Brandt Commission - Bank Follow-up 1980 (Feb. - Dec.)

Brandt Commission: Current Status of Papers

1. The Bank undertook to prepare 17 papers on specific proposals addressed by the Brandt Commission to the World Bank or to the IFIs. Of these, nine papers have already been submitted to the Board. The other eight are under preparation. In addition, an Overview Paper is being prepared reporting the progress made so far in responding to the Brandt Commission proposals. This paper will be submitted for discussion in the Development Committee (May 1981).

2. The following nine papers have already been submitted to the Board:

   Program Lending: (Expand program lending by the Bank #1)

   Co-financing: (Provide for greater co-financing by the Bank #2)

   Political Conditions: (Abstain from imposition of political conditions on operations of IFIs #3)

   Poverty Belts: (Develop an action program to reduce absolute poverty in the poverty belts of Africa and Asia during the 1980s #6)

   Debt: (Analyze the likely debt and debt servicing problems in various categories of LDCs and the capacity of existing private and public institutions to meet these needs #7)

   Energy: (Substantially increase Bank financing for exploration and development of energy resources #9)

   Guarantee Power: (Use the Bank's guarantee to improve access of developing countries to capital markets #10)

   Food: (Develop an action program to increase food output in low income food-importing developing countries during the 1980s #11)

   Non-fuel Minerals: (Set up a new institution for exploration and development financing for non-fuel minerals #13)

3. The following eight papers are currently under preparation:

   Effective Utilization: (Plan to effectively utilize the increased borrowing capacity of the Bank resulting from the doubling of its capital #4)

   Gearing Ratio: (Change the Bank's present "gearing ratio" /a so as to raise its lending capacity #5)

/a The ratio of receivables to capital, as prescribed by the Articles of Agreement.

Surplus Countries: (Define the role of the surplus countries in financing the adjustment problem of developing countries #8)

LDC Participation: (Provide greater participation of LDC staff in Bank management #12)

Decentralization: (Provide greater decentralization of the management of the Bank's operations #14)

Voting Structure: (Provide borrowing countries a greater role in the decision-making process in the Bank #15)

Export Credit Refinance: (Examine the possibility of the Bank's refinancing export credits for capital goods #16)

World Development Fund: (Consider the creation of a new international financial institution - a World Development Fund - to supplement existing institutions and to diversify lending policies and practices #17)

December 5, 1980

DOCUMENT OF

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

NOT FOR PUBLIC USE

FOR EXECUTIVE DIRECTORS' MEETING

For consideration on December 9, 1975

R75-215

FROM: The Secretary

November 5, 1975

REVIEW OF IBRD CAPITAL STRUCTURE

Attached is a copy of the President's memorandum entitled "Review of IBRD Capital Structure" dated November 4, 1975.

2/8

Distribution:

Executive Directors and Alternates
President
Senior Vice President, Operations
Executive Vice President and Vice President, IFC
President's Council
Directors and Department Heads, Bank and IFC

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

Office of the President

November 4, 1975

MEMORANDUM TO THE EXECUTIVE DIRECTORS

SUBJECT: Review of IBRD Capital Structure

SECTION I: Introduction and Recommendations

1. IBRD commitments have grown very rapidly over the past decade, in part to offset the effect of inflation and in part to help meet the needs of the developing countries for larger real transfers of external capital. The growth is already beginning to cause major changes in the Bank's capital structure and will lead to even more rapid changes in the next few years. For example, the ratio of the Bank's funded debt to its equity (excluding callable capital), which was 1.13 in FY68 and 2.68 in FY75, is currently projected to rise to 5.57 at the end of FY80. The same pattern emerges when funded debt is compared to total equity (i.e. including callable capital): the ratio increased from 0.15 in FY68 to 0.39 in FY75 and is projected to go up to 0.90 in FY80. Changes of this magnitude inevitably raise questions about the adequacy of the Bank's capital base. Moreover, the rapid growth in loans outstanding and disbursed has brought forward the date when either a Bank capital increase will be needed or the limitation on the Bank's operations laid down in its Articles of Agreement will have to be amended.

2. The main options open to the Bank for responding to these problems can be summarized as follows:

a. The Bank's subscribed capital may be increased;

b. Future lending may be reduced;

c. The Bank's Articles of Agreement may be amended to permit greater lending with a given capital base.

The purpose of this memorandum is to assess the scale of the Bank's capital needs over the next decade and to examine how these various options may be used, either singly or in combination, to meet those needs.

3. The issues which arise in considering the Bank's long-term capital requirements are complex. This memorandum does not attempt to offer definitive solutions to all these issues. What it does try to do is provide a framework for analyzing the issues and to indicate the points on which critical judgments are required. The aim is to advance our understanding of the Bank's capital problem sufficiently to permit a first step to be taken toward a solution of that problem with confidence that we are on the right path. The specific first step proposed is a Selective Increase in Bank capital subscriptions.

4. The remainder of this introduction briefly summarizes the content of the memorandum and states the principal conclusions.

Scale of the Problem

5. Section II describes the scale of the Bank's subscribed capital requirements. If presently projected levels of lending are maintained, the Bank's statutory authority to make loan disbursements will be exhausted in FY82, unless there is an intervening increase in subscribed capital or a change in the Bank's Articles.1/ To postpone the date when the statutory limit would be reached for a period of say five years would require an increase in subscribed capital and reserves and/or a reduction in disbursed loans totalling about $27 billion between now and the end of FY87.

6. This estimate of the scale of the problem is sensitive to assumptions about the rate of growth in commitments after FY80, the rate of loan disbursements and the level of IBRD net income transfers to IDA. Plausible variations in these assumptions generate capital requirements by FY87 which range from about $20 billion to $35 billion. An illustrative figure of $30 billion has been selected as the basis for subsequent analysis.

Alternative Solutions

7. Section III outlines the major alternatives available to the Bank for meeting its future capital requirements assuming the limit on operations imposed by the Articles is not amended. Specifically, the Section examines: (a) ways of increasing the Bank's

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1/ Article III, Section 3 (entitled "Limitations on Guarantees and Borrowings of the Bank") states that "the total amount outstanding of guarantees, participations in loans and direct loans made by the Bank shall not be increased at any time, if by such increase the total would exceed one hundred percent of the unimpaired subscribed capital, reserves and surplus of the Bank."

lending authority under the present statutory limit by adding to subscribed capital and reserves (mainly through an increase in capital subscriptions); and (b) ways of reducing the amount of loans disbursed and outstanding (mainly through reduction in the level of future Bank commitments).

8. It is argued that an increase in capital subscriptions is the preferable way of dealing with the Bank's capital problem. The alternative of reducing Bank commitments would have seriously adverse effects on our borrowers. A reduction in commitments sufficient to solve the Bank's capital problem without any increase in subscribed capital would reduce the Bank's net disbursements to borrowing countries in FY85 by about 70% from presently projected levels. A reduction in future commitments of anything approaching this magnitude would be incompatible with the Bank's development responsibilities and would run directly contrary to the understandings reached in the Development Committee and the recent U.N. Special Session regarding the capital needs of the developing countries. The case against a large cutback in lending is strengthened by the fact that an increase in capital subscriptions is a low cost solution, since the greater part of any increase would give rise to a contingent liability only and this liability would not involve a greater relative "exposure" than has been accepted by the Bank's shareholders in the past.

Approach to the Increase

9. There are two alternatives for proceeding with an increase in capital subscriptions:

a. A "two-step" approach involving a Selective Capital Increase (related to the IMF quota increase) followed by a General Capital Increase a few years later;

b. A "one-step" approach combining both Selective and General Capital Increases.

10. Section IV concludes that the Bank should proceed with the "two-step" approach. The main reason for recommending this approach is that it allows the Bank to address several difficult issues associated with the Bank's long-run capital requirements in a more orderly manner and under more auspicious circumstances than would be possible in a "one-step" approach. Some of the more important of these issues are: (a) the total size of the increase; (b) the distribution of the increase among member countries; (c) the proportion of the increase to be paid-in; and (d) the voting power of the developing countries.

11. If the case for a "two-step" approach is accepted, then the main question for immediate action becomes the design of the first step, i.e. the principal features of a Selective Capital Increase. Section IV examines the prospective size, distribution and timing of a Selective Increase.

Amendment of the Statutory Limit

12. Section V examines the possibility of amending the Bank's Articles to permit a different capital structure than is required under the terms of Article III, Section 3. In exploring the desirability of altering the statutory limit, the nature of the risks the Bank faces are examined in some detail. The risk of loss on loans is related to the Bank's debt/equity ratio and to the coverage of funded debt by the Bank's callable capital. The debt/equity ratio is also seen to be relevant in relation to the risk of fluctuations in Bank net income.

13. When the capital structure associated with the Bank's present statutory limit is examined in relation to the risks the Bank faces, it appears that the present limit is, to some extent, both anomalous and unduly restrictive. The case for amending the Articles relates to possible economies in the level of callable capital. When reasonable allowance is made for the value of the Bank's loan portfolio, the relationship of callable capital to funded debt required under the present statutory limit appears to provide more than adequate security for bondholders.

14. While therefore amendment of the Articles could perhaps be justified on narrow financial grounds, the low cost of maintaining a high level of callable capital makes it far from obvious that amending the Articles would be a desirable step. There is no need to reach a final position on this issue now, provided a "two-step" approach is adopted. Regardless of whether or not a change in the Articles may eventually prove desirable, the Bank will nevertheless need additional subscribed capital in the amount proposed for the first step, i.e. for the Selective Capital Increase.

Recommendations

15. The review of the Bank's capital structure leads to the following principal recommendations:

a. A "two-step" approach to meeting the Bank's capital should be followed.

b. The first step, a Selective Capital Increase, should

(i) continue the policy of parallelism with the IMF

(ii) provide for further special increases for some, but not necessarily all, of the major oil-exporting countries

(iii) be finally negotiated early in calendar 1976, so as to enable member governments to enact legislation for the Selective Increase in a single package with the IMF quota revisions.

c. No decision need be made now, and none should be made, as to the timing and form of the second step: it may later be decided that it should be a General Capital Increase, an amendment of the Articles, a reduction of the lending program, or some combination of these, supplemented perhaps by certain selective changes in financial policies. The timing and content of the alternative courses of action should be reviewed by the Board again within two years time.

SECTION II: Scale of the Bank's Subscribed Capital Problem

16. The Bank's Articles of Agreement limit the volume of loans which may be disbursed and outstanding to the total of the Bank's unimpaired subscribed capital and reserves. This limitation will become a critical constraint on Bank operations in the next few years unless corrective action is taken soon. As shown in the following table, the projected volume of disbursed loans corresponding to presently projected Bank commitments would first exceed the statutory limit in FY82 if there were no intervening increase in subscribed capital. The gap between disbursed loans and the statutory limit would grow by about $5 billion per annum in the ensuing years.

Statutory Limit and Disbursed Loans: /a FY81-87
(current $ billion)

End of:	FY81	FY82	FY83	FY84	FY85	FY86	FY87
Disbursed Loans	31.6	36.4	41.4	46.8	52.2	57.5	62.7
Statutory Limit	33.8	34.1	34.3	34.6	34.9	35.2	35.6
Difference	(2.2)	2.3	7.1	12.2	17.3	22.3	27.1

/a Projections assume Bank commitments in current prices grow at 5% per annum after FY80. "Disbursed Loans" refer to amounts disbursed and outstanding at the end of the year.

17. As a practical matter, it seems desirable to consider solutions which would "close the gap" for at least five years. Since a gap first appears in FY82, this objective requires us to consider the impact of proposed actions on the Bank's financial position at the end of FY87.

18. Financial projections for a period as long as 10 or 12 years into the future are commonly regarded with scepticism--and justifiably so. It is important therefore to consider how sensitive the projected shortfall in subscribed capital is to plausible variations in the assumptions which underlie the projections. In particular, it may be useful to consider the impact of alternative assumptions regarding: (a) the rate of growth of commitments beyond the present planning period (i.e. after FY80)1/; (b) the rate at which loans are disbursed; (c) the level of Bank transfers to IDA.

19. Rate of Growth of Commitments. In the period after FY80 the current financial projections assume that Bank commitments remain constant in real terms, i.e. that they increase at 5% per annum in nominal terms, thus keeping pace with the assumed rate of inflation. This assumption is intended to be neutral and not to prejudge the question of what the Bank's role should be in the early 1980s. Since, however, there may be quite different views about this role or about the rate of inflation to be expected over the next several years, this "neutral" assumption may unintentionally be blurring real differences of opinion concerning the scale of the Bank's subscribed capital problem.2/

20. As the following table shows, a continuation of real growth in Bank commitments at a rate of 7% per annum (again assuming inflation at 5% per annum) would add about $7 billion to the projected total of loans disbursed and outstanding at the end of FY87. Alternatively, if Bank commitments were to remain constant in nominal terms after FY80--implying a progressive reduction in real value--disbursed loans would be $5.6 billion lower at the end of FY87.

1/ Alternative levels of Bank commitments for FY77-80 are examined in Section III below.

2/ It now appears likely that the next annual revision of the price assumptions used to deflate future Bank commitments will show a figure higher than 5% after FY80.

Impact of Alternative Nominal Growth Rates on Commitments after FY80
(current $ billion)

	Growth Rate of Commitments in Nominal Terms		
	0% p.a.	5% p.a.	-12% p.a.
Disbursed Loans at End of FY87	57.1	62.7	69.6
Excess of Disbursed Loans Over Statutory Limit /a	21.5	27.1	34.0

/a Variations in net income due to changes in commitment levels may affect reserve levels and hence the statutory limit itself. However, the effect is likely to be small and is not considered further in this analysis.

21. Variations in the Rate of Disbursement. Disbursements are currently projected on the basis of different profiles for each of the sectors in which Bank loans are made. In effect, the aggregate disbursement pattern is an average of the sectoral profiles with the weights for each sector determined by the volume of commitments in that sector. Hence the actual level of total disbursements for the Bank can vary from the amounts projected either because the underlying sectoral profiles prove to be incorrect or because the weights assigned to various sectors fail to anticipate shifts in the relative importance of those sectors in total lending. Plausible variations in the profiles themselves could alter the total of loans disbursed and outstanding at the end of FY87 by about $2.5 billion--either up or down. If the shift toward "new style" projects should proceed more rapidly than is now foreseen, this could tend to reduce the total of disbursed loans, though the impact would probably be less than $1 billion. On the other hand, each percentage point increase in the share of Bank lending accounted for by quick-disbursing program loans would increase disbursed loans at the end of FY87 by about $0.2 billion.

22. Bank Transfers to IDA. The current financial projections assume a continuing transfer to IDA of $100 million per annum out of Bank net income. In the past, transfers to IDA have averaged about 50% of net income. If the projections were to be based on the assumption of 50% transfers rather than the constant amount of $100 million per annum, the projected level of Bank reserves at the end of FY87 would be reduced by $660 million and the gap between disbursed loans and the statutory limit increased by the same amount.

23. Thus it appears that the scale of the Bank's subscribed capital problem by FY87 could reasonably be placed anywhere between a minimum of about $20 billion and a maximum of approximately $35 billion. Within that range the particular figure selected is a matter of judgment, heavily influenced by the view one has of the prospective role for the Bank in the early 1980s. For purposes of subsequent analysis in this memorandum, a figure of $30 billion has been used. Such a figure can be interpreted either as allowing for somewhat faster than expected disbursement rates and a more generous policy with respect to IDA transfers or, alternatively, as providing a modest margin for real growth in commitments after FY80.

SECTION III: Alternative Solutions to the Subscribed Capital Problem

24. The projected shortfall in subscribed capital can be dealt with in a variety of ways. The options available to the Bank may be classified into three broad categories:

a. Steps to increase the total of subscribed capital and reserves, through an increase in capital subscriptions and/or through higher allocations of Bank net income to reserves;

b. Measures designed to reduce the volume of loans disbursed and outstanding at future dates;

c. Amendment of the Articles of Agreement to permit the Bank to lend more with a given capital base.

This section is concerned only with the first two of these three broad options. The possibility of amending the Articles of Agreement is taken up in Section V.

Increasing Subscribed Capital and Reserves

25. Additional Capital Subscriptions. It is a relatively simple matter to calculate the proportionate increase in Bank capital subscriptions necessary to solve the subscribed capital problem. One minor complication is that the impact of any given increase in subscribed capital will vary depending upon what fraction of the capital increase is paid-in and released for use in Bank operations. Additions to usable paid-in capital have a compound effect in that they also increase the Bank's net income and make possible higher allocations to reserves, thereby adding to the statutory limit. However, since

only a small part of capital subscriptions is expected to be made available in usable form, this secondary effect is relatively small. For example, a $10 billion capital increase, subscribed in FY78-80, with the usual 10% portion paid-in and with three-fourths of that amount released for use in operations, would add $10.8 billion to the total of subscribed capital and reserves at the end of FY87.1/

26. The desired increment in capital subscriptions could be accomplished either through a single capital increase (a "one-step" approach) or through a prompt Selective Increase followed a few years later by a General Increase (a "two-step" approach). The relative attractiveness of these two approaches is considered in Section IV. Here it is only necessary to indicate what each approach would imply in terms of nominal amounts and proportionate increases in total capital subscriptions. These are as follows:

Alternative Increases in Subscribed Capital Equivalent to $30 Billion in Capital and Reserves at End of FY87

	Amount Subscribed (current $ billion)	(% increase)	Period for Payment of Subscription/b
One-Step Approach	28.7	93%	FY80-82
Two-Step Approach			
Selective Increase	10.0/a	32%	FY78-80
General Increase	18.7	46%	FY83-85

/a An approximate figure. See para. 52 below.
/b Legislative authorization for a capital increase would be needed before December 1979 in the "one-step" approach and before December 1981 as the second part of the "two-step" approach. Completion of legislative authorization for the first of the two steps would be planned for September 1977. Assuming authorizing legislation is obtained by these dates, actual payment of subscriptions could take place over the periods shown.

27. Additions to Reserves. It would also be possible to achieve some increase in the total of subscribed capital and reserves by raising the level of Bank net income or by allocating a higher proportion

1/ This assumes that all additional net income is allocated to reserves.

of net income to reserves. The impact of such actions on the Bank's subscribed capital position is analyzed in Annex 1. An increase in the average lending rate by 0.5% would add at most $1.3 billion to reserves by the end of FY87. Cessation of future IDA transfers would only add about $1.3 billion to the level of reserves projected for the same date. Given the major problems associated with either of these steps and given the relatively minor impact they would have on the Bank's subscribed capital problem, they are not attractive alternatives to a direct increase in capital subscriptions.

Reducing the Total of Loans Disbursed and Outstanding

28. A variety of measures are available to reduce the volume of Bank loans disbursed and outstanding at future dates. Without altering the level of future Bank commitments, it would be possible to modify the volume of disbursed loans arising from these commitments by shortening the terms of new loans. Grace periods and final maturities could be reduced or the present pattern of loan amortization could be shifted forward. A greater effort could be made to increase sales of loans from portfolio or to encourage prepayment of outstanding loans. Each of these measures is considered in Annex 1. Whether taken singly or in combination, they do not offer reasonable prospects for making a major contribution to the solution of the Bank's subscribed capital problem. At best, such changes would moderate--but not alter the basic dimension of--the reduction in lending which the Bank would have to make if subscribed capital cannot be increased appropriately and if the present statutory limit on lending is retained.

29. A reduction in Bank commitments could be accomplished in several ways, each with different implications for particular groups of countries. Some of the possibilities are surveyed in Annex 2. For purposes of assessing in general terms the degree of lending restraint required, it is sufficient to consider how large a simple across-the-board cut in Bank commitments would have to be in order to avoid having to increase subscribed capital in the amounts shown above.

30. Impact of Reduced Commitments on Disbursed Loans. Because Bank loans are typically disbursed over several years, the earlier a given reduction in IBRD commitments takes place, the greater its impact on the volume of loans disbursed and outstanding at the end of FY87. Thus, for example, a $100 million reduction in FY77 commitments will reduce disbursed loans at the end of FY87 by about $70 million, whereas a $100 million reduction in FY85 commitments will only lower disbursed loans by $39 million. Hence there are many different ways of timing the reduction in commitments necessary to achieve a given reduction in disbursed loans at a future date.

The possibilities may be illustrated by considering the following two types of cut-back: (a) reduction in future commitments by a fixed percentage each year, or (b) lowering the projected rate of growth of future commitments.1/

31. Were future commitments to be reduced by a constant percentage each year beginning in FY77, each percentage point reduction in future commitments2/ would close 1.6% of the "gap" in FY87. Using this relationship, one can calculate an approximate level of commitments which could be maintained over the next decade without increases in subscribed capital. These commitment levels are shown in the following table. If there is to be no increase at all in subscribed capital, annual commitments would have to be cut back by about 55%. If there were to be only a Selective Increase of $10 billion, future commitments would have to be reduced by 33% to compensate fully for the lack of a subsequent General Capital Increase.

IBRD Commitments Consistent with Statutory Limit Through FY87: Fixed Percentage Reduction

	FY77	FY78	FY79	FY80	FY83	FY87
Present Program						
- current $ million	5500	6100	6800	7700	8914	10835
- FY76 $ million	5223	5510	5852	6311	6311	6311
Selective Increase Only						
- current $ million	3685	4087	4556	5159	5972	7259
- FY76 $ million	3500	3692	3921	4229	4229	4229
No Capital Increase						
- current $ million	2475	2745	3060	3465	4011	4876
- FY76 $ million	2350	2480	2633	2840	2840	2840

1/ Another possibility would be to reduce commitments by a constant nominal amount each year. However, the reductions required to close the gap either with no Capital Increase ($4.3 billion reduction each year) or with the Selective Increase alone ($2.6 billion) would be so disruptive to the borrowing programs of established IBRD borrowers and would lead to such inefficiencies in the deployment of scarce staff resources, that this does not seem to be a feasible alternative.

2/ The reduction applies only to IBRD loans to countries; future loans to IFC are assumed to be unaffected.

32. Rather than lowering commitments by a fixed percentage amount each year, the growth rate of future commitments could be reduced. This would have the effect of postponing a larger part of the reduction in commitments into future years and thereby easing somewhat the immediate adjustment problem. The currently projected lending program results in a volume of disbursed loans in FY87 equivalent to what would be generated by a lending program growing at an average of about 5% per annum in real terms. If all real growth in the future were to be eliminated, future commitments would have to be cut back to the levels shown in the following table. The effects of excluding all future growth in nominal terms are also shown.

IBRD Commitments Consistent with Statutory Limit
Through FY87: Reduced Rates of Growth

	FY77	FY78	FY79	FY80	FY83	FY87
Present Program						
- current $ million	5500	6100	6800	7700	8914	10835
- FY76 $ million	5223	5510	5852	6311	6311	6311
Selective Increase Only						
(a) Zero Real Growth						
- current $ million	4265	4483	4706	4941	5719	6954
- FY76 $ million	4050	4050	4050	4050	4050	4050
(b) Zero Nominal Growth						
- current $ million	5200	5200	5200	5200	5200	5200
- FY76 $ million	4938	4697	4475	4262	3683	3029
No Capital Increase						
(a) Zero Real Growth						
- current $ million	2896	3044	3196	3355	3883	4722
- FY76 $ million	2750	2750	2750	2750	2750	2750
(b) Zero Nominal Growth						
- current $ million	3500	3500	3500	3500	3500	3500
- FY76 $ million	3324	3162	3012	2869	2479	2038

33. In the case where subscribed capital is not increased at all, adopting a pattern of zero real growth would require a cutback of 47% in FY77 commitments as compared to the 55% reduction required if the currently projected pattern of growth is maintained. Accepting a pattern of zero growth in nominal terms would be consistent with a cut-back in FY77 commitments of 36%. Thus, the flexibility which the Bank would have in designing a retrenchment in the event (i) subscribed

capital were not to be increased, (ii) the present statutory limit were retained and (iii) other Bank financial policies were unchanged, may be broadly summarized as follows: a new base for future lending would have to be established in FY77 at a level 36%-55% below current plans, the choice within that range being dependent on how much future growth from the new base level is to be allowed.

34. Impact of Reduced Commitments on Development Financing. Such a retrenchment would of course have a seriously adverse effect on the Bank's member countries. The table below shows the consequences in terms of net disbursements from the Bank to the developing countries. If lending program cut-backs are to maintain compliance with the statutory limit through the end of FY87, net disbursements must be reduced by $27 billion over the FY77-87 period.1/ Because Bank loans take several years to disburse, the bulk of the reduction in net disbursements takes place after FY80. Thus, in the early and mid-1980s the Bank's role as a net supplier of funds for development financing would rapidly erode. If allowance is made for the payment of current charges (i.e. interest payments and commitment fees), the resulting net transfer from the Bank to the developing countries turns negative in FY82.

Commitment Levels and IBRD Net Disbursements: FY77-87
(current $ billion)

Commitments Corresponding to:	Net Disbursements FY77	FY79	FY81	FY83	FY85	FY87
Present Program	2.6	3.7	4.4	5.0	5.4	5.3
Selective Increase Only						
- zero nominal growth	2.6	3.5	3.4	3.1	2.8	2.0
- fixed percentage cut	2.6	3.0	2.8	3.1	3.2	3.1
No Capital Increase						
- zero nominal growth	2.6	2.8	2.2	1.8	1.5	0.9
- fixed percentage cut	2.6	2.5	1.8	1.8	1.7	1.6

35. The current and prospective capital needs of the developing countries have been discussed elsewhere2/ and do not require repetition here. In light of these needs, a reduction in the absolute level of net financing supplied by the Bank could only be justified if the

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1/ The reductions in IBRD commitments have been calculated using presently projected commitments as the base. Were commitments to be higher or disbursement rates more rapid--corresponding to a "gap" of $30 billion rather than $27.1 billion--the percentage reductions would be larger.

2/ For instance, in Capital Requirements of Developing Countries, R75-56 dated April 8, 1975 and circulated to the Development Committee as Document DC/75-10 dated April 29, 1975.

steps required to avoid this course were very burdensome indeed. This is certainly not the case with respect to the Bank's subscribed capital problem. The obvious alternative to a reduction in lending is an increase in capital subscriptions. The largest part of any increase in subscribed capital (90% if present practices are followed), and conceivably the entire amount, could take the form of a contingent liability. In nearly 30 years of experience, this contingent liability has cost the Bank's shareholders absolutely nothing. Nor is it likely to do so in the future. A fundamental objective of the Bank's financial policies is to operate in such a way as to keep "remote" the possibility of a call--however small--on the Bank's unpaid capital subscriptions.

36. Member governments may be hesitant to assume a contingent liability which is so large in absolute terms, even though the risk of claims arising from that liability is small. However, it is important to keep the magnitudes in perspective. Even with a Selective Increase of $10 billion in FY78-80 and a General Increase of $19 billion in FY83-85, the resulting contingent liability of the Bank's shareholders would be significantly smaller as a percentage of national budgets than has been the case in the past.

37. Moreover, against the relatively minor cost of increasing the Bank's subscribed capital, the benefits of maintaining the Bank as a major source of development finance are substantial. Both in the Development Committee and in the recent Special Session of the United Nations, the importance of increasing capital flows to the developing countries has been reaffirmed repeatedly. Attention has been drawn, for example, to the desirability of increasing the developing countries' access to private capital markets. The Bank is, of course, already tapping private capital markets on a substantial scale for the benefit of the developing countries. It is to be hoped that ways can be found--particularly for countries with strong financial positions and prospects--to facilitate additional direct borrowing in the capital markets of the world. However, if the objective of increasing the total capital flows to developing countries is to be realized, the expansion of direct borrowing must be accompanied by action to permit continued full use of the Bank's proven reputation and market standing as an intermediary.

Summary

38. The major conclusion to emerge from this review of the options open to the Bank for conducting its operations within the existing statutory limit is that an increase in subscribed capital is unquestionably preferable to the other possible courses of action. Indeed, if a substantial reduction in future lending is to be avoided, then, without a change in the statutory limit, an increase in subscribed capital is indispensable. The scale of increase

required could be altered somewhat by financial policy changes designed to increase Bank net income, raise allocations to reserves, tighten repayment terms on Bank loans or encourage prepayments and sales of loans. But, at most, these changes would permit a somewhat smaller increase in capital; they could not substitute entirely for such an increase. Nor should they. An increase in subscribed capital is almost certainly the least burdensome solution available.- The cost to subscribing members (in terms of paid-in capital) would not be more than a small fraction of their total capital increase and the attendant contingent risk--even with a substantial increase--will be relatively less than member governments have borne in the past. In the next section we consider how and when an increase in subscribed capital should be obtained.

SECTION IV: Approach to an Increase in Subscribed Capital

39. There are two basic questions which must be addressed in deciding how to approach an increase in the Bank's subscribed capital. The first is whether the capital increase should be provided through a prompt Selective Increase followed a few years later by a General Capital Increase (a "two-step" approach) or whether these two actions should be combined (a "one-step" approach). Second, having decided whether to proceed in one step or two, the size, timing and other special features of the capital increase(s) must be determined.

"One-Step" vs "Two-Step" Approach

40. The key dates to keep in mind when considering the relative attractiveness of the two approaches were set out in an earlier memorandum (SecM75-602, dated August 13, 1975); for convenience they are repeated in the table below. In each case the dates cited are the latest ones by which action must be taken if there is not to be a hiatus in the Bank's authority to make commitments. The "disbursement limit reached" is the date when the statutory limit would first be exceeded, if no corrective action were taken to prevent that happening. The "commitment limit reached" is the earlier date at which new Bank lending would have to cease at least temporarily in order to avoid committing the Bank to future disbursements which it might not have the legal authority to make.

IBRD Capital Increase	Disbursement Limit Reached /a	Commitment Limit Reached /a	Negotiations Commencement	Negotiations Completion	Legislation Commencement	Legislation Completion	Period for Payment of Subcription /b
One-Step Approach	12/81	12/79	6/76	12/77	12/77	12/79	FY80-82
Two-Step Approach							
(a) Selective Increase	NA	NA	12/75	3/76	3/76	9/77	FY78-80
(b) General Increase	3/84	12/81	12/78	12/79	12/79	12/81	FY83-85

/a The estimated dates are, of course, sensitive to assumptions regarding disbursement rates. If disbursements were to be more rapid than is presently projected, these dates could be advanced by a few months and earlier legislative action would be required.

/b Assumes authorizing legislation complete by the dates shown for "Completion of Legislation."

41. The case for a "one-step" approach rests essentially on the proposition that two sets of negotiations would be wasteful and would unnecessarily prolong the uncertainty about how the Bank's longer run capital problem is to be resolved. Rather than going through two sets of negotiations and legislative action, the two steps would be combined into one. The closer in time the two steps would have to be, the stronger is the argument for amalgamation into a single process.

42. However, as the table shows, legislative action for a "second step" General Capital Increase would not have to begin for almost four years after the latest date for commencement of legislation to approve a Selective Increase. Moreover, if a "one-step" approach were followed, it would be necessary within the next 24 months to address and solve several very difficult problems which could otherwise be dealt with in a more deliberate fashion and under circumstances likely to be more auspicious. In particular, in the "one-step" approach serious issues could well arise regarding: (a) the scale of Bank commitments in the 1980s, (b) whether it is wise to substitute selected financial changes for part of the increase in subscribed capital, (c) the total size of capital increase, (d) the distribution of the increase among member countries, (e) the proportion of the increase to be paid-in and released for use, (f) measures to be taken to protect the voting power of the developing countries. Furthermore, the "two-step" approach retains a desirable element of flexibility regarding both the timing and amount of the General Increase. As indicated in Section V, approval of a Selective Increase along with

subsequent amendment of the Bank's Articles might permit deferral of a General Increase for some time or result in a change in the amount of such an increase. A "one-step" approach presumes agreement on all the potentially controversial points within the next two years; a "two-step" approach does not. Indeed, a Selective Capital Increase on the order of $10 billion can be agreed without prejudging the final outcome on any of these points.

43. In particular, it would not be necessary to arrive at a concensus on a new formula governing the distribution of subscribed capital among member countries. Currently the distribution is determined primarily by what happens to countries' quotas in the IMF. This rationale has been questioned in recent discussion. However, while it may be easy to agree that the procedure linking IMF quotas and Bank capital subscriptions, which has been followed for 30 years, is in some respects arbitrary, it is likely to be much more difficult to come up with a generally acceptable alternative. In a "two-step" approach the resolution of this problem would be sought in the second step, i.e. as part of the General Capital Increase.

44. Another of the critical issues is the proportion of any subscribed capital increase which is to be paid-in. In Section V below, it is argued that the additional paid-in capital expected in connection with a Selective Increase is desirable because it would help keep the Bank's income position strong and would moderate the rate at which certain conventional financial ratios change over the next few years. Just how the income needed for Bank operations in the longer run should be generated--that is, the appropriate balance between lending charges, paid-in capital and retained earnings--is a much more difficult and potentially controversial issue. The "two-step" approach would enable us to seek resolution of this issue through a process of gradual accomodation of different views over the next few years.

45. Finally, among the issues deserving comment, there is the question of voting power for the developing countries. Under the present system, any increase in subscribed capital automatically dilutes the relative importance of membership votes in determining the voting power of individual countries.1/ This works to the disadvantage of the developing countries as a whole and is particularly harmful to the smaller developing countries whose total votes are made up mainly of membership votes. A change in the system would require an amendment to the Bank's Articles. Since the severity of the problem is directly related to the size of increase in subscribed capital, it would be much more critical in a "one-step" approach than in the selective component of a "two-step" approach.

1/ Under the Articles, a Bank member has 250 membership votes plus one vote for each $100,000 (1944 dollars) subscribed.

46. It is apparent from this review of the problems likely to be encountered that it would be extremely difficult to successfully negotiate a "one step" capital increase within two years even in the most auspicious circumstances. In point of fact, however, the next two years would be a distinctly awkward time to attempt negotiations. There would be an undesirable overlap with the negotiations for the fifth replenishment of IDA's resources. Two of the Bank's three largest shareholders face major elections in this period, which is bound to slow the pace of negotiations. Many governments are currently in a period of exceptional financial stress in which constraints on government budgets are unusually severe. Forecasts in several countries suggest an easing of these strains in two or three years' time. These difficulties should be much less important in the case of a Selective Capital Increase. A Selective Increase could be treated together with the IMF quota revisions in a single legislative "package." Such a "package" is likely to be handled expeditiously and to encounter less legislative resistance than a Bank General Capital Increase considered separately.

Features of a Selective Capital Increase

47. Thus, considering both matters of timing and of approach to the major issues, there seems to be a compelling case in favor of a "two-step" capital increase. The question then becomes: what should the first step be? Rather than attempting at this time to specify the country by country subscriptions which the Executive Directors should recommend to the Board of Governors, this memorandum seeks agreement in principle on the following features of a Selective Capital Increase: (a) the continued application of parallelism with the IMF; (b) the provision of special increases for some major oil-exporting countries; and (c) the timing of the increase.

48. Parallelism with the IMF. The Bank's past policy regarding parallelism with the IMF was reviewed in my earlier memorandum on Selective Increases in IBRD Capital Subscriptions.1/ The reasons favoring continuation of parallel action may be summarized in the following way:

- it maintains the principle that countries which obtain the benefits of higher quotas in the Fund should accept the responsibility of higher subscriptions in the Bank.

- it helps keep the Bank's capital growing in line with world economic activity and ensures that increases come mainly from the richer and faster growing countries.

1/ R75-151 dated July 8, 1975.

- it avoids lengthy negotiations by adopting the adjustments among member countries which are bargained out in the Fund.

- it provides the tactical advantage of combining into one piece of legislation the request for approval of both IMF quota and Bank capital subscription increases.

49. The policy has been criticized as being illogical. Why, it is asked, should criteria which are essentially trade-related be applied in determining relative shares in Bank capital subscriptions? The answer, as the above list of reasons makes clear, is primarily one of convenience, although there are also issues of principle involved. We have continued the policy because, for more than a quarter of a century, it has proven to be a practical way of reaching agreement on a matter which could easily be debated endlessly. While it is reasonable to ask whether there may not be other principles which would be equally workable and more relevant to the Bank's function, it would seem prudent to retain the use of the parallelism principle until a better alternative is developed and generally agreed. Accordingly, it is proposed to design the Selective Capital Increase on the basis of parallelism with the Fund.1/

50. Treatment of Major Oil-Exporting Countries. An exception to the policy of strict parallelism may be justifiable in the case of the major oil-exporting countries. Because of the wider role of these countries in supplying resources to the Bank as compared to the Fund, it has been proposed that they be given the opportunity to increase their subscriptions beyond the level which would follow from parallelism with the Fund. When this proposal was discussed by the Executive Directors on July 29th this year, there was widespread support for accepting a departure from parallelism in this case. Objections were, however, raised concerning the impact of this action on the voting power of the other developing countries. In addition, the justification for treating all the major oil-exporting countries in identical fashion was questioned, since not all of them are important actual or prospective suppliers of resources to the Bank.

1/ In order to be consistent with past practice, the minimum quota increase common to all members (except the Republic of China), namely 4.46%, would be regarded as the "general" component of the quota increases, with the balance of each member's increase being regarded as "special." The calculation would treat all member countries identically.

51. One way of meeting these objections while retaining the principal thrust of the original proposal is to acknowledge the genuine economic differences among the oil-exporting countries. While some of these countries are likely to be long-term suppliers of development finance on a substantial scale, others will not be. For those countries in the former category a capital increase higher than that following from the formula adopted in the IMF continues to be clearly justified. On the other hand, the other major oil-exporting countries could be treated in the same way as all other member countries and assigned an increased subscription corresponding to that agreed in the Fund.

52. Were this approach to be applied, it is likely that there would be no significant disagreement at the extremes. Saudi Arabia, Kuwait, Abu Dhabi and Qatar have per capita incomes sufficiently high and a financial position of sufficient strength to leave no doubt as to their capacity to be regular suppliers of development finance in future years. On the other hand, Indonesia, Nigeria and Ecuador are likely to be importers of capital for development purposes for the foreseeable future. The real issue, therefore, concerns only a few countries. The following table summarizes the possible outcomes. Case A assumes that the intermediate group of oil-exporting countries receives only those capital increases which correspond to the IMF quota revisions, while Case B provides for further special capital increases for these countries on the scale previously proposed.

Prospective IBRD Capital Subscriptions

Developing Countries	Prospective Capital Increase (current $ billion)		Voting Power (%)		
	Case A	Case B	At Present	Case A	Case B
Oil-Exporting Countries					
- suppliers of finance /a	1.65	1.65	1.10	4.58	4.44
- intermediate group /b	0.99	2.38	2.48	4.18	7.11
- poorer countries /c	0.44	0.44	1.49	2.17	2.10
Other Developing Countries	1.95	1.95	30.71	28.48	27.61
Total	5.03	6.42	35.78	39.41	41.26
Industrial (Part I) Countries	4.55	4.55	64.22	60.59	58.74
	9.58	10.97	100.00	100.00	100.00

/a Abu Dhabi, Kuwait, Qatar and Saudi Arabia.
/b Algeria, Iran, Iraq, Libya, Oman, Venezuela.
/c Ecuador, Indonesia, Nigeria.

53. If the Executive Directors were to agree on this more discriminating approach to the question of special increases for the major oil-exporting countries, I would enter negotiations with the countries in the intermediate group with a view to finding an acceptable solution within the range shown above.

54. Timing. It is currently expected that final agreement to the revised IMF quotas will be obtained at the meeting of the Interim Committee in early January. As soon thereafter as agreement is reached on appropriate amendments to the IMF's charter, a formal resolution will be submitted to the IMF Board of Governors. I propose that the Bank follow a similar timetable, subject of course to the Executive Directors' approval of the final proposal concerning special increases for the oil-exporting countries. The objective would be to reach agreement on a specific proposal early in calendar 1976, so that the Bank's Selective Capital Increase could be submitted for legislative approval at the same time as the IMF quota revisions.

SECTION V: Amending the Statutory Limit

55. The analysis thus far has been concerned with the implications of maintaining compliance with the statutory limit in Article III, Section 3 through the end of FY87. We have not inquired whether that statutory limit is appropriate to the Bank's present and prospective mode of operations and to the nature of the capital markets themselves. To complete the review of the Bank's capital needs over the next decade, we should also re-examine this fundamental premise. The statutory limit establishes a ceiling on Bank operations which reflects assumptions made in 1944 concerning the financial constraints within which the Bank must operate if it is to obtain the borrowed funds necessary to finance its lending program. If the statutory limit does not adequately protect the interests of either bondholders or shareholders, then there is an obvious threat to the long run ability of the Bank to perform its intended function. If, on the other hand, the statutory limit is too restrictive, then the Bank will not be making the most efficient use of the share capital which its member countries are being asked to subscribe.

56. In re-examining the appropriateness of the statutory limit, it is necessary to take a fresh look at the Bank's financial position and to ask, in relation to the experience of other financial institutions, what limits on the scale of Bank operations--expressed in terms of alternative capital structures--would be indicated by an analysis of the risks which the Bank runs. In Part A of this section, the risk of loss on loans is assessed and related to the Bank's debt/equity ratio. Part B then examines the prospective adequacy of Bank net income. Finally, Part C explores the possibility of amending the statutory limit so as to reflect more appropriately, in relation to other financial institutions, the financial constraints which emerge from the review of the particular risks the Bank faces.

A. Capital Structure and the Risk of Loss

57. IBRD Debt/Equity Ratio[1/] There are two different debt/equity ratios which may be applied in analyzing the Bank's ability to with-

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1/ Because the Bank has such a high percentage of its assets in the form of cash and securities--on which the risk of loss is minimal--a ratio of disbursed loans to equity might be more useful in analyzing risk of loss on loans in certain circumstances. Nevertheless, a debt/equity ratio has been applied because it is more conventional and has relevance in relation to income risks as well.

stand losses on loans. The first includes a part of the Bank's callable capital in the definition of equity, whereas the second includes only that part of subscribed capital which has been paid-in and released for use in operations. The table below shows the evolution of these ratios under three sets of assumptions: (a) no further capital increase, (b) a Selective Capital Increase of about $10 billion (with 10% paid-in) and (c) a Selective Capital Increase followed by a General Increase (each with 10% paid-in). Callable capital includes only the unpaid subscriptions of Part I-countries and the four capital-surplus oil-exporting countries (about 70% of the total) on the assumption that these are the guarantees considered relevant by bondholders. (See para. 66.)

IBRD Debt/Equity Ratios[/a]: FY68 - FY87

	FY68	FY75	FY77	FY79	FY81	FY83	FY85	FY87
Including "Relevant" Callable Capital								
- No capital increase	.20	.53	.74	1.04	1.37	1.73	2.09	2.46
- Selective increase only	.20	.53	.73	.87	1.06	1.34	1.62	1.90
- Selective & General Increase[/b]	.20	.53	.73	.87	1.05	1.29	1.49	1.74
Excluding Callable Capital								
- No capital increase	1.13	2.68	3.65	4.93	6.16	7.30	8.23	8.97
- Selective increase only	1.13	2.68	3.63	4.37	5.16	6.03	6.73	7.26
- Selective & General Increase[/b]	1.13	2.68	3.63	4.37	5.09	5.53	5.43	5.80

/a Debt is defined to include amounts due to IDA. Equity excludes amounts receivable from subscribed capital

/b Assumes a General Capital Increase of 46%, of which 10% is paid-in in FY83-85.

The Shareholder's Perspective

58. The ratio which excludes callable capital measures the ability of the Bank to incur losses without having to call on the unpaid portion of the capital subscriptions and is therefore a matter of primary concern to the Bank's shareholders. From the shareholder's perspective, the appropriate level for this debt/equity ratio depends on the balance struck between two conflicting objectives. On the one hand, shareholders want to minimize the likelihood of a call on unpaid subscriptions. This objective is served by a high level of usable equity in relation to Bank debt. On the other hand, shareholders also wish to minimize the volume of scarce public funds which must be committed to

the Bank in the form of usable paid-in capital. This objective is served by permitting the Bank to finance a high proportion of its operations with borrowed funds rather than with usable equity.1/

59. In striking a balance between these objectives, shareholders need to have a clear idea of the risk of loss which the Bank faces over the next several years. In the past year, a country-by-country review of the Bank's loan portfolio has been under way and is now virtually completed. The approach adopted in this review is summarized in Annex 3. In essence countries which are borrowers from the Bank are classified into three groups, (a) those presenting little or no risk of default (Category I), (b) those for which the risk of default is more substantial but for which any consequential rearrangements of debt maturities could be expected to be at the current lending rate of creditors (Category II), and (c) those presenting a risk of default requiring concessional rescheduling (Category III).

60. Only in Category III countries are creditors threatened with actual losses as distinct from delayed payments. In such cases, the Bank's first line of defense is obviously to limit its absolute exposure. This is being done, though a refusal to take any risks on loans to Category III countries would be inconsistent with the Bank's development responsibilities. Secondly, efforts are made to limit Bank exposure relative to other lenders; here the objective is to ensure that, if rescheduling should come about, the Bank's share of total debt service is sufficiently low so that it can reasonably expect to maintain its policy against participation in reschedulings.

61. Because of the Bank's policy of refraining from rescheduling--which remains a fundamental element in its financial planning--the most likely outcome even in Category III countries is that the Bank's record of operations without loss on loans will be maintained. It is nevertheless useful to appraise the losses which could arise if it is assumed for the moment that the Bank were to be drawn into reschedulings. Even under quite pessimistic assumptions about future economic developments, it is the judgment of the Loan Portfolio Analysis Unit that no more than about 15-17% of the Bank's loan portfolio will at any time be outstanding to countries whose circumstances could require

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1/ Usable equity can of course also be increased by additions to reserves. Shareholders may be expected to have different views on the attractiveness of this option, depending on whether or not they are active borrowers.

a debt rescheduling involving a significant concessional element. Not all countries which could get into such difficulties will do so. Nor will all the countries whose circumstances could require a concessional rescheduling actually make use of this option. Therefore actual losses to official lenders--measured by the difference in present value between the originally contracted debt service stream and the rescheduled stream--would be only a fraction of the amounts outstanding. If these same loss ratios are (hypothetically) applied to the Bank's projected loan portfolio, the resulting loss could fall anywhere in the range of 0% - 5% of the Bank's disbursed loans. For purposes of analysis we have used 2.5%. (See Annex 3 for justification of these figures.) The estimate of 2.5% is a partial analog in Bank operations to what would be called a "provision against losses" in a commercial banking enterprise, although, in the case of the Bank, its policy against rescheduling and its record of operations for nearly 30 years without any loss experience give the figure a rather different and much more conservative connotation than it has in a commercial banking enterprise.

62. This analysis makes no provision for the possibility that some borrowers which have the ability to pay will, for essentially political reasons, not be willing to do so. Such risks are almost wholly unpredictable and the provision made against them must be a matter of broad judgment rather than detailed analysis. Reserves equal to 1.5%- 3% of disbursed loans ought to give sufficient protection against this type of risk. On the basis of this judgment, usable equity equal to 4% - 8% of the Bank's disbursed loans--2.5% to 5% being related to adverse economic or financial developments and 1.5% to 3% as allowance for political risk--ought to be sufficient

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1/ Reschedulings would generally not involve loss of principal, so that in strict accounting terms no adjustment to the balance sheet of creditors may be required. However, financial markets may apply some discount to loans which have been rescheduled on concessional terms. The difference in present values, by allowing for all future income losses, represents in a single figure the "loss" which has been incurred.

protection against losses on loans. Usable equity equal to 4% - 8% of disbursed loans plus cash and securities is equivalent to a debt/equity ratio of between 12 and 24.1/

The Bondholders' Perspective

63. This degree of protection would be adequate for shareholders if there were no question as to the Bank's ability to continue to borrow on reasonable terms in the capital markets of the world. However, this condition may not always be met in practice. With a debt/equity ratio of between 12 and 24 to 1, a rescheduling resulting in a loss (in present value terms) of say 2.5% of the Bank's loan portfolio might have a damaging effect on the Bank's standing in financial markets. Bondholders as well as the rating services in countries where they exist might assume that potential loan losses could be considerably larger than whatever actual losses had in fact occurred. For this reason, a case can be made for maintaining usable equity at a multiple of the actual losses which could occur if the Bank were, contrary to its policy, to be drawn into reschedulings. From this perspective, a level of usable equity on the order of 15% of disbursed loans plus liquid holdings--equal to three times the maximum loss due to adverse economic developments2/--would seem appropriate. This is equivalent to a debt/equity ratio of about 6.

1/ The calculation can most easily be understood by considering a simplified Bank balance sheet:

Cash and Securities (C)	Funded Debt (D)
Disbursed Loans (L)	Usable Equity (E)
Total Assets	Total Liabilities

By definition C+L = D+E. Hence D = (C+L)-E.

If E is some fraction of C+L, say 8%, then $D = \frac{1}{.08}E - E = 11.5E$ and the debt/equity ratio will be 11.5. In determining the amount of equity required, both cash and securities (C) and disbursed loans (L) are included in the calculation despite the fact that the risk of loss on liquid holdings is minimal. The reason for doing this is that cash and securities may be drawn down to finance loan disbursements as well as debt service obligations. Hence, if the Bank's borrowing program were to be interrupted for any reason, liquid holdings would tend to be converted into disbursed loans as disbursement obligations are met.

2/ Alternatively, the 15% figure may be interpreted as nearly 4 times the loss (of 4%) due to political risks and the plausible level of economic risk if the Bank's policy against rescheduling were infringed.

64. Which ratio is correct: 6 or 12 or 24? The answer depends on the perceptions of bondholders and the rating services regarding the Bank. If the Bank is perceived as an institution enjoying the unquestioned backing of governments whose guarantees are highly valued, then a ratio of 20 or 25 or even a good deal more would probably not impair the Bank's standing in financial markets.1/ If this backing is called into question, and potential investors are asked to rely at least in part on the Bank's loans as security for their investments, then even a ratio as low as 6 could seem too high.

65. In this connection it is worth emphasizing that successful implementation of the Bank's borrowing program over the next few years will depend upon its maintaining a financial position which is perceived as being not merely satisfactory but highly attractive. Although there are solid grounds for believing that the Bank's medium-term borrowing program will be achieved (as will be discussed in a memorandum on Capital Market Prospects and the IBRD Borrowing Program, to be distributed shortly), the projected volume of borrowing will require some increased penetration of the capital markets. Such penetration inevitably means appealing to a wider range of investors whose knowledge of the Bank and sophistication in appraising its financial soundness is limited. In such a situation, it is essential for the Bank to be in the strongest possible competitive position not only by maintaining a Aaa-rating but also by being able to justify it in relatively simple terms, i.e. by reference to the ultimate security provided by the callable capital.

66. Thus the question of an appropriate upper limit for the Bank's debt/equity ratio (excluding callable capital) cannot be divorced from the issue of how large the callable capital should be in relation to this debt. Up until a few years ago, the Bank's funded debt was less than the callable portion of the United States' capital subscription. In such circumstances a Bank obligation could be, and in practice was, regarded as almost equivalent to a U.S. government-guaranteed security of that time. That limit was exceeded in FY72 without causing any repercussions in financial markets. Now the attention of bondbuyers is drawn to the aggregate callable capital of the Part I countries and the capital-surplus oil-exporting countries. As the table below shows, funded debt is projected to exceed this collective total in the next few years even if there is a Selective Capital Increase of approximately $10 billion.

1/ This conclusion is based upon a review of the experience of federally-sponsored credit agencies in the United States. Their market standing appears to be largely independent of their financial structures, provided investors remain convinced of government support in case of need.

Ratio of IBRD Funded Debt/a to the Callable Capital of the Part I and Capital-Surplus Oil-Exporting Countries

End of:	FY76	FY77	FY78	FY79	FY80
No Selective Increase	.76	.92	1.11	1.32	1.54
With Selective Increase	.76	.92	1.00	1.08	1.17

/a Including amounts due to IDA.

67. If the callable capital of countries considered relevant by bondholders is to provide less than full coverage of funded debt, then it is essential that the part of funded debt which is not covered by relevant guarantees be generously covered by the Bank's other claims, including its liquid holdings, loan portfolio and the unpaid subscriptions of countries which are less strong financially. The table below shows the degree of such "coverage" under various ratios of funded debt to (relevant) callable capital guarantees.1/

Alternative Patterns of Coverage for Funded Debt

	Ratio of Funded Debt to "Relevant" Callable Capital			
	1.25	1.50	2.00	3.00
Disbursed Loans Plus Liquid Holdings as a Multiple of "Uncovered" Funded Debt (minimum)/a	5.8	3.5	2.3	1.8
Maximum Percentage Loss on Loans and Liquid Holdings Consistent with Full Payment to Bondholders	83%	71%	57%	44%

/a Assumes a maximum ratio of funded debt to usable equity of 6 to 1. (See para. 69.)

1/ As shown in the footnote on page 26, disbursed loans (L) plus cash and securities (C) equal funded debt (D) plus usable equity (E). Hence disbursed loans plus liquid holdings as a multiple of uncovered funded debt will be $\frac{D+E}{X(D)}$ where X is the fraction of funded debt not covered by relevant callable capital guarantees. The multiple can be rewritten as $1/X + 1/X\ (\frac{E}{D})$. Since $(\frac{E}{D})$ is the reciprocal of the funded debt to usable equity ratio, it will reach its lowest level when the debt/equity ratio is at its maximum.

68. Just what degree of coverage may be required is obviously a matter of judgment which will be heavily influenced by considerations of market psychology. If 80% of funded debt is covered by callable capital considered relevant (i.e. a ratio of 1.25) then the remaining 20% of funded debt is very generously protected by the Bank's disbursed loans and liquid holdings (i.e., more than 5-fold coverage). If, on the other hand, 50% of funded debt is backed by "relevant" guarantees (i.e. a ratio of 2.00), bondholders would have to be persuaded that a lower degree of coverage by disbursed loans and liquid holdings (i.e., 2.3 times) is not merely adequate but unquestionably sufficient. Over time it should be possible to "educate" markets to the value of a loan portfolio which has not had a single loss in 30 years. As the strength of the loan portfolio comes to be recognized, investors may be expected to accept less than full coverage of funded debt by "relevant" callable capital subscriptions. This will clearly have to be a gradual process and, were the Articles to be amended, then a prudent first step might be to accept as a reasonable constraint on Bank operations that the part of funded debt not covered by the callable subscriptions of the Part I and capital-surplus oil-exporting countries be covered at least two or three times by the Bank's liquid holdings plus disbursed loans. This would imply a ratio of funded debt to these callable subscriptions of between 1.6 and 2.4.

69. If shareholders decide to limit their callable capital subscriptions to the full extent permitted by this constraint, then the ratio of the Bank's funded debt to usable equity should be kept to a level much closer to 6 than to 20 or 25. In such circumstances, it would appear that an operating limit of 6 or 7 to 1 would be generally in line with the risks the Bank faces. If, however, shareholders are willing to maintain their callable capital subscriptions at a level sufficient to preserve full coverage of funded debt by the callable subscriptions of the Part I and capital-surplus oil-exporting countries, then it should be acceptable to allow funded debt to increase to a level of say 10 or 15 times usable equity.

Summary

70. Thus, a careful assessment of the risk of loss on loans which the Bank could face in future years suggests that a prudent degree of protection can be afforded both shareholders and bondholders in a variety of ways. One broad option is to seek to maintain the Bank's image as a fully "government guaranteed" institution. This course would require that total callable capital be maintained at a level well above the Bank's funded debt, but it would also permit greater "leveraging" of usable paid-in capital, with funded debt going up to a maximum of perhaps 10 or 15 times usable equity. The other option is to limit the volume of callable capital guarantees by relying

upon the security afforded by the Bank's loan portfolio and liquid holdings. This course would permit callable capital to be kept at a level at or below the Bank's funded debt, depending on the fraction of total callable capital considered relevant by bondholders and the value which bondholders are willing to ascribe to the Bank's assets. But it might also mean that funded debt should be limited to perhaps 6 or 7 times usable equity.

B. Adequacy of IBRD Net Income

71. Another test of the adequacy of the Bank's capital structure is whether, in combination with existing financial charges, it generates an acceptable level of net income. Because the Bank maintains a very low (and sometimes negative) spread between its lending rate and cost of borrowing, net income is primarily determined by its volume of usable equity (since these resources are cost-free to the Bank). Hence, as funded debt increases as a multiple of usable equity, interest on borrowings will similarly increase in relation to net income. At some point, the desirability of maintaining net income at a minimum level in relation to the Bank's gross income and expenses--measured, for example, by the interest coverage ratio--will impose an upper limit on the ratio of funded debt to usable equity. This limit may be more or less confining than that derived from a consideration of potential losses on loans. Accordingly, in this section we review the rationale underlying the Bank's net income "target" and relate that "target" to the volume of usable equity required.

Rationale of the Net Income Target

72. Unlike commercial enterprises in which questions of leverage in the capital structure are in part related to the shareholders' return on equity, the Bank is not a profit-maximizing institution. Its shareholders do not seek a high level of net income for its own sake, though net income is welcomed because it permits transfers to IDA and because it constitutes an alternative to additional paid-in capital as a source of usable equity.

73. In establishing a lending rate--and hence an average spread on borrowed funds--the policy of the Bank has been to fix the rate "as low as is compatible with the maintenance of the Bank's ability to borrow at reasonable cost". In other words, the income sought is the minimum which will be considered to be satisfactory by bondholders. Just what this level might be is obviously a matter of judgment. Past reviews have referred to the desirability of net income showing a gradually rising trend over time.

74. The most recent review of Bank financial policies (R74-256) laid stress on the variable nature of the Bank's net income. If that income were predictable within a very narrow range, it might be permissible to adopt policies which promise a net income of, say, $100 million. But, in fact, various components of the Bank's gross income and expenses are subject to variation for reasons outside the Bank's control. Therefore, it is necessary to establish a high "pre-risk" target net income merely to ensure that the actually realized (or "post-risk") net income is not unacceptably low. Setting an appropriate pre-risk income target thus requires an appraisal of (a) what the income risks are and (b) what is acceptable as a "post risk" income.

Identification of Income Risks

75. The major risks affecting future net income were identified in the IBRD Financial Policies paper (R74-256) and were quantified for FY80 and FY85. A detailed examination has now been made of the particular risks affecting income from loans arising both from reschedulings and temporary interruptions in debt service. An attempt has been made to quantify these risks, as well as the others cited in the IBRD Financial Policies paper, as fractions of the Bank's projected interest on borrowings. Thus, for example, a year long interruption in interest payments by borrowers holding 10 percent of the Bank's disbursed loans could reduce net income from, say, 20 percent of interest on borrowings to 9 percent, i.e. could reduce the interest coverage ratio from 1.20 to 1.09. By expressing the net income objective in this way, it can be converted from an absolute amount to a minimum target for the Bank's interest coverage ratio.

76. The table below quantifies the various risks. A simple summation of the risks would suggest that fluctuations on the order of 20 percent of interest on borrowings (reducing interest coverage from, say, 1.25 to 1.05) could be expected. However, it is extremely unlikely that all the risks would materialize in a single year. Moreover, as indicated in the table, a major part of the risk is due to temporary interruptions in payment occasioned by debt crises. This risk is self-correcting in a sense that the others are not: income which is not collected in one year will be collected in a subsequent year. Depending on the circumstances, the income in question might properly continue to be accrued and included in reported income, though if the amounts were to become significant, they would have to be noted in the Bank's accounts.

Potential Fluctuations in Bank Income and Expenses
(as fraction of interest on borrowings)

	FY80	FY85
Fluctuation in Income from Securities	±.04	±.02
Reduction in Income from Loans		
- due to temporary interruptions/a	up to -.10	up to -.10
- due to other causes/a	approx.-.03	approx.-.03
Increase in Administrative Expenses	up to -.01	up to -.01
Variation in Interest on Borrowings (Net)	±.02	±.02

/a For detailed assumptions underlying these estimates, see Annex 3.

The Bondholders' Perspective

77. A bondholder's assessment of any particular level of net income or interest coverage ratio is largely a subjective matter. A basic concern is that the Bank's ability to meet both principal and interest payments be neither jeopardized nor even appear to be jeopardized. The interest coverage ratio has been used in this connection to measure the likelihood that interest payments may be threatened through a decline in net income.

78. However, to properly interpret the interest coverage ratio in the case of the Bank, it is essential to take into account not only the stability of its income--a feature which it shares with other institutions such as public utilities--but also the very large liquid holdings which it maintains. These holdings of cash and securities make it very misleading to compare the Bank with other institutions which do not have such a ready source of cash. If, in a given year, the Bank's net income were to drop to a very low level or even become negative, the Bank would be able to continue meeting its interest payments by drawing down its liquid holdings which would amount to 10 or 20 times any conceivable deficit in interest coverage. Because net income is so small in relation to liquid holdings, the cash flow consequences would be relatively unimportant. The real danger is not that a loss of income would prevent the Bank from servicing its debt, but that the loss would reduce the Bank's ability to continue borrowing and thereby provoke a liquidity crisis.

79. Whether any particular level of income (or loss) would adversely affect the Bank's ability to continue borrowing and for how long is likely to be influenced by the circumstances in which it occurs. A negative net income would not necessarily be interpreted as a sign of imprudent financial management if the reasons for the loss were obviously temporary, reversible and could not reasonably have been foreseen. Exchange adjustments would fall into this category[1/] as, perhaps, would an interruption in debt service due to unforeseen political turmoil. But if a negative net income were to occur as a result of events which could reasonably have been foreseen and which could last for several years, then the Bank's standing in financial markets would be bound to suffer.

80. This line of reasoning suggests that a rational case could be made for accepting a pre-risk interest coverage target on the order of 1.10. Such a target would virtually assure the Bank of a positive "post-risk" net income, unless there were to be a major temporary interruption in debt service. Such temporary interruptions could in turn be readily accommodated by drawing upon the Bank's liquid holdings. Provided the losses were indeed temporary, drawing down liquid holdings would not represent a liquidation of assets to meet current obligations, but rather a use of the liquidity reserve to smooth fluctuations in an otherwise satisfactory net income stream.

81. This line of argument is open to the criticism that what really matters is not how the capital markets would appraise the Bank if bond buyers were fully informed about the Bank's operations and financial strength but rather how the markets do in fact assess the soundness of the Bank, even if this assessment is based upon incomplete or inaccurate information. A partial answer to this criticism is that, over time, it should be possible to educate financial markets to the extraordinary strength of the Bank's financial structure compared to that of other financial institutions.

Implications for the Bank's Income Target

82. As noted in para. 76, a simple summation of all the income risks--including those which are strictly temporary--would imply a maximum fluctuation of about 20% of interest on borrowings and thus require an interest coverage target of approximately 1.20 (pre-risk) to assure a positive net income. However, it is exceedingly unlikely that all the adverse risks would materialize in the same year. There-

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1/ Exchange losses are charged directly to the Bank's reserves and are not shown as a charge against current income.

fore it appears that a "pre-risk" interest coverage target of 1.10 could be adequate. Of course such a target would not completely eliminate the risk of temporary loss. A pre-risk income target higher than this minimum may therefore be desirable at least for the next few years. This would have the desirable effect of slowing the rate at which the interest coverage ratio declines over the remainder of this decade. Because of uncertainty about just what the interest coverage ratio for the Bank should be, the financial markets may well be as concerned with the rate and direction of change in that ratio as with the absolute level. As shown in the table below, approval of a Selective Capital Increase (with 10% paid in) would keep the "pre-risk" ratio at or above 1.16 through FY80.

Projected (Pre-Risk) Interest Coverage Ratio

	FY75	FY76	FY77	FY78	FY79	FY80
No Capital Increase	1.36	1.23	1.18	1.16	1.14	1.13
Selective Capital Increase	1.36	1.23	1.18	1.17	1.16	1.16

Implications for the Debt/Equity Ratio

83. In the longer run, it should not be necessary to build into the permanent capital of the Bank a ratio of funded debt to usable equity which would foreclose the possibility of temporary income loss even under the most exceptional circumstances.1/ Much will depend on the reaction of the financial markets to the substantially lower levels of interest coverage expected in FY76 and FY77 and our ability to persuade the markets (and the rating services) that these lower levels still assure bondholders of more than adequate projection. Were a decision to be made to maintain a target interest coverage ratio of 1.20 (with a spread between the lending rate and cost of borrowing of .25%), the maximum ratio of funded debt to usable equity in the mid-80s could not exceed 4.4 to 1.

84. The upper limit on the debt/equity ratio which appears appropriate in relation to income risks can be more restrictive than that derived from consideration of potential losses on loans.

1/ Maintaining an interest coverage target much above 1.10 would be likely to result in very high absolute levels of net income in the mid-80s. In FY85, for example, a (post-risk) interest coverage ratio of 1.20 would correspond to a net income of more than $800 million.

In other words, a degree of leverage in the Bank's capital structure which would be prudent in relation to loan losses may nevertheless expose the Bank to temporary income losses. Some increase in leverage could be obtained through raising the spread on lending, as shown in the table below, but this alone cannot alter the basic choice which shareholders must make: either paid-in capital can be maintained at a level sufficient to avoid the risk of temporary income loss, or paid-in capital can be more highly leveraged with the attendant risk that temporary income losses may occur and that the Bank's standing in financial markets may suffer at least a temporary setback.

Maximum Ratios of Funded Debt to Usable Equity (FY85)/a

	Int. Coverage of 1.20		Int. Coverage of 1.10	
	Spread of .25%	Spread of .75%	Spread of .25%	Spread of .75%
Funded Debt/Usable Equity (maximum)	4.4	5.4	8.2	11.9

/a Assumes Bank commitments and amounts due to IDA as in Annex Tables 1 and 2.

85. As in the case of protection against losses on loans, the interpretation the financial markets place on the Bank's income results may be expected to depend on the level of callable capital. If the callable capital is kept high in relation to funded debt--and the Bank is perceived as effectively "government guaranteed"--then the risk that a low or negative income will interfere with continued Bank borrowings should be reduced. Thus the shareholders can reduce the risk of a call on their unpaid subscriptions either by maintaining generous coverage of funded debt by those subscriptions or by keeping usable equity high in relation to funded debt.

C. Amending the Statutory Limit

86. In considering possible amendment of Article III, Section 3 it is useful to review, first of all, what the implications of the present limit are for the Bank's capital structure. Against this background it will be possible to assess the extent to which amendment of the Articles could reasonably substitute for an increase in Bank capital subscriptions, either paid-in or callable. Finally, we may consider the question of whether, in the present environment, it is advisable to seek amendment of the Articles even if it would violate no rational financial constraint to do so.

Implications of the Present Statutory Limit

87. The present statutory limit does not impose a ceiling on the Bank's funded debt. What the limit does do is require that disbursed loans not be more than the sum of the Bank's unimpaired subscribed capital and reserves. Since funded debt and usable equity, taken together, must finance the total of disbursed loans and liquid holdings, the limit implies that funded debt may never exceed the sum of: (a) cash and securities (b) the callable portion of subscribed capital, and (c) the fraction of paid-in capital which has not been released for use in Bank operations.1/

88. What this limit implies in terms of a ratio between funded debt and usable equity depends on the level of Bank reserves and of liquid holdings, as demonstrated in the table below. If reserves were 75% of paid-in capital, then the maximum debt/equity ratio permitted under the statutory limit would be 6.7 to 1. If reserves were larger, say 1.5 times paid-in capital, the maximum debt/equity ratio would fall to 4.6 to 1.

Implications of the Statutory Limit for the Bank's Maximum Debt/Equity Ratio

	Reserves as % of Paid-in Capital			
	75%	100%	150%	200%
Maximum ratio of funded debt/ usable equity/a	6.7	5.8	4.6	3.8

/a Assumes receivable from subscribed capital is 15% of paid-in capital and that paid-in capital is 10% of subscribed capital. Cash and securities are assumed to be 15% of disbursed loans, which is the approximate relationship projected in the late 1980s.

1/ The balance sheet identity requires that liquid holdings (C) + disbursed loans (L) equal funded debt including amounts due to IDA (D) + usable equity (E). The statutory limit requires that disbursed loans (L) be less than subscribed capital, which is 10 times paid-in capital (A) plus reserves (R). Hence $C + (10A + R) \geq D + E$ but since $E = A + R - F$, where F is the amount of paid-in capital not yet released, it follows that $C + 9A + F \geq D$.

At present, reserves are 70% of paid-in capital, but they are projected to rise to 1.3 times paid-in capital over the next ten years, if there is no increase in paid-in capital. With the Selective Capital Increase, the ratio would be about 1.1 in FY85. In practical terms, therefore, the statutory limit implies a maximum debt/equity ratio of about 5 to 1.

89. The statutory limit also implies that funded debt may not exceed about 1.2 times total callable capital subscriptions. Since the Part I countries plus the capital-surplus oil-exporting countries account for about 70% of callable capital subscriptions, the ratio of funded debt to these presumably "relevant" subscriptions is about 1.7. The implication of this is that disbursed loans and liquid holdings will always provide nearly 3-fold coverage of the portion of funded debt which is not backed by "relevant" guarantees.

Scope for Amending the Statutory Limit

90. If the capital structure implications of the present statutory limit are compared with the targets which emerge from a review of the specific risks the Bank faces, it is apparent that the limit is, in some respects at least, both anomalous and unduly restrictive.

91. The anomaly can be seen in the inverse relationship implied by the statutory limit between the level of Bank reserves and the maximum permissible debt/equity ratio. If the Bank had no reserves at all a maximum debt/equity ratio of more than 10 to 1 would be permitted by the statutory limit. If reserves were to grow to twice the level of paid-in capital, the maximum permissible ratio would fall to just under 4 to 1.

92. The anomaly was disregarded by the framers of the Bank's Articles of Agreement in their concern to assure the acceptability of the Bank's obligations (whether as a guarantor, which was the Bank's principal intended role, or as a borrower) in the skeptical and even hostile market atmosphere that they correctly foresaw for the early post-World War II period. Specifically, they wanted to make sure that the subscribed capital would be adequate to pay off all obligations, taking account of the combined risks of defaults on loans as well as on calls on the unpaid portion of subscribed capital. Based on different assessments of these risks by different delegations to the Bretton Woods conference, the percentage limitations proposed ranged from 300% down to 75% of capital and reserves, and 100% was the compromise adopted. It was adopted in full recognition that it was based on extremely pessimistic assumptions. The limitation was probably a wise one in the circumstances of 1944, but is unduly restrictive today.

93. The restrictiveness of the present statutory limit is evident if the maximum debt/equity ratio permitted by the limit (about 5 to 1) is compared with the constraint that follows from an analysis of the risk of loss on loans (at least 6 or 7 to 1) or from adoption of a pre-risk interest coverage target of 1.10 (implying a ratio of about 8 to 1, if a "spread" of .25% is assumed). This suggests that, if it proves feasible over the next several years to "educate" the capital markets to the prudence of a 1.10 target, it may be possible to reduce the Bank's need for paid-in capital. Amendment of the Bank's Articles would not be required to take advantage of this possibility. What would happen in practice is that the proportion of the General Capital Increase required to be paid-in could be set at a level of less than 10%.

94. The implications of the present statutory limit for callable capital also appear more restrictive than would be necessary if investors could be convinced of the value of the Bank's loan portfolio. A reformulated limit might, for example, require that funded debt not exceed 1.4 times total callable capital or 2 times the callable capital subscriptions of the Part I and capital-surplus oil-exporting countries. This is equivalent to requiring that the "uncovered" funded debt will be covered more than twice over by the Bank's liquid holdings and loan portfolio.

95. A liberalization of the limit on funded debt from 1.2 to 1.4 times total callable capital (or from 1.7 to 2.0 times "relevant" callable subscriptions) would mean that the same volume of disbursed loans would require less callable capital as "backing". Therefore, instead of needing $30 billion in subscribed capital to "close the gap" through FY87, $27 billion of which would be callable, a revised limit could reduce callable capital requirements by about $8 billion. This would permit the General Capital Increase to be nearer to 25% ($10 billion) than to 46% ($19 billion), assuming prior approval of a Selective Capital Increase of about $10 billion.

Is Amendment of the Articles Advisable?

96. Provided the Executive Directors approve a "two-step" approach to an increase in the Bank's subscribed capital, there will be no need to reach a decision in the near future on whether or not to seek amendment of the Articles of Agreement. A Selective Capital Increase of about $10 billion would appear to be justified even if the limit on Bank operations stated in the Articles were amended. What is at stake in considering possible amendment is the size, timing and period of effectiveness of the subsequent General Capital Increase.

97. Nevertheless, it may be useful even at this stage to consider some of the factors which will have to be weighed in deciding whether to amend the statutory limit.

98. The primary concern must be how a change in the statutory limit would (a) affect the Bank's standing in financial markets, or (b) increase the risk of a call on the Bank's unpaid capital subscriptions. As we have seen, a case can be made for a reformulation of the present limit. But however rational the case may be, the fact that the limit was being changed might be subject to possible misinterpretation. The most dangerous misinterpretation would be that shareholders are less than fully committed to the continued operation of the Bank. What is critical in this regard is the market's perception. However unjustified it might be, a perception of waning shareholder support would certainly damage the Bank's financial standing. This suggests that if amendment of the Articles is to be sought at all, it should proceed in an environment in which the continued full support of the Bank's shareholders is unquestioned. Such an environment could arise in connection with the General Capital Increase itself, particularly if that increase were to involve a substantial volume of paid-in capital.

99. But even if amendment of the statutory limit could be achieved without damage to the Bank's standing in financial markets, it may not be in the shareholders' interest to make such a change. What would be "saved" through such a change is not real resources, since a reduction in the proportion of capital to be paid in can be achieved without amendment of the Articles. The "savings" would be entirely in the form of reduced callable capital subscriptions. These unpaid subscriptions have been costless in the past and, given appropriate Bank policies, should be costless in the future.1/

100. While the costs of providing additional callable capital thus appear to be minimal, the advantages associated with a high level of callable capital may be considerable. The major threat which could force a call on the Bank's unpaid capital subscriptions is an interruption in the Bank's ability to borrow. This could arise either because of a loss on loans or because of a temporary drop in net income. The real risk is not that the primary events will impair the Bank's ability to meet its obligations, but that the market will overestimate the negative consequences of the events and refuse to support continued Bank borrowing on reasonable terms. As long as

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1/ It is true of course that the "cost" of callable capital cannot properly be assessed only in financial terms. There are also associated political and legislative costs which only the member countries themselves are in a position to evaluate.

the callable capital subscriptions considered relevant by the financial markets exceed the Bank's funded debt, the likelihood of such an adverse bondholder reaction is minimized. Thus, by maintaining callable capital at a high level relative to funded debt, shareholders reduce the risk that the callable capital will ever have to be used. Another way of making the same point is to note that a high level of callable capital enables the Bank to make more efficient use of the real resources which shareholders supply--without a corresponding increase in risk to shareholders. The same amount of usable equity can be used to support a higher level of borrowing and lending, if the scale of callable capital leaves the bondholder with no doubt about the ultimate security of his investment.

Summary

101. The present statutory limit restricts the amount of funded debt to an amount approximately 1.2 times the callable capital and thus undervalues the security provided by the Bank's portfolio. Amendment of the Articles could alter this situation without extending the Bank's financial structure beyond a prudent level. But the overwhelming importance of maintaining the Bank's reputation in the financial markets, and the possibility that the advantages of maintaining a high level of callable capital in relation to funded debt may far outweigh the costs, combine to make it inappropriate to plan for amendment of the statutory limit at this time. In connection with consideration of a General Capital Increase, however, the possibility of amending the statutory limit should be reconsidered. In particular, in light of the circumstances prevailing at that time, consideration may be given to revising the statutory limit with or without a General Capital Increase, in the latter case to reduce the volume of callable capital then required and in the former to extend beyond FY87 the period for which the general increase will solve the Bank's subscribed capital problem.

Robert S. McNamara

IBRD: FINANCIAL PROJECTIONS WITHOUT SUBSCRIBED CAPITAL INCREASE[a/]
($ millions, fiscal years)

ANNEX Table 1

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
IBRD BALANCE SHEET AND INCOME STATEMENT																				
Cash and Securities	1167	1707	2049	2549	3218	3734	3824	5110	5967	6638	7265	7748	8137	8394	8824	8862	8917	9190	10089	11193
Receivable from Delayed Deliveries	234	141	43	17	11	43		120	0	0	60	150	180	156	176	188	183	210	211	207
Receivable from Loans[b/] - Part I	1712	1630	1357	1378	1433	1491	1427	1324	1220	1097	980	858	732	615	541	442	375	312	253	193
- Part II	5774	6907	8322	9754	11651	14185	16673	20578	24525	29380	34703	40590	47160	53866	60679	67615	74597	81638	88724	95840
- IFC[m/]	100	100	200	200	260	297	400	442	496	646	793	909	1031	1150	1275	1404	1546	1680	1405	1321
- Total	7586	8637	9879	11332	13344	15973	18500	22344	26241	31123	36476	42357	48923	55631	62495	69461	76518	83430	90382	97354
Receivable from Subscribed Capital	479	462	432	458	492	551	484	461	421	421	421	421	421	421	421	421	421	421	421	421
Land & Buildings Net of Deprec. Res.	29	34	37	37	36	58	59	58	58	58	58	58	58	58	58	58	58	58	58	58
Accruals, Prepayments & Other Assets	125	161	198	209	281	460	447	513	546	603	678	755	836	915	1001	1074	1142	1219	1299	1382
TOTAL ASSETS	9620	11144	12638	14602	17382	20819	23314	28606	33233	38843	44958	51489	58555	65575	72975	80064	87239	94528	102460	110615
Due to IDA	43	92	163	240	289	342	358	454	553	647	721	779	799	772	791	770	744	771	834	832
Undisbursed Loans	2371	3007	3905	4741	5480	6279	7978	10148	12638	14914	17086	19269	21725	24080	26130	28083	29716	31250	32931	34621
Funded Debt[c/]	3524	4222	4612	5441	6962	8925	9650	12407	14438	17495	21160	25217	29553	33971	38990	43815	49010	54335	60065	66021
Miscellaneous Liabilities	59	89	100	137	211	297	297	338	334	395	460	532	609	689	779	865	959	1054	1158	1265
Capital & - Special Reserves	291	292	292	292	292	292	292	293	293	293	293	293	293	293	293	293	293	293	293	293
Reserves - Retained Earnings[d/]	1038	1135	1250	1364	1487	1644	1696	1885	1891	2013	2152	2313	2490	2684	2906	3152	3431	3739	4093	4497
- Paid-In Capital	2294	2307	2316	2387	2661	3040	3043	3081	3086	3086	3086	3086	3086	3086	3086	3086	3086	3086	3086	3086
- Total	3623	3734	3858	4043	4440	4976	5031	5259	5270	5392	5531	5692	5869	6063	6285	6531	6810	7118	7472	7876
TOTAL LIABILITIES & CAPITAL	9620	11144	12638	14602	17382	20819	23314	28606	33233	38843	44958	51489	58555	65575	72975	80064	87239	94528	102460	110615
Total Uncalled Capital	20648	20733	20843	21484	23946	27357	27388	27729	27774	27774	27774	27774	27774	27774	27774	27774	27774	27774	27774	27774
Income from - Securities	66	88	149	187	187	215	267	383	443	479	528	570	603	629	654	672	676	689	733	808
- Loans: Part I[e/]	84	91	92	72	74	74	78	80	85	92	97	102	106	109	112	114	115	115	113	105
Part II	200	224	253	311	378	463	576	686	801	1029	1298	1617	1974	2348	2761	3221	3701	4176	4664	5153
Total	284	315	345	383	452	537	654	766	886	1121	1395	1719	2080	2457	2873	3335	3816	4291	4777	5258
Other Income	7	8	11	7	6	6	8	9	10	10	10	10	10	10	10	10	10	8	7	8
Less: Administrative Expenses	34	41	45	56	66	79	91	110	126	149	170	191	214	228	243	259	275	293	312	333
Interest on Borrowings	151	195	242	305	392	487	614	765	981	1229	1512	1832	2183	2550	2943	3379	3810	4243	4701	5186
Financial Expenses	2	3	4	4	4	6	8	8	9	10	12	15	19	24	29	33	38	44	49	52
Net Losses on Devaluation	23		-2	-2	-50	-81	54	-14	108											
NET INCOME	147	172	216	214	233	267	162	289	115	222	239	261	277	294	322	346	379	408	455	503
IBRD SOURCES AND APPLICATIONS																				
Net Income	147	172	216	214	233	267	162	289	115	222	239	261	277	294	322	346	379	408	455	503
Less: Transfer to IDA[d/]	10	75	100	100	110	110	110	100	110	100	100	100	100	100	100	100	100	100	100	100
Net Income Retained	137	97	116	114	123	157	52	189	5	122	139	161	177	194	222	246	279	308	355	403
Receipts of Capital Subscriptions	29	30	39	45	69	63	70	61	24	0	0	0	0	0	0	0	0	0	0	0
Repaid to IBRD on Loans - Part I[e/]	68	87	109	67	72	75	89	110	110	118	119	125	126	121	111	110	107	105	104	103
- Part II	168	211	220	252	312	380	398	459	573	637	765	907	1130	1383	1655	1989	2369	2786	3238	3735
- Total	236	298	329	319	384	455	487	569	683	755	884	1032	1256	1504	1766	2099	2476	2891	3342	3838
Borrowing by IBRD	735	1224	735	1368	1744	1723	1853	3510	3800	4400	5000	5700	6500	6746	7549	7286	7105	8588	8113	8263
Less: Debt Retirement	514	526	436	548	608	768	863	1027	1274	1343	1335	1643	2164	2328	2531	2461	1910	3263	2382	2308
Net Borrowing	221	698	299	820	1136	955	990	2483	2526	3057	3665	4057	4336	4418	5018	4825	5195	5325	5731	5956
Exchange Adjustment on Funded Debt	-6		90	10	385	1009	-267	274	-495											
Exchange Adjustment on Capital					171	257														
Receipts from Sale of Loans[f/]	65	52	195	27	29	25	27	48	25	25	25	25	25	25	25	25	25	25	25	25
Increase in Misc. Liabilities	6	30	11	37	74	86		41	-4	61	65	71	78	80	90	87	94	95	103	107
Payments to IDA over (-) or Under Transfer to IDA	-49	-49	-71	-77	-49	-53	-16	-96	-99	-94	-74	-58	-20	-27	-19	-21	-26	-27	-63	-2
TOTAL SOURCES	639	1254	1150	1448	2420	3060	1375	3761	2863	4115	4852	5405	5892	6194	7141	7261	8043	8671	9617	10327
Disbursement on Loans	772	762	772	955	1202	1209	1608	2096	2789	3386	4090	4755	5392	5882	6605	7138	7925	8293	8638	9145
Exchange Adjustment on Loans	-7	2	96	8	484	1101	-266	195	-651											
Real Estate Investment	5	5	3			22	1													
Increase in Accrued & Prepaid Exp.	7	38	35	13	72	179	-13	65	9	57	75	76	81	79	86	73	68	78	80	82
TOTAL APPLICATIONS	777	807	906	976	1758	2511	1330	2355	2147	3443	4165	4831	5473	5961	6691	7211	7993	8371	8718	9227
Cash, Securities & Delayed Deliveries: Year End Balance	1401	1848	2092	2566	3229	3778	3824	5230	5967	6638	7325	7898	8317	8550	9000	9050	9100	9400	10300	11400
MEMORANDUM ITEMS																				
IBRD - Commitments[g/]	847	1399	1580	1921	1966	2051	3218	4320	5200	5500	6100	6800[l/]	7700	8085	8489	8914	9359	9827	10319	10835
- Net Transfer to Current Borrowers[h/]	146	129	160	268	441	271	415	783	1229	1514	1843	2056	2123	1986	2022	1749	1663	1232	732	254
- Loans Disb. & Outstanding	5215	5630	5884	6591	7864	9694	10522	12196	13603	16209	19390	23088	27198	31551	36365[l/]	41378	46802	52180	57451	62733
- Sub. Capital & Total Res.	24269	24497	24702	25526	28389	32336	32418	32988	33044	33166	33305	33466	33643	33837	34059	34305	34584	34892	35246	35650
- Usable Equity[j/]	3144	3272	3426	3585	3948	4425	4547	4798	4849	4971	5110	5271	5448	5642	5864	6110	6389	6697	7051	7455
- Usable Equity as % of Disbursed Loans & Liquid Holdings	49.3	44.6	43.2	39.2	35.6	33.0	31.7	27.7	24.8	21.8	19.2	17.1	15.4	14.1	13.0	12.2	11.5	10.9	10.4	10.1
- Funded Debt/Callable Capital[k/]	.24	.29	.32	.37	.43	.49	.52	.66	.76	.92	1.11	1.32	1.54	1.76	2.02	2.26	2.53	2.80	3.09	3.39
- Debt/Equity Ratio (excl. call capital)[l/]	1.13	1.32	1.39	1.58	1.84	2.09	2.20	2.68	3.09	3.65	4.28	4.93	5.57	6.16	6.78	7.30	7.79	8.23	8.64	8.97
- Interest Coverage Ratio	2.12	1.88	1.88	1.70	1.48	1.38	1.35	1.36	1.23	1.18	1.16	1.14	1.13	1.12	1.11	1.10	1.10	1.10	1.10	1.10

a/ Projections assume:
- Annual transfers to IDA out of IBRD income are $100 million (including grants for agricultural research and onchocerciasis control) from FY77 on.
- Liquidity equal to at least 40% of the next three years' borrowing requirements.
- Borrowing costs of 8.5% in FY76, and 8.25% thereafter.
- A lending rate of 8.5%.
- Rates of return on security investments of 7.3% in FY76, and 7.6% thereafter.
- Commitments totalling $500 million in FY76 from the Intermediate Financing Facility.
- No substantial increase in capital.
- The assumed rate of inflation after FY79 is 5% p.a. The rates for FY76 - 10.5%, FY77 - 8.2%, FY78 - 6.6%, FY79 - 5.5%.
- After FY80, IBRD commitments remaining constant in real terms.

b/ Amounts receivable from loans include undisbursed portions. Loans guaranteed by IDA Part I countries are included in the Part I category.

c/ IBRD funded debt includes delayed deliveries.

d/ Transfers to IDA out of IBRD net income have been charged to IBRD retained earnings, and added to IDA's resources in the year of authorization, i.e. the year following that in which the income was earned.

e/ Loans guaranteed by Part I countries and from IBRD to IFC are included in the Part I category.

f/ Sales of Part II loans are assumed to be $25 million p.a.

g/ IBRD commitments shown here are to countries, i.e. excluding loans to IFC.

h/ Net transfer to current borrowers indicates disbursements, net of repayments and loan charges, paid to both the Bank and third parties. Includes IBRD loans to Part II countries guaranteed by Part I members.

i/ Unless amended, the Article III, Section 3 limitation on loans disbursed and outstanding would be reached in FY82. Without an increase in capital subscriptions by that time, the Bank would have to cease new commitments no later than FY79 to avoid disbursements which would exceed the limit.

j/ Usable Equity equals paid-in capital and reserves less receivable from subscribed capital.

k/ Funded Debt plus Due to IDA divided by callable capital of Part I countries and capital-surplus oil-exporting countries.

l/ Funded Debt plus Due to IDA divided by Usable Equity.

m/ These figures do not take into account a possible IFC capital increase and a resulting greater volume of commitments which would reduce IBRD loans to IFC in FY77-83 but increase them after FY83.

IBRD: FINANCIAL PROJECTIONS WITH SUBSCRIBED CAPITAL INCREASE OF $10 BILLION[a/]
($ millions, fiscal years)

ANNEX Table 2

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
IBRD BALANCE SHEET AND INCOME STATEMENT																				
Cash and Securities	1167	1707	2049	2549	3218	3734	3824	5110	5967	6540	7220	7681	8071	8296	8727	8716	8721	9042	9844	10898
Receivable from Delayed Deliveries	234	141	43	17	11	43		120			60	150	180	154	173	184	179	208	206	202
Receivable from Loans[b/] - Part I	1712	1630	1357	1378	1433	1491	1427	1324	1220	1097	980	858	732	615	541	442	375	312	253	193
- Part II	5774	6907	8322	9754	11651	14185	16673	20578	24525	29380	34703	40590	47160	53866	60679	67615	74597	81638	88724	95840
- IFC[m/]	100	100	200	200	260	297	400	442	496	646	793	909	1031	1150	1275	1404	1546	1680	1405	1321
- Total	7586	8637	9879	11332	13344	15973	18500	22344	26241	31123	36476	42357	48923	55631	62495	69461	76518	83430	90382	97354
Receivable from Subscribed Capital	479	462	432	458	492	551	484	461	421	421	508	594	681	681	681	681	681	681	681	681
Land & Buildings Net of Deprec. Res.	29	34	37	37	36	58	59	58	58	58	58	58	58	58	58	58	58	58	58	58
Accruals, Prepayments & Other Assets	125	163	198	206	281	460	447	513	546	600	675	748	828	906	992	1064	1130	1210	1287	1369
TOTAL ASSETS	9620	11144	12638	14602	17382	20819	23314	28606	33233	38742	44997	51589	58742	65726	73126	80164	87288	94629	102458	110562
Due to IDA	43	92	163	240	289	342	358	454	553	647	721	779	799	772	791	770	744	771	834	832
Undisbursed Loans	2371	3007	3905	4741	5480	6279	7978	10148	12638	14914	17086	19269	21725	24080	26130	28083	29716	31250	32931	34621
Funded Debt[c/]	3524	4222	4612	5441	6962	8925	9650	12407	14438	17395	20860	24617	28653	32965	37905	42595	47648	52923	58444	64230
Miscellaneous Liabilities	59	89	100	137	211	297	297	338	334	393	454	521	593	670	760	843	934	1029	1128	1234
Capital & - Special Reserves	291	292	292	292	292	292	292	293	293	293	293	293	293	293	293	293	293	293	293	293
Reserves - Retained Earnings[d/]	1038	1135	1250	1364	1487	1644	1696	1885	1891	2014	2164	2359	2593	2860	3161	3493	3866	4276	4741	5265
- Paid-In Capital	2294	2307	2316	2387	2661	3040	3043	3081	3086	3086	3419	3752	4086	4086	4086	4086	4086	4086	4086	4086
- Total	3623	3734	3858	4043	4440	4976	5031	5259	5270	5393	5876	6404	6972	7239	7540	7873	8246	8656	9121	9645
TOTAL LIABILITIES & CAPITAL	9620	11144	12638	14602	17382	20819	23314	28606	33233	38742	44997	51589	58742	65726	73126	80164	87288	94629	102458	110562
Total Uncalled Capital	20648	20733	20843	21484	23946	27357	27388	27729	27774	27774	30771	33768	36774	36774	36774	36774	36774	36774	36774	36774
Income from - Securities	66	88	149	187	187	215	267	383	443	475	523	566	598	622	647	663	663	676	718	788
- Loans: Part I[e/]	84	91	92	72	74	74	78	80	85	92	97	102	106	109	112	114	115	115	113	105
Part II	200	224	253	311	378	463	576	686	801	1030	1298	1617	1974	2348	2761	3221	3701	4176	4664	5153
Total	284	315	345	383	452	537	654	766	886	1122	1395	1719	2080	2457	2873	3335	3816	4291	4777	5258
Other Income	7	8	11	7	6	6	8	9	10	10	10	10	10	10	10	10	10	8	7	8
Less: Administrative Expenses	34	41	45	56	66	79	91	110	126	149	170	191	214	228	243	259	275	293	312	333
Interest on Borrowings	151	195	242	305	392	487	614	765	981	1225	1496	1795	2121	2471	2857	3285	3704	4129	4577	5046
Financial Expenses	2	3	4	4	4	6	8	8	9	10	12	15	19	23	28	32	37	43	47	51
Net Losses on Devaluation	23		-2	-2	-50	-81	54	-14	108											
NET INCOME	147	172	216	214	232	267	162	289	115	223	250	294	334	367	402	432	473	510	566	624
IBRD SOURCES AND APPLICATIONS																				
Net Income	147	172	216	214	233	267	162	289	115	223	250	294	334	367	402	432	473	510	566	624
Less: Transfer to IDA[d/]	10	75	100	100	110	110	110	100	110	100	100	100	100	100	100	100	100	100	100	100
Net Income Retained	137	97	116	114	123	157	52	189	5	123	150	194	234	267	302	332	373	410	466	524
Receipts of Capital Subscriptions	29	30	39	45	69	63	70	61	24		246	246	247							
Repaid to IBRD on Loans - Part I[e/]	68	87	109	67	72	75	89	110	110	118	119	125	126	121	111	110	107	105	104	103
- Part II	168	211	220	252	312	380	398	459	573	637	765	907	1130	1383	1655	1989	2369	2786	3238	3735
- Total	236	298	329	319	384	455	487	569	683	755	884	1032	1256	1504	1766	2099	2476	2891	3342	3838
Borrowing by IBRD	735	1224	735	1368	1744	1723	1853	3510	3800	4300	4800	5400	6200	6640	7472	7151	6962	8539	7895	8087
Less: Debt Retirement	514	526	436	548	608	768	863	1027	1274	1343	1335	1643	2164	2328	2531	2461	1910	3263	2375	2300
Net Borrowing	221	698	299	820	1136	955	990	2483	2526	2957	3465	3757	4036	4312	4941	4690	5052	5276	5520	5787
Exchange Adjustment on Funded Debt	-6		90	10	385	1009	-267	274	-495											
Exchange Adjustment on Capital					171	257														
Receipts from Sale of Loans[f/]	65	52	195	27	29	25	27	48	25	25	25	25	25	25	25	25	25	25	25	25
Increase in Misc. Liabilities	6	30	11	37	74	86		41	-4	59	61	66	72	78	89	84	91	94	99	104
Payments to IDA over (-) or Under Transfer to IDA	-49	49	71	77	49	53	16	96	99	94	74	58	20	-27	19	-21	-26	27	63	-2
TOTAL SOURCES	639	1254	1150	1448	2420	3060	1375	3761	2863	4013	4905	5379	5891	6159	7141	7210	7992	8723	9515	10276
Disbursement on Loans	772	762	772	955	1202	1209	1608	2096	2789	3386	4090	4755	5392	5882	6605	7138	7925	8293	8638	9145
Exchange Adjustment on Loans	-7	2	96	8	484	1101	-266	195	-651											
Real Estate Investment	5	5	3			22	1													
Increase in Accrued & Prepaid Exp.	7	38	35	13	72	179	-13	65	9	54	75	73	79	78	86	72	67	79	78	81
TOTAL APPLICATIONS	777	807	906	976	1758	2511	1330	2355	2147	3440	4165	4828	5471	5961	6691	7210	7992	8373	8715	9226
Cash, Securities & Delayed Deliveries: Year End Balance	1401	1848	2092	2566	3229	3778	3824	5230	5967	6540	7280	7831	8251	8450	8900	8900	8900	9250	10050	11100
MEMORANDUM ITEMS																				
IBRD - Commitments[g/]	847	1399	1580	1921	1966	2051	3218	4320	5200	5500	6100	6800	7700	8085[l/]	8489	8914	9359	9827	10319	10835
- Net Transfer to Current Borrowers[h/]	146	129	160	268	441	271	415	783	1229	1514	1843	2056	2123	1986	2022	1749	1663	1232	732	254
- Loans Disb. & Outstanding	5215	5630	5884	6591	7864	9694	10522	12196	13603	16209	19390	23088	27198	31551	36365	41378	46802[l/]	52180	57451	62733
- Sub. Capital & Total Res.	24269	24497	24702	25526	28389	32336	32418	32988	33044	33167	36647	40172	43746	44013	44314	44647	45020	45430	45895	46419
- Usable Equity[j/]	3144	3272	3426	3585	3948	4425	4547	4798	4849	4972	5368	5810	6291	6558	6859	7192	7565	7975	8440	8964
- Usable Equity as % of Disbursed Loans & Liquid Holdings	49.3	44.6	43.2	39.2	35.6	33.0	31.7	27.7	24.8	21.9	20.2	18.9	17.8	16.5	15.2	14.4	13.6	13.0	12.5	12.2
- Funded Debt/Callable Capital[k/]	.24	.29	.32	.37	.43	.49	.52	.66	.76	.92	1.00	1.08	1.17	1.33	1.53	1.72	1.91	2.12	2.35	2.57
- Debt/Equity Ratio (excl. call capital)[l/]	1.13	1.32	1.39	1.58	1.84	2.09	2.20	2.68	3.09	3.63	4.02	4.37	4.68	5.16	5.64	6.03	6.40	6.73	7.02	7.26
- Interest Coverage Ratio	2.12	1.88	1.88	1.70	1.48	1.38	1.35	1.36	1.23	1.18	1.17	1.16	1.16	1.15	1.14	1.13	1.13	1.12	1.12	1.12

a/ Projections assume:
- Annual transfers to IDA out of IBRD income are $100 million (including grants for agricultural research and onchocerciasis control) from FY77 on.
- Liquidity equal to at least 40% of the next three years' borrowing requirements.
- Borrowing costs of 8.5% in FY76, and 8.25% thereafter.
- A lending rate of 8.5%.
- Rates of return on security investments of 7.3% in FY76, and 7.6% thereafter.
- Commitments totalling $500 million in FY76 from the Intermediate Financing Facility.
- A $10.0 billion increase in subscribed capital over the period FY78-80, resulting in a $740 million increase in usable paid-in capital.
- The assumed rate of inflation after FY79 is 5% p.a. The rates for FY76 - 10.5%; FY77 - 8.2%, FY78 - 6.6%, FY79 - 5.5%.
- After FY80, IBRD commitments remaining constant in real terms.

b/ Amounts receivable from loans include undisbursed portions. Loans guaranteed by IDA Part I countries are included in the Part I category.

c/ IBRD funded debt includes delayed deliveries.

d/ Transfers to IDA out of IBRD net income have been charged to IBRD retained earnings, and added to IDA's resources in the year of authorization, i.e. the year following that in which the income was earned.

e/ Loans guaranteed by Part I countries and from IBRD to IFC are included in the Part I category.

f/ Sales of Part II loans are assumed to be $25 million p.a.

g/ IBRD commitments shown here are to countries, i.e. excluding loans to IFC.

h/ Net transfer to current borrowers indicates disbursements, net of repayments and loan charges, paid to both the Bank and third parties. Includes IBRD loans to Part II countries guaranteed by Part I members.

i/ Unless amended, the Article III, Section 3 limitation on loans disbursed and outstanding would be reached in FY84. Without an increase in capital subscriptions by that time, the Bank would have to cease new commitments no later than FY81 to avoid disbursements which would exceed the limit.

j/ Usable Equity equals paid-in capital and reserves less receivable from subscribed capital.

k/ Funded Debt plus Due to IDA divided by callable capital of Part I countries and capital-surplus oil-exporting countries.

l/ Funded Debt plus Due to IDA divided by Usable Equity.

m/ These figures do not take into account a possible IFC capital increase and a resulting greater volume of commitments which would reduce IBRD loans to IFC in FY77-83 but increase them after FY83.

ANNEX 1

Impact of Financial Policy Changes On the Bank's Subscribed Capital Requirements

1. As indicated in paragraphs 27 and 28, this annex describes two basic approaches to reducing the Bank's subscribed capital requirements. The first consists of steps to increase the amount of net income retained. In this regard, the annex discusses the effects of: (a) a higher spread of the Bank's lending rate over its cost of borrowing; and (b) cessation of transfers of IBRD net income to IDA. The second category of actions consists of steps to reduce the volume of loans outstanding that result from a given level of commitments. In this regard, the annex describes: (a) possible alterations in loan terms; (b) changes in the sectoral composition of commitments; and (c) increased loan sales and prepayments.

Steps to Increase Retained Income

2. Additional retained income helps meet the Bank's capital requirement by substituting directly for additional paid-in capital or funded debt. It is important to note that under the present statutory limit additional retained earnings cannot be "leveraged" in the same way as additional paid-in capital when the latter represents only 10% (or less) of subscribed capital. That is, an extra dollar of retained earnings only permits the Bank to lend an equivalent amount, whereas an additional dollar of paid-in capital, as part of an increase in subscribed capital, brings with it the authority to borrow and lend nine additional dollars, thereby permitting ten dollars of additional lending for every dollar of paid-in capital. For this reason, the effects of a higher lending rate and cessation of IDA transfers on the Bank's subscribed capital requirements are not substantial.

3. Lending Rate Increase. Income from loans could be raised either by an across-the-board increase in the average spread of the lending rate over the cost of borrowing or by a more selective increase which would affect only part of the Bank's borrowers. The following table shows the impact of increasing the average spread on lending on new loans by 50 basis points, i.e. on present projections of borrowing costs at 8.25%, an increase in the lending rate from 8.5% to 9.0%, effective at the beginning of FY77. The calculation assumes that the whole of additional net income is retained in the Bank.

Impact of Increasing Average Spread on Lending by .50%

End of:	FY82	FY83	FY84	FY85	FY86	FY87
Cumulative Increase in Retained Earnings ($ m)	180	300	470	680	950	1280
As % of Subscribed Capital Requirements:						
- with Selective Capital Increase	/a	/a	26.4	10.1	8.2	7.8/b
- without Selective Capital Increase	7.8	4.2	3.8	3.9	4.3	4.7/b

/a Statutory limit exceeds loans disbursed and outstanding in these years.

/b These figures refer to capital requirements in FY87 of $16.3 and $27.1 billion, respectively. If the requirements are raised to the equivalent of the $30 billion figure cited in para. 23, the percentages here would be reduced from 7.8% to 6.7% and from 4.7% to 4.2%

4. Cessation of Transfers to IDA. Our current financial projections assume a continuing transfer of $100 million per annum to IDA out of Bank net income. If future transfers were to be discontinued, effective FY77, the Bank would initially gain $100 million per annum in retained earnings. Eventual savings would be even larger, however, reflecting the fact that actual drawings by IDA (which occur with a lag of several years because of the Bank-last provision) must be replaced with borrowed funds. The table below shows the cumulative impact on the Bank's capital position.

Impact of Stopping Transfer to IDA
(current $ million)

End of:	FY82	FY83	FY84	FY85	FY86	FY87
Cumulative Increase in Retained Earnings:-	650	770	890	1010	1140	1350
% of Subscribed Capital Requirements						
- With Selective Capital Increase	/a	/a	49.4	14.9	9.8	8.3/b
- Without Selective Capital Increase	28.3	10.8	7.3	5.8	5.1	5.0/b

/a Statutory limit exceeds loans outstanding in these years.
/b These figures refer to capital requirements in FY87 of $16.3 and $27.1 billion, respectively. If the requirements are raised to the equivalent of the $30 billion figure cited in para. 23, the percentages here would be reduced from 8.3% to 7.0% and 5.0% to 4.5%.

5. In assessing the importance of the various steps which might be taken to increase the subscribed capital and reserves, it is apparent that potential modifications in the Bank's lending rate and in its policy regarding transfers to IDA can by themselves have only a relatively minor impact on the Bank's capital problem. Even if the average lending rate on new loans were raised to 9% and all future transfers to IDA were discontinued, these actions by themselves would only reduce total capital needs in FY87 by about 10%.

Steps to Reduce Disbursed Loans

6. Modified Terms of Lending. Without altering the level of future Bank commitments, it is possible to reduce the volume of loans outstanding at future dates by altering the average grace period, final maturity or amortization schedule of new loans. At present the "typical" Bank loan has a 4-year grace period and a 20-year final maturity.1/ The table below shows the effects of changes in average loan terms on the amount of a loan outstanding at various intervals after the year of commitment.

1/ These are the median terms of all loans approved over the period FY70-74.

Effects of Different Loan Terms:
Annuity-type Repayments

Grace Period	Final Maturity	% Outstanding After 5 yrs./a	10 yrs.	15 yrs.	20 yrs.	Average Life
Current "Typical" Terms						
4	20	70	78	49	- -	10.17
Harder Terms						
4	18	69	72	36	-	8.62
3	18	66	70	35	-	8.32
2	18	64	68	34	-	8.03
2	15	60	54	-	-	5.95

/a On average, IBRD loans are only 73% disbursed after 5 years.

7. The volume of disbursed loans resulting from presently projected commitments could also be reduced by changing the amortization pattern from the present annuity-type amortization (equal annual payments of principal and interest) to equal annual installments of principal. Such a change in amortization pattern would reduce the average life of a "typical" IBRD loan from 10.17 years to 8.34 years, i.e. by about 18%. This change alone would reduce loans outstanding in FY87 by $5.2 billion, or 8.3%.

8. This accelerated amortization pattern would also tend to reinforce the effects of harder loan terms on loan outstanding in FY87. For example, with annuity-type repayments, a reduction in loan terms from the "typical" IBRD terms to 2 years grace and 15 years final maturity would reduce loans outstanding in FY87 by about 16%; with equal annual installments, the same hardening of terms reduces loans outstanding in FY87 by 22%.

9. The extent of reduction that would be acceptable is a matter of opinion. Major changes would, of course, substantially reduce the grant element of IBRD lending and the net outflow of funds to the Bank's borrowers. The combined effect of changing the loan amortization pattern to equal annual installments of principal and hardening terms by a two-year reduction in final maturity would reduce IBRD loans outstanding by about $6.8 billion in FY87.

Composition of Commitments

10. Project Loan Disbursement Rates. The overall rate of disbursement of IBRD loans is projected to increase slightly over the next five years as a result of shifts in the sectoral composition of IBRD lending. The effect of this shift to faster disbursing sectors on average is to increase the amount of loans outstanding for any given volume of commitments. The Bank could conceivably alter its projected lending programs to concentrate lending in slow-disbursing sectors. Such a step would, of course, cause distortions in the sectoral distribution of lending, and would have only a minor impact on the Bank's capital requirements. If the proportion of slow-disbursing sectors were to remain at the FY75 level, loans outstanding in FY87 would be reduced by about $0.5 billion or under 1%.

11. Program Loans. A high proportion of program loans has the effect of increasing the amount of loans outstanding for a given volume of commitments since the full amount of the loan is disbursed well before principal repayments begin. Changes in the presently projected amount of program loans, however, would have a negligible effect on reducing the amount of IBRD loans outstanding, because the proportion of IBRD Lending expected to be in the form of program loans is already small. Each percentage point increase in the share of Bank lending accounted for by program loans would increase FY87 disbursed loans by about $0.2 billion.

Loan Sales and Prepayments

12. A third type of action that could be taken to reduce the amount of loans outstanding without changing commitments is to: (a) increase participation of commercial lenders in IBRD loans; (b) increase sales of already disbursed loans; or (c) encourage prepayments by borrowers. Current IBRD projections assume that total loan sales, including participation agreements, will average $25 million per year.

13. Participation Agreements. Participation by commercial lenders in IBRD loans is unlikely to be substantial as long as the Bank's lending rate remains well below what borrowers' would have to pay if they borrowed on their own account. Moreover, even if participation could be made commercially attractive in some way (e.g. discounting), it might still compete with direct issues by the borrower. Also commercial lenders would normally prefer the shorter maturities, so that only participation agreements made in the period shortly before the capital constraint was to be reached would have much of an effect on the Bank's capital problem.

14. Sales from Portfolio. As in the case of participation agreements, IBRD portfolio sales are relatively unattractive investments for private lenders. There is, however, one important difference. In selling from portfolio the Bank would be able to select loans outstanding to countries which are not current borrowers (e.g. Japan or, in a few years, Iran and Venezuela). It would thus be possible to select obligations of highly creditworthy countries for whom the potential competition between direct borrowings and IBRD portfolio sales would not necessarily be a critical issue. The table below shows the proportion of disbursed loans in FY85 and FY87 projected to be outstanding to past borrowers or to countries that might "graduate" in the next several years if IBRD policy on lending to higher income countries were changed along the lines indicated in Annex 2 (i.e. to countries whose per capita income in 1972 prices is expected to exceed $850 in FY85 and FY87). Portfolio sales of relatively creditworthy borrowers might still be inhibited by interest rate factors and liquidity considerations.

Disbursed Loans to Past Borrowers and Potential "Graduates"

End of:	FY85		FY87	
	$ billion	%	$ billion	%
Past Borrowers	0.2	.4	0.1	.2
Prospective "Graduates"				
- past commitments	6.1	11.7	4.6	7.3
- future commitments	10.5	20.1	14.9	23.8

15. Prepayment or Acceleration Clauses. In discussions of the Bank's capital position, reference is frequently made to the desirability of obtaining prepayments from high income countries. The above table demonstrates that, as far as the impact on disbursed loan balances in the mid-80s is concerned, this is a trivial issue as applied to past borrowers (e.g. Japan). It is more important in relation to past commitments to prospective graduates, though the absence of any provision for renegotiation of terms puts the Bank in a very weak bargaining position. The possibility of inserting prepayment clauses or acceleration provisions in new loan agreements was considered and rejected in the Review of IBRD/IDA Program and Financial Policies (R74-256, paras. 81-83).

ANNEX 2

Alternative Ways of Reducing Future IBRD Commitments

1. This annex describes two different ways in which future IBRD commitments could be reduced other than through an across-the-board cut in lending to all borrowers. These are: (a) revision of the criteria for lending to higher income countries; and (b) change in the Bank's relationship to IFC.

Graduation of Higher Income Borrowers

2. The present policy on "graduation" of higher income borrowers was last reviewed in January 1975. That review reaffirmed the use of a per capita income of $1,000 (1972 prices) as a "rough benchmark for determining when continued IBRD lending demands special justification."

3. If a reduction in future Bank commitments were to be implemented through a change in the policy regarding "graduation," the current benchmark of $1,000 would have to be lowered substantially to have much of an impact. As an illustration, the following table shows the consequences of stopping new IBRD commitments to a country in the second year after that country's per capita income reaches $850 (1972 prices). Such a policy change would be likely to phase out loans to the following major borrowers over the next several years (with the year of final loan in parenthesis); Romania and Yugoslavia (FY76); Mexico (FY80), Brazil (FY84).

Impact of Alternative Graduation Policy
(current $ billion)

End of:	FY82	FY83	FY84	FY85	FY86	FY87
Disbursed Loans						
Present Projections	36.4	41.4	46.8	52.2	57.5	62.7
With $850 Cut-off	34.9	39.2	43.9	48.6	53.2	57.7
Difference	1.5	2.2	2.9	3.6	4.3	5.0
Difference as % of IBRD Capital Requirements						
- With Selective Increase	/a	/a	131.6	50.2	35.9	30.7/b
- No Selective Increase	65.2	31.0	23.8	20.8	19.3	18.5/b

/a Statutory limit exceeds loans outstanding in these years.
/b These figures refer to capital requirements in FY87 of $16.3 and $27.1 billion, respectively. If the requirements are rounded up to the equivalent of the $30 billion figure cited in para. 23, the percentages here would be reduced from 30.7% to 26.0% and from 18.5% to 16.7%.

New Relationship with IFC

4. At present, IFC relies entirely on the Bank for borrowed funds. Even if IFC were successful in negotiating a substantial capital increase, its capital structure would still not be as strong as that of the Bank, since IFC has no callable capital. Moreover, a large portion of IFC's assets are in the form of equity investments which are riskier than IBRD loans. As a result, the security that IFC could offer investors is much less than the Bank can offer and it is unlikely that IFC could borrow directly from private capital markets.

5. In any event, if no further Bank loans were made to IFC after FY76, disbursed loans at the end of FY85 would be reduced by only $1.2 billion, or about 2%.1/ These figures do not take into account the potential changes in IFC commitments and borrowings from the Bank which may occur in conjunction with IFC's proposed capital increase.

1/ Because current projections for IFC do not extend beyond FY85, there is an artificial (and unrealistic) reduction in loans outstanding to IFC in FY87 to $1.1 billion.

ANNEX 3

Assessment of Risks in the IBRD Loan Portfolio

A. Broad classification of the portfolio into risk categories

1. The first step in the analysis has been to carry out a detailed study of the balance of payments prospects of each borrower. The objective was to investigate the likelihood of economic circumstances which would be conducive to default. To avoid unduly pessimistic results, circumstances which were judged to have less than a 20% probability of occurrence were discarded. Potential default situations which might arise because a borrower was able, but unwilling, to meet its debt service obligations have been ignored, since analysis of the future incidence of such defaults is hardly possible. An arbitrary judgment about protection against deliberate defaults of this kind has been made in para. 62 of the main paper.

2. This risk analysis has involved the determination, country by country, of future needs for foreign currency, assuming maximum feasible compression of imports, and a comparison of these needs with an estimate of the minimum foreign exchange likely to be earned over a period of years under "reasonably pessimistic" assumptions. Assumptions were made about the maximum availability of external capital on reasonable terms. The hypothesis is made that the probability of substantial shortfalls in foreign exchange under these assumptions, over an extended period of time, is also the probability of a potential default situation. Cyclical shortages in foreign exchange receipts have been largely ignored, on the assumption that these could be made good by such mechanisms as access to IMF facilities and the drawing down of reserves below what would normally be regarded as a minimum level.

3. The analysis allowed borrowers to be grouped into three broad categories:

Category I: those presenting little or no risk of default;

Category II: those for which the risk of default is more substantial, but for which any consequential rearrangement of debt maturities could be expected to be at the current lending rates of the creditors.

Category III: those presenting a risk of default requiring concessional rescheduling.

Within Category II, the size and duration of the foreign exchange transfer problem was compared to the debt structure, country by country. For some Category II countries, it would appear possible that the problem could be resolved by stretching out short and medium-term credits without requiring rearrangement of long-term debt. Nevertheless, even in these cases there may be a risk to holders of the long-term debt of having to accept a moratorium on all payments while new arrangements were being worked out.

4. A comparison of the projected development of the IBRD loan portfolio through FY87, with the broad risk categories produced the following results:

Proportions of the IBRD Loan Portfolio Outstanding to Borrowers in Various Risk Categories

	Percentage share of the portfolio at the end of						
Risk Category	FY75	FY77	FY79	FY81	FY83	FY85	FY87
Category I (Virtually no risk of default	29.4	24.1	19.4	15.7	12.6	10.5	9.1
Category II (Some risk)	55.1	60.8	65.6	68.9	71.3	72.8	73.7
- of which, a risk of moratoria on payments for short periods	44.7	51.6	57.2	61.0	63.6	65.2	66.0
- of which, a risk of rescheduling at original interest rates	8.8	11.2	14.1	16.0	17.1	17.9	18.4
Category III (Some risk of default requiring concessional rescheduling)	15.5	15.1	15.0	15.4	16.1	16.7	17.2
	100.0	100.0	100.0	100.0	100.0	100.0	100.0

B. Hypothetical costs to IBRD of being involved in reschedulings

5. Theoretically, IBRD is at risk of being involved in rescheduling a portion of its Category II portfolio, and the whole of its Category III portfolio. However, any such rescheduling of its Category II portfolio by itself involves no direct financial costs, since the costs of any additional borrowings which may be made necessary by postponed receipts of principal, would be almost exactly offset by increased interest on loans outstanding (but there might be indirect effects, depending on the attitude that bondholders took of IBRD involvement in reschedulings even of a non-concessional nature). Any such indirect costs are not quantifiable and are not discussed further in this Annex.

6. In assessing the hypothetical costs to IBRD of being involved in any reschedulings of its Category III portfolio, it is assumed that the concessionality would be in the form of extended repayments of principal at interest rates considerably below IBRD's then current lending rate, but that there would be no direct forgiveness of any part of the principal outstanding. The direct financial effect on IBRD could thus take two forms:

(a) increased funded debt (assuming any given liquidity policy) giving rise to increased interest payments; and

(b) decreased interest from rescheduled loans.

One effect would thus be to increase costs, while the other would be to decrease gross income. Both would have the effect of lowering net income. To put these figures in a capital context, the results were converted into an effective loss of portfolio, through discounting techniques (using IBRD's current lending rate as the discount factor).

7. In arriving at an estimate of theoretically possible costs to IBRD, the probability of default was assessed and the degree of concessionality required was determined, for each Category III country. The effects on IBRD were then tested on models which reflect typical Bank-borrower financial relationships.1/ The results were:

(i) an average annual reduction in the interest coverage ratio of about 0.07; and

(ii) a cumulative discounted "loss" of the order of 5% of IBRD portfolio by the mid-80s.

8. The above estimates of theoretically possible costs to IBRD assume that borrowers seek, and creditors are willing to grant, the degree of concessionality in rescheduling perceived to be needed by the long-term foreign exchange constraints of the borrowers. These estimates should therefore be considered as upper limits. Moreover, so long as IBRD maintains its policy of not taking part in rescheduling agreements, concessional or otherwise, there is little risk of actually losing any income or capital on this account. For purposes of discussion in the main text, theoretical losses which lie midway between zero and those assessed in the preceding paragraph have been used, namely:

(i) an average annual reduction in the interest coverage ratio of about 0.03; and

(ii) a cumulative discounted "loss" of the order of 2.5% of IBRD portfolio by the mid-80s.

1/ The model assumed that the defaults would occur gradually over a 7-year period. If all defaults were assumed to occur at the same time, after the rapid increase in commitments had become fully converted into disbursed portfolio, the financial impact would be about 40% greater than indicated.

C. Protection against temporary moratoria on debt service receipts

9. There remains the risk that some reschedulings in Category II and III countries may not take place in an orderly manner. A borrower may feel obliged to impose a temporary moratorium on debt service payments to all creditors, even those--like IBRD--which expect to avoid being involved in the ultimate rescheduling agreement.

10. Temporary moratoria involve very small direct costs, if it can be assumed that the delayed principal payments will continue to earn interest. These losses would be equivalent to interest on the interest payments deferred, plus any losses which would result from any differential that might exist between IBRD's then current borrowing rate and the interest rate on the outstanding loans being deferred. However, the amounts involved are miniscule and can be ignored for all practical purposes.

11. However, there might be a cost to IBRD of being involved in a temporary moratorium if bondholders took a less sanguine view than IBRD of the temporary nature of the default. IBRD's liquidity portfolio provides some protection, in the sense that it gives some flexibility in timing of going to markets. But, in addition, it would be prudent to examine the impact of some involvement in temporary moratoria on cash revenues in the year of occurrence (even though IBRD liquid holdings would easily withstand any conceivable short-term losses which could arise from this cause).

12. What might be the amount of such temporary revenue interruptions? This is an extremely difficult question to answer since it is virtually impossible to predict the probability of occurrence of temporary delays in payment. It is possible that IBRD would totally avoid such involvement over an extended period; but it is possible to conceive of circumstances where it might be involved. A specific projection is simply not practical. With 3 IBRD borrowers each providing shares of income from loans in the region of 7% - 10% by the early 1980s, and a further 8 each providing shares above 3%, it is conceivable (although very unlikely) that the temporary interruption of income in any one year might amount to as much as 10% of interest and charges receivable.

ADDENDUM NOTE

At the time this Annex was finalized, detailed examination of all IBRD borrowers had not been completed, and the figures include some judgments made on an arbitrary basis. Detailed examination had been completed of 34 borrowers, which account for some 75% of the projected portfolio in FY87; moreover, they account for some 80% of that part of the portfolio which has been placed in the highest risk category (III). By the time of the Board discussion of this paper, it is expected that a total of 48 reviews will have been completed, including 93% of the total portfolio, and 94% of the Category III portion of it.

OFFICE MEMORANDUM

TO: The Executive Directors

DATE: February 9, 1978

FROM: P. N. Damry

SUBJECT: "Future Role of the Bank" - Statutory Limitation on Lending under the IBRD's Articles of Agreement

Attached for the information of the Directors is a technical note on the statutory limitation on lending. This was promised to the Directors at an earlier meeting on the IBRD General Capital Increase and is being circulated at this time, for discussion on a date to be determined.

attachment

2/8

February 9, 1978

TECHNICAL NOTE #6

Statutory Limitation on Lending under the IBRD's Articles of Agreement

Introduction

1. The purpose of this note is to consider whether or not it would be desirable to amend the IBRD's Articles of Agreement so as to permit a greater volume of lending with a given capital base. The possibility of amendment was examined in some detail just over two years ago in connection with a review of the IBRD's capital structure.[1/] At that time no firm recommendation was made, and no decision was taken, on the issue of possible amendment. Instead it was decided to proceed with the Selective Increase and to leave open the question of whether the Bank's longer term capital requirements should be dealt with through a General Increase, an amendment of the Articles, or some combination of these steps, supplemented perhaps by certain selective changes in financial policies.

2. While no formal decision was made, there did appear to be a general consensus that amendment of the Articles, if done at all, should be undertaken as a supplement to, rather than as a substitute for, a General Capital Increase. The operative policy question therefore would seem to be whether or not it would be desirable in conjunction with a General Capital Increase to amend the IBRD's Articles in order that such an increase might satisfy the IBRD's capital requirements for a more extended period than would otherwise be feasible.

1/ Review of IBRD Capital Structure; R75-215 dated November 5, 1975.

3. In examining this question it may be useful to take as a starting point the principal conclusions reached in the earlier review of the IBRD's capital structure. These conclusions were as follows:

(a) the case for amending the Articles depends upon the economies which might prudently be achieved in the level of unpaid (or callable) capital subscriptions. This is so because economies in the use of paid-in capital can be achieved without amendment of the Articles.

(b) when reasonable allowance is made for the value of all the Bank's assets -- including its loan portfolio -- it appears that the security provided to bondholders under the present Articles is more than adequate.

(c) while the level of callable capital required under the present Articles may therefore be excessive, the low cost of maintaining the required levels makes it far from obvious that amending the Articles would be a desirable step.

What is to be Gained by Amendment of the Articles?

4. To understand the first of these conclusions it is necessary to examine the part of the present Articles which limits the size of Bank operations. Article III, Section 3 (entitled "Limitations on Guarantees and Borrowings of the Bank") provides that "the total amount outstanding of guarantees, participations in loans and direct loans made by the Bank shall not be increased at any time, if by such increase the total would exceed 100 per cent of the unimpaired subscribed capital, reserves and surplus of the Bank." The effect of this provision has been to create a legal ceiling on IBRD lending.

5. In theory this ceiling can be raised either by increasing retained earnings[1/] or by increasing subscribed capital. But in practice the subscribed capital is so much larger than retained earnings that it becomes the primary determinant of the Bank's legal lending capacity. For instance, once the Selective Increase is completed, subscribed capital should be approximately $40 billion, while retained earnings will then be roughly $3 billion.

6. The principal advantage to be gained from amendment of the Articles is that subscribed capital would not have to be increased as frequently or by as large an amount in order to accommodate any given IBRD lending program. It should be emphasized that the legal ceiling on Bank lending is not directly affected by the division of subscribed capital between amounts paid-in and amounts subject to call. There is, of course, a potential indirect effect in that higher amounts of paid-in capital may lead to higher levels of net income and of retained earnings (provided there are no offsetting changes in the Bank's lending charges or in its transfers to IDA). But if it were felt that the present Articles were leading to excessive levels of paid-in capital, this effect could be avoided without amending the Articles by the simple expedient of reducing the proportion of the General Capital Increase which is to be paid in. This is what happened in the last General Increase approved in 1960. By agreement none of that increase was paid in, so that in effect the proportion of total subscribed capital paid in was reduced from 20% to 10%.

7. The real justification therefore for an amendment of the Articles is that it would permit smaller or less frequent increases in callable capital

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1/ The Articles refer to "reserves and surplus of the Bank", whereas the financial statements show both the Special Reserve and the General Reserve. For simplicity, the more familiar term "retained earnings" will be used in this paper.

subscriptions. The benefits to shareholders from reduced callable capital subscriptions are unlikely to be important in a financial sense. These unpaid subscriptions have not led to any expenditures by shareholders in the past and, barring unforeseen developments, should not lead to any expenditures in the future. Even in the extremely unlikely event that some calls were to be necessary in the future, it is almost inconceivable that such calls would be so large as to reach the limit imposed by shareholders' total uncalled subscriptions. In other words, economies in the level of total callable capital would almost certainly not affect the maximum expenditures required of shareholders.

8. As noted in the Capital Structure memorandum (p.39), the "cost" of callable capital cannot properly be assessed only in financial terms. There may also be associated political and legislative costs. Because of the scale of IBRD operations, the absolute size of subscribed capital increase needed under the present Articles to accomodate continued real growth in IBRD lending is large. What may be particularly difficult for governments to accept is not so much the thought that a large capital increase is required but that such an increase may only be sufficient to cover the IBRD's capital requirements for a relatively short period of time. It is in this context that amendment of the Articles might have some advantages.

"Cost" of Amending the Articles

9. If the principal benefit from amending the Articles is likely to be to enhance the political acceptability of IBRD capital increases, what would be the corresponding "costs" of amendment? The Capital Structure memorandum indentified the primary concerns associated with a change in the

statutory limit as being its effect on the Bank's standing in financial markets and its impact on the risk that a call on the Bank's unpaid capital subscriptions might be required. These are really two aspects of the same concern, namely the impact on investor confidence.

10. The Capital Structure memorandum explored in considerable detail the various ways in which the adequacy of the Bank's capital might be assessed by investors. For present purposes it may be sufficient to recall the main points which were made, without repeating the detailed analysis. Three aspects of the Bank's financial position were distinguished: (a) the extent to which its liabilities are secured by the claims it has on others; (b) the adequacy of its net income both in absolute terms and in relation to the interest due on its own debt; and (c) its capacity to deal with liquidity problems generated by interruptions in the borrowing program.

11. Asset Coverage. The adequacy of IBRD callable capital in relation to its liabilities (that is, its funded debt plus amounts due to IDA) has been a subject of concern throughout the Bank's history. In the early days of the Bank it was commonly assumed that IBRD borrowings could not exceed the callable capital of the United States without major risk to investor confidence. Indeed, when the first General Increase in IBRD capital subscriptions was proposed in 1959, the scale and timing of the increase were determined mainly by the perceived need to increase the callable capital -- and especially the callable capital of the United States -- so as to facilitate expanded IBRD borrowings. That situation reflected the strength of the U.S. dollar as well as the fact that the great bulk of Bank borrowings were then taking place in the United States.

12. During the 1960s and 1970s the Bank managed to diversify its borrowings and this, along with the evident increase in the strength of several industrial economies other than the United States, made it natural to draw the attention of investors to the callable capital of a larger group of countries. In FY72 the liabilities of the Bank exceeded the U.S. callable subscription for the first time. There were no adverse repercussions on the Bank's standing in financial markets.

13. The adequacy of IBRD callable capital was reviewed by the Executive Directors in April 1973.[1/] The projections made at that time showed IBRD funded debt reaching 75% of the callable capital subscriptions of Part I countries and New Zealand in FY78. It was suggested that an increase in callable capital prior to that time might be desirable even though it was thought to be "almost inconceivable that the value of the portfolio of loans would then appear so precarious as to make that ratio (i.e. 75%) unacceptable" (para. 23).

14. The Capital Structure memorandum once again emphasized the very generous protection which IBRD bondholders enjoy against erosion of asset values. On the basis of highly conservative assumptions, the memorandum concluded that future losses due to adverse economic developments would almost certainly not exceed 5% of the loan portfolio.[2/] Even if investors were to apply a discount factor to the loan portfolio which is much larger than this figure, the combination of claims which provide security for

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1/ Review of IBRD Financial Policies; R73-55, dated March 27, 1973.

2/ The basis for this conclusion is spelled out in Annex 3 to the Capital Structure memorandum. The most recent review of the quality of the IBRD loan portfolio suggests that even with extreme assumptions, losses in the next decade would not exceed 3.5% to 7% of projected disbursed loans.

IBRD obligations would still be quite substantial. A follow-up note to the Capital Structure memorandum[1/] presented a table summarizing the various sources of investor security. An updated version of that table is shown below.

Sources of Investor Security: FY79-83 [a/]

	FY79	FY80	FY81	FY82	FY83
Funded Debt & Due to IDA	25.0	28.6	32.8	37.7	42.5
Claims on "Financially Strong Countries"					
Callable Capital of Part I & Capital-Surplus Oil Countries	22.6	24.1	24.1	24.1	31.3
Liquid Holdings	9.1	9.4	9.5	10.0	10.7
Sub-total	31.7	33.5	33.6	34.1	42.0
Claims on Other Countries					
Callable Capital	10.3	11.4	11.4	11.4	14.7
Disbursed Loans [b/]	21.2	25.0	29.3	34.0	39.2
Sub-total	31.5	36.4	40.7	45.4	53.9
Total of All Claims	63.2	69.9	74.3	79.5	95.9

a/ Assumes a General Capital Increase of $35 billion with subscriptions taking place in FY83-85. Other assumptions are as in Table A1. Financial and Operating Data Book.
b/ Disbursed loans include some claims guaranteed by Part I countries.

On the basis of these figures there would seem to be no reason to modify the previously stated conclusion that levels of callable capital implied by continued application of the present Articles provide "more than adequate" protection to bondholders.

1/ IBRD Capital Increase; R75-215/3, dated December 23, 1975.

15. Interest Coverage. The Capital Structure memorandum also examined the implications of alternative capital structures for the adequacy of IBRD net income. Although the adequacy of income is an important aspect of the Bank's overall financial position, it is not directly relevant to the question of possible amendment of the Articles since, as noted in para. 6, it is paid-in rather than callable capital which directly affects net income.

16. Liquidity Position. Even if one accepts the proposition that the level of callable capital required by the present Articles of Agreement is more than adequate in terms of asset coverage, investors will also want to avoid the uncertainty and possible adverse market performance of IBRD bonds which could be triggered by a call on the unpaid portion of members' capital subscriptions. As noted in the Capital Structure paper (para. 100):

> The major threat which could force a call on the Bank's unpaid capital subscriptions is an interruption in the Bank's ability to borrow. This could arise either because of a loss on loans or because of a temporary drop in net income. The real risk is not that the primary events will impair the Bank's ability to meet its obligations, but that the market will overestimate the negative consequences of the events and refuse to support continued Bank borrowing on reasonable terms.

Callable capital is important in relation to this sort of risk because of its impact on investor confidence. The more that investors regard the Bank as effectively a government guaranteed institution the less likely it will be that adverse events may produce a cumulative and self-reinforcing loss of investor confidence. The great virtue of callable capital as an index

of government support is that it is clear and unambiguous; its meaning and value can be immediately grasped by investors who may otherwise be ignorant of the Bank's financial strengths.

17. In contrast to the relative simplicity of callable capital protection, it is quite complicated to measure satisfactorily the Bank's internal capacity to avoid a liquidity crisis or to deal with one should it arise. The essence of the issue is that the Bank does not fully fund its undisbursed commitments. In other words, at any point in time the sum of Bank liquid holdings and cash inflows projected for the following three years will be less than the cash outflows (mainly for disbursements and debt service) projected for the same period.[1/] In normal circumstances this difference is readily financed by new Bank borrowings. The risk arises because this new borrowing is not absolutely assured.

18. Clearly, there is some trade-off between dealing with liquidity risk by maintaining generous levels of callable capital and dealing with it by maintaining more complete funding of undisbursed commitments. To take an extreme example, if the Bank were to fully fund undisbursed commitments, or if the capital-exporting countries were to underwrite future IBRD borrowings to the extent required to bridge the gap between actual liquid holdings and full funding,[2/] then it would be unnecessary to maintain a high level of callable capital in order to protect against a cumulative and self-reinforcing loss of investor confidence.

1/ The present liquidity policy provides that liquid holdings should always be at least 40% of "borrowing requirements" (i.e. the difference between projected cash inflows other than borrowing and projected cash outflows) over the next three years.

2/ The gap between actual liquid holdings and full funding will depend upon the corrective action which the Bank takes in the event of a liquidity crisis. For example, part of the disbursements projected for the next three years are due to commitments which have not yet been approved and are therefore subject to control.

19. Indicator of Shareholder Support. Apart from the "guarantee" role played by callable capital, there is also a vitally important psychological aspect. Few things would be more damaging to the Bank's standing in financial markets than the impression that amendment of the Articles was being undertaken to qualify or limit the commitment of member governments to the continued operation of the Bank or that this amendment was only the first of a likely series of reductions in callable capital coverage. It is the danger of misinterpretation of this sort which underlies the consensus referred to earlier; namely, that amendment of the Articles should be undertaken in the near term, if at all, only in combination with a General Capital Increase which is sufficiently large to demonstrate the strong support of governments for the Bank. Another advantage of combining amendment with a major capital increase is that it could help keep bondholders from feeling that the protection described in IBRD prospectuses was being unfairly withdrawn. Since the possibility of amendment to the Articles is clearly set forth in the prospectus, there is no sound legal basis for bondholder complaint. Irrespective of the legal situation, however, it would be important to minimize the possibility of negative investor reaction.

20. To sum up, the "gains" of amendment would appear to be small if one focusses either on asset coverage or on the Bank's income position. The impact of amendment on the liquidity risk which the Bank faces is much more difficult to assess. A high level of callable capital is one way -- but certainly not the only way -- to guard against a cumulative and self-reinforcing loss of investor confidence. Finally, the "costs"of amendment would be unacceptably high if there were any significant chance that such action could be misinterpreted as indicating lack of strong shareholder support for the institution.

Is Amendment Desirable at this Time?

21. Because a decision regarding the desirability of amendment must take into account such changeable elements as the political environment legislative tactics and the strength of investor confidence, the balance of advantages and disadvantages may shift over time. But in the circumstances as they exist today, there would appear to be a reasonably strong case for not proceeding with amendment of the Articles. The case rests on a number of factors which may individually or in combination make it particularly important to maintain exceptionally strong investor confidence in the Bank over the next few years. The first such factor is the widespread investor concern about the indebtedness of developing countries. Whether this concern is well-founded or not, it cannot but have an influence on investors' perceptions of the quality of the Bank's loan portfolio. Thus, the next two or three years are not likely to be a favorable period for trying to persuade investors to reduce their reliance on callable capital as a source of security and to increase their reliance on other Bank assets.

22. Secondly, the expansion of IBRD operations in the past few years has resulted in a fuller utilization of its capacity as a financial intermediary. In consequence, certain of its financial ratios (e.g., reserves to disbursed loans; interest coverage) have shown downward trends. Our projections show, however, that most of the key ratios stabilize in the next few years, but of course investors quite properly look not at what might happen in the future but rather at what has happened in the past.

23. Third and finally, IBRD borrowings are projected to grow quite rapidly in the next few years. Achievement of these borrowing objectives will require increased penetration of traditional markets, a task which will be easier if the Bank not only is strong financially but is able to demonstrate this strength both clearly and simply. Moreover, the liquidity risk associated with interruption in Bank borrowings has as a major component the fear of investors that a resumption of vigorous private loan demand in industrial countries may lead to a competition for capital which will be resolved not by market forces but rather by restrictions on IBRD access to funds. As experience accumulates to show that this fear is unjustified, it may be expected to fade in importance. For the moment, however, it continues to be a factor to be reckoned with.

24. In light of all these circumstances existing at present, it seems preferable to avoid any policy decision which might call in question investors' traditionally strong confidence in the Bank.

10/24/80

Background Papers

RMcN says keep.

B.

February 15, 1980

Mr. McNamara:

re: Role of Field Offices

1. Late last year you mentioned in the PMC that you would like to have a review of the above subject in CY 80 when Bruce Rohrbacher came on board.

2. We have now looked into this subject and drafted TOR for a possible study but we feel that to undertake a meaningful review of the field structure before more basic outlines of what is ahead for the Bank as a whole are available, is likely to be counter-productive and maybe dangerous. A full field office study could have a potentially sweeping impact on the Bank overall, also, to undertake it we would have to make some broad assumptions about the future direction of the Bank and I would not like to formulate these in isolation in the Administrative complex.

3. While we were in the process of formulating an approach to the field office item, the structural adjustment focus of additional future operations surfaced and also the Brandt Commission's paper, the latter raising the broad issue--to be investigated--of "providing greater decentralization of the management of the Bank's operations".

4. All this, I think, gives even more emphasis to the need for seeing the field structure as well as the decentralization issue as elements in a larger overall effort to study the Bank's future program, approach, structure and processes. This would entail a carefully orchestrated undertaking throughout and with the cooperation of large parts of the Bank.

5. However, you may feel that there are obstacles to the launching of such a broader study at this time or you may feel that you are committed to inform, for example, the Board on segments of it before such broader--but nevertheless essential work--could be reasonably completed. I would appreciate it if you could meet with Bruce Rohrbacher and me to have your views on this entire matter.

Martijn Paijmans

P.S. In case you would like to see them, I am attaching a copy of the draft TOR mentioned in paragraph 2 above.

D R A F T
BWRohrbacher:cfa
January 28, 1980

TERMS OF REFERENCE

OPD Study of Role of Bank Field Offices
(Project Brief OPD 25)

Client: President

Background

1. During mid-1979 Board discussions of the budget and the education sector, a number of members spoke about the Bank's field offices.

(a) Most of the speakers encouraged the President to consider establishing more field offices and to broaden their role.

(b) Most of the speakers indicated they felt that both the borrowers and the Bank could benefit from increased on-site Bank presence--borrowers largely from the added help they might receive in the form of on-the-ground technical assistance, and the Bank largely from closer project supervision and relief from the burdens on the Headquarters staff that growth has brought and is expected to continue to bring.

(c) Most of the speakers indicated the desirability of decentralization, but few were clear on whether that meant simply more field responsibility for additional activities of the project cycle or, more broadly, for dispersion of authority to make decisions now made by the Headquarters staff and Board.

(d) None of the speakers indicated specifically the time frame within which potential new roles for the field should be considered and none of the speakers offered any opinion on the adequacy or inadequacy of the present written policy of the Bank relative to establishment of field offices.

(e) Only a few of the speakers touched on the broad implications of decentralization and added field decision authority and their relationship to the Bank's overall organization structure, lending approach, decision-making processes, and costs.

2. The President, in his responses, touched on the implications of decentralization and potential field growth on the Bank's present approach, structure, and processes. Thus, it seems clear that he sees the problems as an extremely broad-guaged one and the time frame as long term.

Study Objective

3. The basic objectives of this study are to:

(a) examine the potential longer-term roles of field offices within the context of ~~expected growth~~ the questions as now projected of the Bank in the 1980s ~~and the changes that that growth is likely to require in the Bank's approach, structure, and processes.~~

(b) To block out the functions and broad structure of future field offices and to develop guidelines for when and where they should be established.

Study Design

4. The study will start with a fact-finding phase. It will include the assembly of the most up-to-date information now available in Headquarters on the number, location, size, and cost of existing field offices as well as on current plans for adding new offices and for expanding, reducing, or discontinuing existing offices. This phase will also include interviews with responsible Headquarters personnel and reviews of available documents to determine present responsibilities, authorities, functions and activities of existing offices. In short, this phase will provide a profile of the field as it now exists and is currently planned.

5. The next phase will be to assemble from documents and through interviews a picture of how the Bank's programs, activities, approach, structure, and processes are likely to change in the 1980s. ~~During this phase, a working group should be established to help OPD. The working group should include, at a minimum, knowledgeable representatives from Operations, DPS, PAB, and PMD. They would help in this stage to lead OPD to authoritative information or sources of information and, once assembled, to help judge its validity.~~

6. The third phase would be aimed at developing hypotheses about the future roles, structures, functions and authorities of field offices. ~~Here again, although OPD would have to take the lead, the working group members would be called upon for extensive help in formulating the hypotheses~~. Likely, there would be developed a number of "models" representing a range of the types and sizes of offices that the Bank might have in the future, together with an

indication of the functions, responsibilities, authorities, and staffs each might have.

7. The fourth phase would be designed to test the hypotheses. A sample of field offices would be visited to help prove or disprove the validity of the hypotheses. Bank personnel in the field as well as officials of borrowing governments would be consulted. ~~If appropriate, a number of Bank Executive Directors would also be interviewed.~~

8. The fifth phase would be the analysis of field findings and development of conclusions. ~~This stage should also involve the full working group.~~ Conceivably, this effort could result in agreement on specific recommendations for the future. More likely, however, it would require development of broad guidelines and alternative sets of assumptions on Bank growth, lending approach, overall structure and processes under which the guidelines should be applied in varying combinations.

9. After presentation of the conclusions to the President in this sixth phase and to others he might wish to involve, a report would be prepared which he could present to the Board.

10. Finally, depending on final decisions, various implementing documents (e.g., policies, organization and functional statements, delegations, operating instructions, personnel statements, administrative guidelines) would be developed during this seventh phase.

Staffing

11. For the first phase of the study (paragraph 4 above), a three-man team should be assembled:

(a) The Director of OPD;

(b) An OPD Senior Management Consultant; and

(c) The AOP Field Coordinator.

This team should be helped to the extent necessary by PAB, PMD, and the Regions.

12. ~~In subsequent phases, the working group referred to in paragraph 5 should be added to the study team.~~ From the second through the sixth phases, the Field Coordinator would need to be only minimally involved. However, he would be expected to play a major role again in the seventh and final phase. In fact, it might be appropriate for him to take over lead responsibility from OPD at that time.

13. At present, the timetable for this study is tentatively as follows:

Phase 1 - 2 months
Phase 2 - 2.5 months
Phase 3 - 2 months
Phase 4 - 1.5 months
Phase 5 - 2 months
Phase 6 - 2 months

Phase 7 - Indefinite

14. OPD's Senior Management Consultant would be expected to be full time or near full time throughout the first six phases, and possibly through the seventh. The Director of OPD would expect to devote half to three-quarters of his time ~~in~~ phases ~~two~~ through six and approximately one-quarter in phase one and seven. The working group members' involvement is difficult to predict at this time. It would depend somewhat on the individuals and the number of them.

However, it would not seem unreasonable to expect 15% of their time in phase two, rising to two to three times that percentage in phases three and five, and dropping back again to 15% in phase six. Their involvement in phase four, if any at all, would be subject to their availability.

THE WORLD BANK

Office of the President

BRANDT COMMISSION PROSPOSALS OF PARTICULAR RELEVANCE TO THE BANK

A. Increase in the Volume of Resource Flows from the Bank

1. Amend the Articles of Agreement to change the Bank's gearing ratio from 1:1 to 2:1 which would raise its borrowing capacity to $160 billion.

2. Use of Bank's guarantees for improving developing countries' access to capital markets and facilitating recycling of private flows towards LDC development.

3. Greater co-financing by the Bank.

B. Changes in Bank's Lending Policies

4. A substantial increase in financing of exploration and development of energy, including the development of renewable energy resources.

5. Expansion of program lending by the Bank, to provide additional flows if possible.

C. Emergency Measures of Interest to the Bank

6. A program for alleviating poverty in the poverty belt of Asia and Africa: Annual capital requirements $4 billion.

7. A program for increasing food ~~and agricultural~~ output in developing countries: annual outlay $8 billion.

8. ~~Raising co-financing to $50-60 billion annually by 1985.~~

D. Suggestions for Increasing the Flow of Resources to the IFIs

9. An international system of universal revenue mobilization based on a sliding scale related to national income, in which European and developing countries - except the poorest countries - would participate.

10. Adoption of specific timetables to increase ODA from industrialized nations to the level of 0.7% of GNP by 1985, and to 1% before the end of the century.

11. Introduction of automatic revenue transfers through international levies on some of the following items: international trade, arms production, exports of selected goods, international travel, global commons especially seabed minerals.

12. Establishment of SDR link with development assistance.

E. Changes in the Bank's Structure

13. Greater decentralization of the management of the Bank's operations.

14. Greater participation of the staff from LDCs in Bank management.

15. Changes in the voting structure to provide greater role to LDCs in policy decisions.

F. Other Institutional Proposals that would Affect the Bank

16. Consideration be given to the creation of a new international financial institution - a World Development Fund - with universal membership and evenly shared control over decision making, to supplement existing institutions and to diversify lending policies and practices.

17. Setting up of a food financing facility.

18. Setting up of a facility for the development of minerals and energy.

19. Strengthening of Regional Banks.

PPR
2/7/80

BRANDT COMMISSION PROPOSALS RELATING TO THE WORLD BANK
TO BE REVIEWED BY THE EXECUTIVE DIRECTORS

	Proposal	Primary Responsibility for Drafting Memo to Board	Submission of Draft to President	Submission of Memo to Board
1.	Change the Bank's present "gearing ratio" a/ so as to raise its lending capacity.	Finance VP	6/15	7/8
2.	Use the Bank's guarantee to improve access of developing countries to capital markets.	Finance VP	7/15 ~~8/15~~	8/5
3.	Provide for greater co-financing by the Bank.	Bd. Memo of 2/19		
4.	Substantially increase Bank financing for exploration and development of energy resources.	Oper. VP (Rovani) (Energy Dept.)	7/8 ~~9/15~~	7/27
5.	Set up a new facility for financing the development of minerals and energy.	Oper. VP (Rovani + Energy Dept.)	8/15 ~~10/15~~	9/4
6.	Expand Program Lending by the Bank.	Board Memo of 2/5		
	Examine the possibility of the Bank's refinancing export credits for capital goods.	Finance VP	10/30	11/11
8.	Plan to effectively utilize the increased borrowing capacity of the Bank resulting from the ~~recent~~ doubling of its capital.	Finance VP	5/30	6/15
9.	Abstain from imposition of political conditions on operations of the IFIs.	VP External Relations	5/15	5/27
10.	Develop an action program to reduce absolute poverty in the poverty belts of Africa and Asia during the 1980s.	Oper VP	6/15	7/8

a/ The ratio of receivables to capital, as prescribed by the Articles of Agreement

	Proposal	Primary Responsibility for Drafting Memo to Board	Submission of Draft to President	
11.	Develop an action program to increase food output in low-income, food-importing developing countries during the 1980s.	Oper. VP (Baum)	7/30	8/1 ✓
12.	Analyze the likely debt and debt servicing problems in various categories of LDCs and the capacity of existing private and public institutions to meet these needs.	Finance VP	6/30	7/15
13.	Define the role of the surplus countries in financing the adjustment problem of developing countries.	Finance VP	6/30	7/1 ✓
14.	Provide greater decentralization of the management of the Bank's operations.	VP Administration (Rohrbacher)	~~7/1~~ 8/15	9/9
15.	Provide greater participation of LDC staff in Bank management.	VP Administration	7/30	8/1 ✓
16.	Provide borrowing countries a greater role in the decision-making process in the Bank.	General Counsel and Secretary (Rohrbacher)	8/30	9/23
17.	Consider the creation of a new international financial institution - a World Development Fund - to supplement existing institutions and to diversify lending policies and practices.	Finance VP	12/15	1/14/81

Procedure:

1. All papers will be reviewed by the Finance Committee before they are submitted to the President's Council, after which they will be sent to the Board.

2. Policy Planning and Program Review will review and comment on individual papers before their submission to the Finance Committee.

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

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OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara DATE: February 11, 1980

FROM: Mahbub ul Haq, Director, PPR

SUBJECT: Brandt Commission Proposals

Attached is a list of Brandt Commission Proposals to be reviewed by the Board. Proposal no. 9 about IDA replenishment was not discussed at the meeting with you last Friday but I have included it since it has important policy implications for the Bank.

The departmental responsibilities and completion dates indicated in the attached list are highly tentative and represent my own suggestions at this stage. No time was available to discuss these with other departments. It is quite likely that some of the responsibilities and proposed dates may shift after further discussion, especially in respect of the individuals who would be able to write these policy papers.

2/11 The attached proposals have been cleared with Mr. Chenery. After your approval, they will be circulated to the Finance Committee for a preliminary discussion at the meeting scheduled on February 12.

Attachment

cc: Mr. Chenery

BRANDT COMMISSION PROPOSALS TO BE REVIEWED BY THE BOARD

Proposal	Responsibility - Primary Responsibility	Collaborating Dept.(s)	Submission to Finance Committee
1. Change Bank's present gearing ratio so as to raise its borrowing capacity.	PAB (Gabriel)	PPR	June 15
2. Use Bank's guarantees to improve access of developing countries to capital markets.	PPR (Jacob)	PAB (Ikram)	June 30
3. Greater co-financing by the Bank.	PAB (Baneth)	PPR (Jacob)	March 15
4. a) Substantial increase in Bank financing for exploration and development of energy resources.	OVP (Goodman)	Energy/EPD (Rovani/Lambertini)	Sept. 15
b) Set up new facility for development of minerals and energy.			
5. Expansion of ~~program~~ lending by the Bank to finance structural adjustment in developing countries.	PPR (Haq)	OVP (Stern)	~~Done~~
6. Possibility of Bank's refinancing of export credits for capital goods.	PPR (Edelman)	IFC (Richardson)	Oct. 30
7. Effective utilization of increased borrowing capacity of World Bank resulting from recent doubling of its capital.	Treasurer (Rotberg)		~~Apr. 30~~
8. Abstaining from imposition of political conditions on operations of the IFIs.	VPE (Benjenk)		May 15
9. Future modalities of IDA replenishment, including lengthening of the replenishment period.	VPF (Qureshi)	VPE (Benjenk)	Nov. 30
10. Action program to reduce absolute poverty in the poverty belts of Africa and Asia during 1980's.	Regions/PPR (to be worked out)		Oct. 15
11. Action program to increase food output in low-income, food-importing developing countries during the 1980s.	PPR (Burki)	AGR (Donaldson)	July 30
12. Analysis of likely debts and debt servicing problems in various categories of LDCs and capacity of existing private and public institutions to meet these needs.	PPR (Hicks)	EPD/PAB	June 15

Proposal	Responsibility: Primary Responsibility	Responsibility: Collaborating Dept.(s)	Submission to Finance Committee
13. Role of surplus countries in financing adjustment problem of developing countries.	Finance VP EPD (Colaco)	PAB (Hope)	6/30 ~~Aug. 30~~
14. Greater decentralization of the management of Bank's operations.	VP Admin ~~OPD~~ (Rohrbacher)	VPD (Wright)	7/1 ~~Oct. 30~~
15. Greater participation of LDC staff in Bank ~~senior~~ management.	VP admin (Paijmans)	OVP	7/30 ~~May 30~~
16. Provide borrowing countries a greater role in decision making process in the Bank.	General Counsel and Secretary Legal Dpt. (Nurick)	OVP	8/30 ~~Nov. 30~~
17. Consider creation of a new international financial institution - a World Development Fund - to supplement existing institutions to diversify lending policies and practices.	Finance VP PPR (Haq)	VPE (Qureshi)	Dec. 15

Procedures:

3. ~~1.~~ Above ~~inventory~~ will be updated by PPR on the first of every month and circulated to the President's Council for information.

1. ~~2.~~ All papers will be reviewed by the Finance Committee before their submission to the ~~Board.~~ President's Council, after which they will be sent to the Board.

2. ~~3.~~ PPR will ~~coordinate and monitor~~ review and comment on the preparation, review and submission of individual papers before their submission to the Finance Committee

PPR
2/11/80

2/11/80