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M. QURESHI  
PRESIDENTIAL CHRON

February 15 - March 10, 1980



  
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Moeen Qureshi Files - Presidential Chronological Correspondence - February 15 to March 10, 1980

## OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara  
(through Mr. Moeen Qureshi, VP, Finance)  
FROM: Jean Baneth, Assistant Director, P&B

DATE: March 7, 1980

SUBJECT: Capital Flows

Please find attached herewith the updated version of the draft paper on prospects for capital flows, corresponding to Sections 1 through 5 of the draft you reviewed on February 13.

As you know, the revision of Part I (Sections 1 through 5) was delayed, pending the availability of the numbers corresponding to the base case of the WDR model. The latest available numbers have now been incorporated in our paper. You may nevertheless get the impression that the tone of the text is more pessimistic than is warranted by the broad indications one may derive from an independent analysis of the projections.

The present projections incorporate the assumption that an adjustment effort will be successfully carried out by oil-importing developing countries. Despite a deterioration in the international environment, OIDCs are therefore projected to suffer only a modest reduction in their growth rates, and to be able to reduce their reliance on net resource inflows to minimal levels by the end of the eighties. There is no alternative to OIDC's making a heroic adjustment effort; in many cases, failure of such efforts may not merely lead to a further marginal decline of growth rates, but to a true collapse. Nevertheless, the probability that the adjustment reflected in the projections will be successfully carried out in all important cases is low.

## Attachments

cc: Mr. Gabriel  
Messrs. Isenman/Hope  
Mr. Ikram  
Mr. Bock

JB:ba

PROSPECTS FOR FINANCIAL FLOWS TO DEVELOPING COUNTRIES

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## PROSPECTS FOR FINANCIAL FLOWS TO DEVELOPING COUNTRIES

### I. Introduction

1.01 Any retrospective assessment of the aggregate growth performance of developing countries in 1974-78 probably would conclude that they weathered the crisis much better than had been feared in 1974. Taking together all of the developing countries except the capital surplus OPEC countries,<sup>1/</sup> the GNP growth rates achieved in the 1970s were not significantly lower (at around 5.7%, depending on the method of measurement) than the rates achieved in the 1960s, and this comprehensively out-performed the industrial countries. The growth rate of the industrial countries fell to 2.5% in 1974-78, down from 4.7% during the preceding decade. For the oil-importing developing countries (OIDCs), however, the effects of the crisis were severe: their growth rates declined significantly to a real GNP growth rate of 4.9% in 1974-78 from about 6.2% in 1963-73.

1.02 That the fall-off in OIDC growth was not worse than this can be attributed to several factors. Some countries, especially the low income countries of South Asia, were favored by a series of excellent harvests. Still others, including some in the group already mentioned, helped themselves by raising domestic savings rates and otherwise improving their economic policies. Developing countries also continued to increase their exports, including manufactured goods to the industrial countries, although at a reduced pace. Exports to OPEC countries rose sharply during this period, as did remittances from migrant workers. Despite some protectionist moves, the OIDCs were able to expand rapidly in markets where trade barriers were low.

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<sup>1/</sup> Includes Kuwait, Libya, Qatar, Oman, Saudi Arabia and United Arab Emirates.

1.03 In addition, the developing countries benefitted from a very significant increase in the volume of external resources available to them. The table below, which shows the current account deficit of the oil importing developing countries for 1973-78, indicates the extent to which external resources increased. From a deficit on current account (excluding official transfers) of only 1% of aggregate GNP in 1973, OIDs were financing a deficit of over 5% of their GNP in 1975. By 1978 the adjustment to the higher real price of oil appeared virtually complete, and while the current account deficit of 2.3% of GNP was still well above the pre-crisis level, it had returned to a more normal long-term level.

CURRENT ACCOUNT DEFICIT OF OIDS, 1973-78 a/  
(Percentage of Aggregate GNP)

	1970*	1973	1974	1975	1976	1977	1978
Low Income	2.3	1.4	3.3	3.5	1.0	1.0	2.6
Middle Income	1.9	0.9	4.7	5.5	3.8	2.9	2.2
Total	<u>2.0</u>	<u>1.0</u>	<u>4.4</u>	<u>5.1</u>	<u>3.3</u>	<u>2.6</u>	<u>2.3</u>

a/ Excludes official transfers.

Source: EPD.

\* Estimates.

1.04 The expanded capital flows from abroad enabled developing countries to sustain higher levels of both consumption and investment than otherwise would have been possible. Initially, in 1974-75, additional resources were provided mainly by flows from traditional sources--aid flows from OECD nations, augmented by a four-fold increase in concessional assistance from

the newly wealthy OPEC countries, and private direct investment. However, additionally and increasingly, resource flows to developing countries were supported by loans from the international banking system. An upsurge in the foreign lending activities initially of the US money center banks was complemented and exceeded by the lending activities of banks operating in the Euromarkets.

1.05 Despite this better than expected outcome, the reduction of 1-1/3 percentage points in real GNP growth by the OIDs represents a tragic loss of economic improvement for the people in those countries. Moreover, with the further round of oil price increases in 1979 and with the additional increases forecast for 1980, the prospect of recouping these losses, or even of restoring OID growth rates to the levels of the 1960s, appears impossible. Indeed, at least two factors suggest that OID growth rates may be lower again in the early 1980s than they were in the 1970s.

1.06 First, the "once for all" adjustment problem that developing countries were thought to face in the mid-1970s has turned out to be a fundamental and continuing structural problem of rising energy costs. The implication of this is that OIDs must deal with sharply increased current account deficits while at the same time undertaking structural changes in their national economies to adjust to what is now expected to be a permanent, sharp deterioration in their terms of trade, possibly followed by further terms of trade erosion. Second, the difficulty in making the adjustment now required is compounded by the unfavorable outlook for growth in the OECD countries in the early 1980s with a consequent depressing effect on LDC exports. Aggregate GNP of the OECD countries is now expected to



continue to grow more slowly in the 1980-85 period than in the 1960s (3.3% versus 5.0%) or at about the same rate as in the 1970s. The growth rate of OIDC exports is projected at 5.5% in 1980-85 compared to 6.5% in the 1970s.

1.07 These forces will have a doubly deleterious effect on the OIDCs in the 1980s: they will need relatively more capital than in the 1970s and they will grow more slowly. The only way for OIDCs to maintain their growth momentum will be for them to succeed in making the structural changes in their economies required to sustain growth in a more adverse external environment. Preliminary projections indicate that the OIDCs can achieve a growth rate of 4.9% in 1980-85--about the same as that achieved in the 1970s--while reducing the current account deficit from a renewed high of 4.2% of aggregate GDP in 1980 to 2.7% by 1985. However, this growth performance depends on successfully carrying out adjustment programs that include for most countries quite substantial (and possibly optimistic) improvements in savings performance, export programs, energy conservation and production, import substitution and investment returns. Because of the demanding nature of the improvements required, the risks are high that the adjustment programs will not be entirely successful and that OIDC growth will, therefore, fall below the rates achieved in the 1970s.

1.08 In order for the OIDCs to have a reasonable chance of success in these adjustment efforts, it is essential that the recycling of the OPEC surpluses and the general flow of financial resources to the OIDCs in the 1980s be at least as favorable as in the previous oil crises. If the

availability of external resources is too constrained, the risks of not achieving the adjustment programs escalate sharply and the scope for sustaining growth through higher-than-projected borrowings will be reduced. This paper addresses the question of whether financial developments will be sufficiently favorable for the OIDs in the absence of special initiatives by the international community. The conclusion reached is that they will not; indeed, it is more likely that the development financing mechanism will work less effectively relative to OIIC needs than it did previously. There is therefore a need for a major effort by the international community to ensure that capital flows to the OIDs are adequate in amount and appropriate in cost, terms, and developmental impact to sustain OIDs' growth in the 1980-85 period.

1.09        There are four main reasons for this conclusion:

- First, the availability of finance for the OIDs will be constrained by a reduced capital outflow from OECD countries and downward pressures on international liquidity caused by the anti-inflationary stance of monetary policy in the major industrial countries. While OPEC surpluses will indeed guarantee substantial liquidity, the cost of borrowing will probably be higher and there will be greater discrimination among borrowers;
- Second, the major commercial banks--which have been the main intermediating mechanism for private flows to OIDs--are likely to be constrained in their ability to expand lending to OIDs, and other channels for recycling the OPEC surpluses are likely to be less favorable for the OIDs than the major banks have been in the past;
- Third, the creditworthiness of many developing countries for substantial amounts of capital on commercial terms will be strained by unfavorable growth prospects, higher borrowing costs, and the possibility that adjustment programs will not be successful; and



- Fourth, the projected level and type of efforts by the international community are not yet sufficiently responsive to the need for widespread financing of structural adjustments in the OIDs.

The analysis underpinning each of these reasons is set out in separate sections of this paper. A final section outlines the probable evolution of OIIC financing in the 1980s. The remainder of this introduction gives a brief background summary of how resource flows to OIDs responded in 1974-78.

#### The Response of 1974-78

1.10 Following the oil price increases of 1973-74, the international community responded rapidly and dramatically to the clearly perceived need to provide financial assistance to developing countries, especially to those identified as "most severely affected" by the higher cost of oil products. OECD donors increased their aid flows by 45% in two years, from a historically low 0.3% of GNP in 1973 to 0.35% in 1975. OPEC flows expanded even more spectacularly, increasing from \$1.3 billion in 1973 to \$5.5 billion in 1975. The IMF successfully arranged two oil facilities to help recycle surpluses accumulated by OPEC and strong OECD economies. An interest subsidy reduced the costs of finance to low income countries and the IMF disbursed \$7 billion to developing countries between January 1974 and June 1976.

1.11 The multilateral lending agencies also responded to the increased needs of developing countries. As a group, they expanded their commitments by 23% in 1974 and 24% in 1975, while disbursements increased by 35% and 40% respectively in these years. The IBRD expanded its activities even

faster. Commitments rose by 41% in 1974 and by 30% in 1975 while disbursements increased by 41% and 52% in the same years. The "Third Window" was introduced to subsidize borrowing on market terms by low income countries. In addition, both bilateral and multilateral agencies expanded the share of program lending and other quick disbursing forms of assistance in their financial flows.

1.12 These actions by the international community were accompanied by, and indeed may have been a requirement for, the sharp growth of lending to developing countries by commercial banks. According to OECD statistics, commercial bank lending increased from 17% of total net external financial receipts of developing countries in 1970 to 32% of a volume four times as great in 1978. The importance of commercial banks is, of course, much greater in terms of gross flows. Much of the increase was in the form of syndicated bank loans extended by private banks operating in the Euromarket. The gross volume of publicized Eurocurrency credits to developing countries increased continuously from \$4 billion per year in 1972 to an estimated \$40 billion in 1979, while the number of developing countries with access to the market increased over the same period from 29 to 57 (in 1978). In addition, direct foreign lending by banks, principally those of the US but also banks in Germany, Switzerland and Japan, contributed to the rapid increase in the flow of private lending to developing countries.

1.13 The supplementary resource flow to developing countries in 1974-78 was initiated by the actions of governments and official agencies and sustained by the activities of private banks. These developments were made possible in part by the failure of the OECD economies to recover strongly

from the recession of 1974-75, which was harmful to the developing countries because of a restraining effect on their exports and on inflows of aid and private direct investment, but did reduce competition for capital from the banking system. However, the OPEC surpluses were recycled and eliminated much more smoothly than had been feared and developing countries benefitted by the willingness of OPEC governments to accumulate financial assets--thus contributing to the liquidity of the capital markets--by increases both in export sales to OPEC countries and in remittances from migrants working in these countries, and by a deterioration in OPEC's terms of trade. In addition, the monetary policy stance of the US contributed to the liquidity of the international capital markets, which, with the depressed environment for investment in the OECD, encouraged banks to seek alternative borrowers for their plentiful deposits. Many developing countries suddenly discovered that they were considered creditworthy by an international banking community that had a comparatively small portfolio of loans to developing countries and was urgently seeking opportunities to expand portfolio lending activities.

## II. The Macroeconomic Environment for Capital Flows

2.01       The size and direction of capital flows are determined both by real variables (e.g., savings/investment surpluses) and financial variables (e.g., growth rates of monetary aggregates). In addition, the pattern of capital flows and any individual borrower's (or group of borrowers') access to resources is affected by the specific mechanism whereby these capital flows are intermediated. This section discusses how the macroeconomic environment--i.e., the pattern of savings/investment surpluses and monetary growth--affected the OIDCs' access to resources during 1974-78 and how it may be expected to affect these flows in the future. Subsequent sections analyze the more 'institutional' aspects of capital flows, namely the capacity of the commercial banks to intermediate the OPEC surpluses, the prospective creditworthiness of OIDCs, and the outlook for official action to transfer capital resources to developing countries.

2.02       During 1974-78, the main macroeconomic developments contributing to the unexpectedly high level of resources supplied to developing countries were the depressed level of demand, especially of investment demand, in OECD economies during the period, the manner in which and ease with which OPEC surpluses were initially recycled, and subsequently virtually eliminated, and the stance of international monetary policy, largely determined by the US, that contributed to the rapid growth of international lending by the banks. Despite some expected similarities between the 1974-78 period and the probable behavior of the international economy over the next few years, it seems unlikely that macroeconomic aggregates will evolve in as favorable a manner for capital flows to OIDCs as was the case in the earlier period.



The reasons for this are: first, the flow of resources from OECD countries will probably be depressed due to a combined current account deficit for the next few years; second, the OPEC surpluses are likely to be neither as easily recycled nor eliminated in the same favorable manner as in the 1974-78 period; and third, the stance of monetary policy, especially in the US, will probably continue to be more restrictive than during the earlier period. The overall effect of these developments is likely to be substantially tighter capital market conditions for OIDC borrowing with relatively high real interest rates and greater discrimination among borrowers with respect to spreads.

Future Resource Flows from the OECD

2.03 After the oil price increases of 1973-74, the aggregate current account of the OECD North shifted abruptly from the traditional surplus balance (including all transfer payments) to a deficit of more than \$21 billion in 1974, a swing of over \$30 billion in a single year.<sup>1/</sup> In 1975, this swing was almost entirely reversed as the recession deepened and the US, aided by the prior currency realignments, registered a massive current account surplus of \$18 billion. The US surplus melted away rapidly during the recovery of 1976-77 and the OECD North was a net recipient of foreign investment in those years, but by 1978 the OECD again was providing substantial additional resources for foreign investment beyond the resources provided through official and private grants.

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<sup>1/</sup> OECD North is the DAC members plus Iceland, Ireland and Luxembourg.



2.04 With hindsight, the OECD deficits--that is their net absorption of resources from abroad--were much less prolonged than might have been expected. Only the US, where the recovery was more sustained and relatively strong and where policy adjustment to the oil price rise was relatively delayed and weak, absorbed large net amounts of foreign goods and services after 1976, and the large US deficit in 1978--\$14 billion--was more than offset by the \$16.5 billion surplus run by Japan alone.

2.05 The rapid elimination of the deficit was by no means a triumph of economic policy making. The OECD recovery from the recession of 1974-75 was faltering and bedevilled by the inability of policy makers to control inflation and simultaneously stimulate effective demand. Countries failed to regain the growth momentum of the early 1970s and they accepted as normal levels of unemployment that would not have been tolerated five years previously. However, because of the expansionary stance of monetary policy (see below) and reasonable success in mitigating protectionist pressures, the elimination of the current account deficit did not transmit as much deflationary pressure to the developing countries as otherwise might have occurred.

2.06 Developing countries were affected adversely by slower growth of their exports resulting mainly from the slower growth of the OECD, and their trade prospects were threatened further by the resurgence of protectionist sentiment in the OECD. About two-thirds of OI DC export growth took place in industrial countries during 1973-78, and increased exports to OPEC countries and, for some developing countries, rapid growth in remittances from

migrant workers in OPEC countries also helped. Moreover, developing countries were assisted in their attempts to acquire financial resources by the low level of effective demand in the OECD.<sup>1/</sup> The lack of effective demand resulted primarily from the pervasive low level of investment in non-residential fixed capital in OECD countries.

2.07 Since the oil price increases of 1973-74, savings and investment behavior in OECD countries have been erratic. Initially, personal savings rates fell sharply but by 1975 they were rising again--so much so, that the aggregate current account moved strongly back into surplus. Since 1975, savings rates for individual countries have fluctuated, but by 1978, with the main exception of the US, savings rates generally were closer to more normal levels. In the US, where consumption demand has prolonged the upswing of the business cycle, the savings rate continues to be below historical levels. Even this weak recovery in savings was not shared by investment demand. In the seven major industrial countries, the levels of non-residential fixed investment were not significantly higher in real terms in 1978 than they were in 1973. Consequently, a large surplus of savings over investment again had emerged by 1978 and this was available for investment in developing countries.

2.08 With the new oil price increases, the industrialized countries again have moved into deficit. Their external savings surplus has been eroded fully and, once more, they will be net recipients of resource flows

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<sup>1/</sup> Of course, developing countries may have done even better if the OECD countries had achieved higher growth rates. Then lower levels of capital inflow would have been required for any given growth rate of the developing countries.

from abroad. Including transfer payments, the OECD deficit in 1980 may reach \$55 billion or about \$35 billion before government transfers. The two main sources of external savings surpluses over the last five years, Japan and Germany, are both projected to be large capital importers in 1980. Past experience indicates just how quickly current account movements can be reversed. However, in the current situation a rapid restoration of an external savings surplus is unlikely unless there is a serious recession. The net current account deficit of the OECD is likely to persist because savings incentives will be depressed strongly in the short term while investment levels (in the absence of a disastrous recession) are unlikely to fall much further.

2.09      Outlook for Savings. As in the earlier period of oil price increase, the industrialized world has sustained a significant income loss through the deterioration in the terms of trade. If the earlier period is a guide, personal savings rates should fall as consumers spend a larger share of their income to insulate themselves from immediate declines in consumption levels. As government deficits will increase, government savings also should fall. The pressure to expand military expenditures will make it all the more difficult to contain government deficits. Business savings will be affected adversely by depressed economic conditions and by downward inflexibility of real wages. Moreover, the savings rate is likely to recover quite slowly if oil prices continue to rise in real terms (as is expected), and if growth rates fall below the levels required to sustain anticipated growth in real incomes.



2.10      Outlook for Investment. Investment, rather than consumption, bore the brunt of the real income loss in industrial countries after 1973, and levels of capital formation have stagnated or even fallen since then. The absence of a sustained investment response combined with the persistence of inflation sapped the vigor of the cyclical upturn that began in 1976. Indeed, the inflationary problem has been exacerbated by the failure of investment to respond. Part of the sluggishness of investment has been due to structural weaknesses in the industrial economies that have become even more evident during the 1970s. Many countries have a legacy of aging industries, which are unable to compete successfully with those of other industrial countries and the newly emerging industrial powers of the developing world. Considerable excess capacity exists in some industries, thus discouraging investment and creating a need for adjustment. Many countries also have very inefficient high-energy-using agricultural sectors. Investment has also been adversely affected by the fact that profit rates have been falling steadily in most OECD economies since the mid-1960s, by environmental concerns, by uncertainty with respect to growth and inflation, and by rising energy costs.

2.11      A result of the complex of supply side difficulties faced by industrial countries has been that their ability to respond to reflationary stimulus has been curtailed severely. Demand stimulus has tended to generate inflationary pressure in some sectors of the economy, while it has failed to eliminate excess capacity in others. Investment for necessary adjustment has been postponed, and some protectionist measures have been introduced to prop up declining industries. Although under the circumstances it can be

argued that protectionism could have been much worse, adjustment would have been much easier and protectionist pressures much less necessary and successful if economies had been growing rapidly. Now, it appears that considerable structural adjustment is required as a prerequisite for more rapid growth rather than as a means by which higher growth rates may be achieved. As governments become increasingly aware that supply side factors are contributing directly to the failure of anti-inflation and full-employment policies, they will take stronger measures to promote increased levels of investment. In particular, the further increase in oil prices provides a strong incentive for governments to attempt to shift the structure of production to less energy-intensive patterns, as well as to encourage investment in domestic energy sources and in energy-saving technologies. Given the vulnerability of OECD economies to changes in primary energy costs, governments may provide additional incentives to investment that will help to insulate economies from external shocks resulting from oil price increases.

2.12 These considerations suggest that investment will not be further compressed even in a deflationary short-term environment, and as governments will have considerable difficulty in reducing consumption the likelihood is that the industrial economies will continue to run deficits in the next several years. Hence, while developing countries will benefit indirectly from a higher level of activity in the OECD if investment levels are maintained, the benefits are likely to be offset by the lack of foreign investment by OECD. This would be especially true if protectionist measures are



used by the OECD to hold down non-oil imports from the developing countries so that import levels can be controlled while domestic investment is encouraged.

Prospects for the OPEC Surpluses

2.13 After the oil price increases of 1973-74, there was widespread fear that the international economy would be subjected to severe and sustained deflationary pressure due to the OPEC surpluses. In this view, OPEC would be able to maintain its terms of trade at the favorable level determined by the increases in the real price of oil. The presumed low absorptive capacity of the OPEC countries then would ensure that the surpluses remained high. There was also concern as to how the surpluses themselves would be recycled.

2.14 In practice, the OPEC countries adjusted their expenditures and imports rapidly to conform to the much higher level of oil revenues. The absorptive capacity of OPEC countries--especially for weapons, food, construction projects and migrant workers--proved much greater than many had feared. From 1974-78, OPEC imports of goods and non-factor services totalled almost \$500 billion, about three quarters of the \$660 billion it received for exports during the period. By 1978, the overall OPEC current account (goods, all services and transfers) was in balance, and the OECD had resumed its traditional position of net supplier of goods and services to the developing world. The elimination of the OPEC surplus was aided by a decline in the real price of oil from its 1974 level (through 1978), which reduced the real value of oil revenues. It was also aided by the slow growth in oil consumption in the industrial countries which occurred despite

the lack of an active effort on the part of the US to restrain energy use. Oil consumption in the non-communist world increased by only 1% per year in 1974-78 and it declined by 3% per year in the recession years of 1974-75. OPEC production and export levels were virtually unchanged over the whole period. Oil from new sources--Alaska, Mexico and the North Sea--was adequate to supply the modest additional demand.

2.15 The recycling of OPEC surpluses was also much easier than had been feared, in large part because of the willingness of OPEC governments to accumulate large holdings of financial assets, the bulk of which was in the form of deposits with commercial banks. The banks therefore played a dominant role in recycling and in 1976-78 directed a substantial amount of lending (not exclusively derived from OPEC surpluses) to the developing countries. Bank claims on these countries increased from \$33.5 billion in 1974 to an estimated \$150 billion in 1978.<sup>1/</sup> OPEC members also lent or contributed significant amounts to the development banks and the IMF oil facilities, created a group of new development institutions, and substantially increased bilateral aid to developing countries. All of these actions made the recycling of the surpluses much more favorable to the developing countries than seemed likely in 1974.

2.16 With the further increase in oil prices the OPEC surplus on merchandise trade account could reach \$100 billion in 1980 and the current account almost certainly will do so, taking account of net investment income. This implies a recycling problem of at least the same magnitude

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<sup>1/</sup> Includes claims on banks reporting to the BIS as reported by the BIS.

as before. The question is: Will the outcome this time be as comparatively favorable to developing countries as it was before? There are several reasons to believe that it will not. First, although some oil producers will increase their imports from abroad quite quickly in response to growing oil revenues, the absorptive capacity of others really does appear constrained under existing circumstances. OPEC countries are unlikely to step up the pace of their development programs in the same way that occurred before. The experience of many of them over the past five years has been that absorptive capacity in fact was exceeded and, through inefficient investments, unnecessary consumption, and high levels of domestic inflation, many of the potential benefits from higher foreign earnings were dissipated. In addition, countries that used immigration to overcome constraints on investment imposed by the limited availability of domestic skilled and unskilled laborers now are experiencing internal social and political difficulties, suggesting a much slower increase in their foreign work forces in future. Hence, the plans adopted by OPEC countries in the early 1980s are likely to call for more measured investment programs than in the earlier period. A more deliberate policy on investment is not likely to result in a rapid elimination of the collective surplus of the major oil-exporters, although some countries are likely to reduce surpluses rapidly or even continue to run deficits.

2.17 Second, the real price of oil is not likely to fall again (indeed, it is more likely to rise) both because demand for oil will probably remain stable or rising and because of production limits and aggressive pricing by OPEC.\* Energy conservation efforts in the major consuming countries--

especially the US--have not been as successful as hoped and the development of alternative resources continues to be hindered by environmental as well as cost factors. Indeed, short of a major and sustained recession, demand for oil is likely to continue at least at present levels. Barring a major change in the political environment, it seems most unlikely that OPEC will expand oil production significantly. Some producers (e.g. Iran) have made major cutbacks in oil production on a mixture of political and economic grounds, in part in order to slow the pace of economic activity and deal with the supply constraints and other bottlenecks mentioned above.

2.18 In addition, to some degree oil revenues in excess of requirements for current import costs have come to be viewed in portfolio terms, i.e., as the exchange of a domestic asset (oil in the ground) for external financial and real assets. The implication of this is that some OPEC members may begin to moderate production according to the availability of acceptable foreign investment opportunities. This is a significant change in the macroeconomic environment for capital flows because it means that the OPEC countries will be more discriminating with respect to the yield and risk characteristics of assets that they are willing to hold. Their concerns over the liquidity and safety of foreign assets have undoubtedly been heightened by the freeze imposed on Iranian bank deposits by US authorities. Indeed, one of the most worrying possibilities at this time is that the oil exporters will not find sufficient acceptable investment opportunities and will cut back on production in order to eliminate an unwanted surplus.<sup>1/</sup>

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<sup>1/</sup> This could, of course, lead to a progressive decline in oil production and world economic activity if demand-induced oil price increases frustrate OPEC attempts to reduce the surpluses.



At a minimum, this "portfolio approach" is likely to reinforce other considerations for OPEC to keep the price of oil increasing in real terms.

2.19 A significant portion of whatever surpluses are generated will undoubtedly be recycled through the same mechanisms as before. Developing countries will be able to borrow from these sources to support their deficits, but in this adjustment period they are likely to face considerably more competition for funding than previously. In the preceding section, it was argued that OECD economies are unlikely to eliminate their current account deficits nearly so rapidly as they did in 1974-78. The likelihood that the real price of oil will rise steadily over the 1980-85 period will worsen any prospects for a return of a combined surplus for the OECD countries. Borrowers from these countries therefore are likely to command a larger share of the net reflows generated by the OPEC surplus than they did in the earlier period. In addition, the European centrally planned economies other than the USSR are net importers of energy and they probably will endeavor to increase their claims on the market both in order to support higher energy costs and to offset the heavy burden of debt service payments they have incurred by previous borrowing. Finally, China seems poised to enter the market to finance an ambitious modernization program. Chinese borrowing is likely to be prudent; nevertheless it is likely also to be significant and sustained. These considerations suggest that oil-importing developing countries will experience a decrease in their share of commercial capital relative to the share attained in 1974-78.



Developments in Monetary Policy

2.20       The final important macroeconomic development that contributed to the increased access of developing countries to commercial sources of finance was the accommodating stance of monetary policy, particularly US monetary policy, during 1974-78. Historically, the US has contributed to international monetary expansion even when it was running substantial current account surpluses. This was true during part of this period as well. Even at the bottom of the recession in 1975, when the US ran a current account surplus of \$18 billion, the deficit on long-term capital account more than offset the current surplus, and US liabilities to foreign official agencies increased by \$5.3 billion. Subsequently, the capital account remained in deficit while the current account moved from surplus to substantial deficit.

2.21       One of the main mechanisms for the transmission of the expansionary stance of US monetary policy to the rest of the world was the foreign lending activities of US commercial banks. US banks were relatively unconstrained by official policy during this period, and their overseas lending helped finance higher levels of activity in other countries, including OIDs. While overseas lending by non-US banks could also be (and was) demand-stimulating, the outflow of dollars from the US had an especially expansionary effect for several reasons.

2.22       First of all, there was no corresponding US current account surplus to offset the capital outflow created by, inter alia, the foreign lending of US commercial banks. As a result, world-wide deficits and surpluses were greater, and economic activity was sustained at a higher

level, than would have occurred had the US been in external balance (on an official settlements basis). This was made possible, of course, by the willingness of governments to hold dollars as part of their foreign exchange reserves. The US benefitted directly from this form of financing for its deficit, and the rest of the world experienced the indirect expansionary stimulus of the US deficit and higher international liquidity.

2.23 Because a significant portion of foreign official dollar holdings were redeposited in the Euromarkets, international liquidity was further increased through relending of these dollar deposits by US and non-US commercial banks. This higher level of liquidity provided the opportunity for developing countries to expand their international borrowings. It also contributed to exchange market instability as the inflows of dollars exceeded the desired inflows of monetary authorities, who were trying to pursue tight domestic monetary policies. To some extent, neither exchange rate movements nor domestic "sterilization" of dollar inflows were sufficient, and there was some unavoidable easing of monetary restraint in other countries.

2.24 The creation of credit was abetted during this period by the rapid growth in the activities of banks operating in the Euromarkets. Excluding interbank transfers, Eurocurrency liabilities grew at an annual average rate of 18.5% in 1974-78, compared with growth rates for the narrowly and broadly defined US monetary aggregates (M1 and M4) of 6.3% and 8.5% respectively. For borrowers and lenders alike, the Euromarkets offered a more efficient form of financial intermediation (meaning, essentially, that the spread between the borrowing and lending rates was lower than in the traditional

forms of intermediation) and, therefore, Eurobanking exerted an expansionary influence on the international economy. This was particularly important for the developing countries since they accounted for about half of publicized Eurocurrency credits, with the Euromarket supplying more than half of developing countries' total use of private finance.<sup>1/</sup>

2.25 Controversy has surrounded the question of whether the Euro-markets add to their expansionary impact by internal credit creation. Compared with domestic banking activities, Eurocurrency lending enjoys advantages conveyed by the absence of regulation, in particular by the absence of a formal reserve requirement on deposits denominated in foreign currency. Theoretically, as long as borrowers from the Eurobanks transfer the funds to recipients who redeposit within the system, the market has a potentially very high credit multiplier. Although many observers believe the size of the Euromarkets depends more on superior efficiency in using the reserve assets provided to domestic banking systems by central banks, credit creation certainly has taken place within the Eurobanking system thereby expanding the volume of credit that can be created from a given increase in the money base.

2.26 Prospects for Monetary Policy: Both because of exchange market instability and the weakness of the dollar and, more importantly because of a resurgence of concern about internal inflation, US monetary policy tightened sharply during 1979. Monetary authorities now seem determined

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<sup>1/</sup> The absence of information on private placements makes it impossible to determine accurately just how important the Euromarkets are for OIDs. For some countries, the Euromarkets have been the only source of private commercial finance.



to maintain tight monetary conditions in the face of further oil price increases; they recognize that inflation will not eliminate the income losses imposed by oil price increases and that it has inhibited severely necessary economic adjustment. This is true also of the monetary authorities in other industrial economies. They are less concerned about expanded levels of unemployment in their economies than they are with the need to eliminate inflation, and given the difficulties national authorities have experienced in adjusting fiscal policies, they are likely to continue to rely heavily on monetary policy.

2.27 Two consequences of the change in stance of, especially US, monetary policy are likely to be detrimental to developing countries in the next few years. Contractionary monetary policies will depress the levels of activity in the industrial economies with an accompanying decline in the growth of demand for imports (including oil imports). OPEC surpluses will tend to fall, and as developing countries will have considerable difficulty in maintaining the growth rate of their exports, undesirable deflationary pressures will be transmitted to them. However, while deflationary pressure will act to lower imports in the OECD, as argued earlier, the current account deficits of OECD countries are unlikely to be eliminated easily.

2.28 The second consequence of tighter monetary policy relates to the financing of the US current account deficit. As long as monetary conditions in the US are stringent, capital outflows will be inhibited and capital inflows encouraged. The bulk of the current account deficit, therefore, is likely to be financed by net long-term inflows of private capital rather than by expanding dollar liabilities to foreign central



banks. Thus, the stimulus to credit creation arising from dollar outflows from the US will be much more muted and the international capital markets will be much less liquid.

#### Conclusion

2.29 These considerations point to tighter financial markets over the next few years than existed on average over the 1974-78 period of adjustment, one major effect of which will be relatively higher interest rates and wider spreads. For developing countries in particular, this has troublesome implications. As in all tight capital market conditions, the largest and most creditworthy borrowers will obtain desired finance, albeit at higher cost. Unfortunately, the prospect of continued OECD deficits means that the pressures on developing countries--generally judged to be relatively less creditworthy--will be especially severe. Thus, the OIDs probably face an even harder adjustment problem in the 1980s than they did in the mid-1970s. The international environment seems certain to be more deflationary than after the previous round of oil price increases, and developing countries are likely to find their access to capital restricted both by slower growth of the capital markets, by more intense competition for funds, and by more discrimination in spreads.

2.30 At present, the real interest being paid by the OIDs on floating rate borrowings is positive for the first time in almost a decade. For some borrowers, the real rate of interest may be as high as 5% or 6%. Continuation of high interest rates will have serious adverse effects on many OIDs' debt servicing ability as the debt acquired during the 1970s becomes more and more a real burden on their economies rather than one which is depreciating over time relative to export earnings.

### III. Commercial Bank Lending to Developing Countries

3.01 By common agreement, commercial banks have played a major and highly successful role in recycling the OPEC surpluses during 1974-78. However, this has not been accomplished without strains on the banking system and concern has been expressed as to whether banks can continue to (i) expand their total lending at comparable rates in the future; and (ii) maintain the share of developing country borrowers in their portfolios. The first of these issues relates to the deterioration of the asset structure of commercial banks and the inadequate capital base with which they enter into another round of massive OPEC surpluses. The second issue will be decided by the degree to which some banks have already reached internal portfolio limits to their exposure in some developing countries and by the results of the efforts of bank regulators to control bank exposure in developing countries.

#### Problems Stemming from Inadequate Bank Capital

3.02 The rapid expansion of bank lending during the seventies has been accompanied by a significant increase in leverage as the capital base (shareholders equity plus retained earnings) of the banks has failed to keep pace with the growth in earning assets. The capital base represents the buffer for absorbing unexpected losses and, although an "adequate" level of capital is difficult to define--bank regulators in different countries use different measures for and accept different amounts of leverage--clearly there is for any given country's capital market a prudent level below which a bank's capital to assets ratio should not fall. Once this level has been reached a bank's lending activities can increase no

faster than, and therefore are constrained by, the bank's capital base. The banking industry and its regulators were sensitized to the question of capital adequacy by the turmoil in the capital and exchange markets in 1974. Losses in foreign exchange markets caused the well-publicized collapse of Bankhaus Herstatt. Three major American banks--the National Bank of San Diego (1973), the Franklin National Bank (1974) and the Hamilton National Bank (1976)--also failed, primarily as a result of poor management, foreign exchange losses and bad real estate loans.<sup>1/</sup> Many other banks suffered losses in foreign exchange dealing and real estate, and the publicity surrounding these losses, the decline in dividends thereby forced upon banks, and the knowledge that banks were lending increasingly to "unreliable borrowers" in the developing countries led to a public perception that banks are a risky investment; the result was a decline in the market value of bank stocks.

3.03 Despite frequently voiced admonitions to improve capital-to-asset ratios, banks continued to expand their assets faster than their capital bases. By end-September 1979, the ratio of capital to assets for the US money center banks had declined to 3.5% from 4.5% at the end of 1972. The banks have been handicapped in their attempts to raise capital by: (i) the need to maintain dividends in the face of fluctuating earnings; (ii) the low market price relative to book value of bank stock; and (iii)

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<sup>1/</sup> It is worth noting in this regard that no bank in recent history has failed in the US because of inadequate capital nor has a relatively high level of capital saved a bank from failure caused by other factors. Of far more importance is the loss of confidence brought on by large income losses in relation to earnings or other management failings.



the difficulty in maintaining the value of the capital base under conditions of high inflation. Other US banks are less leveraged than the money center banks, but the banks of some other countries--Japan and Canada in particular--are even more highly leveraged.

3.04 As a result of the Basle agreement of 1974, bank supervisors in all countries have undertaken to ensure that a bank's commitments throughout the world are not disproportionate to the capital base of the parent group in its home country. It seems quite unlikely that regulatory action will impose rigid constraints on lending by commercial banks in any country, but it will reinforce financial and economic pressures that are likely to make future growth of international lending by the major banks more dependent on the growth rate of their capital bases than has been the case in the past. For the major US banks, this presents particular problems because of prevailing unfavorable conditions for raising new equity capital and because some banks' existing exposure in relation to capital in individual developing countries already attracts regulatory comments. British banks have somewhat similar problems, compounded by the fact that their equity is mainly in sterling, which has fallen in value relative to the banks' external assets. How binding of a constraint this will be for the major German banks is unknown. The relationship between their external assets and their capital bases has been strengthened by exchange rate effects, but there is some concern that consolidation of international and domestic lending (due for the first time this year) will show some banks to be under capitalized. In the case of the Japanese banks, capital ratios are not binding but administrative restrictions may be constraining (see below).



3.05 To some extent, a reduction in the rate of growth of lending by the major banks should be offset by an increase in the international lending activity of second-tier US banks and some non-US, including OPEC, banks with comparatively strong capital bases.<sup>1/</sup> However, profitability may have to increase to induce the second-tier banks to enter the market; they are much smaller in aggregate than the major banks and probably more risk-averse with respect to developing countries, and they have benefitted less in the past from the substantial underwriting fees on Eurocredits that have made such lending profitable for the large banks even though spreads have been small. The spread between borrowers' and lenders' rates will rise and maturities are likely to shorten. Weaknesses in the major banks' capital bases are also likely to produce upward pressures on spreads as the banks seek the higher profitability needed to attract equity capital and generate more retained earnings. On balance then, the capital adequacy problem is likely to slow the growth of total commercial bank lending, including lending to developing countries, and make it significantly more expensive.

#### Portfolio Limits

3.06 Despite the rapid increase in bank lending to developing countries during the past decade, banks have been very selective in their allocation of funds among borrowers. Consequently, the bulk of outstanding loans is concentrated in a select group of developing countries. Brazil and Mexico together account for over a quarter of outstanding bank claims on developing

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<sup>1/</sup> Some potential new entrants are quite large. Caisse Nationale de Credit Agricole, which is just beginning to lend internationally, is larger in terms of assets and capital than either Bank of America or Citibank.

countries; the top five borrowers account for about 50% of outstanding claims; and the top twenty borrowers account for over 80% of outstanding claims.

3.07 In one respect, the degree of concentration of lending argues for a continued ability of commercial banks to lend to developing countries. Banks entering the new market for loans to developing countries quite naturally have followed earlier lenders in concentrating on countries that were better established as market borrowers and more experienced in dealing with banks. Now that the banks have established themselves in developing countries and determined that lending there is profitable, they have an incentive to diversify their portfolios to include countries where they have not been active previously. Total commercial bank lending to OIDs is perhaps equivalent to only about 5% of the total assets of the banks reporting to the BIS and claims on Brazil--the largest LDC borrower--less than 1%.

3.08 However, there are banks that have reached levels of exposure in some countries that represent large proportions of their capital base. Moreover, in some instances banks are deriving a dangerously high proportion of their net income from their activities in a single country, thus making them very vulnerable to possible defaults or interruptions of service payments.<sup>1/</sup> The banks themselves and their regulators (see also below) are concerned about the magnitude of possible losses from the failure of a

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<sup>1/</sup> For example, in 1977 Citibank derived more of its income from Brazil than any other single market including the United States.

single borrower, so some borrowers may find that they no longer are able to rely on their customary banking sources for finance. While interbank lending will ensure that funds flow to the banks with the ability to lend, it seems almost certain that there will be an increase in costs to some borrowers.

#### Regulatory Constraint

3.09        There is concern among bank regulators that the increase of foreign lending in the past several years has resulted in imprudent lending by private banks. Pressure on regulators has been increased by the concern expressed in Congress that the US banking system itself was being put at risk by the over-extension of private banks in developing countries. The example of Zaire was cited frequently to illustrate how Congress could be compelled to use public funds to bail out the private banks in order to preserve the stability of the domestic banking system. Underlying this is a more general concern that commercial bank lending has been imprudent in a macroeconomic sense and has enabled certain borrowers to sustain inappropriate economic policies. Adjustments may be delayed by commercial lending, and when a country eventually does have to seek assistance from the Fund the outcome is much more deflationary.

3.10        Prior to the 1979 oil price increases, the regulation of commercial bank lending showed a clear trend towards greater stringency world-wide, with regulators taking a much more cautious view of exposure in developing countries. With the re-emergence of serious payments imbalances, central banks and other regulatory authorities must now balance the need for the international banking system to play a key role in recycling the surpluses

against their prudential concerns about lending to LDCs and the counter inflationary stance of monetary policy. The monetary authorities of the UK, Germany and Switzerland as well as the BIS are now stressing the need to avoid actions that could unduly restrict international bank lending.

3.11 The next few years are likely to witness delicate maneuvering by regulatory authorities. Consolidated reporting of foreign and domestic lending will be pursued where it is not already required, and authorities may wish to see improvements in the profitability of international lending. Potentially, consolidated reporting could restrict the activities of some banks in the Euromarkets. The deterioration of OIDs' growth and trade will add to concern about commercial bank exposures in these countries. This could intensify regulatory pressures on the banks to avoid financing deficits that authorities believe should be reduced or eliminated.

#### Conclusion

3.12 The preceding discussion points to a more conservative, risk-averse environment that will govern developing countries' borrowing from the international capital market in the next few years. Key factors that contributed to the rapid expansion of commercial bank lending to LDCs are no longer present: capital bases are more highly leveraged than they were in 1974; portfolios now contain substantial amounts of LDC debt; and regulators have tightened their control on lending to developing countries. The impact on the volume of capital available to developing countries is not cut-and-dried; other forms of financial intermediation and other lenders in the banking community will probably take up slack left by restraint in lending



by the major international commercial banks.<sup>1/</sup> The efficiency with which resources flow in the interbank market will work to offset capital and portfolio constraints on particular banks. The danger, however, is that the OPEC surpluses will be recycled less efficiently (in an economic sense) in the early eighties than they were in the mid-seventies. The constraints faced by the international banking system will reinforce upward pressures on the cost of borrowing by the OIDs. Reasonably creditworthy borrowers will still be able to borrow, but at higher spreads than have existed in recent years. The combination of higher real interest rates--stemming from the more restrictive macroeconomic environment--and higher costs of intermediation will put additional strain on the debt servicing capacity of many OIDs.

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<sup>1/</sup> Direct investment flows, one potential alternative to commercial bank lending, are not considered explicitly in this paper primarily because their ability to contribute significantly to capital flows in the next few years is limited. Clearly, stepped direct investment from OPEC countries could have a major impact on capital flows to developing countries in the long run.

#### IV. Developing Countries' Creditworthiness

4.01 A third reason why the flow of resources to OIDs is likely to be less favorable in the 1980s than in the 1974-78 period relates to the OIDs' creditworthiness. The OIDs enter the 1980s with a legacy of not yet complete adjustment to the 1973-74 oil price rise and succeeding events. Now they must deal with a further sharp reduction in their terms of trade and current account positions against a background of tighter financial markets, slower OECD growth and, collectively at least, weakened creditworthiness.

4.02 As was discussed above, the unexpected buoyancy of OID growth in the 1970s was due in substantial part to the availability of large amounts of private capital on commercial terms. The overall conclusion to be drawn from the preceding sections is that such finance will continue to be available but at higher cost and in less rapidly growing amounts than previously. The question addressed in this section is whether OIDs can (and should) attract the volume of commercial resources needed to prevent their growth rates from falling still further. A review of preliminary projections for a sample of OIDs suggests that while there are countries (e.g., Korea) that will be able to maintain a reasonable growth rate by relying on the same pattern of financing as in recent years, for many OIDs the risks are very high that the flow of resources will not be adequate to sustain even the reduced growth rates now projected for them. These risks stem mainly from the demanding nature of the adjustment programs required to sustain growth while keeping external capital needs within reasonable bounds. If these adjustment efforts are unsuccessful, the debt servicing capacity of many

OIDCs may be over-reached. Because creditworthiness is likely to be severely strained even with these adjustment programs, access to larger borrowing on commercial terms most likely will not be of much help to many OIDs in raising growth rates or in assuring successful adjustment.

4.03 This section first reviews briefly the nature of the adjustment process required and then illustrates the problems confronting OIDs with several country examples.

#### The Adjustment Process

4.04 Two groups of countries with current creditworthiness problems can be identified. The first group contains countries such as Ghana, Zambia, Zaire, Turkey and Somalia where emergency financial packages have been put together but where banks are unwilling to enter into extensive new commitments. In addition, it includes countries that have experienced arrearages on debt-service payments and/or have requested debt negotiations, in some cases under the threat of default unless concessions are made. Countries falling into these categories are, for example, the Dominican Republic, Sierra Leone, Sudan, Tanzania and Pakistan. Such countries will probably have to undertake deflationary fiscal and monetary policies aimed at reducing import levels and, hence, external capital requirements. This type of action is what is normally regarded as necessary to "adjust" to a worsened external environment. It is, however, an unfortunate outcome for these countries for two reasons; first, it represents a significant loss of economic growth for countries that can ill-afford sluggish or declining levels of activity even temporarily. Second, it makes more difficult adjustments of a longer-term structural nature that are desperately needed

to enable these countries to cope with steadily rising real cost of energy and slower growth in OECD countries. These structural changes, which involve greater import substitution, development of new export markets and improved energy conservation or production, are all far easier to undertake in an expansionary context than a deflationary one. Many of the changes will require sustained and perhaps increased investment levels in some sectors. Some investment will have to be directed towards energy conservation which may not add to capacity or increase labor productivity. These considerations suggest that consumer goods imports will need to bear the brunt of the adjustment in the trade balance. In some instances, per capita consumption may need to fall in real terms for several years if investment is to be maintained.

4.05       The second group of countries includes those that depend heavily on continued net inflows of commercial capital while confronting very fragile balance-of-payments situations. This group of countries runs a serious risk of severe debt service problems and disruptive financial "rescue operations" before the mid-1980s, if they continue to borrow heavily on commercial terms. Countries that tentatively might fall in this group include Bolivia, Costa Rica, Ivory Coast, Kenya, Morocco and the Philippines. While these countries have somewhat more room to maneuver than the first group in making needed structural adjustment, they must attempt to maintain private capital inflows while hopefully pursuing non-deflationary economic adjustment programs. If their external sectors start to deteriorate further (as seem likely), pressure will build to impose monetary and fiscal restraint in order to preserve creditworthiness. Their key policy problem



will be to develop the adjustment programs that preserve as much growth as possible and then convince private creditors to continue supplying needed finance. If these countries' creditworthiness declines--or is perceived to decline by private creditors--potential shortfalls in private capital inflows will reduce growth and also forestall the adjustment measures needed to make these economies' growth rates less vulnerable to rising energy costs and sluggish OECD growth.

Specific Country Examples

4.06 Brazil, the largest borrower among developing countries is a potential member of the second group mentioned above. Brazil has increased its commercial debt rapidly, in an attempt to maintain a high growth rate in the face of rising costs of oil imports. The exercise has been partially successful, but Brazil's growth rate still has fallen from a real annual average rate of 11% in 1967-73, to 7.6% in 1973-76, to about 6% in 1976-79. Oil imports in 1980 will cost Brazil an estimated \$10 billion, or about half of total imports, while debt service payments in 1980 are expected to reach \$12 billion. The estimated debt service ratio is 68%, with interest payments alone reaching 33% of exports as a result of the rapid rise in international interest rates and the high proportion, 70%, of Brazil's debt that is on floating rates linked to LIBOR.

4.07 The Brazilian situation is a stark illustration of the problems confronting the countries in the second group. Brazilian authorities are taking steps to effect the structural changes necessary to retain creditworthiness, and may have to accept a further decline in the growth rate in the short term. There may be no realistic alternative. Continuing

to push borrowing opportunities to the limit will restrain the decline in growth, but unless it is accompanied by successful adaptation of the economy to a continuing more adverse external situation, it is a high-risk strategy that may result in severely depressed growth rates in future years. While the Brazilian experience of the recent past has shown the limitations of simple rules of thumb as to the sustainable debt service ratio (what can be sustained in Brazil's case has more to do with the ease with which debt service can be refinanced rather than with coverage by exports), the sensitivity of the economy to a loss of confidence by creditors is that much higher.

4.08       An alternative to further borrowing on a large scale is to accept the high short-term costs--lower growth rates and less capital inflow--in order to implement a harsher adjustment program, designed to ensure growth prospects in the medium-term. Brazil's growth rate is already projected to fall to 4% in the 1980-85 period; in 1980-82, it is expected to be 3.4%, involving only 1.3% annual growth in per capita GNP. Given Brazil's adverse terms of trade movements and increased saving needed to adjust while continuing to grow, per capita consumption will most likely fall throughout the period. Thus, further reduction in aggregate GNP growth would appear likely to raise profoundly difficult social and political problems for Brazil. Of course, a fairly severe short term reduction in growth may become the only option if commercial banks perceive that attempts to defer needed adjustment ultimately will create insurmountable debt service difficulties.

4.09 In 1973 Morocco's external resource gap and budgetary deficit both exceeded 20% of GNP. Morocco attempted to reduce the imbalances by sharp curtailment in the investment program and associated imports, a course of action that has a serious impact on the level of economic activity. The deficits persisted and were financed in substantial part by borrowing from private commercial banks, resulting not only in a 5-fold increase in external debt between 1974-79, but also in a deterioration in the term structure of debt. Debt service increased from ...% of exports to 25%. By December 1979 gross foreign exchange reserves had been run down to less than four weeks of imports.

4.10 Per capita GNP stagnated in 1979. It is likely to decline by 2% during 1980 and is not expected to reach its 1979 level before 1985. Even this scenario is predicated on the assumption that the country can continue to compress its imports while improving upon its past export performance, raising saving rates and containing the cost of military conflict with the Algerian and Libyan Polisario forces. Even on the assumption of a highly efficient adjustment and the projected slow economic growth, private net non-concessional borrowing of well over \$7 billion is needed in the period 1980-85, which may well be an upper limit. The debt service ratio is expected to increase from 25% in 1979 (up from 6% in 1975) to 46% in 1985.<sup>1/</sup>

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<sup>1/</sup> KEY INDICATORS OF MOROCCO'S ECONOMIC PERFORMANCE: 1960-85  
(Average Annual Growth Rates)

	<u>1960-70</u>	<u>1970-77</u>	<u>1980-82</u>	<u>1982-85</u>
GNP	4.1	4.8	3.0	4.0
Population	2.7	2.8	3.1	3.1
Exports	2.5	2.1	5.8	5.7
Imports	3.3	11.9	-0.6	-0.3

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4.11 Turkey is one of the countries hardest hit by the developments of the late 1970s. From 1960 to 1977 the country had one of the best performances in terms of GNP growth, with an average of over 6.5% per annum. In the Bank's sample Panel of countries, only Brazil, Korea and Thailand did markedly better. The fast growth of GNP was accompanied by fast growth of imports, in particular oil imports, which are projected to be 130% greater in volume by 1980 than in 1972 (11% per annum) with total imports rising from \$124 million to \$3.2 billion. Exports rose more slowly than imports during the 1970s and the balance on goods and net factor services widened from less than \$5 million in 1973 to a projected figure of over \$3 billion in 1980. At the same time, workers' remittances, the growth of which had financed until 1973 the rapid growth of imports (in 1973 they paid for over 50% of imports), have fallen in absolute value and are likely to amount to only 28% of imports in 1980. Import growth was financed through borrowing from banks both on medium and short term, leading to the debt crisis and rescheduling of the late 1970s.

4.12 Unlike countries such as Egypt or Pakistan, Turkey did not benefit much from the growth in labor demand in the Middle East. Despite a projected reversal of the trend in workers' remittances, improved export growth and a reduced volume of imports, net borrowing will continue to be required on a large scale. Slow GNP growth is expected until 1985, implying a significant reduction in per capita consumption and at best stable employment (domestic employment grew at 1.5% per annum with GNP growing 7% per annum). Nevertheless, the debt service ratio is projected to rise from 20.7% in 1979 (when it led to a debt crisis) to 43% in 1985. Thus, Turkey

will find it difficult to finance faster growth or less drastic adjustment through higher borrowing on commercial terms. At the same time, one must be aware of the fact that the projected slow growth and compression of consumption may also be incompatible with orderly adjustment and a gradual return to a development path after 1985.

4.13 The Philippines achieved a very respectable per capita GNP of over 3% per annum in the 1970s. This growth rate was sustained by augmenting domestic resources with large foreign borrowing. The current account deficit during 1975-79 averaged 5.3% of GNP compared to 3.5% for all middle-income OIDs. During 1980-82, the Philippines' reliance on external savings is likely to be even higher at over 6% of GNP compared to 3.7% for all middle-income OIDs. The Philippines' reliance on private capital has not only led to a rapid increase in total indebtedness, but also to a deterioration in the term structure of debt. On quite favorable assumptions about the cost of borrowing and about trade developments, the debt service ratio is expected to rise to 25% in 1982 and 34% in 1985.<sup>1/</sup> Provided the Philippines succeeds in containing petroleum imports--an assumption

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<sup>1/</sup> KEY INDICATORS OF PHILIPPINES' ECONOMIC PERFORMANCE: 1960-85  
(Average Annual Growth Rates)

	<u>1960-70</u>	<u>1970-77</u>	<u>1978-79</u>	<u>1980-82</u>	<u>1982-85</u>
GNP	5.1	6.4	6.0	5.5	6.0
Exports	2.2	5.0	2.1	5.9	5.6
Imports	7.2	4.4	10.5	0.7	2.6
Debt Service Ratio (End Period)		14.1	17.9	24.9	34.1

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crucial to the projected adjustment--the Philippines' growth prospects are reasonable but further acceleration of growth would appear to be constrained by debt servicing limits.

#### Conclusion

4.14 OIDs face a significantly worsened creditworthiness position than they faced in 1974-75, which will make their task of adjusting the structure of their economies to a continued more adverse external environment that much more difficult. Some countries, which have already encountered severe debt crises, may need to take steps to deflate their economies in order to restore balance in the external sector. For them the adjustment process is doubly constrained by a lack of external resources and GNP growth. Others still have access to commercial sources of finance but are vulnerable to a deterioration in their creditworthiness in the short term--particularly if they continue to borrow heavily on commercial terms. They face a difficult problem of balancing present versus future growth according to the use they make of commercial finance to sustain growth over the next few years.

4.15 Some OIDs' positions are quite weak. Even with significantly reduced growth rates in the 1980s as compared to the 1970s, these countries will find it difficult to sustain creditworthiness, particularly if the structural adjustment programs are unsuccessful. There is a further substantial risk that commercial sources of financing, upon which the OIDs relied heavily in the previous period of crisis, will not consider some OIDC's creditworthy for the volume of external finance that will be required to make needed structural adjustments while continuing to grow. Nor for



that matter does it appear likely that many OIDs will be able to service adequately even a reduced flow of commercial funds as compared with the 1970s.

4.16       The possibility that commercial banks may be unwilling to continue lending to support financial adjustment of the type required is, of course, one of the main objections to the use of medium term private capital for development financing purposes. Much of the commercial bank financing provided in the late 1970s was seen by lenders and borrowers alike as essentially short term financing of balance of payments disequilibria. Now that it is recognized that the problem faced by the OIDs was structural in nature, these countries clearly require longer term financing. To some extent commercial bank financing has become "permanent" i.e., major banks have entered new markets to stay and will therefore lend more or less continually to the same customers including, where necessary, roll-over of debt obligations that (temporarily) cannot be met. In this regard, the banks are only playing the same role in developing countries that they do in the industrial countries.

4.17       But the pressure and temptation to cease lending would be strong when economic management in a country is weak, especially among banks that may not have the same interest in international diversification as do the US money center banks. When creditworthiness deteriorates, some banks will seek to recover funds and of course this will compound the creditworthiness problem. In short, the traditional concern about developing countries' reliance on short term private finance is still well founded despite the rapid internationalization of banking in recent years. On the

other hand, since the bulk of international capital flows are essentially short term, it is not possible for developing countries to restrict themselves to long-term sources of finance except at considerable cost in terms of growth. There continues to be a need for some mechanism to: (a) convert this large volume of short- to medium-term capital flows into a stable and more permanent finance for developing countries; (b) orient the financing more onto programmatic development objectives and structural adjustments intended to restore, maintain or enhance a country's creditworthiness; and (c) reduce the cost of such funds wherever possible to enable countries to sustain growth momentum without encountering intolerable debt service burdens.

## V. Response by the International Community

5.01 By contrast with the initiatives introduced in 1974-75, the international community has done little so far in 1979-80 to meet the adjustment needs of oil-importing countries. The muted response to their prospective difficulties results partly from the internal preoccupations of the OECD countries and partly from the comparative lack of drama surrounding the recent oil price increases; the spot market gave ample warning of the likely levels of future oil prices. Possibly, also, the international community has become more "aid weary", despite the number and variety of international meetings, proposals and calls for action.

5.02 In the preceding crisis, the international community mobilized in three ways, namely: (a) an expansion of assistance through traditional bilateral channels; (b) an expansion of assistance through existing multi-lateral channels; and (c) the introduction of new mechanisms to stimulate capital flows to developing countries. The most notable examples of "new mechanisms" were the two IMF oil facilities; they were implemented rapidly, they were a clear addition to the existing functions of the Fund, and they were designed more to recycle monetary balances than to finance balance-of-payments adjustment. There have been no such similar actions this time.

5.03 Nor is there evidence of a significant expansion of assistance through existing channels. A preliminary assessment of the prospects for ODA flows leads to the following conclusions:

- (i) Prospects for significant increases in ODA flows from the DAC members have deteriorated markedly since the summer of 1979. The projections on which WDR-III ODA flows are based appear low measured against the needs of developing countries for concessional assistance but they seem decidedly optimistic in the current international environment.



- (ii) The potential for increasing concessional assistance to low income countries by a reallocation of DAC aid away from high and middle income countries is more limited than initial examination of the existing aid distribution suggests.
- (iii) Multilateral institutions are not receiving the support that they did during the early seventies, and their disbursements appear likely to increase only slowly in real terms. The main hope for more rapid disbursement lies in substituting program for project assistance.
- (iv) OPEC donors have the means to finance significant additional transfers to developing countries. Some increase in their aid efforts seems certain but nothing firm is known about their intentions. To date, attempts by some OPEC donors to expand the resources of OPEC multilateral institutions have been disappointing. Major increases in assistance in the short-term therefore will have to be provided by the major bilateral donors--Saudi Arabia, Kuwait and UAE.

5.04 International political developments and the heightening of international tension could result in different outcomes. The volume of aid both from DAC and OPEC donors may expand relative to what might have been expected in a less tense environment. Unfortunately, much of any additional aid offered may be military rather than development assistance. In addition, increases in politically motivated aid flows are unlikely to result in redistribution towards lower income countries; to the contrary, some low income countries may find that their shares in aid flows decline if aid is redirected towards client countries in sensitive regions.

5.05 At the multilateral level, initiatives have been limited to attempts to make the existing resources of the IMF more attractive to borrowers; to expand the role of program lending by the multilateral lending agencies; and, by some OPEC donors, to establish a new international development fund financed by a tax on oil exports. The OPEC proposal is

an attractive one. However, OPEC members have not yet agreed on proposals for comparatively modest increases in the capital of the OPEC Special Fund. The most recently proposed increase--\$1.6 billion, to bring the total capital of the Fund to \$4.0 billion--cannot be discussed until the apportionment among numbers of the earlier increase of \$800 million has been determined.

5.06 Attempts to make IMF resources more attractive to developing countries have originated within the Fund rather than outside. A Fund staff recommendation to the Board to extend the maturity of drawings under an extended arrangement from 8 to 10 years has already been approved. More informally, there has been talk of an interest subsidy for developing countries, but no firm proposals have been advanced. The reaction of the international community appears to have been that the IMF is not in need of additional resources; the existing resources are sufficient to finance the balance-of-payments adjustment programs of its members. The implication is that this time the Fund will not play a role in recycling the OPEC surpluses, but will make its contribution to the financing needs of the OICs basically from of its own resources. This makes it likely that the conditionality of Fund assistance will be on average more stringent than in the previous period of crisis. At that time, the bulk of drawings on the IMF were in low conditionality facilities (i.e., oil, compensatory and first credit tranche). Care must be taken that conditions for use of IMF resources are not so stringent that the Fund finances a sharp deflation rather than a smooth adjustment.

5.07       The expansion of program lending by the multilateral lending agencies, especially the World Bank, also is proposed as a means of helping developing countries adjust. The loans would be advanced in support of programs of structural adjustment to respond to higher energy prices and to reduce external deficits. However, no additional resources have been provided to the multilateral agencies; program lending will use resources at the expense of projects that otherwise could have been financed. Of course, in the short term, program lending for adjustment should be a more productive use of finance than project lending. The limited resources available for such lending, however, suggests that the ability to sustain growth rates during the adjustment process will be strained severely.

#### Conclusion

5.08       So far, the response of the international community to the requirements of developing countries for additional capital from official sources has been muted in comparison with the previous oil crisis and with the need for specific action to secure capital needed to support an adequate level of growth. Developing countries do not face an adjustment problem that is self created. Quite the contrary, it has been imposed on them from abroad. Developing countries that dealt with the earlier adjustment problem comparatively successfully did so in part because flows of official capital were sufficient for growth rates to be maintained at reasonable levels while necessary structural changes took place. Without similar assistance during the next few years, the developing countries will have to adjust over a shorter period, the consequence being that growth rates will fall further than they did last time.



# VI. Financing the OIDs' Deficits

6.01 The table below sets out preliminary projections of the OIDs' aggregate current account deficit in the 1980s and its financing. As the table shows, the flow of resources to the OIDs is expected to grow much more slowly in the 1980s than in the 1970s. From 1980 to 1985, OIDs' use of external capital will increase by only 4.4% per annum, compared to 15.4% from 1975 to 1980. This represents a sharp decline in real terms.<sup>1/</sup>

## OIDS DEFICITS AND FINANCING: 1975-90

	Current \$ Billions				% Average Annual Growth		
	1975	1980	1985	1990	1975-80	1980-85	1980-90
Current Account Deficit	35.3	57.0	63.8	72.0			
Additions to Reserves	-5.0	5.3	13.3	27.4			
Total to be Financed	30.3	62.3	77.1	99.4	15.4	4.4	4.8
Private Direct Investment	4.0	6.0	9.0	16.2	8.1	8.8	10.6
Medium & Long Term Loans	21.9	45.9	60.8	78.4	16.0	5.7	5.5
Official Sources	8.4	14.5	26.7	41.9	11.5	13.0	11.2
• Concessional	5.3	7.3	17.4	26.9	6.6	19.0	13.9
• Non-Concessional	3.1	6.2	8.4	14.9	14.9	6.3	9.2
Private Sources	13.6	31.4	34.1	37.1	18.2	1.7	1.7
Other Capital	4.3	10.4	7.3	4.7	19.0	-7.1	-8.2

<sup>1/</sup> The projected growth rate of external capital in the 1980s is substantially less than that contained in last year's World Development Report in part because of the higher than anticipated inflows in 1979-80 which have constrained borrowing in later years (on creditworthiness grounds) and also raised the base for measurement.

6.02 As the figures in the table indicate, private direct investment in the OIDs is expected to continue growing at about the same rate as the past. Most of this flow benefits the middle income OIDs and will constitute an increasing proportion of these countries' external financing in the 1980s (13.1% in 1985 compared to 10.2% in 1980).

6.03 Despite a substantial increase in use of short-term capital (mainly trade related finance) the main source of finance for all OIDs will continue to be medium and long term loans. There is expected to be a major shift in the relative proportions of private and official sources of such loans, however, reflecting the more restrictive environment for OID borrowing from private sources and the potential for more rapid disbursements of official funds. Concessional lending by official sources is expected to increase by 19% annually in the 1980-85 period, a development that will result in healthier debt structures for many OIDs. This relatively favorable outlook for official flows is seen also in projected official net transfers, which are expected to increase by 13.5% from 1980 to 1985, about the same rate as in the late 1970s. By 1985, official transfers will cover about 17.7% of OIDs aggregate deficit on current account (excluding transfers) as against 11.4% in 1980 and 9.8% in 1975. Private medium- and long-term borrowing by the OIDs will show no significant growth in the 1980s and will decline by more than 17% in real terms, reflecting the tighter conditions in capital markets, reactions by OIDs to the sharply increased real cost of funds and the limited scope for servicing additional debt.

6.04 Real resource transfers will decline sharply in the 1980s from a level that was already almost 20% lower in 1980 than in 1975. By 1985, real net transfer of about \$20 billion will be 44% of the amount transferred in 1975 and by 1990 it will be only about one-sixth of the 1975 level. The net transfer of resources in 1990 will finance less than 1% of OIDC imports; 90% of gross borrowings in that year will go towards the financing of debt service.

6.05 As discussed in previous sections, the OIDCs face not only less favorable prospects for capital flows but a continued sluggish external environment for export growth and permanently worsened terms of trade due to the oil price increases of 1979-80. The burden of maintaining their growth in the early 1980s, therefore, will fall on domestic efficiencies and policy improvements. Growth is less likely to be sustained either by buoyancy in the OECD countries or in increased flows of external savings than was the case in the 1970s.

6.06 This leaves the OIDCs in a generally precarious position. The risks are very high that they will not be able to implement successfully the structural adjustments needed to grow at reasonable rates while reducing the dependence on foreign capital from the renewed peak of 1980. In the present environment, growth could fall sharply or even become negative for many countries, if these adjustment programs fail. It would be clearly desirable for the economic pressures on the OIDCs to be relieved, at least in part, by expanded capital flows on appropriate terms. This would enhance the likelihood of their being able to keep growth rates up and reduce the risks of failure in adjustment programs.

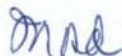


March 6, 1980

Mr. McNamara,

As you know, my own outlook with respect to our borrowing prospects, is not as bleak as that of Gene but I do agree with him that we should begin to put the machinery in place which would enable us to have substantial access to the U.S. market if and when we find it necessary to do so.

You are undoubtedly aware that our existing managers are going to say to you that the addition of one or two more investment banking firms to our syndicate is not going to help one little bit. I personally feel that the addition of Merrill Lynch, in particular, would bring the kind of security retailing capabilities to our syndicate which no other investment banking firm has. In regard to the agenda for discussion I hope that you will put the issue of the Bank's recourse to the U.S. market in a longer term perspective, and not raise definitive expectations that we shall go to the U.S. market in the beginning of FY 81. I feel strongly that we must carefully evaluate this issue within the next 2-3 months in the light of market developments and the success we have had in the intervening period, and then determine the appropriate timing and extent of our move into the U.S. market.



Moeen A. Qureshi

## OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara ✓  
 Through: Mr. Moeen A. Qureshi  
 FROM: Eugene H. Rotberg *ER*

DATE: Marcy 6, 1980

SUBJECT: New York Visit to Salomon Brothers, Morgan Stanley and First Boston

The bond markets in Germany, Japan and Switzerland have deteriorated even further during the last week. Our Swiss public issue of two weeks ago, brought to market at 5 3/4% at 99 1/2, is trading between 92 and 93. There is a hiatus on further issues. The Deutsche Bank has advised us that a 10-year placement in Germany today would require a coupon of 9 1/2% as compared to 8 1/2% two to three weeks ago. Our Investment Division has been offered Japanese government bonds with a two-year maturity of 10.61% and the response of the Japanese authorities to our request for access to the domestic market (in size) has not been encouraging. These conditions make it difficult to assess how much we will have to borrow in US dollars in FY81; it is clear, however, that there is a lot of work to be done in connection with the managing syndicate, educating investors and attracting the attention of salesmen and financial institutions.

I recommend as a first step that you visit with the three above-named firms separately and discuss with them (a) how they would propose to finance the Bank in dollars over the next three years; (b) what are their projections for interest rates and timing; and (c) their frank views on the addition of Merrill Lynch and Goldman Sachs as syndicate co-managers. I propose that before such meetings we advise our current managing underwriters that these are the subjects on the agenda and provide them with some background material. I think that a discussion which encompasses the size of our borrowing program, how it is to be financed as well as the current conditions of the market will place the question concerning Merrill Lynch and Goldman Sachs in a somewhat less threatening perspective.

Timing

I suggest a dinner/evening meeting in New York on Thursday, April 3, and two meetings on Friday, April 4, or, alternatively, a dinner/evening meeting on Thursday, April 10, and the two remaining meetings on Friday, April 11. I would think that each meeting would take two hours. While time-consuming, I think it preferable to have separate meetings with the three firms; otherwise each firm would have to take a "public" position against adding Merrill Lynch and Goldman Sachs, which might not be the case in private meetings. I also think that separate meetings will give us a better feel of each firm's reactions to market conditions, their attitude toward our financial program and to the Bank, their particular expertise, etc., which is not likely to come out in a joint meeting.

*Flanigan, return 3/11/80  
 me 3/3/80  
 Conrad  
 Ben  
 Hughes  
 Bond  
 return 3/3/80*

*(9411:46 for 12/29/79)*

*Flanigan  
 Hughes  
 my schedule  
 15:30 on 3/27/80*

Mr. Robert S. McNamara  
(through Mr. Moeen A. Qureshi)

March 6, 1980

Dr 4/3  
i.e. 4/3  
I would think that within a week thereafter, you might make a firm decision and communicate that decision to Merrill Lynch and Goldman Sachs and to the other managers. Then, assuming Merrill Lynch and Goldman Sachs are added, it may be necessary to consider the size of the full syndicate, the underwriting and selling responsibility of the five firms vis-a-vis other members, the role of the major European banks, etc. I would also plan, under the sponsorship of all five firms, to set up a series of financial seminars throughout the United States and in Washington to bring up to date the financial community with our financial affairs and general policies.

May I have your reaction to the procedure involved and whether you are available on these dates (or others) so that I might communicate the foregoing to our managers.



March 5, 1980

Mr. McNamara,

Attached is a list of briefing papers for discussion regarding assignment of primary responsibilities and establishment of appropriate dates for completion.

Moeen A. Qureshi

cc: Messrs. Damry  
Husain  
Nurick  
Gabriel  
Golsong  
Murli

## CHINA - BRIEFING PAPERS

1. The first set of papers, for which the Legal Department will assume primary responsibility, will cover the following topics

- (i) Quotas and subscriptions (including Board representation);
- (ii) Procedures for admission;
- (iii) Implications of Bank-IMF relationships;
- (iv) Financial obligations;
- (v) Taiwan (ROC);

Separate papers will be prepared for IDA and IFC, even though many of the issues may be common.

2. The second set of papers will deal with the following operational issues:

- (i) (a) Economic Brief (based on available data);  
(b) Program for initiation of systematic economic work;
- (ii) Creditworthiness;
- (iii) IDA eligibility;
- (iv) Operational strategy: alternative approaches;
- (v) Impact on the Bank Group:
  - (a) Financial;
  - (b) Organizational;

The East Asia and Pacific Region will assume primary responsibility for these papers except 2(v) regarding the impact on the Bank Group, for which the Programming and Budgeting Department will have primary responsibilities.

3. The target date for completion of all papers will be March 25, 1980, but individual papers will be circulated as they are completed. Specific earlier dates will have to be set for some of the papers listed above to permit informal discussion of the issues involved with members of the Board and the IMF.

## OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara  
DATE: March 5, 1980  
FROM: Moeen A. Qureshi *mdq*  
SUBJECT: Commitment of exchange gains accrued on IDA contributions after the close of a replenishment period

This note is for your information and, if you wish, for circulation to the Finance Committee. *7 Mandy*

In my view, while there are financial risks in committing exchange gains, this paper makes particularly heavy weather of them. *Free*

When Ernie originally raised this matter with me, I thought that, should there be excessive delay in the passage of the aid bill (and the Continuing Resolution not be forthcoming), we could use this source on the understanding that we would reconstitute IDA 4 when the U.S. third tranche funds were released.

There is no longer that need; we expect to get the U.S. funds under the Continuing Resolution.

On the question of whether we should now decide, as a matter of policy, whether we should, or should not, be prepared to commit exchange gains after the end of the replenishment period, my own view is that there is no necessity to take such a decision at this time, one way or the other. Among other things, I have China in mind. I am not now suggesting that such exchange gains could, in one form or another, be allocated to China, but I feel that we are going into a period when we need to have as much potential flexibility in our policies and procedures as possible, and we should not close any options that might be available in the future.

MAQureshi:gmb



## OFFICE MEMORANDUM

TO: Mr. Moeen A. Qureshi, Vice President, Finance  
Through: Mr. K. Georg Gabriel, Director, PAB  
FROM: Paul V. Applegarth, Chief, Financial Analysis, PAB  
SUBJECT: Commitment of IDA Exchanges Gains after End of  
Replenishment Period

DATE: February 26, 1980

1. Attached please find a draft paper, requested at the last Finance Committee meeting, on committing IDA exchange gains. The paper recommends against committing exchange gains arising after the close of a Replenishment period, until disbursements on credits committed under the Replenishment are completed.
2. This paper was requested for the next Finance Committee meeting. If you agree, we would propose to distribute it to the Committee on February 29.
3. You may wish to clarify the disposition of the paper with Mr. McNamara. As we understand it, the paper is for Finance Committee review. If the intention is to circulate it to the Board some editorial changes may be necessary. It may also be preferable to delay its circulation until after the situation regarding the third tranche of IDA5 is clarified.

Attachment

PVApplegarth:sl

COMMITMENT OF EXCHANGE GAINS ACCRUED ON IDA CONTRIBUTIONS  
AFTER THE CLOSE OF A REPLENISHMENT PERIOD

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Introduction

1. This note examines whether IDA should adopt a policy of committing exchange gains on member contributions that may accrue after the close of the pertinent replenishment period. The issue immediately facing the Association relates to exchange gains on non-dollar contributions to IDA4, and the note therefore focuses on the situation obtaining with respect to IDA4 resources. After examining the potential benefits and risks associated with the commitment of post-replenishment period exchange gains, the note concludes that on balance it would be prudent not to commit the available funds under IDA4. Many of the arguments developed in the note are however of general validity, and the conclusion would be applicable to future replenishments as well.

Availability of IDA4 Resources

2. At the time of the Fourth Replenishment Agreement in Nairobi (September 27, 1973), the total value of members' contributions was \$4,435 million, computed at <sup>the time</sup> prevailing market rates of exchange. It was agreed to commit these contributions in three equal amounts, that is about \$1,500 million annually, in the FY75-77 period. In the two years subsequent to the Nairobi Agreement, exchange rate changes did not alter the total IDA4 value significantly. As a result, the Association committed \$1,576 million and \$1,655 million in FY75 and

FY76 respectively, taking into account further resources available from Bank transfers and other sources. By June 1976, however, the value of member contributions had dropped by about \$350 million to \$4,083 million.<sup>1/</sup> Consequently, commitments in FY77 were limited to \$1,308 million. The remaining balance available for commitment at the end of the IDA4 commitment period (June 30, 1977) amounted to only about \$5 million, as shown below:

<u>US \$ Equivalent of IDA4 Resources at the End of the Commitment Period</u>		<u>\$ million</u>
IDA4 Contributions <u>a/</u>		4151.5
Part II Releases		13.7
Transfers from IBRD <u>b/</u>		290.1
Cancellations		18.6
Repayments		40.4
Grant Participations		22.4
Balance Available 7/1/74		1.0
Net Income <u>c/</u>		6.5
Total IDA4 Resources		4544.2
Less: Commitments FY75-77		4538.9
Balance Available		5.3

a/ Valued at exchange rates prevailing on June 30, 1977; includes adjustments for amounts disbursed till that date.

b/ Net of grants for agricultural research and for onchocerciasis control.

c/ Excludes devaluation losses on Swiss loans, which do not affect commitment authority.

1/ The decline in the dollar equivalent of Fourth Replenishment contributions was caused by the depreciation of all member currencies against the dollar. A significant portion of the loss, representing about 87% of the decline, was attributed to the change in the value of contributions from France, Germany, Italy, Japan and the United Kingdom.



3. After June 30, 1977, the value of member contributions underwent a small further decline of about \$7 million, reaching a level of \$4,144 million at the end of December 1977. The trend was sharply reversed thereafter, and significant exchange rate gains were registered on the undisbursed portions of non-dollar contributions (Attachment I). As of January 31, 1980, the available IDA4 resources amounted to \$378 million (Attachment II).

4. The principal benefit from committing these resources is that it would help to ease the present constraint on commitment authority in the IDA Fifth Replenishment. As a result of delay in the receipt of the third installment of the US contribution to IDA5, the third tranche of member contributions is not yet effective. Consequently, after the available commitment authority was exhausted late in 1979, all IDA credits have been approved on a conditional basis, subject to the availability of additional commitment authority. As of this date, there have been 20 such conditional credits, for a total of \$670 million. Use of the additional resources from IDA4 would enable several of these credits to be made effective.

5. This benefit is offset, however, by several significant risks. Legislative action is still to be completed on the delayed US contribution of \$292 million, so that the timing of its receipt must be regarded as uncertain. If the US funds have still not been received when IDA4 nears full disbursement (FY85 approximately) and the IDA4 exchange gains were not committed, the gains, assuming they

still exist, would be available to make up some or all of the shortfall. If this amount is excluded from consideration for the present, the balance available gets reduced to the much smaller figure of \$86 million.

6. More importantly, committing the exchange gains involves the risk that funds will not be available when needed for disbursements. This can happen if the dollar strengthens against the other replenishment currencies, with a consequent exchange loss for IDA, during the period between commitment and disbursement. In such a case, IDA has the legal right to transfer resources from one replenishment to meet obligations arising under any other replenishment (except for IDA2, for which special arrangements were made). Language to this effect was in fact included in the IDA5 Agreement at the request of the United States and in the original drafts of the IDA6 Agreement. It was subsequently deleted from IDA6, again at the request of the United States who objected that the possibility of such switching would circumvent the carefully negotiated conditions of payment under each replenishment, as well as understandings reached with Congress on the use of funds in each replenishment. Notwithstanding this deletion, the General Counsel has given an opinion that as a legal matter the resources available under one replenishment (except for the Second Replenishment) are available if necessary to meet obligations arising under any other replenishment. Thus the problem of a shortfall is less a legal one

than one of whether it is in IDA's interest to incur the risk of violating donors' wishes in what is an essentially voluntary association.<sup>1/</sup> If it is decided that donor contributions of one replenishment would not be used, or used only as a last resort, to meet obligations arising from commitments under another replenishment, then such obligations can be funded, at least for IDA4, only through the temporary diversion of repayments from past credits. These repayments will be relatively small for the next several years, <sup>2/</sup> and in any one year might well be insufficient to cover a funds gap arising from exchange losses. The other important source of free funds, namely net income, would not be available since IDA is not expected to earn any surplus from current operations till FY87. The use of repayments for disbursement could result in serious cash flow problems for IDA because of the deficits.

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<sup>1/</sup> There is also a real financial risk to be considered. If there is a delay in reaching agreement on a future replenishment, there would in fact be no additional member contributions that could be diverted to meet the shortfall, and other resources may be insufficient. Moreover, even if there is an agreement, diversion of member contributions may still not be possible, either because of a stipulation against it in the agreement itself, or because the agreement fails to become effective as a result of members falling behind in their payments (as has happened in IDA5).

<sup>2/</sup> Repayments in FY81-85 are likely to be as follows: FY81-\$33 million; FY82-\$44 million; FY83-\$58 million; FY84-\$78 million; FY85-\$96 million. These repayments would normally be included in the determination of the commitment authority for the replenishment periods in which they fall due. If the Swiss loans to IDA2 and IDA3 are converted into grants, an additional \$1 million on average will be available annually through FY85.

7. Committing to the limit against exchange gains in IDA4 may not be prudent for another reason. These gains provide some protection for the Association's policy of fully committing exchange gains on IDA5 contributions during the IDA5 commitment period. Use of the IDA4 resources would eliminate this safeguard for IDA5. Furthermore, making additional commitments to utilize exchange gains that have accrued after the end of a replenishment period, without providing for a corresponding reduction in commitments when there are exchange losses, introduces an asymmetry in policy that increases the risk of a future shortfall of funds. 1/

8. The potential costs of committing the IDA4 exchange gains are thus considerable. The benefit, though real, is not substantial when viewed against the extent of the present shortfall in IDA5 commitment authority. 2/ The conditional credits already made (\$670 million) exceed the \$378 million available from IDA4, so commitment of the latter will not gain additional time for the Association. On balance, therefore, it appears financially prudent to hold the IDA4

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1/ It should be noted that after the dollar devaluations of 1972 and 1973, the increases in commitment authority (reckoned in current dollars) arising from exchange gains were fully committed, including the portions pertaining to previous replenishments. However, these exchange gains arose from a change in par values that was expected to be maintained, and thus the risks of committing them were substantially less than the ones arising under a system of floating exchange rates as at present.

2/ Planned credits during the rest of the current fiscal year call for the commitment of an additional \$2,320 million.



resources in reserve and not to commit them until disbursements already committed under IDA4 are completed. A decision could be taken at that time on the utilization of the balance, if any, of IDA4 resources still available. 1/

9. The risks discussed above will for the most part apply also to future IDA replenishments. It would be prudent, therefore, to follow a similar policy for them as well.

Financial Analysis Division  
Programming and Budgeting Department  
February 26, 1980

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1/

If large exchange gains build up towards the close of the disbursement period, the Association could plan for their commitment even before disbursements on previous commitments are actually completed.

379  
WORLD BANK / INTERNATIONAL FINANCE CORPORATION

March 5, 1980

Mr. McNamara:

Attached is a draft Board  
paper on the Swiss Franc Central Banks  
issue, for your approval.

*M.A.Q.*  
Moeen A. Qureshi

3/6

*Approved*  
*Law*

## OFFICE MEMORANDUM

TO: Mr. Moeen Qureshi  
 (Through Mr. Eugene H. Rotberg)  
 FROM: Joseph P. Uhrig  
 SUBJECT: Proposed Swiss Franc Central Banks Issue

DATE: March 5, 1980

The attached Board paper is for Mr. McNamara's approval. The paper has been cleared by the Legal Department. We would plan to distribute this paper on Thursday, March 6 for consideration by the Board on Tuesday, March 11.

This would be the second offering by the World Bank of Swiss franc denominated notes to central banks and other governmental institutions. Our last offering was in September 1979, for SwF 200 million maturing in 4 years. The new issue would also be in an amount of SwF 200 million (about \$116.7 million equivalent) but, at the suggestion of the Swiss National Bank (SNB) and also to offer maturity diversification to subscribers, the maturity would be for 3 years. We would hope that the SNB would allow such issues to be made also in the future, either annually or semi-annually.

At the request of the SNB, we agreed that our offering cables would include the following provisions, which applied also for our last central banks offering in Swiss francs: (a) that purchaser buy with US dollars the Swiss francs required for the payment of the notes, through the SNB at market rates; (b) that the notes be held in custody with the SNB (there would be no charge for the custody of the notes); and (c) that transfers, subsequent to initial delivery of the notes, be made only to another central bank or other governmental institutions and only after consultation with the SNB. In addition, the SNB has requested that no offering cables in respect of the new issue be sent to central banks of the Group of 10. (In respect of our last issue, the SNB had informally expressed a preference to Group of 10 central bank representatives that they not participate; participations in that issue aggregated SwF 29.2 million by 4 such central banks, i.e., 14.6% of the issue.) On the other hand, the SNB has arranged for the Swiss Confederation to take SwF 30 million of the new issue on a stand-by basis.

The final pricing would be on Monday, March 10, in consultation with the SNB. If the issue were priced today, we would recommend an annual coupon of 5-3/4% at par. This would result in a yield of 5.67%. After taking into account a handling fee of 1/16%, payable to the SNB, and encashment commissions of 1/8% on coupons paid and 1/16% on Notes redeemed, the total cost to the Bank would be 5.72%. On this basis the revaluation breakeven point would be 25.4% in relation to a 3-year dollar borrowing at a cost today of 14%.

*J.P.U.*

For consideration on  
March 11, 1980

R80-

FROM: The President

March 6, 1980

PROPOSED SWISS FRANC THREE-YEAR NOTES OF 1980, DUE 1983

1. The attached draft Resolution (Attachment I) authorizing the issuance and sale by the Bank of SwF 200,000,000 principal amount of Three-year Notes of 1980, due April 15, 1983, will be considered by the Executive Directors at their meeting on Tuesday, March 11, 1980.
2. The principal terms of the proposed borrowing would be as follows:
  - (a) Principal amount: SwF 200,000,000 (US\$116,672,500 equivalent\*).
  - (b) Maturity: 3 years. The Notes would be dated April 15, 1980 and be repayable at par on April 15, 1983.
  - (c) Interest rate, issue price and cost to the Bank: To be discussed at the meeting of the Executive Directors.
3. The Notes which would be in bearer form in denominations of SwF 100,000, SwF 500,000 and SwF 1,000,000 would be sold to central banks and other governmental institutions. They would not be secured by any lien, and a negative pledge clause would be included.
4. The Bank would enter into an Agreement with the Swiss National Bank for the purpose of servicing the Notes. The Agreement would provide for the payment to the Swiss National Bank of a fee of 1/16% of the principal amount of Notes issued and of encashment commissions of 1/8% on the amount of coupons paid and 1/16% of the principal amount of Notes redeemed. The Swiss National Bank would also act as custodian for the Notes, free of charge to purchasers of the Notes.

Distribution

Executive Directors and Alternates  
Senior Vice President  
Vice President, Operations  
Vice President, Finance  
Vice President and General Counsel  
Vice President and Treasurer  
Controller

\*Based on the market rate as of  
March 3, 1980 of US\$1 = SwF1.7142



5. Under the proposed timetable for the issue, the offering cables to the prospective purchasers would be sent on Tuesday, March 11, 1980 subsequent to the Executive Directors' consideration of the issue on that date. The offering would close on March 18, 1980.

6. The proposed borrowing would be charged against the FY80 Borrowing Program. The amount borrowed to date applicable to FY80, including the amount of the proposed three-year issue, would be \$4,779.7 million (see Attachment II).

Recent market yields on selected World Bank Bond issues are given in Attachment III.

Robert S. McNamara

Legal Department  
March 3, 1980

ATTACHMENT I  
Page 1 of 3

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

(DRAFT)

RESOLUTION NO. 80\_\_

Authorizing the Issuance and Sale of \_\_\_\_%  
Swiss Franc Notes of 1980, due April 15, 1983

WHEREAS International Bank for Reconstruction and Development (hereinafter called the Bank) has determined to issue and sell an issue of Swiss Franc Notes of the Bank in an aggregate principal amount not to exceed SwF 200,000,000 to be known as the \_\_\_\_% Swiss Franc Notes of 1980, due April 15, 1983;

NOW THEREFORE BE IT RESOLVED AS FOLLOWS:

1. The Bank hereby creates an issue of its notes to be known as the \_\_\_\_% Swiss Franc Notes of 1980, due April 15, 1983, of the Bank (hereinafter called the Notes); in an aggregate principal amount to be determined by the President or the Vice President, Finance or the Vice President and Treasurer but not to exceed SwF 200,000,000 (except for Notes issued in lieu of or in exchange for lost, destroyed or mutilated Notes); to mature April 15, 1983; and to provide for the payment of interest at the rate of \_\_\_\_ per centum (\_\_\_\_%) per annum, payable annually on April 15 in each year, the first payment to be made on April 15, 1981.

- 2 -

2. The Notes shall be bearer notes dated April 15, 1980, with interest coupons attached and shall be otherwise in such form and in such denominations as shall be approved by any of the persons specified in paragraph 4 of this Resolution.

3. Notes shall be signed in the name and on behalf of the Bank with the signature of its President or its Vice President, Finance, and shall be countersigned by its Vice President and Treasurer or its Director, Treasury Operations and Deputy Treasurer, and a facsimile of the Bank's official seal shall be printed, lithographed or engraved thereon. The coupons shall bear the signature of the Vice President and Treasurer or the Director, Treasury Operations and Deputy Treasurer of the Bank. Any signature or countersignature provided for in this paragraph may be manual or facsimile.

4. Subject to any approval required from the Government of Switzerland, the President, the Vice President, Finance, the Vice President and Treasurer, the Director, Treasury Operations and Deputy Treasurer, the Vice President and General Counsel, the Associate General Counsel, the Chief, Financial Operations Division, and the Director, European Office of the Bank are fully authorized, jointly and severally, in the name and on behalf of the Bank to sell for Swiss Francs the Notes at a price of 100 per cent of the principal amount thereof and upon such other terms and conditions as such person or persons shall determine.

5. Pending the preparation and delivery of definitive Notes, a temporary global note in the aggregate principal amount of the Notes to be issued may be executed and delivered to the Swiss National Bank, as custodian for the purchasers.

- 3 -

Such temporary global note shall be in such form as shall be approved by any of the persons specified in paragraph 4 of this Resolution and shall be signed manually in the name and on behalf of the Bank by any such person.

6. Any of the persons specified in paragraph 4 of this Resolution are hereby authorized, jointly and severally, in the name and on behalf of the Bank, to enter into such other agreements, to execute, publish and deliver such notices, reports and other documents, and to do any and all such other acts and things as any of the persons specified in paragraph 4 of this Resolution shall deem necessary or advisable in order fully to carry into effect the purposes of this Resolution.



INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
ACTIONS TO BE CHARGED AGAINST BORROWING PROGRAM FOR FISCAL YEAR 1980

Country/Institution	Approved	Terms (Yrs.)	Average Life (Yrs.)	Amount (million)		Yield to Initial Purchaser-%	Cost to IBRD-%	Recent Market Yield-%
				Currency	\$ equiv.			
Switzerland	5/08/79	10.0	10.0	SwF 100	58.1	4.57	5.01	6.24
Japan (Loan)	5/29/79	20.0	17.5	¥ 30,000	136.7	8.00	8.03	N.A.
Japan (Loan)	5/29/79	20.0	17.5	¥ 40,000	182.3	8.10	8.13	N.A.
Japan (Loan)	5/29/79	20.0	17.5	¥ 12,000	54.7	8.00	8.06	N.A.
Japan (Loan)	5/29/79	20.0	17.5	¥ 18,000	82.1	8.10	8.16	N.A.
Japan (Private)	5/29/79	20.0	17.5	¥ 15,000	68.4	8.06	8.12	N.A.
Switzerland (Loan)	6/05/79	7.0	7.0	SwF 100	57.5	4.45	4.51	N.A.
Libya (Private)	6/12/79	7.0	7.0	DM 300	156.6	7.38	7.38	N.A.
Germany	7/03/79	12.0	12.0	DM 400	217.3	7.75	7.81	9.24
Switzerland (Private)	7/12/79	6.0	6.0	SwF 200	121.5	4.33	4.66	N.A.
Germany (Private)	7/19/79	5.0	5.0	DM 250	136.9	8.00	8.00	N.A.
Germany (Private)	7/31/79	8.0	8.0	DM 200	110.7	7.08	7.35	N.A.
Central Banks (Private)	8/09/79	2.0	2.0		350.0	9.40	9.40	N.A.
Germany (Private)	8/09/79	6.0	6.0	DM 400	219.2	7.09	7.32	N.A.
Germany (Private)	8/28/79	15.0	15.0	DM 150	81.9	7.85	7.97	N.A.
Germany (Private)	8/28/79	10.0	10.0	DM 50	27.3	7.68	7.73	N.A.
Germany (Loan)	8/28/79	20.0	20.0	DM 100	54.6	7.97	7.97	N.A.
Germany (Loan)	8/28/79	15.0	13.0	DM 150	81.9	7.95	7.97	N.A.
Switzerland	8/28/79	10.0	10.0	SwF 150	90.4	4.27	4.66	6.44
Switzerland (Loan)	8/28/79	6.0	6.0	SwF 200	120.5	4.64	4.70	N.A.
Central Banks (SwF Private)	9/11/79	4.0	4.0	SwF 200	120.7	3.96	4.01	N.A.
Mexico (Private)	9/18/79	5.0	5.0	DM 150	82.8	6.94	7.00	N.A.
Saudi Arabia (Private)	9/18/79	5.0	5.0	DET 100	55.2	6.88	6.89	N.A.
Switzerland	10/16/79	12.0	10.5	SwF 100	61.4	4.57	5.00	6.21
Japan (Private)	10/16/79	6.5	6.5	¥ 30,000	132.5	7.71	7.71	N.A.
Germany (Private)	10/16/79	15.0	15.0	DM 250	138.5	7.85	7.88	N.A.
Germany (Private)	10/16/79	15.0	15.0	DM 200	110.8	7.85	8.01	N.A.
Japan (Loan)	10/30/79	20.0	17.5	¥ 55,000	234.5	8.30	8.34	N.A.
Japan (Loan)	10/30/79	20.0	17.8	¥ 30,000	127.9	8.30	8.34	N.A.
Germany	12/11/79	10.0	10.0	DM 250	145.3	7.73	8.03	N.A.
Germany (Private)	12/11/79	10.0	10.0	DM 100	58.1	7.73	7.99	N.A.
Japan	12/18/79	15.0	12.3	¥ 30,000	128.2	8.23	8.52	N.A.
Austria	1/7/80	10.0	8.0	\$ 1,000	81.0	7.93	8.39	N.A.
Third Window	3/22/76	25.0	13.0		8.2	8.50	8.50	N.A.
Germany (Private)	1/15/80	5.0	5.0	DM 250	145.6	8.60	8.60	N.A.
Germany (Loan)	1/15/80	12.5	12.5	DM 100	58.2	8.22	8.22	N.A.
Germany (Loan)	1/15/80	12.5	12.5	DM 100	58.2	8.22	8.22	N.A.
Switzerland (Private)	1/15/80	6.0	6.0	SwF 150	95.3	5.43	5.78	N.A.
Central Banks (Private)	2/12/80		2.0		350.0		12.65	N.A.
Switzerland	2/21/80	10.0	9.5	SwF 100	62.0	5.80	6.27	N.A.
			9.6		4,663.0		7.73	
Central Banks (Proposed Private Placement)		3.0	3.0	SwF 200	116.7			
			9.4		4,779.7			

N.A. - Not Applicable

Projected Average Returns/Costs on IBRD Assets and Liabilities for FY80

	Balances as of June 30, 1980 (in \$ billions)	Returns/Costs <u>1/</u> (in %)
Cash and Investments	8.9	8.5
Receivable from disbursed loans	26.8	7.9 <u>2/</u>
Other Assets	<u>1.8</u>	-
Total Assets	<u>37.5</u>	<u>7.7</u>
Borrowings	28.8	7.7
Other Liabilities	1.3	-
Capital and Reserves	<u>7.4</u>	-
Total Liabilities, Capital and Reserves	<u>37.5</u>	<u>5.5</u>

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<u>1/</u> Current Yields/Costs are:	Investments	9.86
	Borrowings Outstanding	7.20
	Borrowings to date - FY80	7.73

2/ Interest on loans and commitment charges as a percent of average disbursed loans outstanding.

ATTACHMENT III

Recent Market Yield on Selected World Bank Bond Issues

<u>Issues</u>	<u>Recent Market Yield %</u>
7% Canadian dollar Bonds of 1968, due 2/15/93	13.75
7-1/4% Belgian Franc Bonds of 1972, due 3/1/84	11.65
7-3/4% Deutsche Mark Bonds of 1979, due 7/1/91	9.24
6-1/2% Japanese Yen Bonds of 1978, due 7/28/93 (Ninth Series)	8.44
6-1/4% Yen Bonds of 1977, due 8/15/84	10.32
8% Netherlands Guilder Bonds of 1976, due 5/16/86	10.47
4-5/8% Swiss Franc Bonds of 1979, due 9/25/91	6.44
7-1/8% United States dollar Bonds of 1977, due 8/1/82	14.98
7-3/4% United States dollar Bonds of 1977, due 8/1/87	13.98
8.35% United States dollar Bonds of 1977, due 8/1/2002	13.27

Mr. Robert S. McNamara

March 5, 1980

Moeen A. Qureshi

Criteria for Selective Capital Increases

There are two points that I would like to flag in connection with this paper. We have liberalized the criteria in comparison to the earlier draft and incorporated proposals for selective increases in individual countries. Nevertheless, Kuwait is one of the countries that does not meet the criteria. Kuwait's present quota is over 90% of its calculated quota in the Fund, and therefore the only case for increasing its quota in the Bank would be the fact that it has made a relatively high contribution to IDA. Second, the proposed 25% increase recommended for Korea is on the generous side and we are stretching the argument somewhat, mainly because of Korea's desire to increase its quota and our continuing dialogue with that country for some time on this issue.

If this paper is approved after the Finance Committee review then I would like to take up this subject informally with the Directors before circulating it.

MAQureshi:gmb



## OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara  
Through: Mr. Moeen A. Qureshi, Vice President, Finance  
FROM: K. Georg Gabriel, Director, PAB  
SUBJECT: Criteria for Selective Capital Increases

DATE: March 4, 1980

1. Attached please find a revised draft of the Board memorandum on Criteria for Selective Capital Increases. The draft incorporates the comments made in the Finance Committee on the earlier version, and also makes specific recommendations for selective increases to 21 member countries from whom requests have been received.

2. If you agree, we would propose to distribute the new draft to the Finance Committee for the meeting on March 11.

Attachment

JMurli:sl

CRITERIA FOR SELECTIVE CAPITAL INCREASES

Introduction

1. At the time the Executive Directors approved the proposals for selective increases in Bank capital subscriptions for Japan and France in 1979, 1/ several Directors expressed the view that it would be desirable to agree on the criteria for determining such increases before considering any new proposals. This memorandum suggests certain general criteria that the Bank might use in considering requests for special capital subscriptions. Specifically, it recommends that selective increases in the Bank should be based essentially on the principle of parallel action to the Fund, with some flexibility for the Bank to grant selective increases independent of the Fund when it would be in the Bank's interest to do so. Such action may be justified in recognition of special actions of member countries that further the objectives of the Bank Group, or when there is a significant change in the economic circumstances of member countries that enables them to play a larger role in the Bank. The memorandum recommends the grant of selective increases to [21] member

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1/ Japan - Increase in Subscription (R79-29, dated February 22, 1979)  
and France - Increase in Subscription (R79-44, dated March 8, 1979).

countries, [18] based on existing principles and [3] applying the new criteria.

Bank Policy in the Past

2. At the Bretton Woods Conference in 1944, it was intended that the initial subscriptions of the original members of the Bank be equal to the members' Fund quotas. However, twenty-three developing countries requested lower subscriptions to the Bank's capital, and the shortfall was taken up by three countries -- Canada, China and the United States -- that subscribed more than their Fund quotas indicated (Appendix 1). 1/

3. Since then, members' quotas in the Fund and subscriptions in the Bank have been increased on several occasions. Following the Bretton Woods precedent, the Bank has adopted a policy of maintaining proportionality between IMF quotas and Bank capital subscriptions, and has authorized increases in capital subscriptions whenever there was a selective increase in Fund quotas.

4. The quota increases in the Fund have been the end result of

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1/ In 1956 (Brazil) and 1979 (Yugoslavia), two of the original twenty-three obtained special capital increases which brought their Bank subscriptions into line with their Fund quotas (cf. R-976, dated June 22, 1956 and R79-23, dated February 14, 1979). These increases, which permitted the two countries to make up the initial shortfall in their subscriptions, were granted in recognition of their growing economic strength that enabled them to assume a greater share of the burden of financing the Bank.

a process that commences with the preparation by Fund staff of sets of quota calculations based on recent economic data, using various formulae used in the past. The results of several of these formulae are then combined to determine a "calculated" quota for each member. The Fund staff also prepares tables indicating the divergence between calculated quotas and the actual quotas as a result of previous increases. These tables and calculations then form the basis of the quota negotiations that end with a set of "agreed" quotas approved by the Fund's Governors. Although the principal purpose of special increases in Fund quotas is to adjust the relative positions of individual member countries to reflect changes in their positions in the world economy, it is important to recognize that the "agreed" quotas are arrived at on the basis of a number of considerations which include, but are not confined to, the relative financial and economic standing of countries indicated by the quota formulae. 1/ Quota reviews are required at intervals of not more than five years, 2/ and the "agreed" quotas become the actual quotas when countries subscribe

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1/ In the past, these considerations have included:

- (1) to give certain developing countries access to more conditional liquidity in the Fund (prior to Fifth General Review of Quotas, 1970);
- (2) to meet the needs of the Fund for additional resources through special increases granted to industrial countries (Fourth Review of Quotas, 1965).

2/ The Seventh Review of Quotas took place in 1978, only three years after the previous review.



to them.

5. In the Bank, the general policy that has emerged with regard to capital increases has been the following:

- General increases in the capital of the Bank are determined by the objectives and specific needs of the Bank. For example, the General Capital Increase under consideration at present is primarily necessitated by the need to sustain current and projected higher levels of lending in the future.
- Selective increases are granted to further the policy of parallelism with the Fund. Thus, whenever the Fund has granted a selective increase in quotas, whether to individual countries or to a group of countries, the Bank has taken parallel action so that the increases authorized in Bank subscriptions are in the same proportion as the selective increases in the Fund. For purposes of parallel action in the Bank, the common component (percentage), if any, of quota increases for all countries is regarded as a general increase, and the balance is regarded as a selective increase for the countries concerned.

6. Separating Bank increases in this manner into general

increases independent of the Fund and selective increases parallel to selective increases in the Fund has helped to ensure that the relative positions of countries in the two institutions were similar even though the sizes of the institutions may have changed because of general increases. 1/

Criteria for the Future

7. Over the years, the principle of parallelism has served the Bank well. It has generally ensured that increases in the Bank's capital come from the richer and faster-growing countries. It is a simple and practical system, which has avoided duplication of time-consuming negotiations. It is consistent with the precedents of Bretton Woods, which have been reviewed and endorsed by the Executive Directors on several subsequent occasions. 2/

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1/ Parallel action has not achieved perfect parallelism, although relative positions of member countries in the Bank and the Fund are quite close (Appendix 2). Differences can be traced to the smaller initial subscription to Bank shares by 23 developing countries (paragraph 2), and converse action by three other members; to occasional decisions by members not to take up their authorized Fund quotas, while taking up their authorized additional Bank shares, or vice versa; to the occasional exercise of preemptive rights by some member countries (Article II, Section 3(c) of the Bank's Articles of Agreement gives each member country the right to purchase shares in the new capital increase in proportion to their existing holdings.); to the two selective capital increases of 1979 referred to in paragraph 1; and to the decision to grant each IBRD member 250 "membership" shares as part of the General Capital Increase.

2/ See, for example, Draft Report of the Executive Directors, attached to Special Increases in Certain Subscriptions to Capital Stock, dated February 14, 1979, (M79-24). See, similarly, M70-4, dated January 7, 1970 and R69-221, dated November 24, 1969.

8. The various reasons that have justified the use of parallelism in the past continue to be valid. It is therefore desirable from the point of view of the Bank as well as its members to retain parallelism as a cornerstone of Bank policy, and it is recommended that the Bank do so. However, parallelism should not be so strictly applied as to prevent the Bank from authorizing in exceptional circumstances special increases beyond those agreed in the Fund even when there is a consensus among Bank members that such increases would be justified.

9. The idea that, in granting special increases, the Bank ought to take note of other factors is of course not new. It was recognized in the recent increases for Japan and France, as well as in earlier Board documents. 1/ The reason why the Bank stayed with strict parallel action until recently was simply that an agreed alternative was not available.

10. Selective increases which have not been preceded by action in the Fund seem most justified when there is a wide disparity between the concerned member's economic strength and support it provides to the Bank Group, and its capital participation. It is recommended that such circumstances be considered in future selective increases. It is

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1/ See, for example, Review of IBRD Capital Structure (R75-215, dated November 5, 1975), paragraph 49.

impossible to establish any sort of mechanical link between a country's economic situation, the support provided by it to the Bank Group, and the amount of the selective capital increase justified by it. One cannot list in advance all the criteria that might be relevant, although some illustrative examples of specific support can be provided. Exceptional contributions to IDA would figure prominently among them. Official long-term lending to the Bank could also constitute a valid consideration. Other types of support might also be relevant. The merits of eligible requests would have to be considered on a case by case basis; and in accordance with the Articles, all capital increases would be subject to approval by the Bank's Board of Governors.

#### Technical Aspects

11. Selective increases granted on these considerations should not be allowed to compromise, over the long-term, the principle of parallelism with the Fund. This could best be accomplished by restricting selective increases independent from the Fund to cases where a member country's authorized participation in the Bank's capital fell exceptionally short of its calculated subscription, derived from its calculated quotas in the Fund. 1/ In the past, when

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1/ Calculated subscriptions in the Bank can be derived by multiplying the Bank's total authorized capital by the ratio of each country's calculated quota in the Fund to the total of calculated quotas.



extreme divergence developed in the Fund between actual and calculated quotas, special increases authorized by the Fund have been granted to reduce them. It is therefore reasonable to expect that, provided independent action by the Bank is limited to cases of extreme divergence, such independent action will often just anticipate Fund action and will therefore constitute only a limited departure from the principle of parallelism over the long-run. While any definition of extreme divergence will be to some extent arbitrary, applying a standard that a member country's actual participation in the Bank's capital must be less than three-fourths (75%) of its calculated share seems reasonable. Out of the Bank's 135 member countries, only 16 1/ are in this position now, which serves both to indicate that a three-fourths standard is a useful measure of extreme divergence and to allay concerns that departures from parallelism with the Fund would be large.

12. The scope of the exception to the rule of strict parallelism with the Fund can be further reduced by restricting the frequency of selective increases. It would be reasonable to arrange the timing of such increases so that they are taken up immediately after quota reviews in the Fund, which would normally be once every five years,

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1/ Of these sixteen members, two would qualify for increases under the Brazil and Yugoslavia precedents (see footnote to para. 2). If shares were granted under these precedents, one member would move above the three-fourths cut-off point.

and in addition once approximately midway through the five year period. Considering all requests for increases together at those times would be administratively convenient and would enable the requests to be evaluated in light of one another and against the same standards. It also seems desirable that member countries should be eligible for extraordinary selective capital increases, i.e. those not determined by parallelism with the Fund, only if they have taken up any shares still available to them under earlier capital increase resolutions.<sup>1/</sup> Finally, additional shares attributed to any member in such exceptional capital increases might be limited to no more than 25% of the shares already authorized for it at the time of the increase.

#### Selective Increases for Individual Member Countries

13. The criteria developed above can be employed in evaluating the requests for selective capital increases currently pending with the Bank.

14. The first group of requests involves [eighteen] countries that have followed the Brazil and Yugoslavia precedents <sup>2/</sup> in

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<sup>1/</sup> Since procedural formalities relating to subscription take time to be completed, it might be provided that for a request for a special increase to be processed, the member concerned must have applied formally for any shares available under previous resolutions and must be actively pursuing its application. The special increase, if any, authorized would be subject to satisfactory completion of action on the earlier application.

<sup>2/</sup> See footnote to paragraph 2.

requesting selective increases to bring their Bank subscriptions in line with their Fund quotas. The new criteria for selective increases proposed in paragraphs 10-12 are not applicable to these requests, since they are based solely on an existing precedent. Many of the requests were in fact received prior to the formulation of the General Capital Increase proposals last year, and a block of about 25,000 shares had been set aside in the GCI for meeting these requests as well as other requests that were expected. The table below shows the names of the countries concerned, the number of additional shares (pre-GCI) that would be required in each case to eliminate the disparity between Bank subscriptions and Fund quotas, and the further increases that would be appropriate under the principles adopted for the GCI:

<u>Member</u>	<u>Required Increase in Shares</u>		
	<u>Pre-GCI</u>	<u>Increase under GCI</u>	<u>Total</u>
1. Bolivia	104	97	201
2. Brazil	31	29	60
3. Chile	533	499	1032
4. Colombia	402	376	778
5. Costa Rica	204	191	395
6. Dominican Republic	274	256	530
7. Ecuador	204	191	395
8. El Salvador	210	197	407
9. Guatemala	250	234	484
10. Haiti	14	13	27
11. Honduras	169	158	327
12. Mexico	1214	1136	2350
13. Panama	152	142	294
14. Paraguay	118	110	228
15. Peru	402	376	778
16. Suriname	42	39	81
17. Uruguay	168	157	325
18. Venezuela	1616	1513	3129
	<u>6107</u>	<u>5714</u>	<u>11821</u>

15. Since these requests follow precedent and are in consonance with the principle of parallelism with the Fund, it is recommended that the additional shares be allocated as requested. The increases corresponding to the GCI would be subject to the same "scaling down" condition as the other increases under the GCI. 1/

16. From 1959 (when Bank capital subscriptions were doubled with no additional paid-in capital) until the GCI, all new or increased subscriptions to the Bank contained a 10% paid-in portion. Under the GCI, the paid-in portion of the increased subscriptions has been fixed at 7.5%. In order to maintain parity of treatment, the proportion to be paid in of the increases proposed in paragraph 14-15 above would be so fixed as to be equivalent to a 10% paid-in portion on the pre-GCI increase (6107 shares) and a 7.5% paid-in portion on the component corresponding to the GCI (5714 shares).

17. The proposed new criteria would apply to a second group of requests for selective increases. These requests are not based on parallelism with the Fund but rely on considerations relating to economic performance in general as well as specific support for the Bank Group. Such requests have been received from Saudi Arabia, the United Arab Emirates, [Kuwait] and Korea. [As far as Kuwait is

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1/ See "IBRD General Capital Increase" (R79-57/2, dated June 20, 1979), Attachment I, paras. 6-8.



concerned, its actual subscription in the Bank, assuming that it takes up all the shares allocated to it under the various capital increase resolutions already approved, will amount to over 90% of its calculated subscription. Consequently, Kuwait would not be eligible for a selective increase under the technical criterion proposed in paragraph 11 above.] The [other] three cases are discussed individually below:

- (1) Saudi Arabia: If Saudi Arabia takes up its entire allotment under the GCI, its actual subscription would be 46.7% of its calculated subscription, implying a condition of extreme divergence in terms of the definition in paragraph 12. Saudi Arabia has subscribed to all the shares available to it under previous resolutions. It would therefore be entitled to a maximum increase of 25% of its post-GCI subscription, or 2803 shares, provided it meets the criterion relating to support for the Bank Group. As against its projected share of [1.66%] in the Bank's capital after the GCI, and a share of [2.20%] in the capital contributed by IDA6 donors alone, Saudi Arabia contributed 3.25% of both the Fifth and Sixth IDA Replenishments, and an additional \$100 million to the Fifth Replenishment. Further, the Saudi Arabian Monetary Agency has directly purchased Bank bond issues

in both FY79 and FY80, and additional borrowing from it is contemplated in coming years. Under these circumstances, and in view of Saudi Arabia's growing economic strength as a capital exporting country, we believe that it would be appropriate to grant a selective increase of 2803 shares to Saudi Arabia, amounting to 25% of its post-GCI subscription.

(ii) United Arab Emirates: This again is a case of extreme divergence, since the UAE's post-GCI share of Bank capital would be 47.2% of its calculated share. UAE meets the other technical criteria of eligibility for a selective increase, and would be entitled to a maximum increase of 596 shares. It has contributed 0.66% to both the Fifth and Sixth Replenishments of IDA, significantly in excess of its post-GCI share of [0.35%] in total Bank capital and [0.47%] in capital contributed by IDA6 donors alone. It is recommended that a selective increase of 596 shares be granted to UAE.

(iii) Korea: Assuming that Korea takes up the shares allocated to it under the GCI, its actual subscription would be [67.8%] of its calculated subscription. Since Korea also fulfills the other technical criteria for selective increases, it would be eligible for a maximum

increase of 737 shares. Korea was one of four Part II donors in the IDA Fifth Replenishment, and has increased its contribution in the Sixth Replenishment. Korea's example has encouraged other middle- and high-income developing countries to participate in the IDA replenishment exercises. In view of Korea's growing economic strength, it is hoped that opportunities for official Bank borrowing from it may also arise in the future. Korea has expressed a very strong desire to increase its share in the Bank's capital. Since it fulfils the technical criteria proposed for selective increases, it is recommended that a special increase of 737 shares be granted to Korea.

18. The proportion of capital to be paid-in may be fixed at 7.5% for the capital increases recommended in the preceding paragraph, in line with the arrangements agreed upon for the GCI.

19. An adequate number of unallocated shares is available to cover the special increases recommended in paras. 16 and 18 above. The increases would as before be subject to adjustment if the allocations under the GCI are scaled down.

#### Summary and Recommendations

20. As a general rule the Bank should continue to allocate selective increases of its capital in parallel with selective

increases of quotas in the International Monetary Fund. However, it is desirable for the Bank to have some flexibility in recognizing actions by member countries that are specially supportive of the Bank Group, as well as significant changes in their economic circumstances, particularly when those changes are not fully translated into higher quotas due to the length of the period over which the Fund reviews its quotas. Such flexibility could enable the Bank to respond positively to strong support received from its members, and to encourage and elicit further support from members for the Bank Group in the future. It would also enable the Bank to recognize changes in country positions and grant selective increases during the intervals between adjustments of Fund quotas, when there was a consensus to do so. Therefore, I recommend that requests for selective capital increases independent of action by the Fund should be eligible for consideration in the exceptional circumstances described above. Eligibility to be considered for such increases, their magnitude and their frequency should be restricted according to the criteria defined in paragraphs 11 and 12 above. I also recommend that selective increases be granted to individual countries as recommended in paragraphs 14 to 18.

[Financial Analysis Division  
Programming and Budgeting Department]



Appendix 1

ORIGINAL BANK MEMBERS WHOSE SUBSCRIPTIONS  
DIVERGED FROM THEIR FUND QUOTAS  
(See Paragraph 2)

Initial Bank Subscription higher than Fund Quota:

Canada  
China  
United States

Initial Bank Subscription lower than Fund Quota:

Bolivia  
Brazil  
Chile  
Colombia  
Costa Rica  
Dominican Republic  
Ecuador  
Egypt  
El Salvador  
Ethiopia  
Greece  
Guatemala  
Honduras  
Iran  
Iraq  
Mexico  
Nicaragua  
Panama  
Paraguay  
Peru  
Uruguay  
Venezuela  
Yugoslavia

MEMBERS' RELATIVE SHARES IN THE IBRD AND IMF

<u>Country</u>	<u>Members' Relative Shares</u>		
	<u>Post GCI</u>	<u>Post 7th Review</u>	<u>IBRD/IMF</u>
AFGHANISTAN	.137	.115	1.1880
ALGERIA	.703	.730	.9632
ARGENTINA	1.382	1.370	1.0091
AUSTRALIA	1.883	2.023	.9308
AUSTRIA	.809	.845	.9568
BAHAMAS	.114	.085	1.3524
BAHRAIN	.084	.051	1.6339
BANGLADESH	.393	.389	1.0084
BARBADOS	.077	.044	1.7626
BELGIUM	2.117	2.279	.9290
BENIN	.071	.041	1.7248
BOLIVIA	.113	.115	.9763
BOTSWANA	.058	.023	2.5211
BRAZIL	1.583	1.703	.9295
BURMA	.206	.187	1.1025
BURUNDI	.087	.059	1.4735
CAMEROON	.107	.115	.9314
CANADA	3.220	3.475	.9267
CAPE VERDE	.042	.003	12.1675
CENTRAL AFRICAN EMP	.071	.041	1.7248
CHAD	.071	.041	1.7248
CHILE	.392	.556	.7053
CHINA	1.146	.939	1.2203
COLOMBIA	.373	.494	.7553
COMOROS	.042	.006	6.9528
CONGO	.073	.044	1.6709
COSTA RICA	.075	.105	.7097
CYPRUS	.117	.087	1.3381
DENMARK	.759	.794	.9565
DOMINICAN REPUBLIC	.087	.141	.6183
ECUADOR	.142	.179	.7934
EGYPT	.509	.584	.8721
EL SALVADOR	.077	.110	.7022
EQUATORIAL GUINEA	.059	.026	2.3036
ETHIOPIA	.079	.092	.8548
FIJI	.079	.046	1.7160
FINLAND	.649	.671	.9680
FRANCE	5.065	4.914	1.0307
GABON	.103	.077	1.3375
GAMBIA, THE	.056	.023	2.4120
GERMANY	5.078	5.521	.9198
GHANA	.282	.271	1.0387
GREECE	.308	.474	.6491
GRENADA	.044	.008	5.6964
GUATEMALA	.085	.131	.6487
GUINEA	.105	.077	1.3721
GUINEA-BISSAU	.045	.010	4.4328
GUYANA	.096	.064	1.4942
HAITI	.087	.059	1.4735
HONDURAS	.068	.087	.7828
ICELAND	.101	.074	1.3538

<u>Country</u>	<u>Post GCI</u>	<u>Post 7th Review</u>	<u>IBRD/IMF</u>
INDIA	3.281	2.932	1.1189
INDONESIA	1.150	1.229	.9354
IRAN	1.653	1.835	.9006
IRAQ	.311	.400	.7772
IRELAND	.399	.397	1.0061
ISRAEL	.516	.525	.9826
ITALY	2.934	3.175	.9238
IVORY COAST	.183	.195	.9412
JAMAICA	.208	.189	1.0954
JAPAN	5.057	4.248	1.1904
JORDAN	.104	.077	1.3491
KAMPUCHEA, DEMOCRAT	.110	.043	2.5703
KENYA	.194	.177	1.1003
KOREA, REPUBLIC OF	.436	.437	.9973
KUWAIT	.954	.671	1.4205
LAOS	.071	.041	1.7248
LEBANON	.088	.048	1.8469
LESOTHO	.054	.018	2.9857
LIBERIA	.111	.095	1.1750
LIBYAN ARAB REPUBLI	.491	.509	.9641
LUXEMBOURG	.122	.079	1.5365
MADAGASCAR	.115	.087	1.3245
MALAWI	.089	.049	1.8293
MALAYSIA	.628	.648	.9698
MALDIVES	.039	.002	16.2068
MALI	.095	.069	1.3749
MAURITANIA	.073	.044	1.6777
MAURITIUS	.100	.069	1.4498
MEXICO	.940	1.370	.6863
MOROCCO	.386	.384	1.0053
NEPAL	.079	.049	1.6196
NETHERLANDS	2.235	2.428	.9206
NEW ZEALAND	.577	.594	.9713
NICARAGUA	.068	.087	.7862
NIGER	.071	.041	1.7248
NIGERIA	.879	.922	.9533
NORWAY	.727	.755	.9621
OMAN	.092	.060	1.5346
PAKISTAN	.758	.730	1.0386
PANAMA	.099	.115	.8570
PAPUA NEW GUINEA	.107	.077	1.3972
PARAGUAY	.057	.059	.9689
PERU	.305	.420	.7273
PHILIPPINES	.528	.538	.9815
PORTUGAL	.416	.440	.9442
QATAR	.140	.113	1.2415
ROMANIA	.610	.627	.9718
RWANDA	.087	.059	1.4735
SAO TOME & PRINCIPE	.041	.005	7.9962
SAUDI ARABIA	1.658	1.776	.9335
SENEGAL	.165	.108	1.5355
SIERRA LEONE	.088	.079	1.1081
SINGAPORE	.152	.158	.9635
SOLOMON ISLANDS	.042	.005	7.6588
SOMALIA	.091	.059	1.5463
SOUTH AFRICA	1.028	1.086	.9469

<u>Country</u>	<u>Members' Relative Shares</u>		
	<u>Post</u> <u>GCI</u>	<u>Post 7th</u> <u>Review</u>	<u>IBRD/IMF</u>
SPAIN	1.340	1.426	.9392
SRI LANKA	.312	.305	1.0237
SUDAN	.238	.225	1.0556
SURINAME	.083	.064	1.3025
SWAZILAND	.065	.031	2.1169
SWEDEN	1.089	1.152	.9452
SYRIAN ARAB REPUBLI	.182	.161	1.1299
TANZANIA	.163	.141	1.1547
THAILAND	.460	.464	.9923
TOGO	.089	.049	1.8293
TRINIDAD & TOBAGO	.228	.210	1.0850
TUNISIA	.171	.161	1.0612
TURKEY	.504	.512	.9838
UGANDA	.151	.128	1.1789
UNITED ARAB EMIRATE	.353	.346	1.0195
UNITED KINGDOM	7.479	7.490	.9985
UNITED STATES	22.287	21.523	1.0355
UPPER VOLTA	.071	.041	1.7248
URUGUAY	.185	.215	.8612
VENEZUELA	1.118	1.690	.6613
VIETNAM	.253	.230	1.0982
WESTERN SAMOA	.044	.008	5.6964
YEMEN ARAB REPUBLIC	.067	.033	2.0207
YEMEN, PDR	.133	.105	1.2673
YUGOSLAVIA	.685	.709	.9652
ZAIRE	.391	.389	1.0039
ZAMBIA	.366	.361	1.0146



ROUTING SLIP		DATE: March 3, 1980	
NAME		ROOM NO.	
McNamara		E-1227	
2/3			
APPROPRIATE DISPOSITION		NOTE AND RETURN	
APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
COMMENT		PER YOUR REQUEST	
FOR ACTION		PREPARE REPLY	
<input checked="" type="checkbox"/> INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS:  3/5 Returned by Mrs. McNamara			
FROM: Moeen A. Qureshi		ROOM NO.: E-1241	EXTENSION: 73665

r. Qureshi

3/2

Mr. Rotberg

89 QURESHI/ROTBERG

Copy to Mr. McNamara

DUE TO THE CONTINUED LOSS OF YEN VALUE ON EXCHANGE MARKETS, LAST NIGHT (SUNDAY) IN SEPARATE EMERGENCY ANNOUNCEMENTS, THE MOF AND BOJ ISSUED THE FOLLOWING PLAN FOR JOINT EFFORTS BY JAPAN AND, AMONG OTHERS, THE UNITED STATES:

1. STEPPED-UP INTERVENTION IN EXCHANGE MARKETS BY JAPAN'S MONETARY AUTHORITIES, COUPLED WITH A REQUEST FOR THE UNITED STATES TO DO THE SAME ON BEHALF OF JAPAN AS WELL AS THE POSSIBLE USE OF "SWAP FUNDS" HELD BY CENTRAL BANKS OF VARIOUS COUNTRIES TO STABILIZE EXCHANGE RATES.
2. RELAXATION OF CONTROLS ON THE INFLUX OF FOREIGN CAPITAL THROUGH FREE YEN DEPOSITS IN FOREIGN EXCHANGE BANKS.
3. LIBERALIZATION OF INTEREST RATES ON FREE YEN DEPOSITS BY FOREIGN CENTRAL BANKS.
4. RELAXATION OF CONTROLS ON THE FLOTATION OF YEN-DENOMINATED BONDS IN FOREIGN COUNTRIES BY JAPANESE ENTERPRISES.
5. AUTHORIZING FOREIGN EXCHANGE BANKS TO INDUCE MEDIUM AND LONG TERM IMPACT LOANS FROM FOREIGN MARKETS.

THE YEN DEFENSE PLAN WAS AGREED UPON IN CONSULTATION WITH THE UNITED STATES, WEST GERMANY AND SWITZERLAND. REGARDS

KAYA

COMMUNICATIONS DIVISION

1980 MAR -3 AM 8:38

RECEIVED

February 29, 1980

Mr. McNamara:

2/3

In the attached Board paper you will note that we are indicating that the unsubscribed principal amount of \$15.1 million be held by the Bank in expectation of this amount being allotted in the future, if and when later subscriptions come in. We are also trying to see whether it may be possible to get Iran to revolve its subscription of \$23.5 million to the previous issue - that would greatly facilitate problems we would face in retirement of those bonds since they are blocked under current U.S. regulations. We shall keep you posted on further developments in this matter.

MAAL  
Moeen A. Qureshi

3/3  
Approved  
LW



February 29, 1980

Mr. McNamara:

In the attached Board paper you will note that we are indicating that the unsubscribed principal amount of \$15.1 million be held by the Bank in expectation of this amount being allotted in the future, if and when later subscriptions come in. We are also trying to see whether it may be possible to get Iran to revolve its subscription of \$23.5 million to the previous issue - that would greatly facilitate problems we would face in retirement of those bonds since they are blocked under current U.S. regulations. We shall keep you posted on further developments in this matter.

Moeen A. Qureshi



SecM-80

FROM: The President

TWO-YEAR BONDS OF 1980, DUE MARCH 15, 1982

At their meeting on February 12, 1980, the Executive Directors approved the Issue of Two-Year Bonds of 1980, due March 15, 1982, to central banks, other governmental institutions and international organizations, in a principal amount not to exceed \$350,000,000 and an interest rate of 12.65% per annum. This Issue replaces the maturing Issue of 7.75% Two-Year Bonds of 1978, due March 15, 1980 in the principal amount of \$350,000,000.

Although the principal amount authorized for the new Issue was \$350,000,000, we received firm subscriptions totalling \$334,900,000. The unsubscribed principal amount of \$15,100,000 will be held by the Bank in the expectation of this amount being allotted in the future.

There is attached a Schedule (Attachment I) which shows the countries which responded to this offering of the Bank's two-year bonds, their subscriptions and whether or not the subscriptions were equal to their maturing holdings or represented an increase or reduction over their maturing holdings. Of the 63 subscribers to this Issue of two-year bonds, 37 subscribers rolled over their maturing holdings aggregating \$99.2 million and 23 subscribers, including those who were not holding bonds of the maturing issue, increased their subscriptions to this Issue over their maturing holdings by \$119.5 million for subscriptions aggregating \$224.2 million. Twenty countries holding \$125.4 million of the maturing Issue did not subscribe of which over \$85 million was held by 3 central banks alone. Three subscribers reduced their subscriptions to the new Issue over their maturing holdings by \$7.9 million.

Distribution:

Executive Directors and Alternates  
Senior Vice President  
Vice President, Operations  
Vice President, Finance  
Vice President, and General Counsel  
Vice President and Treasurer  
Controller

When we recommended an interest rate of 12.65% for this Issue to the Executive Directors for their approval, there was a 5-basis point spread between the rate recommended and the yield (12.60%) on a U.S. Treasury note with a similar maturity. Immediately subsequent to the offering of the Bank's two-year bonds there was a rapid deterioration in the U.S. market and yields on two-year U.S. Treasury notes went from 12.60% to 14.02% prior to the close of the subscription period.

Also attached is a Schedule (Attachment II) showing in detail the subscribers to this Issue, the amounts allocated and the purchasers of the Bank's previous three Issues of similar two-year bonds.

Robert S. McNamara

Responses  
to the Bank's Offering of  
12.65% Two-Year Bonds of  
1980 due March 15, 1982  
(in millions)

	<u>Response</u>	<u>+ or (-) Over Maturing Issue</u>
Abu Dhabi	No	-
Afghanistan	1.3	-
Algeria	3.0	1.0
Argentina	14.0	0.6
Australia	2.0	0.7
Austria	1.0	-
Bahrain	2.0	1.0
Bangladesh	No	(1.0)
Belgium	10.0	6.5
Bolivia	0.5	0.5
Brasil	8.0	-
Burma	1.0	-
Canada	No	(16.8)
Chile	No	(4.0)
China	1.3	-
Colombia	4.0	-
Costa Rica	No	-
Cyprus	1.0	-
Denmark	2.7	-
Dominican Republic	No	(0.5)
Ecuador	3.5	-
Egypt	No	-
El Salvador	No	(0.2)
Fiji	0.5	-
France	5.0	2.3
Germany	18.8	2.0
Ghana	0.7	-
Greece	1.0	-
Guyana	No	-
Honduras	0.5	-
Iceland	1.0	-
India	7.0	2.3
Indonesia	20.0	10.0
Iran	No	(23.5)
Ireland	12.0	0.5
Italy	10.0	-
Japan	No	-
Jordan	1.3	-
Kenya	2.7	-

Korea	6.7	-
Kuwait	1.5	-
Lao 1/	0.1	0.1
Liberia	No	-
Libya	No	(47.0)
Malawi	1.3	-
Malaysia	5.0	3.0
Nepal	1.0	-
Netherlands	4.0	(2.7)
New Zealand	1.3	-
Nicaragua	No	(2.0)
Nigeria	50.0	36.6
Norway	10.0	6.0
Oman	No	(1.3)
Pakistan	1.3	-
Panama	0.4	0.2
Philippines	4.0	2.0
Portugal	No	-
Quatar	1.0	1.0
Sao Thome & Principe	No	-
Saudi Arabia	20.0	-
Senegal	1.0	-
Singapore	No	-
Sierra Leone	1.0	-
Solomon Islands	1.0	1.0
South Africa	1.0	-
Spain	2.0	-
Sudan	No	-
Swaziland	1.3	-
Sweden	No	-
Thailand	5.0	(5.0)
Trinidad & Tobago	1.0	-
Turkey	No	-
United Kingdom	2.5	(0.2)
Crown Agents for Oversea Governments & Administra- tions	No	(1.0)
Uruguay	No	(3.5)
Venezuela	No	(6.7)
Vietnam	3.5	-
Yemen Arab Republic	33.4	20.0
Yemen, People's Democratic Republic	2.0	0.7
Yugoslavia	10.0	-
Zambia	1.0	-
Zaire	No	-
Vatican	0.3	-
United Nations Develop- ment Programme	15.0	11.5



United Nations Capital		
Development Fund <u>1/</u>	10.0	10.0
OPEC Special Fund	0.5	-
Inter Arab Investment		
Guarantee Corp.	No	-
Arab Bank for Economic		
Development in Africa	<u>No</u>	<u>(6.7)</u>
	334.9	(2.6)

---

1/ New subscriber

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENTPURCHASERS OF LAST FOUR TWO-YEAR ISSUES OFFERED BY IBRD

(Expressed in millions of United States dollars)

	8.35% of 1978 due Sept. 15, 1980	9.85% of 1979 due March 15, 1981	9.40% of 1979 due Sept. 15, 1981	12.65% of 1980 due March 15, 1982	Total
Abu Dhabi	\$ 1.000	\$ .500	\$ -	\$ -	\$ 1.500
Afghanistan	4.300	4.900	2.000	1.300	12.500
Algeria	3.000	1.600	2.000	3.000	9.600
Argentina	17.300	9.500	17.500	14.000	58.300
Australia	2.000	2.300	5.400	2.000	11.700
Austria	1.500	.600	1.500	1.000	4.600
Bahrain	-	2.600	-	2.000	4.600
Bangladesh	2.000	1.300	-	-	3.300
Barbados	.100	.500	-	-	.600
Belgium	17.300	13.000	8.800	10.000	49.100
Bolivia	.500	-	1.000	.500	2.000
Brazil	21.700	6.200	8.000	8.000	43.900
Burma	1.000	.600	1.000	1.000	3.600
Canada	-	5.400	-	-	5.400
Chile	-	4.600	-	-	4.600
China	1.000	1.300	2.200	1.300	5.800
Colombia	4.300	2.300	-	4.000	10.600
Cyprus	.500	1.000	.500	1.000	3.000
Denmark	2.000	1.300	2.000	2.700	8.000
Dominican Republic	-	-	-	-	-
Ecuador	-	5.200	5.000	3.500	13.700
El Salvador	-	-	2.200	-	2.200
Ethiopia	2.000	1.300	2.500	-	5.800
Fiji	-	.500	.500	.500	1.500
Finland	1.000	1.900	-	-	2.900
France	4.100	1.900	2.000	5.000	13.000
Gambia	.500	-	.500	-	1.000
Germany	17.300	-	13.900	18.800	50.000
Ghana	-	-	.500	.700	1.200
Greece	1.000	-	2.000	1.000	4.000
Guatemala	-	.250	1.000	-	1.250
Honduras	.500	-	.250	.500	1.250
Iceland	-	1.300	2.000	1.000	4.300
India	8.600	10.400	7.150	7.000	33.150
Indonesia	17.300	13.000	17.500	20.000	67.800
Iran	21.700	-	20.000	-	41.700
Ireland	-	-	4.000	12.000	16.000
Israel	-	-	-	-	-
Italy	13.000	13.000	8.800	10.000	44.800
Ivory Coast	-	2.700	-	-	2.700
Japan	8.600	6.500	13.200	-	28.300
Jordan	2.000	1.300	1.500	1.300	6.100
Kenya	2.000	1.300	3.000	2.700	9.000
Korea	3.000	1.900	-	6.700	11.600
Kuwait	3.000	1.200	2.500	1.500	8.200

	8.35% of 1978 due Sept. 15, 1980	9.85 of 1979 due March 15, 1981	9.40% of 1979 due Sept. 15, 1981	12.65% of 1980 due March 15, 1982	Total
Lao	-	-	-	.100	.100
Libya	52.050	41.250	26.300	-	119.600
Malawi	-	-	1.500	1.300	2.800
Malaysia	4.300	3.300	5.000	5.000	17.600
Mauritius	.300	-	-	-	.300
Mexico	6.900	6.500	5.000	-	18.400
Morocco	.200	.200	.200	-	.600
Nepal	.800	1.300	1.900	1.000	5.000
Netherlands	8.600	6.500	8.800	4.000	27.900
New Zealand	-	1.900	2.200	1.300	5.400
Nicaragua	1.000	-	-	-	1.000
Nigeria	4.300	3.300	8.800	50.000	66.400
Norway	8.600	3.300	5.000	10.000	26.900
Oman	3.500	-	-	-	3.500
Pakistan	-	-	-	1.300	1.300
Panama	-	-	.500	.400	.900
Papua New Guinea	.750	-	-	-	.750
Peru	2.000	.600	1.000	-	3.600
Philippines	3.000	3.300	4.200	4.000	14.500
Qatar	.100	.100	.200	1.000	1.400
Saudi Arabia	17.300	26.000	26.300	20.000	89.600
Sierra Leone	-	-	-	1.000	1.000
Singapore	-	1.900	-	-	1.900
Solomon Islands	-	.600	1.000	1.000	2.600
South Africa	1.000	.600	1.000	1.000	3.600
Spain	11.300	6.500	2.000	2.000	21.800
Sri Lanka	2.000	-	-	-	2.000
Sudan	-	.100	-	-	.100
Swaziland	1.000	1.900	-	1.300	4.200
Sweden	-	1.300	2.000	-	3.300
Tanzania	-	-	-	-	-
Thailand	4.300	1.300	5.000	5.000	15.600
Trinidad & Tobago	1.000	1.300	3.800	1.000	7.100
Tunisia	-	1.300	-	-	1.300
Uganda	-	.600	3.000	-	3.600
United Arab Emirates	-	6.500	3.000	-	9.500
United Kingdom	4.000	3.300	2.500	2.500	12.300
Uruguay	3.000	.600	1.000	-	4.600
Venezuela	4.000	5.400	3.800	-	13.200
Viet Nam	3.000	2.900	5.000	3.500	14.400
Yemen Arab Republic	-	28.600	37.600	33.400	99.600
Yemen, People's Dem- ocratic Republic of	-	1.300	1.500	2.000	4.800
Yugoslavia	8.600	3.300	8.800	10.000	30.700
Zambia	1.000	-	.500	1.000	2.500
Union Arabe pour le Developpement Economique en Afrique	-	-	-	-	-

	8.35% of 1978 due Sept. 15, 1980	9.85% of 1979 due March 15, 1981	9.40% of 1979 due Sept. 15, 1981	12.65% of 1980 due March 15, 1982	Total
Crown Agents for Oversea Governments and Administrations	-	-	1.000	-	1.000
Banque Centrale des Etats de l'Afrique de l'Ouest*	-	1.400	1.500	1.000	3.900
OPEC Special Fund	-	.600	.500	.500	1.600
Other Governmental Institutions	.700	.200	.700	.300	1.900
Arab Petroleum Investment Corporation	-	-	-	-	-
International Organizations	6.300	7.800	6.000	25.000	45.100
Totals	\$ 350.000	\$ 300.000	\$ 350.000	\$ 334.900	\$1,334.900


\*Central Bank for: Benin, Ivory Coast, Niger, Senegal, Togo and Upper Volta.

Treasurer's Department  
Financial Operations Division  
February 25, 1980



FORM NO. 75  
(9-78)

THE WORLD BANK

ROUTING SLIP		DATE: February 29, 1980	
NAME		ROOM NO.	
Mr. R. S. McNamara			
Through Mr. M. A. Qureshi			
cc: Mr. S. S. Husain			
Mr. M. Paijmans (re Note 8)			
APPROPRIATE DISPOSITION		NOTE AND RETURN	
APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
COMMENT		PER YOUR REQUEST	
FOR ACTION		PREPARE REPLY	
INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS:  Please find attached Back-Up Notes for the FY80 Midyear Budget Review.  			
FROM:	K. Georg Gabriel, P&B	ROOM NO.:	EXTENSION:
		D-1330	75831

FY80 MIDYEAR BUDGET REVIEW - BACK-UP NOTES

1. Bunching: Quarterly and Regional tables
2. Delays in FY80 Project: Table of Projects Delayed by Country Difficulties
3. Supervision: Effort in FY80
4. Economic and Sector Work: Effort in FY80
5. IDA Conditional Credits in FY80: Table of Projects Approved Through 2/26/80.
6. IBRD Net Income: Components of Difference; Current vs. Budget
7. Administration Expenses: Components of \$3.0 million underrun, Current vs. Budget
8. Staffing: Explanation of staffyear shortfall in operating and support departments

FY80 Midyear Budget Review: Back-Up Note 1

Bunching

1. The table below shows the number and percentage of lending operations by quarter for FY68 through FY80.

NUMBER AND PERCENTAGE OF LENDING OPERATIONS  
APPROVED BY QUARTER OF FISCAL YEAR

	Number						Percentage				
	First 3			IV	Total						Total
	I	II	III				I	II	III	IV	
FY68	16	6	15	37	23	60	27	10	25	38	100
FY69	24	19	22	65	46	111	22	17	20	41	100
FY70	17	20	24	61	58	119	14	17	20	49	100
FY71	14	27	23	64	65	129	11	21	18	50	100
FY72	16	17	41	74	66	140	12	12	29	47	100
FY73	9	25	33	67	81	148	6	17	22	55	100
FY74	26	32	37	95	79	174	15	18	21	46	100
FY75	35	36	33	104	86	190	18	19	17	46	100
FY76	28	46	53	127	87	214	13	21	25	41	100
FY77	37	40	46	123	105	228	16	18	20	46	100
FY78	30	37	60	127	109	236	13	16	25	46	100
FY79	27	54	52	133	114	247	11	22	21	46	100
Prog. FY80 <u>a/</u>	21	50	64	135	118	253	8	20	25	47	100

Memo:

FY80 Budget

Memorandum b/ 36 51 56 143 109 252 14 20 22 44 100

a/ First half actuals, second half RVPs' estimates as of 2/22/80.

b/ The FY80 Budget Memorandum indicated 38 first quarter and 254 FY80 approvals; this was adjusted to 36 and 252, respectively, because two FY80 projects were advanced to FY79.

2. The schedule of 64 Board presentations in the 3rd quarter and 118 Board presentations in the 4th quarter of FY80 is based on February 22 review held by each RVP with the acting VPO. The 118 projects scheduled in the fourth quarter exceed by eight the 110 presentations which Mr. Stern tentatively set as a ceiling in his memorandum of January 18 to the RVPs. The schedule is acknowledged as being optimistic in terms of the projected processing dates for some projects and in the assumed full utilization of all available board slots for the last six weeks of the fiscal year. We also note that extra Board slots in excess of the currently accepted maximum of ten regular projects per week would be required during four weeks in May and June to accommodate the current schedule of 118 fourth quarter presentations. The number of "extra" slots required are shown below:

<u>Week</u>	<u>Extra Slots</u>
5/13-15	1
5/27-29	2
6/3-5	2
6/10-12	2
Total	<u>7</u>

It would be prudent, therefore, to expect a shortfall in the currently scheduled number of 4th quarter presentations. Depending on the projects which have to be slipped it may still be possible to meet the IBRD/IDA lending objectives for FY80 with a reduced number of operations.

3. The table below shows the Regional shares of fourth quarter presentations for FY74-79 and estimates for FY80 based on the February 22 review:

REGIONAL PERCENTAGES OF LENDING OPERATIONS  
APPROVED IN FOURTH QUARTER BY FISCAL YEAR

	<u>FY74</u>	<u>FY75</u>	<u>Actual</u>		<u>FY78</u>	<u>FY79</u>	<u>RVP Est. FY80</u>
			<u>FY76</u>	<u>FY77</u>			
Eastern Africa	47%	43%	29%	41%	52%	43%	45%
Western Africa	50%	46%	32%	38%	37%	37%	43%
EMENA	46%	51%	58%	52%	45%	51%	47%
Latin America	37%	53%	40%	54%	53%	58%	49%
East Asia & Pacific	41%	33%	40%	44%	43%	40%	40%
South Asia	55%	37%	37%	40%	44%	42%	55%
All Regions	46%	46%	41%	46%	46%	46%	47%



Delays in FY80 Projects Due to Country Difficulties

1. In para 7 it is stated that the shortfall in project approvals in the first half of FY80 from 35% to 28% of the lending program (from 89 to 71 projects) is due primarily to country difficulties which caused deferral and delay of a number of FY80 projects which were well advanced at the beginning of the fiscal year. A summary list of such projects by country indicating current project status is shown below:

<u>Country</u>	<u>No. Advanced FY80 Projects</u>	
	<u>Of which delayed</u>	<u>Of which deferred to FY81 or dropped</u>
Afghanistan	-	2
Chad	2	-
Chile	3	-
Ethiopia	2	1
Ghana	2	2
Nigeria	3	1
Syria	2	1
Turkey	-	1
Zaire	2	-
Total	<u>16</u>	<u>8</u>

FY80 Midyear Budget Review: Back-Up Note 3

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Supervision Effort in FY80

1. In para 9 it is stated that whereas supervision/PCR effort continues to be programmed at the budgeted level the required level of supervision effort may turn out to be higher due to project implementation difficulties. Based on the first half actuals P&B now estimates an FY80 supervision/PCR effort of about 407 staffyears, some 39 staffyears or 10% more than the budgeted level.

FY80 Midyear Budget Review: Back-Up Note 4

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Economic and Sector Work Effort in FY80

1. In para 10 it is stated that despite changes in economic and sector work tasks to support program lending and other initiatives, total CESW may closely approximate the budgeted staff effort. P&B now estimates an FY80 CESW effort of about 257 staffyears, some 24 staffyears or 10% more than the budgeted level. This is thought to be due to increased effort on preparatory work for program lending.

1. Paragraph 10 of the memo attributes adjustments in the content of the FY80 CESW program to the following factors:

- \* Newly active countries. CESW on Uganda and Seychelles was not included in the original program. The total effort on these countries could amount to 1.8 staffyears in FY80 or 6% of the approved CESW budget of Eastern Africa.
- \* Countries with increased economic and financial difficulties. Changes in the CESW program for these countries were mainly in support of their economic stabilization and/or structural reform objectives. These countries include those for which program loans/credits have been scheduled in FY80/81 (Kenya, Zambia, Ghana, Dominican Republic) as well as those considered likely candidates for program lending of the traditional or "structural adjustment" type (Somalia, Senegal, Mauritania, Sierra Leone, Bolivia, Philippines).
- \* Support for a greater number of potential program loan initiatives. In addition to the countries already mentioned, consideration of program lending to other countries in FY81/82 (e.g. Tanzania, Malawi, Mauritius, Ivory Coast, Liberia, Togo, Costa Rica, Nicaragua, El Salvador) could lead to changes in their CESW program in the course of FY80.

2. Political uncertainties have also led to deferment of planned ESW in a number of countries, including Afghanistan, Viet Nam, Nicaragua, and El Salvador. In addition, a number of planned economic missions to Nigeria had to be postponed because of the general elections and transfer of power to the civilian government.

3. The table below compares the output targets of the FY80 CESW program with the estimated outcome.

FY80 CESW PROGRAM: OUTPUT TARGETS vs. ESTIMATED OUTCOME  
(in number of reports)

	<u>Output Targets<sup>a/</sup></u>	<u>Estimated Outcome<sup>b/</sup></u>	<u>Shortfall</u>
<u>I. Economic Reports</u>			
BERS	4	3	-1 (South Asia)
Other Economic Reports	77	58	-19 (Western Africa -4) (East Asia -12) <sup>c/</sup> (South Asia -3)
<u>II. Sector Reports</u>	87	83	-4 (Western Africa -2) (East Asia -9) (CPS +7)
<u>III. CPPs</u>	45	41 <sup>d/</sup>	-4 (Western Africa -4) (LAC +3) (East Asia -1) (South Asia -2)

(cont.)



- a/ From Annex Table 2, Review of World Bank Group Financial and Operating Programs and FY80 Administrative Budget, R79-111 dated May 14, 1979.
- b/ Tables VIk, October 1979.
- c/ Of this total, 10 were reclassified as informal reports.
- d/ PAB estimate, February 26, 1980.

4. The table below compares the approved FY80 CESW budget with the estimated outcome presented in the recent Indicative Statements.

FY80 CESW PROGRAMS: BUDGET vs. ESTIMATED OUTCOME  
(in staffyears)

	<u>Current Budget<sup>a/</sup></u>	<u>Estimated Outcome<sup>b/</sup></u>	<u>(%) Budget Overrun (Underrun)</u>
Eastern Africa	29.9	29.9	0
Western Africa	32.3	34.3	6.2
EMENA	39.7	41.5	4.5
South Asia	35.4	35.0	(1.1)
East Asia & Pacific	35.2	36.3	3.1
LAC	<u>49.6</u>	<u>49.9</u>	<u>0.6</u>
Total Regional	222.1	226.9	2.2
COPDs	13.5	n.a.	n.a.
Total Bankwide	235.6	n.a.	n.a.

a/ From Tables IVk, October 1979 (except South Asia).

b/ From FY81 Indicative Statements.

FY80 Midyear Budget Review: Back-Up Note 5

FY80 IDA "Conditional" Credits Approved Through 2/26/80

<u>Date Approved</u>	<u>Country</u>	<u>Project</u>	<u>\$ million</u>
10/16/79	India	Maharashtra Irrigation	210.0
12/4/79	Kenya	IADP II	46.0
12/11/79	India	Gujarat Community Forestry	37.0
12/20/79	Niger	Dosso Rural Development	20.0
12/27/79	Zambia	Railways III	15.0
1/15/80	Cameroon	Havecam II	15.0
	Pakistan	Highways III	50.0
1/29/80	Burundi	Education II	15.0
	Madagascar	DFC/SSI	5.0
	Madagascar	Andekaleka	10.0
	Sri Lanka	Mahaweli T.A.	3.0
	Yemen, A.R.	Tihama IV	5.5
2/12/80	Bangladesh	Program Credit VIII	50.0
	India	Population	46.0
	Upper Volta	Forestry	14.5
2/19/80	Indonesia	Rubber	45.0
	Uganda	Program Credit	55.0
2/26/80	Bolivia	Oil and Gas Engineering	16.0
	Lesotho	DFC II	4.0
	Mali	SSI	8.0
	TOTAL	20 projects	670.0

PAB  
2/27/80

FY80 Mid Year Budget Review - Back-Up Note 6

Components of Difference Between Current and  
Budget Estimate of IBRD Net Income

1. In para 19 the increase in projected IBRD net income for FY80 is attributed in large part to lower than estimated interest on borrowings and higher income from loans and investments. A more detailed breakdown of the changes in components of IBRD net income is shown below: 1/

<u>Income</u>	<u>Increase - Decrease (\$ million)</u>
Investment income	18
Of which: Higher rate of return	53
Currency realignments	5
Lower investment holdings	-9
Phasing of borrowing program including delayed deliveries	-31
Loan Income	45
Of which: Currency realignments	37
Higher outstandings	9
Lower commitment fees (caused by faster disbursements)	-1
Other Income	<u>7</u>
Sub-total	<u>70</u>
<u>Less Expenses</u>	
Interest on Borrowings	-57
Of which: Phasing of borrowing program	-48
Lower borrowing cost	-44
Currency realignments	35
Administrative Expenses	5
Of which: Higher inflation	5 a/
Financial Expenses	<u>7</u>
Sub-total	<u>-45</u>
TOTAL	<u>115</u>

a/ Per Annex Table 1 of the FY80 Budget, R79-111 dated May 14, 1979 IBRD FY80 administrative expenses were estimated at \$193 million. In the subsequent budget revision R79-111/2 dated June 21, 1979, which allowed for the budgetary impact of the compensation adjustments, the estimate was increased to \$200 million. The current estimate of \$198 million is \$2 million less because of the projected volume underrun.

1/ In response to a request the above data was provided to Mr. Nakagawa on February 8, 1980.

FY80 Midyear Budget Review - Back-Up Note 7

Volume and Price Differences Between Current and  
Budget Estimate of Administrative Expenses

1. The estimated underrun in FY80 administrative expenses of \$3.0 million or 0.9% of the Budget estimate shown in para 25 is the net effect of under and overruns in volume and price as explained below:

	Effect on Administrative Expenses (\$ million)
<u>Volume Changes</u>	
Underruns <u>a/</u>	-4.7
Of which: Personal Services (exclud. Temp. Salaries) <u>b/</u>	- 3.0
Operational Travel	- 0.5
Consultant Fees	- 0.5
Benefit Travel	- 0.7
Overruns	+1.7
Of which: Temporary Salaries <u>c/</u>	+0.7
Contractual Services <u>d/</u>	+0.5
Communications <u>e/</u>	+0.3
Overhead	+0.2
Net Volume Changes	<u>-3.0</u>
<u>Price Changes</u>	
Underruns	-1.5
Of which: Personal Services (exclud. Temp. Salaries) <u>a/f/</u>	- 1.4
Temporary Salaries <u>g/</u>	- 0.1
Overrun: Operational Travel <u>h/</u>	<u>+1.5</u>
Net Price Changes	
Total	<u>- 3.0 i/</u>

- a/ Underruns mainly related to the projected shortfall of 18 professional and 8 consultant and non-professional staffyears.
- b/ Includes salaries, post allowances, overtime, tax reimbursements, dependency tax allowance, terminations and staff benefits.
- c/ Compensates partially for the shortfall in secretarial staffing.
- d/ EEC special action fund and staff compensation study.
- e/ Higher than budgeted expenses for long-distance calls.
- f/ Increase in "average real salaries" is estimated at 0.5% as against 1.0% budgeted.
- g/ Total price increase is estimated at 9% vs. 10% budgeted.
- h/ Increase in airfares is estimated to average about 15% as against 6% budgeted.
- i/ In view of the reconfirmation of the estimated underrun based on updated data, authorization has now been given to commit one-half of the \$3.0 million to selected high priority expenditures which are listed in paragraph 2 of this note. Taking these into account, the underrun now projected is about \$1.5 million (0.5% of the budget) and is accounted for entirely in the volume of expenses.



2. Considering the volume underrun projected in the budget (no variation in prices in the estimate from the budget), authorization has been given to incur certain high priority expenditures a/. Taking these expenditures into account, the underrun now projected is about \$1.5 million; details are given below:

	(\$ millions)	
Underrun in the Midyear Review Memorandum		
Less: Additional expenditures now authorized:		3.0
(a) Compensation Study (Compensation Department)	0.4	
(b) Data Processor (Computing Activities)	0.4	
(c) UNIX Computer (East Africa and South Asia regions and Economic Analysis and Projections Department)	0.3	
(d) Advanced Recruitment (Language Services in ADM Department)	<u>0.1</u>	1.2
Additional Expenditures now under consideration (mainly in East Africa and Central Projects Staff)	<u>0.3</u>	<u>1.5</u>
Underrun now projected in the budget		<u>1.5</u>

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a/ In order to minimize the risk of an overrun in the budget, authorization for the additional expenditures is limited to 50% of the estimated \$3.0 million underrun.

Staffyear Shortfall in Regular Operations

1. Overall, we project a shortfall of 18 professional and 5 consultant staffyears (see the table attached): 5 consultant and 5 professional staffyears in operating departments, 10 professional staffyears in the support departments, and the remaining 3 professional staffyears in the young professional and special recruitment programs. The shortfall in the operating departments is almost entirely accounted for by slower than expected recruitment for the new positions authorized in the Energy and the Population, Health and Nutrition departments. Such shortfalls commonly occur when a unit is budgeted for substantial expansion and may indicate that more consideration should be given to absorptive capacity when budgeting for such expansions.
2. The projected manpower use in the regional offices remains as budgeted, with only minor variations in individual regional allocations. In the support departments, the shortfall is due to delays in the filling of vacancies, especially in the Controller's, Treasurer's, Legal and Personnel departments.
3. We also project an underrun of 60 non-professional staffyears, distributed almost equally between the operating and support departments. This shortfall, however, is offset by overtime work and increased use of temporary staff. The introduction of international recruitment for secretaries in calendar year 1979 for a trial period of 6 months has led to a marked improvement in the availability of candidates.

FY80 IBRD/IDA ACTUAL PROFESSIONAL/CONSULTANT STAFFYEARS VS. BUDGET  
REGULAR OPERATIONS <sup>a/</sup>  
(Para. 115 of the Board Document)

	FY78	FY79 Actual				FY80 Budget <sup>b/</sup>				FY80 Estimate				Overrun (+) Underrun (-) from Budget
	Fill Ratio	Fill Ratio	Prof.	Cons.	Total	Fill Ratio	Prof.	Cons.	Total	Fill Ratio	Prof.	Cons.	Total	
Eastern Africa	.974	.991	200.2	12.9	213.1	.973	200.4	14.7	215.1	.969	199.6	13.1	212.7	-2.4
Western Africa	.950	.968	206.2	15.8	222.0	.960	208.4	15.8	224.2	.964	209.1	15.9	225.0	+0.8
East Asia & Pacific	.957	.972	183.8	25.6	209.4	.975	193.0	22.5	215.5	.971	192.3	23.9	216.2	+0.7
South Asia	.978	.988	178.8	26.2	205.0	.980	190.1	29.7	219.8	.974	188.9	28.4	217.3	-2.5
LAC <sup>c/</sup>	.958	.957	238.8	32.3	271.1	.958	259.6	34.9	294.5	.968	262.3	33.0	295.3	+0.8
EMENA (Excl. Tech. Assistance)	.958	.972	230.4	26.6	257.0	.967	231.2	25.6	256.8	.986	233.6	25.6	259.2	+2.4
Total Region	.962	.974	1238.2	139.4	1377.6	.968	1282.7	143.2	1425.9	.970	1285.8	139.9	1425.7	-0.2
CPS (Excl. Tech. Assistance)	.949	.959	322.2	82.4	404.6	.961	345.8	85.9	431.7	.938	337.8	83.9	421.7	-10.0
Total Regions and CPS	.960	.967	1560.4	221.8	1782.2	.966	1628.5	229.1	1857.6	.964	1623.6	223.8	1847.4	-10.2
DPS	1.006	.987	148.0	-	148.0	.993	152.0	-	152.0	.990	152.5	-	152.5	+0.05
Support Departments	.964	.967	551.3	-	551.3	.984	597.5	-	597.5	.962	586.8	-	586.8	-10.7
YP & Special Recruitments	.823	.928	60.3	-	60.3	1.031	67.0	-	67.0	.982	63.9	-	63.9	-3.1
Total IBRD/IDA	.960	.963	2320.0	221.8	2541.8	.974	2445.0	229.1	2674.1	.967	2426.8	223.8	2650.6	-23.5

<sup>a/</sup> Excludes Reimbursable Technical Assistance.

<sup>b/</sup> Original budget as adjusted for contingency and interdepartmental transfers through the end of October.

<sup>c/</sup> Includes Technical Assistance for Venezuela.

Note: Staffyears shown for consultants are for regular operations of operating departments only.

12/31/79

February 21, 1980

Mr. McNamara,

For your information.

*Moe*  
MOeen A. Qureshi

## OFFICE MEMORANDUM

TO: Mr. Moeen A. Qureshi

DATE: February 20, 1980

FROM: H.C. Hittmair *CHH*SUBJECT: Proposed Public Issue in Switzerland

The following is a short briefing concerning the public issue which will be considered by the Board tomorrow morning.

As has been pointed out in Mr. Uhrig's memo of February 20 we are expecting a coupon of 5-3/4% at an issue price of 99-3/4%. On that basis the yield to investors would be 5.70% and the total cost to us 6.16%.

For the break-even point calculation, taking today's closing quotations, a 9-1/2 year U.S. Treasury issue would yield about 12.75%, a hypothetical IBRD dollar bond with the same maturity would have to be set at 13.75%. The revaluation break-even point on this basis would be 93% a figure which exceeds any of the break-even points for Swiss franc borrowing operations within the last 2-1/2 years (see Cost of Borrowing study); it looks therefore like a clear case to proceed with this issue in the interests of the Bank and our borrowers.

HCHittmair:mb

cc: Mr. Rotberg  
Mr. Uhrig



Mr. Robert S. McNamara  
(thru Mr. Moeen A. Qureshi)  
Masaya Hattori

February 15, 1980

Table 1c - Revised FY80 Projections

At the end of January, the Bank's projected net income from operations remained unchanged at \$586 million. The net exchange gain, however, was increased by \$2 million to \$53 million mainly as a result of the appreciation, in terms of US dollars, of the net assets held in Pounds sterling.

cc: Mr. E. H. Rotberg  
Mr. K. G. Gabriel  
Mr. V. C. Chang

ICMazzitti/vp

(\$ millions)

CONFIDENTIAL

	Actual FY1979	Jul.31	Aug.31	Sep.30	Oct.31	Nov.30	Cumulative from July 1, 1979 to					Projected FY 1980 a/	Revised FY 1980 b/		
							Dec.31	Jan.31	Feb.28	Mar.31	Apr.30	May 31	Jun.30		
<b>IBRD</b>															
Cash and Investments c/	9750	9751	9557	9923	10054	10080	10143	9547					9256	8929	a/ Original projection of May 15, 1979. Non-dollar items translated into US dollars at rates prevailing on March 31, 1979.
Receivable from Borrowings d/	461	511	856	272	258	679	207	381					-	-	
Receivable from Loans e/	44688	44835	44840	45808	46001	46306	46573	46888					50994	51447	
Receivable from Subscribed Capital	665	665	664	665	662	659	658	658					654	695	
Land and Buildings, Net of Depreciation	81	82	83	84	85	86	87	87					89	87	b/ Non-dollar items translated into US dollars at rates prevailing on January 31, 1980.
Accruals and Other Assets	1244	1492	1372	1548	1587	1559	1677	1642					1350	1647	
<b>TOTAL ASSETS</b>	<b>56889</b>	<b>57336</b>	<b>57372</b>	<b>58300</b>	<b>58647</b>	<b>59369</b>	<b>59345</b>	<b>59203</b>					<b>62343</b>	<b>62805</b>	
<b>CALLABLE SUBSCRIBED CAPITAL o/</b>	<b>33686</b>	<b>33713</b>	<b>33713</b>	<b>34409</b>	<b>34409</b>	<b>34409</b>	<b>34398</b>	<b>34429</b>					<b>34920</b>	<b>35487</b>	c/ Investments are shown on a settlement basis and include \$293 million Special Reserve Fund Assets, which are not available for lending.
Due to IDA	792	792	792	792	880	875	865	840					721	722	d/ Borrowings include delayed deliveries and undrawn portions.
Undisbursed Loans e/	21801	21649	21342	21378	21367	21350	21666	21645					24919	24615	
Borrowings d/	26741	27084	27618	28213	28498	29128	28666	28578					28660	28821	
Miscellaneous Liabilities	907	1074	834	976	1110	1126	1190	1112					919	1260	e/ Amounts Receivable include undisbursed portions. Undisbursed amounts include both effective and non-effective portions, but exclude amounts sold or agreed to be sold.
Paid-in Capital and Reserves f/	6648	6737	6786	6941	6792	6890	6958	7028					7124	7387	
<b>TOTAL LIABILITIES AND CAPITAL</b>	<b>56889</b>	<b>57336</b>	<b>57372</b>	<b>58300</b>	<b>58647</b>	<b>59369</b>	<b>59345</b>	<b>59203</b>					<b>62343</b>	<b>62805</b>	
Income from - Investments	743.9	76.6	151.0	216.8	275.3	328.4	407.5	488.7					805	823	f/ Transfers to IDA out of IBRD Net Income have been charged to IBRD reserves, and added to IDA's resources, in the year of authorization, i.e., the year following that in which the income was earned.
- Loans	1668.8	151.9	304.7	463.7	625.4	789.6	944.0	1109.6					1925	1970	
Other Income	11.8	1.5	3.0	4.8	6.5	8.4	11.8	15.1					11	18	
Less: Administrative Expenses	172.0	15.8	29.5	42.0	57.5	69.2	91.7	104.7					193	198	
Interest on Borrowings	1817.4	156.4	314.0	476.6	642.6	809.7	969.2	1136.6					2049	1992	
Financial Expenses g/	28.6	4.3	7.0	10.0	14.1	17.7	22.8	26.7					28	35	g/ Financial Expenses include amortization of issuance cost of borrowings and discount on sales of loans, if any.
<b>NET INCOME</b>	<b>406.5</b>	<b>53.5</b>	<b>108.2</b>	<b>156.7</b>	<b>193.0</b>	<b>229.8</b>	<b>279.6</b>	<b>345.4</b>					<b>471</b>	<b>586 m/</b>	
<b>NET EXCHANGE GAIN (+) OR LOSS (-) h/</b>	<b>+114.7</b>	<b>+32.0</b>	<b>+27.0</b>	<b>+55.9</b>	<b>-28.7</b>	<b>+32.1</b>	<b>+51.2</b>	<b>+53.3</b>						<b>+53</b>	h/ Net exchange gain or loss on revaluation is allocated directly to the reserves.
<b>IDA</b>															
Investments	161	140	128	106	101	92	94	132					66	81	i/ IDA Unrestricted Cash, Notes and Receivables are from replenishment contributions of members, IBRD transfers and earnings.
Unrestricted Cash, Notes and Receivables i/	6917	6861	6736	6863	6776	8595	8460	8303					8852	8912	
Receivable from IBRD	792	792	792	792	880	875	865	840					721	722	
Receivable from Credits e/	16945	17214	17246	17289	17517	17579	17840	17941					20401	20419	j/ IBRD/IDA Number of Operations shows operations involving more than one loan agreement or both a loan and a credit as one IBRD operation.
Restr. Sub. and Other Assets	355	355	350	355	363	361	356	359					363	343	
<b>TOTAL ASSETS</b>	<b>25170</b>	<b>25362</b>	<b>25252</b>	<b>25405</b>	<b>25637</b>	<b>27502</b>	<b>27615</b>	<b>27575</b>					<b>30403</b>	<b>30477</b>	
Undisbursed Credits e/	7296	7458	7396	7350	7492	7476	7643	7607					9310	9436	k/ The number of IFC approvals excludes those under \$250,000 representing primarily exercise of stock rights.
Swiss Loans and Other	147	143	134	125	116	120	121	119					118	145	
Transfers from IBRD f/	1280	1280	1280	1280	1378	1378	1378	1378					1373	1364 n/	
Accumulated Net Income	(14)	(17)	(21)	(32)	(29)	(37)	(42)	(44)					(51)	(67)	l/ Distribution of loan disbursements to countries of \$4,700 million by quarter:
Paid Sub. and Suppl.	16461	16498	16463	16682	16680	18565	18515	18515					19653	19599	1st quarter \$1,042 million
<b>TOTAL LIABILITIES AND CAPITAL</b>	<b>25170</b>	<b>25362</b>	<b>25252</b>	<b>25405</b>	<b>25637</b>	<b>27502</b>	<b>27615</b>	<b>27575</b>					<b>30403</b>	<b>30477</b>	2nd quarter 1,103 million
Income from - Investments	17.1	.9	2.5	3.2	3.6	4.1	4.5	5.9					6	8	3rd quarter 1,175 million
- Credits	67.6	6.1	12.2	18.4	24.7	31.0	37.4	43.8					75	75	4th quarter 1,380 million
Less: Administrative Expenses	121.4	11.2	22.5	33.6	44.9	56.1	67.4	78.6					129	135	
Net Exchange Gain (+) or Loss (-)	-9.2	1.0	.6	-6.4	1.1	-2.6	-3.1	-1.3					-	-1	m/ IBRD RATE ASSUMPTIONS FOR FY 1980 TRANSACTIONS:
<b>NET INCOME (LOSS)</b>	<b>(45.9)</b>	<b>(3.2)</b>	<b>(7.2)</b>	<b>(18.4)</b>	<b>(15.5)</b>	<b>(23.6)</b>	<b>(28.6)</b>	<b>(30.2)</b>					<b>(48)</b>	<b>(53)</b>	
<b>IFC</b>															
Cash and Securities	33.0	34.0	66.2	66.6	47.6	58.3	32.9	52.2					59.5	41.3	
Investments - Loans	889.4	883.4	878.4	873.7	869.9	881.4	896.6	925.4					1047.4	1037.7	1. Average return on investments 8.0 8.5 8.7
- Equity	222.8	223.2	223.2	223.7	224.5	226.4	230.1	234.8					261.7	259.8	
Less: Reserve Against Losses	41.7	42.5	43.3	44.1	44.9	45.7	46.5	47.3					52.8	51.1	2. Average interest rate on loan disbursements 8.2 8.1 8.0
Accruals and Other Assets	1103.5	1098.1	1124.5	1119.9	1097.1	1120.4	1113.1	1165.1					1315.8	1287.7	
<b>TOTAL ASSETS</b>	<b>1101.6</b>	<b>1098.7</b>	<b>1124.1</b>	<b>1114.7</b>	<b>1103.7</b>	<b>1117.1</b>	<b>1112.2</b>	<b>1165.3</b>					<b>1321.8</b>	<b>1293.7</b>	3. Average cost of gross borrowings:
Undisbursed Commitments	298.7	292.8	286.1	273.9	269.2	279.7	273.5	315.1					415.9	382.7	Weighted by amount and life 8.0 7.7 7.7
Loans from IBRD and Others	522.9	520.3	520.3	522.1	513.6	513.6	513.8	511.0					500.6	500.6	Weighted by amount only 8.0 7.7 7.6
Less: Undrawn Loans	67.7	67.7	67.7	67.7	67.7	67.7	67.7	67.7					73.7	57.7	
Withdrawn Loans	455.2	452.6	452.6	454.4	445.9	445.9	446.1	443.3					426.9	442.9	n/ The amount shown is net of \$61 million for grants for agricultural research and for control of onchocerciasis.
Capital and General Reserve	347.7	353.3	385.4	386.4	388.6	391.5	392.6	406.9					479.0	468.1	
<b>TOTAL LIABILITIES AND CAPITAL</b>	<b>1101.6</b>	<b>1098.7</b>	<b>1124.1</b>	<b>1114.7</b>	<b>1103.7</b>	<b>1117.1</b>	<b>1112.2</b>	<b>1165.3</b>					<b>1321.8</b>	<b>1293.7</b>	
Operating Income	78.0	7.2	13.8	20.4	27.9	34.2	40.2	47.7					82.5	83.8	
Less: Administrative expenses	20.9	2.0	4.0	6.0	8.1	9.9	11.8	14.2					25.8	26.7	
Charges on Borrowings	33.9	2.8	5.6	8.4	11.2	13.9	16.7	19.4					32.5	33.3	
Income from Operations	23.2	2.4	4.2	6.0	8.6	10.4	11.7	14.1					24.2	23.8	
Realized Gains on Sales	4.6	-	-	-	.2	.4	.9	.9					6.0	6.0	
Provision for Losses	(8.6)	(.8)	(1.6)	(2.4)	(3.2)	(4.0)	(4.8)	(5.6)					(9.4)	(9.4)	
<b>NET INCOME</b>	<b>19.2</b>	<b>1.6</b>	<b>2.6</b>	<b>3.6</b>	<b>5.6</b>	<b>6.8</b>	<b>7.8</b>	<b>9.4</b>					<b>20.8</b>	<b>20.4</b>	
<b>MEMO</b>															
Operations approved - IBRD to Countries	142	4	6	13	19	26	45	55					152	152	
- IDA	105	3	4	8	11	13	26	32					102	100	
- Total j/	247	7	10	21	30	39	71	87					254	252	
- IFC k/	48	5	6	10	11	13	19	23					51	51	
Amt. approved - IBRD to Countries	6989	205	344	675	1072	1410	2087	2497					7600	7600	
- IDA Credits	3022	271	306	349	598	663	927	1030					3560	3500	
- IFC Commitments k/	425	45	46	87	99	98	159	183					420	420	
- Total	10436	521	696	1111	1769	2171	3173	3710					11520	11520	
Disbursements - IBRD to Countries l/	3602	355	752	1042	1444	1781	2145	2582			</				

Controller's  
2/15/80

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Investment Holdings as of January 31, 1980

(US\$ million equivalent)

Maturity	United States Dollars	Euro Dollars	Pounds Sterling	Deutsche Mark	Euro Mark	Japanese Yen	French Francs	Euro Francs	Canadian Dollars	Italian Lire	Euro Lire	Belgian Francs	Netherlands Guilders	Others	Total
Up to 6 mos	91.5	830.7		66.8	86.9	166.2	2.4	179.4	59.8		68.1	24.1	59.9	118.1	1,753.9
6 mos to 1 yr	593.9	15.1					3.0	.6	5.0	9.6		16.4	6.2	43.1	692.9
1 yr to 2 yrs	1,599.8	38.9				38.2	9.7		8.7	70.0		11.4	11.8	32.9	1,821.4
2 to 3 yrs	479.3	180.0		83.6		55.0	6.0	9.5	75.1	26.5		49.6	13.9	56.2	1,034.7
3 to 4 yrs	1,366.0	329.2	80.1	146.6			7.7		29.7	1.8		25.9	7.9	47.0	2,041.9
4 to 5 yrs	1,059.6	190.2	316.4	24.4			23.9		8.4			19.8	10.3	19.7	1,672.7
Over 5 yrs	27.1		158.3	5.4											190.8
TOTAL	5,217.2	1,584.1	554.8	326.8	86.9	259.4	52.7	189.5	186.7	107.9	68.1	147.2	110.0	317.0	9,208.3

	<u>Yields</u> %														
Up to 6 mos	13.49	13.52		7.94	8.45	6.85	9.46	12.14	12.49		17.92	12.24	11.21	10.97	12.14
6 mos to 1 yr	8.47	8.02					8.80	12.37	11.53	12.69		9.18	11.23	10.06	8.69
1 yr to 2 yrs	8.42	8.29				8.45	9.55		7.73	12.91		8.41	7.58	11.98	8.65
2 to 3 yrs	7.51	8.89		5.39		8.65	9.99	11.05	8.24	12.45		8.98	8.09	9.62	8.06
3 to 4 yrs	10.04	9.01	14.32	6.01			10.04		8.65	12.67		9.02	8.81	11.76	9.76
4 to 5 yrs	9.81	10.35	13.00	6.97			10.91		10.98			9.65	9.14	13.99	10.50
Over 5 yrs	10.48		10.10	8.14											10.10
	9.15	11.49	12.36	6.35	8.45	7.47	10.24	12.09	9.85	12.77	17.92	9.59	10.06	11.02	9.86

NOTE: Amounts are amortized book values at date of the Table.

Yields are average annual weighted yields.

Other currencies are Australian dollars, Austrian schillings, Brazilian cruzeiros, Danish kroner, Finnish markkaa, Kuwaiti dinars, Libyan dinars, Norwegian kroner, Saudi Arabian riyals, Swedish kronor, United Arab Emirates dirhams, Venezuelan bolivares each one being less than one percent of holdings.

Controller's  
2/15/80

His Excellency  
Dr. Hans Matthöfer  
Bundesminister der Finanzen  
Bundesministerium der Finanzen  
Graurheindorferstrasse 108  
D-5300 Bonn 1  
Federal Republic of Germany

February 25, 1980

Dear Mr. Minister:

I am writing to thank you for your letter dated January 16 following up on your agreement to the pledge Germany made for an additional 0.5 percent contribution to the Sixth Replenishment of IDA over and above a share of 12 percent.

This additional contribution was instrumental in bringing the negotiations to a successful conclusion in December since it also made it possible for Japan to provide an extra contribution and at the same time facilitated a collective effort by a number of smaller European countries. In fact, including Germany's extra effort, an additional two percentage points in the burden sharing arrangements could be found between the time of our discussion in Belgrade and the time of the final meeting of IDA Deputies, and as a result made it possible to bring about a consensus on the burden sharing arrangements. While there remains an "unallocated" amount of a little over 1 percent in a total of \$12 billion, I hope this will be filled before too long by contributors that have not as yet made extra contributions.

I note from your letter your wish for a return to the traditional contributions in future IDA replenishments and for an approximation of shares in IDA and the World Bank. The Report on the Replenishment (approved by the Executive Directors on January 15) does in fact distinguish between Germany's 12.0 percent share and the extra contribution of 0.5 percent so that the extra effort that Germany has made on this occasion will not be forgotten in discussions on this subject in future replenishments.

I also note your preference for seeing the contributions to IDA fixed on a uniform basis of valuation rather than in respective

national currencies. Although the example that the Federal Republic has set in expressing its obligations to IDA in terms of Special Drawing Rights was not followed by other contributors on this occasion, this is a subject which is reviewed in each negotiation and it may well be that Germany will be accompanied by others on the next occasion. In the meantime, our Executive Directors will be having a discussion later this year on the use of Special Drawing Rights for denominating IDA credits which will give the Board an opportunity for expressing its views on the use of the SDR as unit of account, as part of the general discussions taking place in international fora on increasing the use of the SDR.

Thank you again for the outstanding help which the Federal Republic has given to IDA in the Sixth Replenishment.

Best wishes,

Sincerely,

Robert S. McNamara

cc: Dr. KUrth  
Mr. Cargill  
Mr. Qureshi  
MR. Rotberg  
Mr. Gabriel

FVibert:gmb  
February 20, 1980



February 20, 1980

Mr. McNamara,

Attached is a draft reply  
from you to Matthoefer - for your  
approval.

Moeen A. Qureshi

DRAFT  
FVibert:plo  
February 20, 1980

Seine Exzellenz  
Herrn Hans Matthöfer  
Bundesminister der Finanzen  
Bundesministerium der Finanzen  
Postfach 1308  
Graurheindorferstrasse 108  
D 5300 Bonn 1  
Federal Republic of Germany

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Thank you again for the outstanding help which the Federal Republic has given to IDA in the Sixth Replenishment.

Best wishes,

Yours Sincerely,



Robert S. McNamara

cc: Executive Director

## OFFICE MEMORANDUM

CONFIDENTIAL

TO: Mr. Robert S. McNamara  
FROM: Moeen A. Qureshi *MAQ*  
SUBJECT: Mr. Morioka's visit

DATE: February 20, 1980

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Mr. Morioka called upon me this morning. He expressed his concern with respect to three issues:

1. Indonesia: He recalled that when I was in Tokyo (Mr. Morioka participated in the first round of discussions), the representatives of the Ministry of Finance had drawn my attention to the proposed cessation of IDA lending to certain Far Eastern countries, in particular Indonesia. They had stated that this would greatly weaken their hand in obtaining congressional support for Japan's growing IDA participation. From an internal political point of view, keeping in view the fact that IDA 6 legislation was now in the Diet, the Japanese authorities assigned the highest importance to maintaining the IDA eligibility of Indonesia. In this connection Mr. Morioka expressed his alarm about a statement that he said you had made at the Board yesterday that you would not support another IDA credit to Indonesia in view of their changed balance of payments conditions. Mr. Morioka emphasized that the Japanese authorities were not too concerned about the amount of IDA lending to Indonesia (in other words about the substantive merits of the issue); they were much more concerned about the principle of the eligibility of these countries for IDA financing. The mere fact that these countries continued to be eligible for IDA financing -- even if they did not receive much in the way of IDA funds -- constituted an extremely important political argument for defending their growing participation in IDA. He wanted me to convey to you therefore the great concern of the Japanese authorities that no formal position be taken by the Bank regarding the eligibility of Indonesia for IDA funding.

2. Mr. Morioka wanted to have some further information about our attitude with respect to an appropriate quota for China, whether China would seek IDA financing and whether it would be eligible for it.

I said that we had not yet studied the matter, and we had not yet the contacts with the Chinese Government that would permit us to have any clear perception of these issues. He was particularly worried as to whether China's quota would exceed that of Japan, and whether existing IDA 6 arrangements could be maintained if China were deemed to be eligible for IDA financing.

3. He also talked to me about the concern of the Japanese Government regarding the adverse publicity relating to the Tokyo Office matter. He said that the Ministry of Finance was greatly embarrassed by it. The IDA 6 bill was before the Diet, and such publicity could have an unfavorable impact on the passage of the bill. He hoped that the Bank would not do anything that would lead to further publicity of this issue.



I told Mr. Morioka that I was equally concerned about the Bank's image and about our relationships with the Japanese Government. It was in no one's interest that a matter such as this should be given publicity, and everything that we had done so far was designed to have the contrary effect. I told him that we were looking into this matter internally. The Ministry of Finance on their part could help by not circulating reports that were untrue and which we were bound to contradict. He expressed "amazement and shock" when I referred to the fact that some official of the Ministry of Finance was reported to have said that Mr. Kaya gave the money to Mr. Qureshi for his expenses in Tokyo. Mr. Morioka added that if we were to fire Mr. Kaya as a result of this affair he did not think that any other official of the Ministry of Finance would ever wish to accept a position as the Head of the Bank Office in Tokyo. I responded that at this stage there was no question of firing anyone. We had not yet arrived at definitive conclusions as to what had happened. We were looking into it. We intended to inquire into this matter in a careful and confidential manner and I would be in touch with him after we had come to some conclusions as to what had transpired.

MAQureshi:gmb

Tokyo

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sj

Mr Qureshi ✓  
Mr. Hopper  
Mr. S.S. Husain  
Mr. Benjenk

1980 FEB 19 AM 9:57  
COMMUNICATIONS DIVISION

77 M A QURESHI

COPY TO HOPPER, HUSAIN, BENJENK

RE STRENGTHENING OFFICIAL AID TO "DISPUTE" NEIGHBORING COUNTRIES  
AAA

UNDER THE MOUNTING U.S.-SOVIET TENSIONS, JAPAN'S ODA IS BEGINNING TO REFLECT THE IDEOLOGICAL SPLIT. THE JAPANESE GOVERNMENT HAS DECIDED TO INCREASE ITS OFFICIAL AID TO "DISPUTE" NEIGHBORING COUNTRIES. STRENGTHENING ASSISTANCE TO PAKISTAN AND THAILAND IS BEING CONSIDERED AND POSITIVE AID POSTURE TO IRAN AFTER SOLUTION OF THE HOSTAGE ISSUE AND OTHER MIDDLE EAST NATIONS IS UNDER REVIEW. ON THE OTHER HAND, THIS YEAR'S ASSISTANCE TO VIETNAM (16 BILLION YEN LOAN AND 4 BILLION YEN GRANT) AND AFGHANISTAN (1.2 BILLION YEN GRANT) HAVE BEEN SUSPENDED.

BBB

THE FOREIGN MINISTRY ANNOUNCED YESTERDAY THAT THE GOVERNMENT OF PAKISTAN HAD REQUESTED YEN 45 BILLION (YEN 25 BILLION COMMODITY AID, YEN 10 BILLION PROJECT AID, AND YEN 10 BILLION GRANT) AID PROGRAM WHICH IS TRIPLING THIS FISCAL YEAR'S PROGRAM AS WELL AS YEN 8 BILLION DEBT RELIEF FOR FY1980. THE JAPANESE GOVERNMENT HAD EARLIER DECIDED TO DOUBLE ITS FY1979 AID PACKAGE TO PAKISTAN TO YEN 30 BILLION AND THE FINAL AMOUNT FOR FY1980 WILL BE NEGOTIATED WHEN FORMER FOREIGN MINISTER SONODA VISITS PAKISTAN LATER THIS WEEK AND IS LIKELY TO SETTLE SOMEWHERE IN BETWEEN. AS FOR THE DEBT RELIEF REQUEST, THE GOVERNMENT TAKES A STAND OF 'UPON CONSULTATIONS WITH THE CONSORTIUM'.

CCC

INCREASING AID PACKAGE FOR THAILAND (YEN 32 BILLION ORDINARY AND YEN 7 BILLION ADDITIONAL FOR AGRICULTURAL DEVELOPMENT IN FY1979) IS LIKELY TO INCREASE SUBSTANTIALLY IN FY1980. THE GOVERNMENT MISSION IS IN THAILAND CURRENTLY TO STUDY THE SCOPE OF INCREASE.

DDD

THE GOVERNMENT IS ALSO CONSIDERING FULL-SCALE TECHNICAL ASSISTANCE AND FINANCING OF INDUSTRIAL PROJECTS INCLUDING REFINARY PLANT CONSTRUCTION IN IRAN. FURTHER, THE GOVERNMENT IS CONSIDERING TO CONSIDERABLY STRENGTHEN ECONOMIC AND TECHNICAL SUPPORT TO D EGYPT AND THE GULF NATIONS FROM THE VIEWPOINT THAT STABILITY OF THESE REGIONS IS INDISPENSABLE TO THE SECURITY OF JAPAN.

EEE

FOREIGN MINISTER OKITA IS PROPOSING NEW DOUBLING OF ODA IN FIVE YEARS AFTER THE THREE-YEAR DOUBLING PERIOD IS OVER IN FY1980, WHICH IS UNDER CONSIDERATION IN THE FOREIGN MINISTRY. IF THE CONSENSUS IS OBTAINED AMONG THE FOUR MINISTRIES, IT COULD BECOME A JAPANESE PROPOSAL IN THE VENICE SUMMIT.

FFF

WILL FOLLOW-UP ON DEVELOPMENT AND KEEP YOU INFORMED.

REGARDS

KAYA

PLS READ FOURTH LINES OF DDD AS FOLLOWS

CONSIDERABLY STRENGTH

QUOTE

CONSIDERABLY STRENGTHEN ECONOMIC AND TECHNICAL SUPPORT TO EGYPT AND THE GULF NATIONS FROM THE VIEWPOINT THAT STABILITY OF THIS REGION IS INDISPENSABLE TO THE SECURITY OF JAPAN.

TKS



## OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara  
FROM: Moeen A. Qureshi *MAQ*  
SUBJECT: China

DATE: February 15, 1980

I attach for your information a first draft of a paper on China which will need a good deal of further work. I am also attaching to it two memoranda which have been prepared by Lester Nurick: one indicating a possible procedure that could expedite China's membership, and the other giving a history of our relationship with China, including the understandings reached with Taiwan. We will need to do some further work on the operational implications of China's membership, outlining both the issues that are involved and possible alternative solutions more clearly than is done in this draft.

cc: Mr. Stern  
Mr. Nurick  
Mr. Husain  
Mr. Gabriel

MAQureshi:gmb

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Office of the President

CONFIDENTIAL

FROM: The President

February 19, 1980

Chairmanship of the Board During My Absence

I propose to be away from Washington February 21 and February 22. In accordance with the Rules of Procedure, I propose to designate Mr. Moeen A. Qureshi, Vice President, Finance, to act as Chairman of the Board during my absence.



Distribution:

Executive Directors and Alternates



# Record Removal Notice

<b>File Title</b> Moeen Qureshi Files - Presidential Chronological Correspondence - February 15 to March 10, 1980		<b>Barcode No.</b>  1670490		
<b>Document Date</b> Feb 15, 1980	<b>Document Type</b> Memorandum			
<b>Correspondents / Participants</b> To: Robert S. McNamara From: Moeen A. Qureshi				
<b>Subject / Title</b> China				
<b>Exception No(s).</b> <input type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/> 4 <input type="checkbox"/> 5 <input type="checkbox"/> 6 <input type="checkbox"/> 7 <input type="checkbox"/> 8 <input type="checkbox"/> 9 <input type="checkbox"/> 10 A-C <input type="checkbox"/> 10 D <input type="checkbox"/> Prerogative to Restrict				
<b>Reason for Removal</b>  Pending review by/consultation with the relevant World Bank unit(s).				
<b>Additional Comments</b>		<p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.</p> <table border="1"><tr><td>Withdrawn by Sherrine M. Thompson</td><td>Date Jun 27, 2013</td></tr></table>	Withdrawn by Sherrine M. Thompson	Date Jun 27, 2013
Withdrawn by Sherrine M. Thompson	Date Jun 27, 2013			

The World Bank

February 15, 1980

Mr. McNamara,

Attached for your approval is a copy of the revised draft of the Cofinancing paper. In order to save time we have not done a full line-in and line-out marking but paragraphs that have been revised (mostly added) are marked in red. Two paragraphs have been dropped from the earlier version and these are separately shown for your review (Attachment).

We are also simultaneously distributing it to the Regional Vice Presidents.

MAD  
Moeen A. Qureshi

2/15

Approved for distribution  
on 2/15 for the Board  
meeting of 3/11.  
Lorel

February 14, 1980

## MEMORANDUM TO THE EXECUTIVE DIRECTORS

SUBJECT: World Bank Cofinancing

I. Introduction

1. The World Bank has been playing an increasing role in coordinating and stimulating external capital flows to its borrowers. It has done so through a range of activities of different degrees of intensity and formality. Cofinancing is the most formal type of role played by the Bank, in which World Bank funds are directly associated with funds provided by other sources in financing specific projects or programs in developing countries. 1/ The number of IBRD/IDA cofinancing operations rose from about 10 per year in the late 1960s to 34 in FY73 and 107 in FY79, and is expected to reach about 130 in FY80. The volume of cofinancing, i.e. the amount of funds provided by the co-lenders, rose from \$448 million in FY73 to \$3,205 million in FY79, and may reach \$7,000 million in FY80. 2/ In FY79, 43 percent of the projects approved by the Board involved some cofinancing, and the funds provided by co-lenders were equivalent to 32 percent of total Bank lending. Though these amounts should be seen in the context of overall capital flows to developing countries, which are many times larger and have also grown rapidly, they are nevertheless

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1/ Annex A contains definitions and terminology relating to cofinancing.

2/ Attachment 1 shows the breakdown of cofinancing by source for the period FY73-79. In the first four months of FY80, actual cofinancing was about \$2,300 million.



substantial. Developing countries again face sharply increased resource requirements. Within the range of World Bank activities aimed at helping them surmount this problem, and perhaps increasingly important, cofinancing can play a useful role. This is especially true with respect to the Bank's cooperation with private capital sources.

2. This memorandum reviews the Bank's recent experience with operations cofinancing / and analyzes the main ways in which their volume and development impact might be enhanced. In general, the memorandum concludes that there are several practical ways in which the Bank can proceed with its efforts to expand its cofinancing role. It is worth noting at the outset, however, that the overall thrust of the proposals is to strengthen this activity in the near term and not to make radical changes in World Bank operations. The memorandum discusses past experience and new proposals separately for each of the three main categories of cofinancing partners, namely: official aid agencies, export credit institutions, and private lenders.

3. One factor common to all cofinancing operations is the set of services the Bank offers to all cofinanciers in sharing with them the benefits of its project preparation, appraisal and supervision procedures. These services are not cost free. The Bank incurs the cost of the additional staff time spent on cofinanced projects and rarely receives similar services in return. It is not yet possible to calculate these additional costs accurately, but it has been estimated that cofinancing a project's increases / appraisal costs by 5% to 10% and supervision costs by about 20%.

Naturally, when the Bank funds released by cofinancing are used for other projects, the new projects also add to the Bank's overall administrative costs. Some other services rendered to specific cofinanciers such as acting as billing agent, also entail costs. These costs are modest in comparison with the benefits of cofinancing, which accrue to Bank borrowers as a group, both those which receive cofinancing directly, and those which receive the Bank resources released by it. It is therefore appropriate that these additional costs should be borne by the borrowers collectively, that is by the Bank itself.

## II. Cofinancing with Official Agencies

4. Throughout the period FY73-79 official agencies provided around 60% of the total cofinanced funds, and participated in 70% of cofinancing operations. Until 1975, these were almost exclusively DAC agencies. Following the oil price rise in 1973-74, official aid from OPEC sources rose dramatically. The Bank had an opportunity at that time to assist both the oil-importing developing countries and relatively new OPEC development institutions, which wished to accelerate the commitment of their funds through cofinancing, and thereby benefit from the World Bank's project preparation, appraisal and supervision experience. OPEC sources accounted for over half of the Bank's cofinancing with official sources in FY75 and FY76. <sup>1/</sup>

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<sup>1/</sup> Including national government agencies and multilateral institutions deriving their resources wholly or largely from OPEC members.

These efforts may have secured some increase in aid pledges. The main benefit from the Bank's cofinancing, however, was to increase the effectiveness of the aid and hasten its commitment to specific projects. Because of earlier commitment, disbursements were also advanced, even if the disbursement process itself may not always have been accelerated. In subsequent years, the share and even the absolute amount of cofinancing with OPEC sources fell, as these agencies built up their own staffs and procedures.

6. In some cases, the Bank has also helped to accelerate the utilization of aid from DAC members. However, most cofinancing with DAC aid agencies has been motivated by a mutual will for coordinated approaches and by a desire to spread aid activities over many countries and sectors. Such spreading of aid <sup>activities</sup> may by itself entail a cost, particularly for small borrowers, in confronting their small administrations with an array of external agencies. However, given the political and other motives for spreading aid to several beneficiaries, cofinancing reduces the administrative burden on the borrower. Furthermore, cofinancing activities <sup>can</sup> ~~offer~~ benefit from the considerable country experience and large technical assistance resources of some bilateral aid agencies.

7. Cofinancing with the World Bank can also reduce or eliminate the procurement disadvantages of tied aid financing. This is done in a particularly effective way when several aid agencies participate, and tied aid does not have to finance supplies for which the aid agency's country is an inefficient supplier. The Bank facilitates this by combining



cofinancing from appropriate sources. Thus in FY78, the Madagascar  
Project was financed by IDA and six aid agencies. The complementary  
credit for Tarbela in Pakistan, also in FY78, brought together IDA and  
seven aid agencies.

8. On the whole, cofinancing with official aid agencies has worked  
well. It has helped to channel aid funds to high priority uses and it has  
been an increasingly active instrument of aid coordination. The  
qualitative impact of such coordination cannot be rigorously measured, but  
it is generally agreed that it has increased the developmental impact of  
aid by avoiding fragmentation and by saving scarce managerial time in the  
borrowing countries.

9. The renewed crisis faced by developing countries as a direct and  
indirect result of the latest oil price increases will again require  
extraordinary efforts by the international community, especially in meeting  
the needs of the poorest countries for sharply increased concessional  
assistance. There will be renewed needs and opportunities for the Bank to  
make a vigorous effort to reactivate and develop cofinancing arrangements  
with the aid agencies of oil-exporting countries. The pressures on  
developing countries will also intensify the need for efficiency and  
coordination of aid, and the Bank can continue to expand its joint  
activities with bilateral and multilateral aid programs originating in DAC  
member countries.

### III. Cofinancing with Export Credit Institutions

10. In export financing, the Bank's partners are specialized agencies (like the US Export-Import Bank) and also ordinary commercial banks extending buyers' credits. <sup>1/</sup> Official insurance or guarantee agencies (like ECGD and COFACE) are important indirect participants, as are monetary authorities which refinance export credits on specially favorable terms. Cofinancing allows these agencies to participate in deals which they could not conclude alone, either because the loans would be too big or because their country's suppliers would be clearly unsuitable for substantial parts of the projects.

11. Cofinancing with export credits grew from \$71 million in FY73 to \$514 million in FY74, but [ ] has shown no clear trend since. At \$652 million in FY79, cofinanced export credits were a little lower than in FY74 in real terms. During the same period, net disbursements of all export credits to developing countries rose from about \$3.3 billion in 1973 to \$13.2 billion in 1978.<sup>2/</sup>

12. Cofinancing with export credits can take the form of organized joint financing. In this, the Bank plays the central role in organizing

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<sup>1/</sup> In this paper no distinction is made between buyers' credits and suppliers' credits unless otherwise noted. Commercial banks also make direct "sovereign risk" loans, unguaranteed in the capital exporting country. These are discussed in Section IV on page 9.

<sup>2/</sup> Source: DAC. The commitments, of course, were much higher.



and supervising the financing process, by arranging for export credit agencies to provide on appropriate terms an agreed share of a common list of goods to be procured under international competitive bidding. This procedure ensures competitive suppliers, but borrowers sometimes feel that it results in adverse financial terms. In recent years, unorganized parallel financing has been a more usual practice. The Bank and the borrower agree on dividing the project into separate packages. The borrower assumes full responsibility for negotiating export credits, and takes into account their availability and terms in awarding the contract. Under this procedure, it is difficult to ensure that the best suppliers are selected, and the division of the project between financial sources may be somewhat arbitrary. Yet cofinancing with export credits, when successful, has several advantages for borrowers: it ensures that this resource is applied to high priority projects and programs, it helps to reduce and even cancel the cost disadvantage of procurement tying, and when the World Bank loan covers the cost of down-payment, the overall financial terms of export credits compare quite favorably with those of IBRD itself. 1/

13. In recent years, most export credits have been extended by commercial banks insured by specialized agencies in the exporting countries and given access to specialized refinance facilities. In practice, commercial banks have generally found it easier to work without World Bank

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1/ Attachment 2 shows the terms of export credit cofinancing arrangements obtained for selected recent projects.

involvement, often complementing export credit facilities with straight financial credits for downpayments, local currency costs, or procurement in third countries. This is because it has been difficult to reconcile the Bank's procurement rules with those governing access to specialized insurance and refinancing facilities in the exporting country. These difficulties have also hampered efforts by the Bank and the borrowers to arrange coordinated financial packages for projects.

14. There is no easy solution to this problem. One possible approach might be to establish general lines of credit for individual borrowing countries to cover procurement on a range of projects, rather than waiting to arrange financing at the time of bidding or once the source of supply has been determined. With the prior authorization of export credit insurance agencies and monetary authorities, commercial and specialized banks would agree in advance to finance a certain proportion (possibly up to 100 percent) of procurement placed  in that country based on international competitive bidding. Once established, such arrangements would have administrative simplicity as well as the advantages of continued full adherence to efficient procurement practices, and  might well enhance the volume and development impact of resources flows to developing countries. Provided such an agreement covers a high proportion of potential suppliers, it should be beneficial to all involved. Because of the many countries and types of agencies involved, considerable negotiating effort will be required. The Bank has  started to consult with export credit agencies and commercial lenders as to their interest in such "umbrella type" arrangements, and proposes to pursue these efforts.

#### IV. Cofinancing with Private Sources

15. Perhaps the most dramatic change in development finance in the 1970s was the expansion of lending to developing countries by commercial banks. In terms of net annual disbursements, these grew from an average of \$4 billion in 1970-72 to \$10 billion in 1974, \$20 billion in 1978 and an estimated \$23 billion in 1979.<sup>1/</sup> In 1974 and 1975, the recycling of OPEC surpluses constituted the main source of these funds.

In the following years, very liquid conditions dominated the international banking system, because of a combination of easy monetary policy in the United States and weak credit demand throughout the OECD area. This allowed commercial bank lending to continue expanding after OPEC surpluses fell, and actually to reach its greatest growth rate in 1978 when the OPEC countries were overall net users rather than sources of commercial bank funds. This state of high liquidity of the banking system also created intense competition among banks, which in turn resulted in a narrowing of "spreads" charged over the basic cost of funds (the London Interbank offered rate, LIBOR, for six-month funds is the most widely used point of reference), lengthened maturities of loans, and greatly reduced differentials in the terms applied to developing countries and other borrowers.

16. In this environment of highly liquid markets, easily available loans and little discrimination between borrowers, neither borrowers nor lenders saw much benefit in cofinancing with the World Bank. The rate of growth in the volume and number of such operations has nevertheless been significant. There were three operations accounting for \$136 million in private cofinancing in fiscal years 74 and 75, and a total of 26 cofinancing operations accounting for \$929 million in private funds over the following three fiscal years. In calendar year 1979, there were 18 cofinancing operations with commercial banks, supplying \$1353

<sup>1/</sup> Source: OECD. Amounts exclude guaranteed export credits.

million to 13 countries. However, these amounts are modest in comparison with the estimated \$39 billion lent to developing countries by commercial banks in 1979. Banks were so eager to lend to developing countries in the past few years that there is no indication that past cofinancing has added significantly to the flow of funds to the beneficiaries, or eased the terms on which such funds were available. The benefits of the Bank's cofinancing with private sources must be seen in long-run terms, in terms of laying the groundwork for assisting developing countries secure continued access to international capital markets ~~on reasonable terms~~. As noted in para 24 below, developing countries will need to continue and, in fact, increase their borrowing from commercial banks in the next few years. Yet broad economic and institutional factors will both make for much tighter credit conditions and will create specific constraints on developing country borrowings from these sources. These new circumstances could make for a sharp further increase in cofinancing with the World Bank; more importantly they should enhance the value of such cofinancing in securing additional capital on reasonable terms. In formulating policies for maximising the Bank's usefulness in this new situation, it may be useful to review the Bank's procedures and experience to date.

#### Procedures and Experience

17. In contacts with commercial banks, regular operating staff are assisted by the Senior Adviser, Cofinancing, whose office was established in October 1975 and, in the Latin America and Caribbean Region, by an adviser in the Regional Vice President's Office. The specialized cofinancing staff which is now reinforced by a special cofinancing unit in the Legal Department, initiates contacts with commercial banks and is a major

focal point for continuing relationships with them. They inform lenders about the Bank's and borrowers' general policies and concerns, but for project-specific information, they refer lenders to the Regional Offices and to the borrowers. The specialized staff is also the Bank's original source of information and advice on the best sources of commercial financing for particular projects. In general, they actively promote cofinancing both with commercial banks and with borrowers.

18. Lenders may seek general information or be interested in a specific project listed in the "Monthly Operational Summary." The Bank then gives them broad, non-confidential information about cofinancing needs and possibilities, and facilitates contacts with the proper agency of the borrower. When mutual interest develops, potential cofinanciers can be given confidential documents, with the borrower's permission. Normally, the organization of the cofinancing arrangement will be quite advanced, and a lead bank will have been selected, before confidential materials, such as appraisal reports, are released to commercial banks.

19. When commercial banks extend untied financial loans as part of cofinancing with the Bank, the Bank generally includes a cross-default clause in its loan agreements. Cross-default clauses, a standard feature of commercial banks' international loans, link the loans of several lenders in such a way that a default on any associated loan is a default on all associated loans. The Bank has accepted optional cross default provisions which give it the right, at its option, to exercise its remedies in the event that the cofinancier suspends or accelerates its loan as the result of a default under its loan agreement. Some private cofinanciers feel that this clause gives them



additional security in that the Bank has the right to apply its remedies if default occurs on these loans. They often press for a removal or reduction of the optional character of the clause so as to increase its deterrent effect and its value to them. The Bank has refused to commit itself in advance to exercise its remedies in the case of a suspension or acceleration by the commercial banks on their loans. It has made it clear that it reserves the right to decide whether and in what way to take action in such a case. As for borrowers, they have shown some distaste even for optional cross-default provision.

20. Past cofinancing operations of the Bank have not substantially increased the volume or improved the terms of commercial bank loans. In the prevailing easy market conditions, this was usually neither feasible nor <sup>particularly</sup> politically useful. However, the Bank has increased the market's base by introducing new lenders. This will help to protect the market against the emergence of problems affecting particular lenders, such as portfolio limits on lending to specific countries, insufficiency of the capital base, or limitations arising out of national monetary and balance of payments policies. This impact may be achieved even if after introduction of one or a few operations, subsequent loans are concluded without reference to the Bank. This has indeed happened occasionally.

21. Measured by this standard of diversification and given the limited interest for cofinancing due to market condition, the Bank's role has been <sup>helpful</sup> ~~fairly successful~~. In particular, the Bank has had some success at introducing new lenders to the market. In early years, US banks dominated private cofinancing sources. From about 50% in 1975 and 1976, their share dropped to 17% in 1978 and 37 percent in 1979, while the share of European banks increased

from 18 percent to 37 percent over the same period. 1/ The share of Japanese banks increased from 5 percent in 1975 to 19 percent in 1979. It is noteworthy that while overall Japanese commercial bank lending to developing countries contracted sharply between 1978 and 1979, cofinancing did not.

22. In 1975, 14 commercial banks participated in cofinancing arrangements with the World Bank; in 1976, there were 20 (of which only 6 were "repeaters" and 14 were new to this type of operation); in 1977, 58 (of which 46 new and 12 repeaters); in 1978, 19 (of which 8 new and 11 repeaters); and in 1979 (January-August) 23 (of which 7 new and 16 repeaters). Thus 89 commercial banks have already participated in cofinancing operations, many of them several times. "Repeater" banks' cofinancing loans have tended to increase over time. Relatively recent newcomers include both large banks e.g., Credit Agricole, and second-tier banks, whose involvement in international lending operations can give such markets greater depth and stability.

23. Most of the commercial banks cofinancing well-established international borrowers like Brazil and Argentina had already lent to those countries in recent years. In several other cases, however, most participants were making their first loan to the borrowers. For example, none of the six commercial banks which cofinanced the Pattani Hydroelectric Loan to Thailand, none of the six involved in the Second Livestock Loan to Romania, and only four out of the 19 participants in the Eighth Power Loan to Malaysia had previous relations with the country. Thereafter, five of the participants in the Thailand project, and five of the new participants in the Malaysia project undertook direct eurocurrency lending to those same countries.

1/ These figures relate to calendar years.

### Present Opportunities for Expanded Cofinancing

24. Developing countries now face a deteriorating economic environment. To mitigate the slowdown in their economic growth and facilitate their adjustment to the new economic environment, they need to incur and finance sharply increased balance of payments deficits. These cannot be financed without large private lending to them, in particular continued active lending by commercial banks. The effective recycling of the surpluses generated by the new oil price rise is also dependent upon such lending. Yet commercial bank lending will be constrained by a variety of broad economic factors, including competition from developed countries on capital markets, and the generally more restrictive monetary policies likely to prevail. More specific institutional factors will also constrain commercial bank lending to oil-importing developing countries. They include the increased share of such loans in the banks' portfolios, the relationship of these assets to the banks' capital, and the banks' risk-bearing capacity. Many of these factors are, in the ultimate analysis, related to uncertainties concerning the creditworthiness of developing countries and the soundness of their development. Cofinancing with the World Bank takes up an important new role in this context. Cofinanced loans are used for sound development projects and programs. By thus ensuring the soundness of the final assets, cofinancing can effectively contribute to bolstering the banking system and expanding its lending on a sustainable basis. It can also help to introduce assets best suited to the needs of specific types of banks and other investors.

25. There are three main opportunities for the Bank to play an expanded role in cofinancing with private sources. The first lies in the creative use of lending to finance structural adjustments; the second involves additional flexibility in terms and conditions of Bank loans; and the third is to assist borrowers in gaining access to private sources of long-term finance.

26. Structural Adjustment Loans. Such lending <sup>may</sup> ~~will~~ form an increasingly important part of the Bank's efforts to help developing member countries adjust to structural problems. Cofinancing by commercial banks can greatly increase the volume and development impact of such assistance. Close and specialized contact with commercial banks will be particularly necessary if the World Bank is to organize such cofinancing. The very existence of ~~xxx~~ <sup>structural adjustment</sup> problems ☐

☐ would sometimes deter commercial bank lending. <sup>adjustment</sup> A structural loan signals the Bank's confidence that effective policies are being applied, and cofinancing with such a loan may be the best way to introduce or reintroduce commercial banks to that country.

Close cooperation with the World Bank in the framework of/ <sup>structural adjustment</sup> ~~xxxxxx~~ lending would ensure that commercial bank loans were effectively used. In particular, it would offer some assurance that they contributed to strengthening debt service ability.

27. Terms and conditions of lending. The Bank's present loan portfolio offers limited resale possibilities because it is made up of fixed-rate instruments. Given a choice between an IERD bond and an unguaranteed World Bank loan to a developing country, lenders will normally prefer the bond unless the loan were priced to yield substantially more. The Bank can enhance prospects for sales of participations to the private sector by deliberately designing particular loans to include a portion for resale on terms other than those used for financing by the Bank itself, i.e., on floating rate terms. Both the Inter-American Development Bank and the International Finance Corporation do this regularly. While the volume of their operations is much smaller than the Bank's (IDB has arranged 14 such private cofinanced loans, for a total of \$378 million, in the past four years), their experience indicates that this technique <sup>could</sup> offer a useful additional tool to be used by the Bank in selected cases.

28. actively explore the desirability of making  
In future, the Bank will ~~xxxxxxxxxxxx~~ part of its loans for selected projects in the form of floating rate medium-term loans, with the deliberate intention of reselling to private investors the instruments

pertaining to these loans. Such resales would be arranged before, or at the time of disbursement, so that <sup>the Bank's</sup> its xxxi / lending authority will remain exclusively committed to long-term, fixed interest loans. <sup>The Bank could</sup> XXXXXXX thus supplement its own resources by tapping the very large potential offered by short-term private capital funds. The number, variety and interest of cofinanciers should be increased by the loans having "passed through" the books of the Bank. All loan sales would be made without Bank guarantees or any other type of recourse to the Bank, and would leave unimpaired the Bank's further lending authority out of its own resources. This will be usually preferable to the use of other methods, such as firm "buy-back" agreements, which would involve some impairment of the Bank's future lending authority.

29. We think these and similar new arrangements could be attractive to some commercial banks and provide more assurance to colenders than the Bank's current cofinancing practices. We see no need to take the further step of making the exercise of the Bank's remedies manadatory in the event of defaults on colenders' loans, in connection with these or more traditional cofinancing operations.

30. Assistance with long-term finance. In the 1950's and 1960's, several higher-income borrowers arranged for bond issues -- both public and private placements -- to complement World Bank loans in financing specific projects. The practice stopped when the Bank ceased lending to those countries. Some variation in this arrangement might be used to assist



present helps in improving access to private sources of long-term finance. In 1978, World Bank borrowers raised over \$4 billion worth of international bonds. Association with a World Bank project through cofinancing, particularly if the Bank administers and disburses the proceeds to ensure that they are effectively spent on the project, could add to the attractiveness of developing country bonds to certain investors. We plan to identify a limited number of projects suitable for such cofinancing, beginning with large projects related to sectors which relevant institutional investors are already financing in countries most likely to be successful in securing such private finance, and we shall consult with borrowers as to how the Bank might assist them. Such projects could then be simultaneously discussed with large insurance companies and pension funds operating on national markets (with respect to private placement), and with underwriters operating in international markets (with respect to public issues of international bonds).

## V. Conclusion

31. Cofinancing has grown rapidly in recent years. Through cofinancing arrangements with official aid agencies, export credits, and commercial banks, the Bank has improved the development impact of external capital and increased the effectiveness with which tied funds are used.

32. The Bank has achieved some success at introducing new lenders to developing countries. However, while cofinancing with private sources increased substantially in recent years, this increase was only a fraction of the total increase in commercial bank lending to developing countries that took place over the same period. It is unlikely that much cofinancing with private banks was additional to capital flows which would have otherwise taken place, or that it materially affected the terms and conditions of such flows.

33. Over the next few years, competition for external capital is going to be more acute, in particular by developed countries. Monetary policies are likely to continue the restrictive, anti-inflationary stance they recently assumed and thus reduce the liquidity of the world banking system and increase the cost of funds. Past borrowing, which has increased the share of developing country loans in the portfolios of commercial banks will also make further lending to such countries increasingly difficult, particularly in view of the deteriorating capital structure of many banks. In these circumstances, co-financing with the World Bank ~~can~~ play a much more important role. By ensuring the sound use of external capital and the overall effectiveness of development and structural adjustment programs, it can serve as the catalyst needed in critical cases for the ☐ private capital inflows actually to occur, on reasonable terms.

34. Implementing the approaches suggested in this paper will introduce new complication into the Bank's operations, it will somewhat increase administrative costs, and it will definitely entail greater Bank responsibility to private cofinanciers. We believe that the benefits to the developing countries will outweigh these costs, which are expected to be modest in any case. Both the quantity and quality of capital flows to the developing countries can be improved. This is especially crucial as we look to the great capital needs of developing countries and difficult capital markets expected in the 1980s.

## COFINANCING DEFINITIONS AND TERMINOLOGY 1/

1/ As currently used in the Bank, 2/ the term "cofinancing" refers in general to any arrangement under which funds from the Bank are associated with funds provided by other sources outside the borrowing country in the financing of a particular project. In some cases, funds from other sources may support parts of an entity's or agency's overall program in the sector to which the Bank project relates; such other financing is regarded as cofinancing if it is required to complete the financing plan for the Bank-supported project or if the Bank has played an active role in inducing the investment of funds by the other sources.

### Types of Cofinancing

2. Joint Financing - the term "joint financing" refers to a cofinancing operation for which there is a common list of goods and services, and where the financing of a disbursement for all or certain items is shared between the Bank and the co-lender in agreed proportions. Orders for all goods and services must be placed in accordance with procurement procedures acceptable to the Bank, normally the Bank's standard international competitive bidding rules.

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1/ This Annex is derived from Operational Manual Statement 1.24.

2/ As used in this paper, "Bank" means Bank and IDA and "loan" means loan and credit.

competitive bidding rules.

3. Parallel Financing - the term "parallel financing" refers to a cofinancing operation in which the Bank and the co-lender finance different goods and services or parts of a project. Parallel financing is preferred by some co-lenders, either because they wish their financing to be identified with particular parts of a project for public relations purposes or because their procurement procedures are not compatible with the Bank's requirements for international competitive bidding. Under parallel financing arrangements, the Bank and the co-lender agree in advance on the parts of the project to be financed by each. The Bank then administers procurement related to its part of the project and the co-lender does likewise. Often, however, arrangements are made for regular exchange of information and joint supervision of the implementation of the project. Parallel financing permits greater flexibility in arranging for finance.

4. Participations - under some circumstances, the sale of participations in a Bank loan may be regarded as a type of cofinancing. This is particularly true where arrangements for the sale of participation are worked out prior to the making of the Bank loan in order to complete the required financing plan. In such cases, the Bank will administer the loan on behalf of the participant, who enters into a participation agreement with the Bank. Sales from the Bank's portfolio of portions of old loans, while releasing Bank funds for other purposes, are generally not regarded as cofinancing as the term is employed in the Bank.

Sources of Cofinancing

5. Official - official sources of cofinancing include governments, their agencies and multilateral financing institutions. This source is sometimes referred to as "donor" financing and the terms of such financing are often concessional in some degree.

6. Export Credits - as used generally in the Bank, export credits refer to financing which is linked to the procurement of certain goods or services from a particular country. The source of funds may be governmental or commercial or a mixture of both, and the actual financing may take the form of "buyer's credits" where loans are made by banks in the exporter's country directly to the importer (the borrower) or "suppliers' credits" where loans are made by the exporter to the importer in the recipient country. Export credits are often guaranteed or insured in a significant portion by an agency of the supplying country.

7. Private institutions - financing by private institutions includes direct financing provided by commercial banks, insurance companies or other institutions or persons in the private capital markets outside the country of the borrower.



COFINANCING WITH WORLD BANK PROJECTS: FY73-79

	FY73		FY74		FY75		FY76		FY77		FY78		FY79	
	US\$m	No. of Projects	US\$m	No. of Projects	US\$m	No. of Projects	US\$m	No. of Projects	US\$m	No. of Projects	US\$m	No. of Projects	US\$m	No. of Projects
Official Sources														
DAC - Bilateral	257.5	24	422.8	28	306.4	30	458.5	29	452.0	39	841.9	34	1,111.7	31
- Multilateral	28.6	2	9.4	2	25.1	2	106.5	3	-	-	1.0	1	17.0	1
OECD - Bilateral	26.1	3	18.5	2	476.2	14	354.8	14	172.2	18	313.5	14	100.0	14
- Multilateral	-	-	-	-	41.5	3	171.9	14	232.1	16	139.1	13	3.4	3
Other	65.1	9	280.4	18	297.8	17	204.5	23	406.0	27	521.3	21	111.7	21
Total Official	377.3	38	731.1	50	1,147.0	66	1,296.2	82	1,265.3	85	1,817.9	79	2,153.7	79
Export Credits	71.1	3	514.2	10	711.4	7	663.6	10	333.3	10	373.0	11	451.5	17
Private Funds	-	-	60.0	1	76.3	2	286.0	5	423.7	10	213.2	11	347.8	14
Total Cofinancing	448.4	34	1,305.4	40	1,934.9	55	2,245.8	65	2,022.3	71	2,411.6	78	2,953.0	104
Of Which: Foreign Cost	407.7		1,290.8		1,876.6		2,157.7		1,917.5		2,187.5		2,623.7	
Local Cost	40.7		14.6		58.3		88.1		104.8		224.1		329.3	
Financing by World Bank	751.1		1,268.2		1,349.4		1,871.5		2,172.7		2,446.0		2,455.7	
Of Which: IBRD	445.9		1,102.6		1,018.3		1,485.6		1,895.2		1,911.7		2,432.4	
IDA	305.2		165.6		331.1		386.0		277.5		534.3		1,023.3	
Total Project Cost	2,783.2		5,197.4		8,746.2		8,927.2		8,333.4		11,242.3		13,337.8	
Percentage Shares														
Official Sources	84.1		56.0		59.3		57.7		62.7		75.6		82.5	
Export Credits	15.9		39.4		36.8		29.5		16.5		15.5		21.3	
Private Funds	-		4.6		3.9		12.7		21.0		9.1		17.2	

Note: Breakdown of the number of cofinanced projects by source may exceed total, as several Agencies participate in cofinancing a given project

Source: Senior Adviser Cofinancing/PAB.

## CO-LENDER TERMS, FY79

Country	Board	Export Credits				Private			
	Approval	Amount (\$m)	Mat. Grace		Interest (%)	Amount (\$m)	Mat. Grace		Interest L=LIBOR
	Date		--(Yrs.)--				--(Yrs.)--		
Portugal	1/4 -79	31.0	-	-	-	28.8	10	4	L + 7/8
Romania	11/28-78	12.9	8	2.5	7.5	-	-	-	-
	1/9 -79	11.0	8	3	10.0	-	-	-	-
	3/20 -79	-	-	-	-	100.0	10	4	L + 5/8 \$70m. L + 3/4 \$30m.
Yugoslavia	3/10 -78	-	-	-	-	20.0	12	5	L + 7/8
Brazil	3/6 -79	-	-	-	-	90.0	10	4	L + 1-1/2
	6/7 -79	-	-	-	-	60.0	10	5	12
Colombia	11/14-78	-	-	-	-	22.9	10	5	L + 3/4 L + 7/8 after 3 years
	6/12 -79	30.1	12	4	8.5	-	-	-	-
Dominican Republic	5/17 -79	-	-	-	-	10.0	10	4	L + 1-1/4 L + 1-3/8 after 4 yrs.
Paraguay	6/21 -79	-	-	-	-	7.0	12	6	L + 7/8 L + 1 after 6 years
Uruguay	4/17 -79	-	-	-	-	5.0	10	3.5	L + 7/8

ATTACHMENT

Paragraphs 30 and 31  
of the original version  
which have been deleted

30. During an initial period, the Bank would seek to identify potential cofinanciers and ensure that full agreement is reached with them and with the borrower before the Bank loan is finally committed. The signing of the Bank loan and the resales of loan participation instruments would in effect be simultaneous. 1/ However, once a certain pattern has

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1/ This is also the present practice of IFC.

evolved and it has become possible to judge accurately the attractiveness of such loan instruments for financial markets -- i.e., their appropriate terms and conditions -- it may be desirable to conclude the final cofinancing arrangements only after the Bank loan is granted, but always before it is disbursed. For the cofinanciers, this would have the advantage of fast disbursement. Alternatively, it may be desirable to sponsor a new institution to finance such loans.

31. Several variations on the general proposal described above are conceivable, and could be developed in future years within its overall framework. Instead of arranging for the sale of floating rate instruments relating to a single loan, it may be possible to make up a pool composed, in predetermined proportions, of instruments relating to loans to several borrowers. Spreading the assets and related risks over several borrowers in this way may increase the attractiveness of these instruments, particularly to relatively small lenders.

March 10, 1980

Mr. McNamara,

I am sending this to you because you had expressed a desire to have this urgently.

I should note that Section IV "Conclusion" (page 42), as well as the Section V "Response by the International Community" (pages 45-51) need considerable revision. At this stage the tone is needlessly critical and abrasive. We should have a revision of these sections to you by tomorrow.

Moeen A. Qureshi