, of little real benefit to borrowers. That charge was justified by the necessity to ensure proper and timely utilization of loan proceeds. He thought that an increase in the commitment charge might even be justified in the case of unreasonably delayed disbursements. Retention of the charge would avoid an estimated decline of about \$5 million a year in Bank earnings and would increase the Bank's future lending capacity correspondingly. He agreed that a transfer to IDA would be likely to have an adverse effect. He also supported the proposal to create a special account for new or expanded Bank activities. The main question was whether earnings should be used to absorb the present rate of interest rather than being devoted exclusively to activities in new fields.

45. Mr. <u>Gutierrez Cano</u> regarded with favor the outlines of the new financial activities of the Bank, particularly those designed to increase investment in human skills. The emphasis placed on future activities designed to promote the modernization of agricultural practices was an important contribution, complementary to other forms of investment. External financial assistance in the field of education was always welcome. The Bank's activities in the field should, however, be directed at qualified participation in an endeavor to build up the resources of human skills needed to meet the requirements of economic development.

46. Mr. Gutierrez Cano felt that long periods of amortization did not always alleviate a country's financial obligations. The question might be reconsidered in terms of the rate of interest to be charged. Longer periods of grace, on the other hand, were very appropriate, particularly in the case of infrastructure investments where the rate of economic profitability rose very slowly. There was urgent need in many countries for increased investment in the infrastructure of agricultural production, in industrial consumption and processing of agricultural products, and in distribution systems. Investment in this field should have a far-reaching effect on the economic structure of a country. The assistance which the Bank could give by helping to develop primary industries could be of extraordinary value. Concerning the making of loans to private industrial concerns without full government guarantee, these were in principle to be welcomed. But attention should be directed to their real importance, and to their role in contributing to the relief of the balance of payments. The rate of interest proposed presumably would reflect the increased risks inherent in that type of activity; in terms of an improvement of countries' borrowing capacity, the measure was not likely to result in any real benefit. The Bank must therefore proceed with caution in this new field. Maintenance import loans were, he thought, very desirable. Although there was a wide field for such lending, the Bank's loans should be directed primarily at export industries.

47. Mr. Gutierrez Cano said that technical assistance was of great importance at present; many countries were developing programs for improvement of their resources of human skills. He noted the importance in this connection of the Economic Development Institute. A Bank policy with the objective of assisting countries to run their own economies was, he thought, better than one providing exclusively for the employment of foreign advisers. Financing of agricultural extension services, credit institutions, production and marketing cooperatives, etc., would make a very effective contribution; training through technical assistance could be of primary importance. In particular, attention should be directed to small- or medium-size concerns which were frequently unable to meet present-day technological and management requirements. The Bank might promote the merging of the technical, industrial or commercial collaboration of such concerns, encouraging a restructuring of this sector of the economy. In the field of education, he thought the Bank should consider only those aspects which were closely related to its normal activities. He shared the views expressed by others in regard to the need for close collaboration with other international agencies such as UNESCO.

48. Mr. <u>Gutierrez Cano</u> considered very useful Mr. <u>Machado's</u> proposal to meet the difficulties encountered by many countries in raising the necessary internal financing to match Bank loans. He thought the Bank's lending operations might appropriately be supplemented by a more active participation in the raising of domestic funds; this could overcome many, perhaps most, of the difficulties.

49. The <u>Chairman</u> said he assumed that the Directors did not wish to embark on a second round of comments at present. However, a few Directors had indicated a wish to supplement their earlier remarks.

50. Mr. Donner said he would like to comment on the best use to which, in his opinion, the Bank could put its net earning. His remarks would be made on a personal basis but he thought they would be close to his government's ultimate position. His comments would be made on the assumption that there was more or less agreement on two points. First, the Bank's reserves

and prospects were such that a certain part of its net earnings -- which he would call surplus profits -- could, without harm to the Bank, be withheld from the Bank's ordinary operations. Under Mr. Black's dividend proposal, that amount would be \$50 million a year. Alternatively surplus earnings might be taken to be the net earnings resulting from the 18 per cent portion of subscriptions at work in Bank lending. Assuming a conservative rate of return, say 4 per cent per annum, the \$1.6 billion 18 per cent monies could be said to contribute to the Bank's net earnings at an annual rate of about \$65 million. It might, in fact, help to establish a certain system of financial discipline in the Bank if the latter approach were taken, with net earnings imputed to a specific source of capital, instead of simply being regarded as large, and therefore not imposing a specific ceiling on expenditures. If this view of net earnings were adopted, proposals for one or another use of those earnings might be considered in a new light. The second point on which Mr. Donner thought there was general agreement was that the surplus profits should not be spread around the world for merely distributive purposes, as for example dividends. They should, instead, be put to special uses which reached into those corners of the field of economic development proper into which the Bank under existing limitations could not enter. That is, they should be employed primarily to give the less developed countries a kind of financial and technical assistance which the Bank, due to limitations inherent in its nature, could not provide through its ordinary operations. The objective would have to be the same as the objective of the Bank's normal operations: to help the less developed countries in a way which most effectively supplements their own efforts to achieve higher productivity and a higher rate of economic growth. Mr. Lieftinck's suggestion for a general assistance grant and technical operations account went a long way in that direction. The proposed "GAGT" would be the recipient of the Bank's surplus profits, and would be the only source for the Bank's activities outside its ordinary operations in what might be called the Bank's "soft sector." It would at the same time set a ceiling to the aggregate amount of such special operations. This arrangement would, in Mr. Donner's view, have a number of significant advantages over the proposal for an earned surplus account. The GAGT would be far less likely to create the suspicion within financial circles that the Bank, by embarking on "soft" activities might have started down a road without an end. The existence of the GAGT would afford a better defense to borrowers' urgings that the Bank should progressively enlarge the scope of its non-financial activities. In contrast, the earned surplus account, which would leave the aggregate level of "soft" operations undetermined and offer only a very limited concession with regard to the terms of any single operation, might open a Pandora's box of proposals in that direction. With a precisely defined GAGT, the Bank would have more freedom to adjust the terms of its special operations to the needs of the particular countries. Since the aggregate amount of such operations would be limited, the Bank could, if warranted by the circumstances of a particular case, move more in the direction of IDA operations than would be advisable under an earned surplus account system lacking such a ceiling. For all these reasons, Mr. Donner said, Mr. Lieftinck's GAGT would seem to be a better receptacle

for the Bank's surplus profits than an earned surplus account. The latter, as Mr. Lieftinck said and as the Chairman confirmed was only another label for continued accrual of the Supplemental Reserve. There was, however, a great weakness in the GAGT proposal: to be effective along the lines indicated it would have to be firmly anchored in the Bank's constitution, probably by way of an amendment. Mr. Donner shared Mr. Pitblado's views concerning amendments. Because one proposal for amendment might generate proposals for many others, the Bank should be sure before deciding to embark on such a venture that it was really necessary.

51. Mr. Donner said that a simpler, more elegant and, in his opinion, more effective way of achieving the ends of the GAGT would be to transfer the Bank's surplus profits to IDA. This arrangement would have all the advantages which the GAGT proposal had over the earned surplus account proposal. And it would be superior to the GAGT in four respects: organizational, economic, operational and psychological. He appreciated that the Inter-American Bank administered different funds, for different purposes, and on different terms, yet kept them all under the same roof in the Inter-American Development Bank. It handled them within the same organization, having one section for regular operations and another section for special operations, besides administering the Social Progress Fund established by the United States. The situation of the World Bank was, however, quite different. It had two legally independent affiliates. Each of the three organizations had its distinctly different tasks and functions. He noted that some Directors had expressed misgivings against the tendency in the management paper, as they interpreted it, to blur the distinctions between the Bank, IFC and IDA in certain respects. They had expressed doubt about the wisdom of the Bank's moving into fields for which conventional loans or almost conventional loans seemed to be inappropriate. He thought these views had merit. If it was agreed that the Bank was in a position to devote part of its net earnings for operations which quite clearly were the kind for which IDA was established, those operations and the resources to finance them should be turned over to IDA. There were no legal obstacles to this action, and it had economic advantages. A transfer of Bank surplus profits to IDA would be a transfer of resources from a field of limited marginal productivity of capital to a field of considerably higher marginal productivity. By this he meant that the field of conventional development lending was, in comparison to the area within which IDA operated, relatively well supplied, while at the same time there was a great shortage of funds for purposes which IDA was intended to meet. Mr. Donner associated himself with Mr. Plumptre's comment concerning the anomaly of one organization having in a sense an excess of funds and its affiliate a shortage. Following the principle of as good a division of labor as possible would also have distinct operational advantages. IDA resources would be enhanced. The flexibility of its operations would make it easy to take care of the projects mentioned as innovations for Bank activities in the management paper and as deserving special consideration, such as agricultural improvement loans, pioneer industry loans, and so on. Moreover, IDA would be in a much better position to tailor its financial assistance to the specific

circumstances of the project and of the country than could be done within a general assistance account managed by the Bank itself. He added that the latter proposition was predicated on the assumption that IDA's standard terms would ultimately be abandoned.

52. As for the psychological advantages associated with transfer of Bank surplus profits to IDA, Mr. Donner said that it appeared that most of the concern expressed at the Financial Policy Committee meeting in February that such a transfer would be inappropriate and might undermine the Bank's standing had disappeared. This was not surprising since the transfer would not eat into the Bank's assets available for its ordinary operations or create any obligations which might become onerous later on. On the contrary, if the Bank were to retain its surplus profits as a justification for extending its activities into the field of non-conventional loans, private investors might begin to wonder how to interpret the innovation and whether they were justified in continuing to trust the business acumen of the Bank. If the policy change were to be made by establishing a GAGT account with its ceiling for "soft" operations, these concerns would, he thought, be less serious than if no such ceiling existed. Mr. Donner said he was aware that the considerations were not merely what might be called "technical" but certain imponderables of a political and other character had to be taken into account. In this connection, there was the problem of timing. He had been much encouraged by the statement in the paper, that direct transfer to IDA would not be desirable "at this time." He did not know in what way the Bank's standing in the financial communities of the world would be adversely affected by a transfer "at this time." He did know with certainty that the financial community in Germany, including the Central Bank, viewed with apprehension a policy which would lead toward establishing a soft lending corner or window in the Bank. That community was convinced that to take such operations, which were not typical Bank operations, out of the Bank and to leave the Bank as a bank would make for a much clearer situation and be less likely to create misapprehensions and misunderstandings. At the same time, he recognized that positions had been taken, and that even those who wished to proceed with a transfer would acknowledge that there was virtue, if not necessity, in allowing things to simmer down; they would not press for immediate action. At the same time, there was the danger that by postponement, a certain freedom of action could be lost and future measures prejudiced, by the establishment of new institutional arrangements, and otherwise. For this reason he urged that the Board proceed slowly in taking decisions on any of these issues, as Mr. Waitzenegger had counseled, avoiding any actions which could prejudice a policy -- the transfer -- which ultimately might be agreed upon. With this in mind, he had misgivings about proceeding quickly to establish an earned surplus account.

53. On the matter of the maintenance import loans, Mr. Donner noted the proposal had been favorably received by his colleagues. He and his government had been greatly impressed by the situation of India. The Indian consortium had recognized the advantages which could be achieved by making

available a fair degree of maintenance import loans to a country; this was also true for Pakistan. But to embark extensively upon this type of lending was another question. In his opinion, maintenance import loans, as well as the other loans of an exceptional character mentioned in the paper, should be examined very closely in the circumstances of a specific case. In the case of India, for example, there was an imbalance between commitments of foreign aid for projects, on the one hand, and for smaller items, on the other. Moreover, India had a well-conceived and well-administered economic development program, which reassured aid-givers concerning the ultimate use of the loans. In a great many countries these conditions did not prevail. He was sure, from the language in the paper, that the management had these considerations in mind.

54. Mr. Donner said that Mr. Machado's paper addressed itself to an extremely important problem. His proposal did raise the question of how to deal with the misgivings of citizens in the financial stability of their own government. It was an interesting proposal in view of the reputed sensitivity of Latin American governments to interference from outside. This was, however, a political question. The second question which Mr. Machado's solution raised was whether it was treating symptoms rather than effecting a basic cure. Giving a guarantee to bond purchasers meant that whatever action their governments took, the purchasers would not suffer. Perhaps it would be more effective to direct attention to governments engaging in inflationary practices, suggesting what might be done to avoid the conditions which gave rise to distrust. Mr. Donner said he had no answer to these questions. He pointed out that they were monetary problems which were the province of the Fund. He did not know whether the Fund had any position on the particular problem, but it did have a position with regard to the broader aspects of what could be achieved by escalators, gold guarantees, and so forth.

55. Mr. Lieftinck said, with respect to the proposal for a special account which he had made at the previous meeting, that he did not believe it would require an amendment of the Articles. He was not in favor of changing the Articles; they had sufficient flexibility to permit the development of policies in the right direction. This comment applied particularly to the nonguaranteed loans to private industrial enterprises. He had stated on previous occasions that he believed there was need to build up additional reserves. A fortiori, he was against any weakening of the Bank's position. He wanted to be fair to the management's proposal with respect to nonguaranteed loans to private industrial enterprises, but he felt it would weaken the reserve position: it would permit investments to be made, up to the limit of the earned surplus account and the Supplemental Reserve, in more risky projects -- more risky because they would not carry a guarantee. If the Bank wanted to expand its operations in the industrial field, very careful consideration should be given to the direction and extent of any expansion. He was not opposed to an exploration of further possibilities in this field, but he fully agreed with Mr. Pitblado and Mr. Waitzenegger that IFC had been created to carry on these operations and that careful consideration should be given before permitting an overflow of Bank activities into

the IFC field. He would prefer to consider the management's proposal for the further promotion of private industrial enterprises in the context of the future of IFC than in the context of Bank financial policy. There were other reasons why he did not favor the management's proposal. First, it indicated a clear preference to assist privately owned industrial enterprises but did not touch at all on the very important question whether the Bank should reconsider its position with respect to publicly owned or mixed enterprises. Secondly, he was not at all in favor of the Bank's charging interest of $6\frac{1}{2}$ to 8 per cent; he thought that would damage the Bank's image. Thirdly, he favored doing industrial financing via intermediaries as much as possible. Finally, he felt that there was ample scope within the Articles for further exploration of the possibilities of doing more in the industrial field.

56. Concerning the maintenance import loan proposal, Mr. Lieftinck wondered whether it might not run counter to the Articles. This was not too important, since the Articles could be changed, but he did not think it would be wise to do it for other purposes as well. As far as the Articles were concerned, Article III, Section 4(vii) provided that loans made or guaranteed by the Bank should, except in special circumstances, be for the purpose of specific projects. The drafters presumably had some particular purpose in mind in this provision; probably they intended to distinguish the projects to be financed by the Bank from general purpose loans. Mr. Lieftinck thought that if the Bank went as far as some Directors had suggested, the point would soon be reached at which difficulties would be presented by the Articles, which after all referred to "special circumstances." His other objection to the proposal was of greater importance. The proposal was that the Bank embark on long-term financing of imports of components and spare parts for industry. He thought the financing of spare parts of industrial equipment, and particularly raw materials, should be done on short-term or medium-term. To do this kind of financing at long-term would, in his opinion, depart from sound banking principles, because maturities would not in these cases be related to the economic life of the assets being financed. Moreover, it would put a burden on the borrower beyond the period during which the equipment contributed to production. In addition to these reasons, there were the difficulties indicated in the management's paper. One particular difficulty he saw was that it might be unwise to leave the allocation of funds provided to the governments concerned; the Bank's staff would have no opportunity to appraise the needs and the priorities, or exercise the end-use supervision on which the Bank's success had to such an extent depended. He agreed that there was a very clear need in the underdeveloped countries for mechanical equipment, spare parts and even raw materials. And he was not opposed to including in the Bank's normal loans funds for mechanical equipment or adjusting the terms of loans, perhaps in a package, to the average life of the assets. But the financing of spare parts and raw materials in his opinion was not the business of the Bank; that should be left to the bilateral aid agencies or governments. The Bank as a development institution should concentrate on the financing of fixed investments for development. There was a clear distinction to be

kept in mind between financing the maintenance of current production and financing additions to the productive potential of an economy. This had not been mentioned in the discussion, but he thought it very important. He was not in favor of the Bank's entering the field of financing current production; it should continue to assist in the building up of new productive capacity. If it entered the field of current production, there would be no end to the requests it would have to consider and, as he had indicated, it would run up against the "special circumstances" in its Articles. Moreover, it would actually be entering a field of recurrent needs; once the raw materials had been consumed, if they were not supplemented from other sources, it would again be the Bank which would have to provide the funds. Finally, he thought it would not be in the interests of borrowers to be burdened more and more on long term for the maintenance of current production; certainly it would not be conducive to making the Bank's members more nearly independent of Bank assistance.

57. Mr. Machado said he would not take up the subject of his paper; it was too important a subject to treat in the short time available. He did, however, want to defend the proposal, which he thought one of the most important in the paper, that the Bank do more in the field of industrial financing, even if the Articles had to be amended. But as he had said at the last meeting -- and at the proper time he would elaborate this statement -he believed it could be done without amending the Articles. What Mr. Woods proposed was nothing new. Ever since the Bank was organized it had been financing industry: steel mills in India and in Japan; shipping and aviation in the Netherlands; electrical manufacturing in Austria; pulp and paper and coal mining in Chile; pulp and paper in Finland. The Bank would go on financing industry. It was about to make an industrial loan coupled with a participation by IFC. The only new element in the proposal was that the Articles be amended to enable the Bank to continue doing industrial financing but without the necessity of a government guarantee. He could not understand the logic of the industrialized countries on this issue, The European Development Bank, whose capital was subscribed by the six large industrial powers of Europe had in its Articles a provision that it could operate with or without government guarantee. According to a report issued by that bank, out of some 60 or 62 transactions, all for private industry, none required a guarantee. The system of not requiring the guarantee of governments for industrial lending must not be so bad if the leading industrial powers of Europe found that from 1954 on government guarantees could be dispensed with. Moreover, although Mr. Bullitt had questioned whether the World Bank could dispense with the guarantee requirement for its industrial operations, the Export-Import Bank, which was, in effect, the development agency of the United States Government, was authorized to make investments without the guarantee of governments; many of its most recent operations had been undertaken without such guarantees. There was some validity to the argument that if the Bank was empowered to make direct loans to private industry without a government guarantee, it might take over the task for which IFC was created. He would be the last to support anything which appeared detrimental to IFC. But the proposal would not undercut IFC.

IFC was primarily intended to encourage equity investment. If each of its operations were to be analyzed, it would appear that part of it was at present in equity and part in loan. He wondered why the Bank could not take the loan part which normally is borne by IFC without a government guarantee. If, in all the instances he had cited, loans were being made to industry, without government guarantee, out of funds provided by the industrial powers, he wondered what was wrong in making comparable facilities available to the poor members of the Bank, who did not have access to the European Development Bank or to the Export-Import Bank.

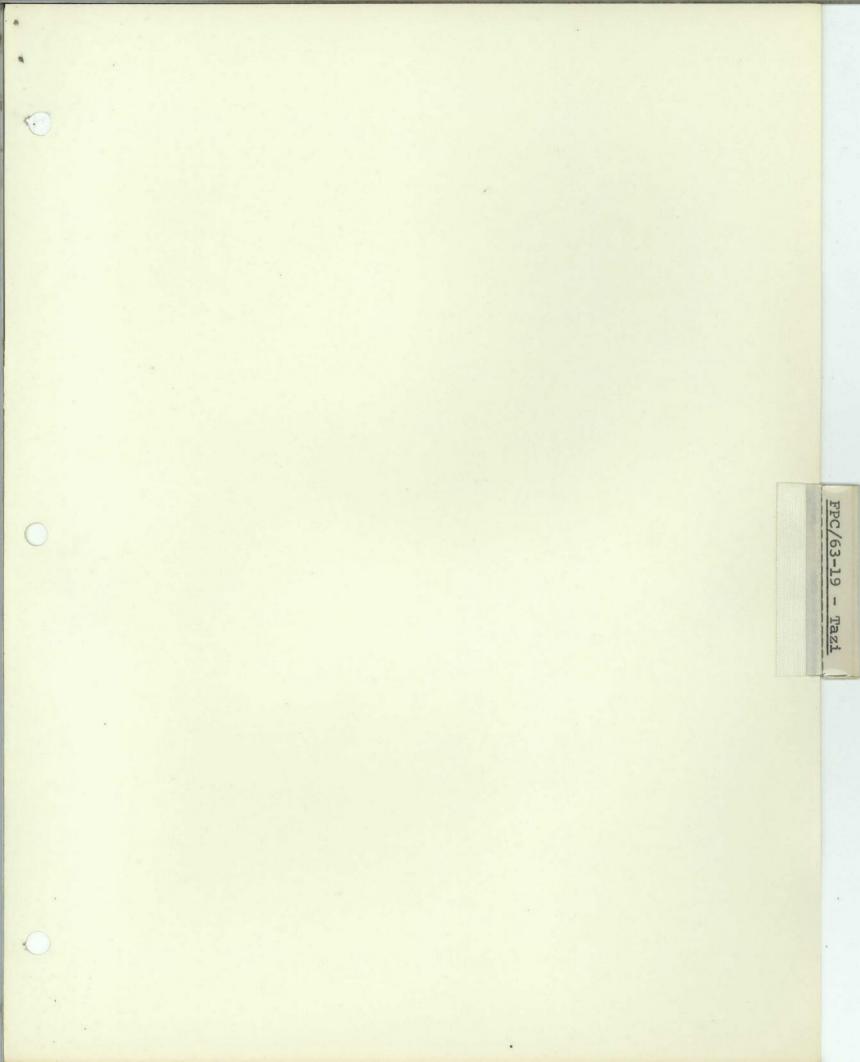
58. Mr. Ghosh said he agreed with Mr. Lieftinck that the Bank should not finance consumption expenditures. He had not proposed that the Bank finance consumption, but that it should finance development--import requirements for development. The words "maintenance imports" gave the wrong connotation. Developmental imports at a certain stage of the development of an economy took the form of components, or of raw materials. In short, he was urging that the Bank consider financing not only the full equipment requirement for projects but also various other developmental needs where it was satisfied that there was a coordinated development program and developmental needs for imports which could not otherwise be financed. Only in such circumstances was he suggesting that the Bank make maintenance import loans.

59. Mr. Hudon said he had listened with interest to Mr. Donner's statement; he might disagree with some of the things Mr. Donner said, but would want to think about it first. However, Mr. Donner had referred to a remark of Mr. Plumptre's concerning maintenance import loans, and he thought some clarification might be desirable. He and Mr. Plumptre were fully aware of the difficulties involved in that type of loan; Mr. Plumptre's remarks were not addressed to the conditions under which such loans were made but only to the question of the products such loans might be used to finance.

60. The Chairman said he would not try to summarize the discussion. A precis would soon be circulated. Secondly, the staff would start to work on the various papers that had been requested during the discussions; these would be produced as quickly as possible. He would also distribute a copy of the statement he had made at the beginning of the day's meeting. Finally, Mr. Woods would be given a full report of the meeting so that he would be able to get the full flavor of the discussion.

61. As for the future, the <u>Chairman</u> noted that only two weeks remained until the recess of the Board. Having in mind the time that would be necessary to absorb the discussion, for Directors to report to governments and for governments to give the questions further consideration, he saw no reasonable prospect of resuming the discussion before the recess. There would be ample opportunity for informal talks of the sort Mr. Waitzenegger referred to, for purposes of further clarification. But as far as a further formal meeting of the Financial Policy Committee was concerned, it would probably be September before the Committee could resume. He would not want to speculate on when Mr. Woods could resume participation in the meetings. Hopefully by September he would be able to do so. The Directors would be kept informed. Mr. Donner said it would be important for the Directors to have some idea of what might be put before the Governors. He assumed Mr. Woods had not intended to put the matter off until after the Annual Meeting. The Chairman replied that Mr. Woods had hoped for as rapid action as possible. He would have liked to have final decision on all the points raised by the time of the Annual Meeting. But the discussion had shown that it was somewhat optimistic to expect everything to be settled that quickly. He thought it was impossible to say whether any of the proposals could be brought to the stage where they could either be reported to the Annual Meeting or brought to it for action. Mr. Lieftinck said that governments would like to have ample opportunity fully to study the proposals and their implications and to consider discussions. He would suggest that no further meetings on the subject be scheduled until perhaps about the middle of September. Mr. Chen and Mr. Donner agreed. Mr. Pitblado said that Mr. Woods would be making a speech, and no doubt would want to indicate in it how he was thinking about the Bank. All governments would find it very helpful to know by mid-September what line was to be taken. For his part, he felt that there should be no constitutional amendments before the Board of Governors in September. The discussion had shown that it would be some while before conclusion was reached on the proposals. It would be premature to try to rush anything; the issues could be dealt with, if they were to be pursued, during the year. Mr. Lieftinck added that even important departures of policy, short of amendments, should be fully discussed before the President announced them in a speech. Mr. Pitblado said he agreed. The Chairman said that he believed Mr. Woods would feel, partly for the purposes of his speech, but partly also for purposes of all the discussions which would be proceeding during the Annual Meeting, that matters should be carried as far as possible before the meeting. He himself would share the view that this was unlikely to result in any specific amendments to the Articles or anything like that being brought before the Annual Meeting. At the same time, he thought that if he were in Mr. Woods' shoes he would like to feel that, before he had had the opportunity to meet with the Board and present his ideas, Directors would not take up entrenched positions on any of the questions. Mr. Woods would want an opportunity to meet with the Directors after hearing the results of the discussions, and present his views in response to the points which had been made. Therefore the Chairman hoped that no Director would crystallize his position before hearing Mr. Woods. Hopefully that would be in the first part or middle of September. But while he was asking that positions not be crystallized until Mr. Woods had been heard, he was also saying he hoped they would be crystallized thereafter as rapidly as possible. Mr. Donner said that it would be advantageous to Directors and also, he thought, to management, if as soon as possible -- say in the early part of September -there might be further discussions, still on an informal, personal basis. The Chairman said management would continue to consult the Board. No meeting would be called without informal consultation to see the extent to which people were prepared to go ahead.

62. At 1:15 p.m., the meeting adjourned.



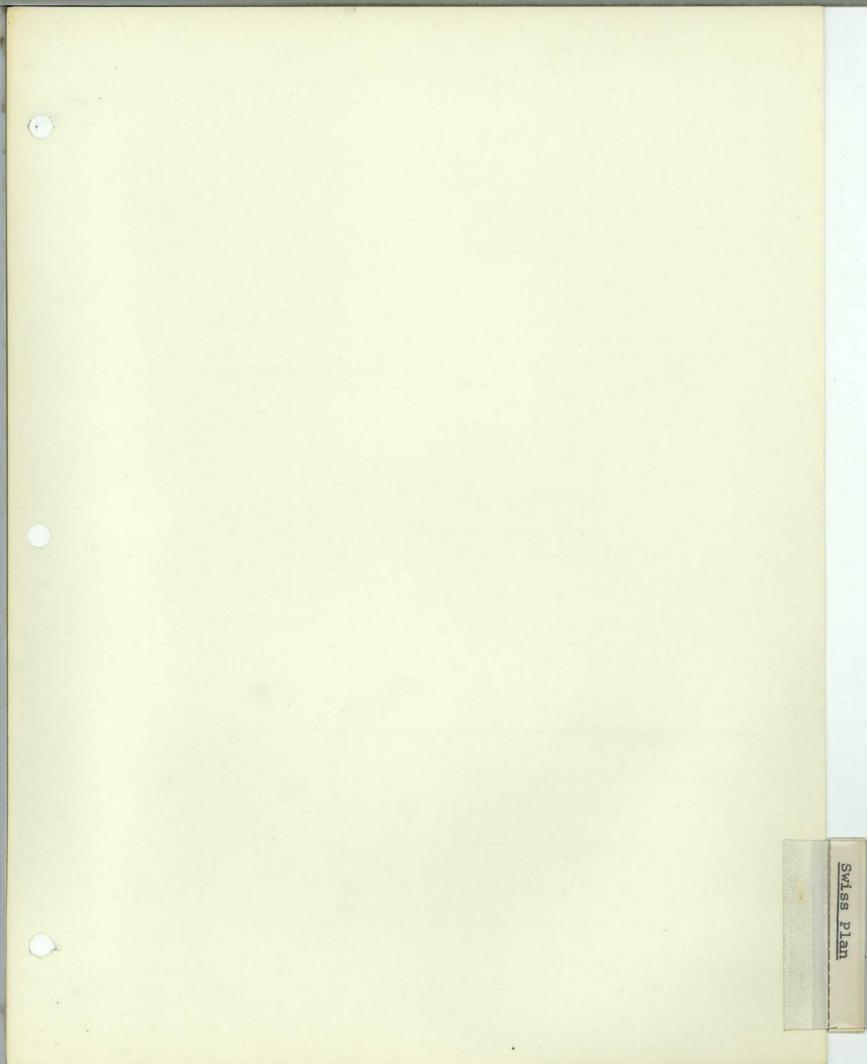
See FPC/63-19 (Rajan)

filed above

Horowitz' Plan

For complete documentation on Horowitz Plan, see separate file

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

European Office 4 Avenue D'Iéna Paris (16e) - France

February 5, 1964

Mr. Leonard B. Rist Special Adviser International Bank for Reconstruction and Development Washington, D.C.

Dear Leonard:

To recapitulate and elaborate on what I told you on the telephone:

1) The Swiss scheme is called, even in Switzerland, the "Plan Montandon" because the First Secretary in the Delegation to OECD, who first spoke to us about it, was its inventor. But he sold it to his Government and they now fully support it.

2) It was circulated to some OECD governments some five or six weeks ago and no thought has yet been given to any meeting to discuss it.

3) The only comment so far received by the Swiss Delegation has been from Germany. They wrote expressing interest in the idea and said that they would study it further.

4) I spoke to André de Lattre who had not seen the Swiss memorandum but found somebody who had and who had discussed it briefly with the Trésor. Their reaction is negative - on general doctrinal grounds plus a doubt (which I think is a reasonable one) whether the markets would continue to have a high regard for the Bank if the scheme were to be tried and would feel like providing the large sums required.

5) I spoke to Denis Rickett who also had not seen the memo. Late the same evening he called back to say that they had had a look at it and although they had not yet talked to the Bank of England about it their first reaction was "pretty negative". The scheme is, of course, as I pointed out, a variant of the new UK method of providing soft loans but I think the Treasury feels that the sums needed would be impossible to raise.

6) Montandon also told me that he had discussed the scheme with Seymour Rubin, the US representative on DAC, who is now back in the State Department and who should be worth talking to.

Yours ever,

/s/ Johnnie

John Duncan Miller

COPY

February 4, 1964

Mr. Geoffrey Wilson

Leonard Rist

Loan Charges .--

Further to my memorandum of yesterday, this morning Johnnie Miller gave me some additional information on the status of the Swiss scheme.

1. The Swiss delegation has circulated a memorandum outlining their proposal to all important members of DAC. It is not known whether it has been distributed to OECD at large.

2. The Germans have indicated that they found the proposal interesting but that they could not take a position before devoting much more thought to it.

3. Sir Denis Rickett had not yet seen the paper, but after consulting with his staff, he told Miller that this procedure was not unknown in bilateral operations of the U.K. A few loans under ECGD Section 3 provide for interest payments which, year after year, are taken in charge by the U.K. Budget.

4. Hiller called de Lattre, at the French Treasury, who had also not seen the paper and also called on his staff. They were much less receptive than the British. It appears that in some bilateral transactions the French Treasury had some experience of "bonifications d'intérêt" - which is really what the Swiss scheme amounts to - (this is true for internal as well as external transactions). The Treasury officials do not seem to feel inclined to extend this system.

Cc: Nessrs. Knapp Cope Cavanaugh N/. Johnson

February 3, 1964

Mr. Geoffrey Wilson

Leonard Rist

Loan Charges

During a telephone conversation with Johnnie Miller, he made the following points:

1. The Swiss Scheme

The Paris Office has heard that the Swiss have informally discussed their proposal for an Interest Equalization Fund with at least two mambers of OECD -- the U.K. and Germany. The proposal was taken under advisement, and no indication was given to the Swiss delegation as to what position the Governments concerned might wish to take in the future. Miller is checking whether any other conversations have taken place in this respect.

2. Auropean Interest Rates

Miller has received the Minutes of the Senior Staff Meeting concerning the paper on Loan Charges. His reaction is that if the Bank is considering calling on the Suropean markets in the near future, any reduction in our present lending rate would be inopportune. He mat with Barings late last week and was told that the borrowing rate for the World Bank in London would be in the neighborhood of 5-3/4%. This compares with something like 5.65% in France, and around 6% in Germany. Taking account of the lower rates prevailing in Switzerland and Holland, our average borrowing rate in Europe would therefore be somewhere between 5-1/4% and 5-1/2% in 1964. This would raise the average cost of the money to us. Barings added that, in their view, Suropean long-term interest rates may fall slightly by the end of 1964, but probably by not more than 1/4% on the average.

ce: Mr. Knapp Mr. Cope Mr. Cavanaugh Mr. Howard Johnson

LBRIAL

DELEGATION SUISSE près L'ORGANISATION DE COOPERATION ET DE DEVELOPPEMENT ECONOMIQUES

> Paris, 7e, le 27 novembre 1963 28, rue de Martignac

N. 10 - MO/hp

Monsieur A. Karasz Délégué-Adjoint de la Banque Internationale de Reconstruction et de Développement 4. avenue d'Iéna Paris, 16e

Cher Monsieur Karasz,

Je biens de recevoir de Berne le memorandum préparé au sujet de la création d'un fonds permettant à la BIRD l'octroi de certains crédits de développement à des taux d'intérêt réduits.

Comme convenu lors de notre dernière entrevue, je vous envoie sous ce pli 3 exemplaires de ce memorandum. J'espère qu'il facilitera l'examen des problèmes inhérents à la création d'un tel fonds par les experts de la Banque Mondiale.

Veuillez croire, cher Monsieur Karasz, à l'expression de mes sentiments les meilleurs.

s/ R. Montandon

Annexes mentionnées

Special Fund for reducing interest rates on BIRD-loans to developing countries

Through a number of years the BIRD has been highly successful in financing development projects on a strictly commercial basis. Thanks to the strict criteria applied and to the high standards of its practices, the Bank has been successful in obtaining funds on the world capital markets and has obviously not exhausted those possibilities.

In addition to the Bank's own activities, its affiliate, the IDA, has been able to grant development loans at especially favorable terms, - loans of extremely long duration with little or no interest payments. Contrary to the BIRD, the IDA has no possibilities of raising capital on the market but relies entirely on government subscriptions, the scope of which limits its operations.

Considering the background of the activities of these institutions, there appears to be considerable scope for operations which can be executed by neither, but which nevertheless are worth considering. There may be a number of basically sound projects which cannot be realized at the BIRD's interest rate of 5% to 6% or the even higher rate on certain markets, but which, on the other hand, do not warrant a credit by the IDA. This appears to be true of may industrial and infrastructure projects of medium and long duration. The could be characterized as projects to be financed through economically or commercially justified loans at reduced interest rates, taking into account the necessity of not unduly straining the balance of payments situations or the debt servicing burden of the borrowing country.

The following proposal attempts to find a solution to this problem through enabling the BIRD to increase the scope of its activity to cover such projects.

Among the member countries of OECD a fund would be created which would cover the difference between the rate of interest at which the BIRD can raise money on the markets and the reduced rate of interest of roughly 2,5% to 4% to be applied by the Bank for credits related to that type of development projects. Through this procedure the BIRD could finance wuch projects by raising capital on the markets, making full use of its international standing and credit-worthiness. Instead of providing

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the capital for the financing of the projects, the donors to the fund would only assure the covering of the difference in interest rates.

The OECD would appear to offer an appropriate frame-work for the setting up of such a fund. The fund could be financed either by a comparatively large contribution, (assuring the BIRD the coverage of the interest differential for a certain lump capital sum for a certain period of time) or by yearly contributions calculated on the same scale as the member countries' contributions to the OECD, or any other agreed scale or on an ad hoc basis.

While the OECD would collect the funds necessary for this new and enlarged activity of the BIRD, the choice of projects to be financed with the aid of the fund should be made exclusively and independently by the BIRD and should conform in all respects to the BIRD's high standards while, however, taking into account the borrower's balance of payments situation and debt service possibilities.

The creation of such an interest rate fund might: - allow the BIRD to increase its scope of operations and give it new room for development lending on easier terms, thus filling the vacuum existing between its operations and those of the IDA. At the same time pressure on the IDA might be somewhat relieved;

- increase the volume of multilateral untied aid;
- make it possible for smaller countries which normally do not export capital or which have limited possibilities for the granting of sizeable government aid, to participate effectively in the efforts aimed at speeding up the growth of developing countries. A relatively modest contribution to the fund would enable the BIRD to raise the necessary capital for financing suitable projects.

Further potential advantages of the fund:

the BIRD could, if it wished to do so, apply sliding interest scales or other devices for encouraging the less developed countries to increase their own participation in the fulfilment of projects coming under this plan;
the larger or more frequent bond issues of the BIRD might, to some extent, pick up liquid means moving through the money markets, which

cannot be channelled into investments in the national economies.

The aim of this proposal is to point out a way in which, without creating new organizations or duplicating existing efforts, some of the problems in the wide field of development aid could be solved. However, the difficulties which both the donor countries and the EIRD might be faced with, should not be underestimated. If yearly contributions were chosen instead of a large initial contribution, or a combination of both, some countries might find it difficult to pledge the necessary funds for a sufficient number of years.

The BIRD would certainly find it difficult to set absolutely clear-cut criteria for loans to be classified as (1) entirely commercial and granted on commercial terms, (2) falling under the scope of the fund, or (3) being entirely suitable for financing through IDA. The Bank might also hesitate to depart from the strictly conservative and commercial practices applied up to now to its lending operations. Even though, in principle, the Fund would not involve any change in the financial stability and credit-worthiness of the Bank, one might argue that any side-step into a

5.

field situated between traditional commercial and IDA loans could be misinterpreted on the money markets and affect the Bank's future possibilities of borrowing.

In spite of their serious character, these difficulties do not seem to be insurmountable. Furthermore, it should be understood that contributions to the Fund would not entitle donor countries to exercise any influence on the Bank's choice of projects to be financed with the aid of the fund.