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Future Role of the Bank -
Board meetings 1984-85

BOARD MEETING
Sept. 3, 1985

International Bank for Reconstruction and Development

FOR EXECUTIVE DIRECTORS' MEETING

FOR OFFICIAL USE ONLY

For consideration on July 9, 1985

R85-193

FROM: Vice President and Secretary

June 14, 1985

RESOURCE IMPLICATIONS OF THE BANK'S FUTURE ROLE

Attached is a paper entitled "Resource Implications of the Bank's Future Role".

Questions on the paper may be addressed to Mr. Wood (ext. 72784) or to Mr. Bock (ext. 78342).

Distribution:

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President
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RESOURCE IMPLICATIONS OF THE
BANK'S FUTURE ROLE

Section 1. Introduction

1.01 During the recent Development Committee meeting, Ministers endorsed the broad outlines of the Bank's future role as set out in "The Future Role of the Bank" (SecM85-247), dated March 6, 1985. The Committee urged Bank Management to present a report to the Seoul meeting which would "include projections of Bank lending over the next five years, together with their implications in terms of resources, so as to seek an early consensus on the future financial requirements of the Bank including the possibility of a General Capital Increase."

1.02 The purpose of this memorandum is to provide a framework for discussion of IBRD's lending prospects and associated capital requirements. A separate paper is being prepared on the implications for IBRD borrowings. Both papers are expected to be discussed by Executive Directors prior to the Seoul meetings.

1.03 The discussion in this memorandum proceeds as follows:

- Section 2 reviews future IBRD lending prospects. The discussion focuses mainly on the next three fiscal years (FY86-88). In light of global, country and internal Bank policy factors that affect lending levels, the IBRD lending prospects both by region and by type of borrower are assessed. The conclusion reached is that IBRD lending is likely to be in the range of $40 to $45 billion over the next three years and that lending by FY90 could be between $16.5 and $20 billion.

- Section 3 discusses briefly how the composition of IBRD lending by type of lending instruments and repayment terms of new loans affect capital requirements and prospective net flows to borrowing countries. The point is made that more liberal repayment terms for loans to certain types of borrowers would be desirable. Because of the sizeable impact such liberalization could have on future capital requirements, liberalization would need to be selective rather than across-the-board.

- Section 4 explores the scope for reducing capital requirements for a given program of commitments through various initiatives such as the use of guarantees, expanded loan sales and a gradual curtailment of lending to IFC. The conclusion reached is that steps such as these offer promise and should continue to be actively pursued but that, under the type of market conditions likely to prevail in the near and medium-term, the degree of capital "saving" that can prudently be relied upon is quite modest and should not be seen as an effective substitute for an increase in IBRD capital. Section 4 then sets out a series of estimates of those capital requirements, based upon various combinations of assumptions about desired commitment capacity, disbursement rates and repayment terms.

- Section 5 then summarizes the main elements of the analysis and indicates certain key points on which discussion might usefully focus in order to establish a framework for consideration of the IBRD's future capital requirements.

Section 2. IBRD Lending Plans and Prospects

2.01 Estimates of overall IBRD lending for the next few years are based upon an operational pipeline built up country-by-country and loan-by-loan in the context of the Bank's continuing operational and policy dialogue with member governments. The content of the future lending program at any point in time is thus a summation of individual projects, including financing for specific investments and sectors as well as adjustment support lending, which the Bank and the borrower agree should have priority within a jointly defined country assistance program. These programs are continuously reviewed and frequently modified in the course of discussions with borrowers. Projects scheduled for approval over the next two to three years are for the most part reasonably well defined in terms of sector and subsector, the investment and/or institutional and policy improvements to be supported, the approximate timing, and a rough indication of the size of IBRD loan envisaged both in absolute terms and as a share of total project costs. For the outer years (4 and 5) plans are of course much more uncertain.

2.02 This section describes the main features of the lending estimates that have been built up in this way, concentrating on the scale of lending envisaged over the next three fiscal years (FY86-FY88). As stated in the memorandum on work programs and budgets for FY86, Management is seeking budgetary resources commensurate with a lending capacity of $40 to $45 billion for this three-year period.

Factors Affecting the Scale of Lending

2.03 The estimates of potential IBRD lending over the next three years are based upon a number of assumptions about world and country conditions and about policies and practices followed by the Bank in its lending operations. These factors were discussed by the Executive Directors earlier this year (February 7 and 8), at which time a number of questions were raised, especially concerning the "self-imposed" constraints on future IBRD lending. In order to put the estimates of future lending into context, it may be helpful to elaborate briefly the assumptions underlying these estimates both with respect to global and country conditions and to "internal" Bank constraints.

Global and Country Factors

2.04 The overall trade and capital flow framework remains as described in the background paper for the recent Development Committee meeting (DC/85-9 dated March 26, 1985). Continued growth in exports to OECD countries is a crucial assumption, especially for IBRD borrowers. It is the foundation for continued progress in restoring the balance between debt and debt-servicing capacity in most IBRD borrowers in Latin America, Africa and much of the Europe, Middle East, North Africa (EMENA) region. It is also a sine qua non for expansion in import capacity in these countries upon which depends the continuation of recovery in both consumption and investment from the sharply compressed levels of 1983-84. The rate of recovery of domestic investment in particular countries is difficult to predict and this directly affects the prospects for IBRD lending in support of investment.

2.05 Another source of uncertainty affecting the prospects for lending in support of investment is what happens to the exchange rate between the US dollar and other currencies. The strengthening of the US dollar over the last few years--and particularly the surge which occurred in the first half of FY85--led to lower dollar denominated procurement costs, reduced the dollar cost of local components, and led to an underutilization of contingency allowances. This experience with ongoing projects, together with the desire to restrain external borrowing and minimize commitment fees, has led to lower contingency allowances in new operations, thus reducing the size of new operations.

2.06 Some idea of the magnitude of the effect of exchange rates on lending plans can be gained from re-expressing previous plans in terms of SDRs rather than US dollars. For example, when IBRD lending plans for FY85 were first formulated in 1979-80, the planning figure in SDR terms equivalent to $13.2 billion would have been about SDR10 billion. At current exchange rates, FY85 commitments are now expected to be about SDR 11.5 billion, i.e. about 15% higher than originally planned. The increase in the SDR value of the planning figure for FY85 took place over a number of years, so the lower than planned FY85 commitment level (in US dollars) was not mainly due to exchange rate movements. But, in retrospect, it is clear that our planning for IBRD commitment levels did not take sufficient account of the growing real level of investment implied by unchanged US dollar figures.

2.07 While uncertainties about exchange rate movements and about the pace of recovery in investment have an impact on the scale of IBRD lending which supports investment, there are equal uncertainties in the component of future IBRD lending that depends on the pace at which borrowers implement their adjustment programs. In many countries where broad adjustment goals are accepted, implementation is delayed for a variety of reasons, ranging from unexpected economic developments to difficulties in mobilizing the requisite political consensus. In such cases, failure to take the requisite actions not only precludes adjustment lending but also undermines the resource mobilization effort without which a resumption of a normal investment effort (and hence a healthy project lending pipeline) cannot materialize.

2.08 While the Bank can help in the design of specific steps--indeed an increasing share of the Bank's research and country economic and sector work is devoted to improving its capacity to provide such help--the decision-making process and the development of the requisite consensus is in the hands of the borrowing member country. The pace of Bank operations in support of adjustment is thus largely determined by events over which it has scant influence.

2.09 Our lending program plans allow for possible delays, based upon past Bank experience in the country concerned or in similar situations in other countries. But the severity of pressures facing many borrowing countries is unprecedented, as is the scope and difficulty of adjustment measures which they face. Accordingly, the conventional "slippage factors" which guided Bank forward planning in the past are of limited use. The lack of any firm basis on which to project the pace at which accepted adjustment goals are translated into action is a major source of uncertainty affecting the planned IBRD lending in support of structural change.

2.10 The upper end of the range of lending estimated for the FY86-88 period--namely, $45 billion--assumes that the great majority of IBRD borrowers engaged in programs of structural change will succeed in moving ahead expeditiously with their adjustment programs and will welcome IBRD lending in support of these programs. It assumes also that the majority of borrowers move from a period of stabilization to one of increasing investment and resumption of growth, and that there will not be a recurrence of global pressures akin to the recession of 1982-84. The bottom end of the range--at $40 billion--assumes a less optimistic scenario in terms of progress in structural change and resumption of growth of investment.

Bank Factors

2.11 In the Board discussion on February 8 and 9 attention was principally focussed on three "self-imposed" constraints: (a) the 10% guideline on exposure in any single borrowing country; (b) the creditworthiness and performance standards applied by staff and Management; and (c) the cost-sharing arrangements which affect the share of total project costs the IBRD is prepared to finance. While none of these guidelines/standards is applied mechanically, they do collectively have an important impact on lending prospects. Hence it may be worthwhile attempting to characterize the posture which is expected to guide their application to IBRD lending over the next few years.

2.12 The 10% guideline on exposure in any single borrower is, as was emphasized in the February discussion, applied flexibly. The only two borrowers currently affected by this guideline are Brazil and India. In Brazil it is expected that actual exposure may temporarily exceed 10% of total IBRD exposure, reaching levels of 11% to 11.5% at some point over the next few years, before being brought back into line with the guideline.

2.13 If the guideline were to be changed, each 1% change would increase the lending capacity to the country by $300-400 million of additional commitments per year, or about $1 billion over the FY86-88 period. This is not insignificant in relation to the potential range of the proposed lending program.

2.14 A separate note on the detailed implications of modifying the current exposure guideline is under preparation and will be presented to the Board in the near future. As noted in the February discussion, there are two sorts of implications which need to be examined. First, there is the question of maintaining an appropriately broad distribution of the IBRD lending resources as a matter of equity. The importance of this issue would be reduced in the short term if there were to be eventual agreement on a substantial General Capital Increase, since in that case expanded lending to any one borrower would not limit the IBRD's capacity to respond to the needs of other borrowers. Secondly, there is the question of how an increased concentration of loans might affect the financial position of the IBRD, either from the point of view of the financial markets or of the shareholders. On this issue, the preliminary reading--which will be developed further in the note mentioned--is that the risks of adverse market reaction are likely to be manageable.

2.15 The posture adopted by Management with respect to creditworthiness criteria and performance standards is to see how the Bank can actively support the country's development and/or adjustment program so as to, *inter alia*, enhance its creditworthiness. Creditworthiness is assessed in a dynamic context. The question asked is whether the country is expected to be able to service its debt to the IBRD when it falls due. Where creditworthiness is weak, the focus is on how the Bank can most effectively participate in the formulation and in the financing of a creditworthiness--enhancing recovery program.

2.16 The demonstration of this posture is perhaps most clearly seen in the lending capacity which is planned over the FY86-88 period for numerous borrowers in Latin America, EMENA and Sub-Saharan Africa where stabilization and adjustment issues loom large. (Cf. paras. 2.23 to 2.35 below.)

2.17 Performance standards (or conditions) are seen as an integral part of the Bank's efforts to ensure effective utilization of resources, whether at the project or country level. They are thus intended to support the objective of enhancing long-term creditworthiness, and in this connection country performance has been a factor constraining the scale of IBRD lending. Project completion reports and OED findings suggest that continued rigor in meeting stringent project preparation and evaluation standards and institutional support requirements are essential to ensure the effectiveness of Bank assistance. The conditions attached to Bank lending are overwhelmingly of this character. Nonetheless, the record of the past few years shows that lending has been in line with--or in excess of--the multiyear expectations for the great majority of IBRD borrowers. Over the FY80-84 period there were substantial shortfalls from planned levels of IBRD lending in only ten countries, with some two-thirds accounted for by just four countries (Argentina, Nigeria, Romania, and Thailand). An important part of this shortfall reflected the borrowing strategies of the countries concerned, and was not affected by creditworthiness considerations on the part of the Bank. Given that performance and creditworthiness standards are applied in a common fashion to all borrowers, the occurrence of shortfalls in lending to a relatively small number of countries--some of whom preferred not to borrow for reasons unrelated to the Bank's posture on these matters--is evidence that such standards are not out of line for the Bank as a whole.

2.18 The types of conditions applied to various IBRD lending instruments were also a focus of concern in the February discussions. A separate note on this subject has already been distributed to the Executive Directors (R85-518 dated April 30, 1985).

2.19 Finally, on the issue of cost-sharing arrangements the posture adopted depends very much upon country conditions. While there is a general tendency for the share of total cost to decrease as countries move up the per capita income scale, the specific provisions vary both by type of project and in relation to the resource mobilization performance of the country concerned. For SALs and sector adjustment loans, cost-sharing limits are not applicable. For projects in the social sectors, where alternative sources of external capital are more limited, there are generally higher limits, so that it is in infrastructure projects and investment operations in the directly productive sectors where cost-sharing limits have the greatest impact.

2.20 In assessing what cost-sharing posture to adopt, a balance has to be struck between showing concern for the budgetary pressures that limit the resources available to governments to finance a substantial share of total costs and showing concern that adequate attention is paid to the appropriate use of debt-creating external capital flows as well as to user charges--frequently an issue in infrastructure projects--and other steps which affect the availability of domestic resources.

2.21 While liberalization of cost-sharing arrangements was a feature of the Special Action Program, and will continue to be used on a case-by-case basis, it is not considered to be a major factor affecting lending prospects over the FY86-88 period. To the extent that IBRD lending is constrained to particular countries over the medium term, the overriding considerations are those of creditworthiness and performance, not inadequate lending opportunities. While in 1983-85, many borrowers cut back their investment programs, drastically in most cases, it is expected that investment programs will begin to grow again in the years ahead. In some countries this has started already. Based on that expectation, and given adequate time and resources to build up a pipeline of operations, it should generally be possible to commit IBRD resources on the broad scale desired without having to accept major departures from normal cost-sharing arrangements.

Growth in Lending: Regional Perspectives

2.22 Against the background of these external and internal factors, specific estimates of lending prospects may be considered. Table 2.1 below gives an overview of the growth in lending which has been achieved over past three-year periods and summarizes the regional distribution of growth anticipated over the next three years. Experience demonstrates that it is not realistic to expect favorable outcomes in all countries simultaneously and future lending plans must take account of probable outcomes. Hence, lending in FY86-88 is currently estimated at between $40 and $45 billion.

Table 2.1. IBRD Commitments: Actual and Potential
($ billion; % per annum)

	FY80-82	FY83-85	FY86-88	Actual/Potential Increase in Lending by Period ---($b)---		--(% p.a.)--	
Latin America	8.7	10.2	13.7	1.5	3.5	5%	10%
Asia							
IBRD Only	6.9	7.3	8.8	0.4	1.5	2%	6%
Blend Countries	2.2	6.7	8.5	4.5	1.8	45%	8%
Europe, Middle East and North Africa	6.7	8.1	10.0	1.4	1.9	7%	7%
Africa	2.2	2.2	4.0	-	1.8	-	22%
TOTAL	26.7	34.5	45.0	7.8	10.5	9%	9%

2.23 In Latin America the growth in IBRD lending over the past three years was very unevenly distributed. The increase in lending to Brazil (which went up from $2.3 billion in FY80-82 to $4.5 billion in FY83-85) more than accounted for the overall growth in the region; aggregate lending to others declined from $6.4 billion to $5.7 billion.

2.24 Over the next three years growth in lending is expected to be much more widely distributed. Two of the IBRD's largest borrowers (Brazil and Mexico) and other borrowers (e.g., Colombia, Ecuador) are now emerging from the import compression stage of the recovery from the crisis of 1982-83. The challenge in these countries is to restore investment and growth momentum while maintaining and even enhancing the confidence of external lenders and investors in the sustainability of the renewed growth process. The Bank's assistance efforts will accordingly emphasize the follow-through (particularly at the sector level) of the adjustment programs which have been launched and the resumption of lending in support of investment.

2.25 The steps taken by these borrowers to assure that new investment is done in a selective manner and in an appropriate policy and institutional setting will be crucial to the resumption and/or expansion of external lending and investment on a voluntary basis. An important catalytic dimension of the Bank's lending in these countries in the next few years will thus be to demonstrate through its presence its support for resumed investment in key sectors.

2.26 A number of other countries in the Latin America region are in an earlier and/or more fragile stage of recovery. Progress has been made in several of these countries (e.g., Chile, Costa Rica, Jamaica) in formulating adjustment programs and taking the first steps toward restructuring their external debt. In a number of other countries stabilization issues remain to be resolved and external lending--even on a non-voluntary basis--is very limited. IBRD lending to both groups of countries was very uneven during the FY83-85 period and less than envisaged in the planning assumptions. IBRD lending declined from $2.7 billion in FY80-82 to $2.1 billion in FY83-85, despite increases to some individual countries within the group.

2.27 For the FY86-88 period IBRD lending to Latin America would, if favorable conditions were to prevail in most of these countries, increase to between $13.5 and $14 billion--a substantial increase in lending from the levels attained in FY83-85. Because lending to Brazil is constrained by the need to bring IBRD exposure back into line with present guidelines,[1] the growth rates envisaged for borrowers other than Brazil are typically well above 10% per annum. Obviously, this implies very substantial increases in lending to particular countries and also reflects a view that the Bank should accept a rather rapid growth in IBRD exposure in countries which face very difficult prospects and major downside risks over the next few years. In some cases the Bank would be taking on a higher share of a country's projected debt service than is customary (the "rule of thumb" being either 15% or 20%, depending upon the prominence of preferred creditors as a group). Provided a borrowing country demonstrates its commitment to adjustment over the medium-term, Management believes it is appropriate to provide lending support on a scale that is generous in relation to historical averages and to accept a relatively high share of incremental exposure during the period when external confidence is being restored. Even a relatively high IBRD share would not be expected to exceed 25% or 30% of the total, however, so that cooperation with other external sources of finance, both official and private, will remain indispensable.

2.28 Given the nature and severity of the problems which some of the countries in Latin America face, it is only realistic to anticipate substantial variation in the pace at which lending grows in particular countries. Nevertheless, if the basis for expanded lending can be

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1/ As discussed in paras. 2.12-2.14 above.

established and sustained, then this part of the IBRD's lending capacity could have a high development (and catalytic) payoff over the next few years. Thus, even though a portion of this capacity may not in the end be utilized in full, to decide against creating it would be to forego a potentially important contribution which the Bank might otherwise make in a region which faces major challenges over the next few years.

2.29 In <u>Asia</u> it is helpful to distinguish between lending to blend countries (mainly China, India and Pakistan) and lending to IBRD-only countries (mainly Indonesia, Korea, Philippines and Thailand). IBRD lending to the former group is projected to continue to expand over the FY86-88 period, although at a lower rate than in the FY83-85 period, reflecting the transition of the China program from its start-up phase to a more mature phase as well as a moderating of the rate of expansion in IBRD lending to India. Commitments to IBRD-only countries are expected to expand more slowly than commitments to other regions, reflecting a levelling off of lending to Indonesia (where the government is giving principal emphasis to strengthened implementation of on-going operations) and the ready availability of alternative sources of finance for some of the other borrowers in this group.

2.30 The Asian borrowers as a group (including both blend and IBRD-only countries) have had the highest rates of GDP growth of any region in the world over the past decade. With the exception of the Philippines, these countries have managed their economies so as to avoid the debt and liquidity crises which have affected other regions. Sustaining this performance in the years ahead will require continued rapid growth of domestic investment, including not only the directly productive sectors but also public investment in infrastructure, human resource development and social services. Mindful of the risks associated with over-reliance on external borrowing, most of these borrowers are giving priority to improvements in the mobilization of their own domestic resources, to making better use of foreign equity capital and technology, and to enhancing the efficiency of that level of domestic investment which can prudently be financed. The Bank has a role to play in support of each of these objectives.

2.31 In the three-year period FY83-85 the whole of the growth in IBRD commitments to IBRD-only countries took place in Indonesia and Korea. Looking ahead to FY86-88, growth in lending seems likely to be more broadly distributed although much depends upon the borrowing strategies followed by Korea, Malaysia and Thailand--all of which enjoy favorable access to international capital markets. The case of the Philippines is similar to that of several Latin American borrowers where the recovery process remains fragile; as in those cases, IBRD participation in support of continued adjustment and renewed investment could be a sizeable and critical component of the financing needed for a multi-year recovery program. As a group the IBRD-only borrowers could easily make good use of the $1.5 billion increment in IBRD lending included in the overall estimate for FY86-88. Since the risks associated with lending to this group are generally less than for other groups, growth--even at the modest rate of 6% per annum--would help balance the overall IBRD portfolio.

2.32 As noted earlier, the Asian blend countries have been by far the fastest growing recipients of IBRD loans. Nearly 60% of the total growth in IBRD commitments in the FY83-85 period was accounted for by this group. That share would fall to about 17% ($1.8 billion out of $10.5 billion) in the FY86-88 period, mainly because of the tapering of growth in lending to China and India. In the case of India the constraint on lending is derived from the current guideline which limits IBRD exposure in any single borrower to about 10% of total exposure.2/ The lending plans in China are not constrained by this guideline, but by the concerns of the Chinese authorities to be cautious in expanding borrowing on IBRD terms, particularly for operations not in the directly productive sectors. Were either of these constraints to be eased (i.e. the 10% guideline or the cautionary limits on IBRD borrowing adopted by the Chinese authorities) additional lending would be feasible.

2.33 In the Europe, Middle East and North Africa (EMENA) region there are a wide variety of country conditions which affect IBRD lending prospects. In higher income countries (such as Yugoslavia and Hungary) lending is not projected to increase beyond current levels. In a few countries (e.g., Turkey, Jordan) where the adjustment process is well in hand, there is scope for increases in IBRD lending in the next three years to follow through--mainly at the sector level--on the adjustment programs which have been successfully launched. In some other countries lending prospects will depend on the effectiveness of government response to stabilization and structural problems. In still others (e.g., Algeria, Syria, Romania, Portugal) lending levels will largely hinge upon the extent to which the governments concerned decide to seek Bank assistance for their investment and adjustment needs.

2.34 These uncertainties translate into a lending volume for the FY86-88 period which is exceedingly difficult to predict. In EMENA as in Latin America, adequate lending capacity will be maintained to allow flexible and tailor-made responses to the turbulent and varied needs of the clientele. Aggregating country-by-country lending estimates for EMENA, it is possible that lending in the EMENA region would reach $10 billion, implying a rate of growth of over 7% per annum in nominal terms, which implies growth rates significantly higher than 7% in a number of borrowers.

2.35 Finally, in Sub-Sahara Africa there is yet a different picture. The set of countries considered creditworthy for IBRD borrowing has declined from a dozen in the 1970s to ten today. Over 80% of all IBRD borrowing during the FY83-85 period was accounted for by Nigeria, Ivory Coast, Kenya and Zimbabwe. This concentration is expected to diminish only slightly in the FY86-88 period. The very substantial potential increase in lending indicated for the region (from $2.2 billion to $4 billion) is thus

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2/ As discussed in paras. 2.12-2.14 above.

dependent on successful pursuit of medium-term adjustment and development programs in these countries. The lending capacity which the Bank is seeking for this region is consistent with very vigorous support for these countries under favorable circumstances.

Growth in Lending: Overview by Type of Borrower

2.36 In addition to considering demand for lending on a regional basis, it may also be helpful to differentiate by type of borrower. The following table shows IBRD lending to three borrower groups: first, the borrowers (Brazil, China, India) where concentration guidelines are, or may become, a constraint on lending; second, the IBRD-only countries of Asia (e.g., Indonesia, Korea, Thailand) where most borrowers have alternatives to IBRD funds; and, third, all other borrowers.

Table 2.2. IBRD Commitments by Type of Borrower
($ billion)

	FY80-82	FY83-85	FY86-88	Actual/Potential Increase in Lending by Period ---($b)---		-(% p.a.)-	
Largest Borrowers	4.2	10.6	12.6	6.4	2.0	36%	6%
IBRD-only Asia	6.9	7.4	8.8	0.5	1.4	2%	6%
Others	15.6	16.5	23.6	0.9	7.1	2%	13%
Total	26.7	34.5	45.0	7.8	10.5	9%	9%

2.37 Whereas the growth in IBRD lending during the FY83-85 period occurred primarily in the three largest borrowers, the bulk of the growth anticipated over the next three years is in other borrowers, particularly in countries other than the IBRD-only group in Asia. The growth rate for these borrowers averages 13% per annum--implying an increase of about 45% over a three-year period.

2.38 In practice, it is unlikely that the whole of this growth potential will be fully used. Management's best estimate--based upon current conditions--is that total lending for the FY86-88 period will fall in the range of $40 to $45 billion. Most of the uncertainty relates to lending in the group of small and medium-sized borrowers in Latin America, EMENA and Sub-Saharan Africa where the potential for substantial expansion from FY82-85 levels exists, but where the risks of slippage are also great.

2.39 As noted earlier (para. 2.13) the potential for modestly higher IBRD lending than is envisaged in these projections does exist in the largest borrowers, if there were to be a relaxation of the 10% guideline. There could also be some increases in lending to the IBRD--only countries of Asia--beyond the increases already allowed for--if improvements in the external environment and in the countries' own efforts to mobilize more resources domestically were to lead these countries to conclude that strategies involving higher growth, investment and external borrowing were prudent.

2.40 In the smaller and medium-sized borrowers outside Asia the levels of lending envisaged for the FY86-88 period already represent a very ambitious program. Not only is the rate of growth quite high, but the share of debt service which the IBRD would have in several countries would exceed 20% of the total. Moreover, the levels of lending on a per capita basis are projected to be much above historical averages--exceeding $15 per capita per annum in a number of cases and reaching $25 in a few cases. While none of these factors poses an absolute limit on lending in any particular case, they do, when considered together, tend to confirm the impression that the IBRD program for these countries in FY86-88 is close to the limit of what can realistically be expected consistent with maintaining high standards of lending and not incurring unacceptable levels of risk.

Outer Year Prospects

2.41 Prospects for IBRD lending beyond the next three years are for continued growth, based on a continuing and perhaps accelerating recovery of investment programs in many countries and a continuing (though diminishing) need for adjustment support lending. The following table indicates the year-by-year range in which IBRD commitments are likely to fall, extrapolating to FY90. As the table shows, lending in FY90 could range between $16.5 and $20 billion.

Table 2.3. Range of Prospective IBRD Lending
($ B illion)

	FY86	FY87	FY88	FY89	FY90
Upper End of Range	13.5	15.0	16.5	18.0	20.0
Lower End of Range	12.0	13.0	14.0	15.0	16.5

2.42 Finally, the many uncertainties with respect to IBRD lending prospects have important implications for the way in which the Bank and its shareholders must approach the discussion of capital requirements. It is not practical in the present environment to base a capital requirements discussion on a precisely defined future lending program. It is more appropriate to focus on the lending capacity that the Bank should have, and leave decisions on specific year-by-year lending programs over a period of five years or longer (i.e. the period over which increased commitment authority would be expected to be utilized) to the annual reviews of financial and operating programs. In assessing IBRD capital requirements, moreover, it is important also to consider the capacity of the Bank to adjust the pace of its disbursements and its repayment terms to the changing circumstances of its borrowers. These considerations are taken up in the next section.

Section 3. IBRD Disbursement Rates and Repayment Terms

3.01 Disbursement and repayment characteristics of IBRD loans have a significant influence on the amount of loans outstanding that result from any given commitment program.3/ Hence, they are a major determinant of the capital that is needed to support a given commitment capacity. The key policy consideration affecting the pace of overall disbursement is the mix of lending as between adjustment-support lending (which tends to be relatively fast-disbursing) and lending for specific investments. Accordingly, the IBRD capacity to undertake such lending needs to be taken into account in planning for future capital requirements. Similarly, repayment terms of IBRD loans have a major impact on capital requirements. While these terms have remained substantially unchanged since they were hardened in FY77 (on what was expected to be a temporary basis) the severe deterioration in the debt profile and other circumstances of many borrowers makes it appropriate to consider whether some capacity to offer more liberal repayment terms on new IBRD commitments ought to be allowed for.

3.02 Mix of Lending Instruments. The need for the Bank to play an important and continuing role in support of adjustment programs in many borrowing member countries was one of the key conclusions in the discussions of the Future Role of the Bank. Emphasis was given in the discussions to the type of lending instrument that best meets the needs of borrowers in different circumstances. As noted in an earlier paper,4/ the types of lending instruments range along a continuum from specific investment loans to various kinds of sectoral operations (sector investment loans, financial intermediary loans, sector adjustment loans) to structural adjustment loans. In terms of financial requirements associated with these various types of loans, they also differ importantly with respect to the rates of disbursement. The fastest disbursing loans are structural and sectoral adjustment loans, while specific investment loans generally disburse more slowly.

3.03 Experience with adjustment-support lending (SALs; sector adjustment loans) suggests that the annual proportion of commitments falling in these categories can vary considerably. For purposes of assessing capital requirements, a range of between 15% and 20% of total commitments would seem to adequately bracket the likely outcomes. While it is possible that the share of such lending could decline to nearer to 10% at the end of the decade, to plan on such a decline would risk significantly constraining the Bank's capacity to respond to a demand for adjustment assistance that could arise in the future, but which cannot by its nature be projected with any precision in advance.

3/ The limit to IBRD lending imposed by the Articles of Agreement (Article III, Sec. 3) is expressed in terms of "the amount outstanding" of loans and guarantees rather than total loan and guarantee commitments.

4/ "Bank Lending Instruments", dated December 21, 1984.

3.04 Repayment Terms on Bank Loans. Repayment terms are another important characteristic of IBRD lending, and one that has not been discussed much in recent years. Repayment terms were last changed in FY77 when country "norms" for maturities and grace periods were established for three income groups, and the method of repayments was changed from a constant annual annuity system to a constant annual principal repayment system.[5] The objective of the change at that time was to increase the amount of new commitments that could be supported by the then-existing IBRD capital base. The change in terms was viewed by many countries as temporary, pending final agreement on a further capital increase. Subsequently, it was not possible to reach a consensus in favor of a restoration of the pre-1977 terms. In recent years the IBRD has been once again in the position where pre-1977 repayment terms would have implied a sustainable level of lending (SLL) that was below prospective lending demand.[6]

3.05 When addressing the question of future capital requirements, it is appropriate to consider whether the capacity of the IBRD to make new loans on more favorable repayment terms should be restored. The primary argument in favor of such a change is that even a partial restoration of the pre-1977 terms would enable the Bank to contribute to an improvement in the debt service profiles of borrowers in the late 1980s and early 1990s. It is during this period that countries now restructuring their existing debt will face renewed debt service "humps". Indeed, the Bank has encouraged borrowers on several occasions to seek to establish more graduated debt service profiles in the context of multi-year restructuring arrangements (MYRAs). The Bank's B-loan program is also designed to support annuity-type terms through the contingent take-out option. It is somewhat anomalous in this context that the IBRD itself lends exclusively on an amortization pattern (i.e. equal semiannual payments of principal) that is traditionally associated with commercial banking.

3.06 There are, morever, many types of projects for which the graduated repayment structure and longer maturities available prior to FY77 would be much more appropriate than the present system. This is particularly true for human resource development and infrastructure projects where project benefits accrue more gradually. In addition, borrowers frequently cite the maturities available from the IBRD as a highly valued feature of its lending compared to that of other lenders. On average, however, the length of time that borrowers have use of IBRD funds is now just over 6-1/2 years--not substantially longer than maturities available for the more creditworthy developing country borrowers in private markets and well short of what is appropriate for certain development projects. While variation of loan terms on project grounds is permissible under the present system of country "norms", the constraints on grace

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5/ See FY77 Budget Memorandum R76-145, dated June 9, 1976.

6/ The SLL under the present terms of lending is about $13 billion. If the pre-1977 lending terms were applied to all future commitments, starting in FY86, the SLL would be less than $10 billion.

periods and final maturities that must be adhered to (on average) by each country have left little scope for tightening the terms on selected projects to a degree that would permit meaningful liberalization for other types of project.

3.07 These considerations suggest that estimates of future IBRD capital requirements should take into account the possibility of enhancing the IBRD's capacity to differentiate repayment terms according to country circumstances and to have average country "norms" which are sufficiently generous to permit meaningful adjustment of specific loan terms to take account of project characteristics.

3.08 The possibilities for liberalizing repayment terms on future IBRD commitments may be approached either through general relaxation or through selective adjustment. The table below shows the impact on aggregate net disbursements of two types of general relaxation; namely, full return to the pre-1977 terms and return to a position mid-way between the pre-1977 terms and the current terms. As will be explained in Section 4, the capital requirements associated with full return to the pre-1977 terms are so large as to cast doubt on the feasibility of this option, whereas partial (e.g., 50%) liberalization is worth careful consideration. The table also shows the impact of two types of selective liberalization; namely, return to annuity-style payments for low-income IBRD borrowers (i.e., those with per capita income below $790 per annum) and the same change for middle-income countries that are implementing adjustment programs with IBRD assistance. The change in repayment terms for middle-income countries is assumed to apply only to commitments made during the next three fiscal years, but the change for low-income countries is assumed to continue throughout the projection period.

Table 3.1. Net Disbursements with Alternative Repayment Terms[a]/
($ Billion)

	FY86	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94
Present Terms	6.6	6.8	6.4	6.2	6.2	6.4	6.7	6.8	6.6
General Liberalization									
-Pre-FY77 terms	6.6	6.8	6.4	6.5	6.8	7.5	8.6	9.4	10.0
-50% relaxation	6.6	6.8	6.4	6.4	6.5	7.0	7.7	8.1	8.3
Selective Liberalization									
-Low-income borrowers									
with present terms	3.4	3.9	4.4	4.8	4.6	4.5	4.6	4.6	4.6
with alternative terms[b]/	3.4	3.9	4.4	4.8	4.6	4.6	4.8	4.9	5.1
-Middle-income borrowers									
with present terms	3.2	2.9	2.0	1.4	1.6	1.9	2.1	2.2	2.0
with alternative terms[c]/	3.2	2.9	2.0	1.6	1.8	2.1	2.4	2.5	2.2

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a/ The commitment assumptions used in these projections correspond to the high end of the range shown in Table 2.3

b/ All IBRD borrowers with 1983 per capita GNP of $790 or less (except India and China) are assumed to revert to annuity-style repayments beginning with FY86.

c/ IBRD borrowers with 1983 per capita GNP greater than $790 (except Brazil) that qualified for the Special Action Program are assumed to revert to annuity-style repayments for all commitments in the FY86-88 period.

3.09 On both country and project grounds, low-income borrowers from the IBRD would appear to be particularly attractive candidates for liberalization of repayment terms. These are countries where there are substantial investments required in infrastructure and human resource development--investments which are critical to sustained development and yet which often realize benefits only over an extended period. The ability of these economies to adjust rapidly to changed circumstances is constrained by structural weaknesses (e.g., relatively inflexible institutions), so that financing provided in support of structural adjustment ought also to be on relatively generous terms.

3.10 The IBRD's current repayment terms already take account of the needs of these low-income borrowers in a modest way, through longer than average grace periods (five years) and final maturities (20 years). A return to annuity-style repayment terms for this group would only begin to affect net disbursements in the early 1990s (because of the five-year grace period) but would have a fairly rapidly growing impact thereafter. By FY94, net disbursements to the group would be $500 million higher than with current repayment terms. This calculation does not allow for changes in repayment terms on IBRD loans to India and China, because it is not clear whether--in light of actual or potential limits on these countries' share of total loans outstanding--they would find it advantageous to make use of more liberal repayment terms. Hence, the $500 million impact in FY94 applies only to other low-income IBRD borrowers and thus represents an even more significant change than is suggested by the figures for the low-income group as a whole.

3.11 The case for liberalization of repayment terms for middle-income IBRD borrowers is different. Since these countries are more reliant on commercial bank financing, the bunching of their future debt-servicing obligations poses more of a problem, particularly in those cases where restructuring of commercial bank debt has occurred. Accordingly, the liberalization illustrated in the projections is structured so as to have its principal impact in the FY89-94 period. The shorter grace periods on IBRD loans to middle-income borrowers (either three or four years) explains why net disbursements begin to be affected in FY89. Also, since these borrowers' capacity to service debt in the mid- and late-1990s could well be such as to make more liberal repayment terms unnecessary at that time, the liberalization assumed in these projections is limited to commitments made during the FY86-88 period.

3.12 The quantitative impact of liberalization for this group of countries peaks at about $300 million per annum in FY92-93. While small in absolute terms, it should be noted that this shift is concentrated in relatively few borrowers (Brazil is not included on the same grounds as were cited for India and China) and can make the difference between whether the flow of funds from the IBRD to a particular borrower is positive or negative during the FY89-94 period.

3.13 Management believes that selective liberalization of repayment terms makes sense in relation to the debt position and prospects facing the various groups of IBRD borrowers. Given the long lead time before liberalization begins to have an impact on net disbursements, early consideration of these possible changes in IBRD terms is desirable. It is recognized, however, that liberalization of terms can have important implications for the scale of IBRD capital requirements and that some trade-offs may be necessary. Accordingly, the recommendation being made at this time is that the possibility of changes in repayment terms be considered explicitly when deciding upon the financing capacity that the IBRD ought to aim for over the next five years.

Section 4: Future Capital Requirements

4.01 As noted above, the need to allow for greater year-to-year volatility in the volume and type of assistance provided to individual countries suggests that the capital requirements discussion should focus on the range of operational capabilities that additional capital would give to the Bank. As a practical matter, such an approach would mean that the shareholders would decide upon the desired IBRD lending capacity (including the desired degree of flexibility in repayment terms) with the knowledge that the rate of growth and composition of annual lending programs would be more uncertain and changeable than has been the case in the past. Departures from the planned growth path would be approved on a year-to-year basis, in light of borrowers' evolving requirements. A higher than planned commitment level for instance, would shorten the period over which the additional lending capacity would be used, whereas a lower than anticipated growth rate of lending or a smaller than expected share of fast-disbursing loans would lengthen the period.

4.02 In the discussion that follows, a planning period of five years is used. This is the minimum period likely to be acceptable to member governments, given the administrative and legislative costs of a capital increase. The prospects for IBRD lending over a longer planning horizon than five years are too uncertain to provide a good basis for capital requirements discussions.

Capital Leveraging Possibilities

4.03 Before discussing the capital required to create the capacity for lending discussed earlier, it is important to form a view on the extent to which the Bank might be able to achieve a higher level of commitments per unit of capital. It should be noted at the outset that the efforts considered in this section do not "leverage" IBRD capital in the technical sense of permitting a larger volume of outstanding loans for a given capital base (this would require an amendment of the Articles). Rather, they enable the IBRD to turn over its loan portfolio more rapidly.

4.04 There are a variety of techniques that may be considered in this connection. One set of techniques affects the rate at which new IBRD commitments are counted against IBRD capital. Another set affects the rate at which loans are removed from the IBRD balance sheet. In addition, the IBRD's capacity to make new commitments to countries is affected by the scale of lending to IFC as well as by the rate at which reserves are built up. Each of these possibilities for economizing on the need for additional IBRD capital deserves attention.

4.05 Deferring Disbursements. Since loans are counted against the IBRD's capital only after they are disbursed, any action which has the effect of deferring disbursements reduces the time a loan is in the portfolio and hence increases the rate at which the portfolio turns over. When the IBRD jointly finances an operation with other lenders--especially commercial banks--it may be possible to structure the arrangement so that the other lenders disburse quickly (usually on loan signing), with the IBRD disbursing later in line with project implementation. However, to this point it has not yet been possible to make such arrangements as part of the cofinancing program because commercial lenders wish to disburse quickly after signing and also have wanted the comfort provided by IBRD disbursements along with their own.

4.06 Another technique--which is also not yet well established--is the use of the IBRD's guarantee power to secure loans actually disbursed by commercial lenders. If the guarantees are structured so as to be callable only after several years, they only become a potential claim against IBRD capital at that time. Hence, they are equivalent to a loan which has its disbursement only after several years.

4.07 While guarantees were very much in the forefront of the thinking of the founders of the Bank at Bretton Woods, the first use of this instrument occurred only about a year ago.7/ There is thus very little actual experience to draw upon in assessing the potential for this instrument. Preliminary indications are that use of guarantees on a non-accelerable basis may have a fairly limited applicability. Borrowers with well-established market access may be expected to shy away from use of such guarantees for fear that it could adversely affect direct borrowings from the market on an unguaranteed basis. Borrowers with less well-established access may not have this concern, but may find the cost of guaranteed borrowing (including the guarantee fee) to be substantially higher than direct borrowing from the IBRD itself. There can, of course, be intermediate cases where guarantees can facilitate a transition back to voluntary lending or make possible lending by non-IBRD sources on particularly attractive terms, but there is as yet no basis for believing that such opportunities will be sufficiently common to have a major impact on the IBRD disbursement rate and hence on its capital requirements.

4.08 Accelerating Repayments. There are essentially two techniques for increasing the rate at which loans are removed from the IBRD balance sheet: (a) repayment by the borrower to the IBRD can be accelerated; or (b) loans can be sold to other creditors, thus removing them from the IBRD balance sheet but not requiring any acceleration of payments from the borrower. The issue of modified repayment terms to the IBRD itself was addressed in Section 3. The conclusion drawn there was that change in repayment terms, if it is to occur at all, should be in the direction of greater liberalization, particularly for low-income borrowers and for middle-income countries that may face a bunching of debt-servicing obligations in the latter part of this decade or the early 1990s.

4.09 The possibility of increased loan sales was discussed earlier this fiscal year8/ and agreement reached on a pilot program. Pending the results of this pilot exercise, one can only speculate on how substantial a market can be developed for loan sales at acceptable risk levels and cost to the IBRD. As the experience of the cofinancing program has shown, current market conditions are not conducive to rapid expansion of new techniques that require commercial lenders to accept added risk. While such lenders show interest in techniques which would reduce the risk associated with existing exposure, they are very cautious in adding to their exposure in many middle-income developing countries. It would not seem prudent therefore to count on a rapid expansion in loan sales, unless or until the pilot program demonstrates to the contrary.

4.10 Given the uncertainties surrounding the ultimate potential for these various capital "stretching" techniques, the conservative approach for estimating future capital requirements is to view these techniques not

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7/ Brazil - Cofinancing through the New Cofinancing Program for the Carajas Iron Ore Project (Loan 2196-BR), R84-145 dated May 25, 1984/

8/ Feasibility of IBRD Loan Sales, SecM84-790, dated September 10, 1984.

as substitutes for additional capital but rather as means for supplementing that capital. They should be pursued vigorously and, to the extent they prove successful, their use would either add to the number of years over which a given capital increase would last or permit additional flexibility in loan terms.

4.11 Much the same posture would appear to be appropriate in relation to the prospective IBRD lending to IFC. The projections of capital requirements presented below assume that the IBRD will continue to meet future IFC funding requirements. The question arises whether the Bank may be able to reduce its lending to IFC as the Corporation meets some of its requirements by borrowing directly on the market itself. The extent to which this may be possible is difficult to judge in the light of the limited experience on borrowing by IFC so far. IFC will be bringing forward a paper on its borrowing policy to the Board in July but it would not be prudent at this stage to assume that any substantial reduction in Bank lending to the Corporation will be possible on a regular basis.

4.12 Finally, a word may be said about the potential contribution of future reserve accumulation to meeting the IBRD's capital needs. The statutory limit on IBRD lending (including the use of guarantees) can be increased either through additional share subscriptions or through additions to reserves. The estimates of capital requirements shown below assume that reserves increase by $10 billion between the end of FY85 and the end of FY95. This is in line with the net income prospects associated with the IBRD's current loan charges and current practices with respect to transfers to IDA. If reserve accumulation were to occur at a different pace, this would of course alter the calculated capital requirements. The plausible variation in capital requirements attributable to different rates of reserve accumulation is, however, quite small.

Capital Requirements

4.13 The table below sums up the range of capital requirements that corresponds to the planning assumptions discussed in Sections 2 and 3. As noted, these calculations do not make any allowance for steps that might be taken to slow the disbursement or accelerate the repayment of IBRD loans. More specifically, the calculations in the table assume that annual IBRD commitment capacity is increased to either $16.5 or $20 billion, that 20% of these commitments are in the form of fast-disbursing adjustment assistance loans, and that repayment terms are either kept as at present, or are selectively relaxed along the lines discussed in the Section 3.9/ As the table shows, the range of capital requirements calculated under these assumptions is quite large--from just over $30 billion to nearly $90 billion. Expressed as a percentage, the range is from 40% to over 100% of existing capital. The table makes clear that even a selective relaxation of repayment terms on new IBRD loans would have a powerful effect on future capital requirements. A full restoration of pre-FY77 lending terms would

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9/ The estimates in the table are calculated assuming an exchange rate of $0.98/SDR.

increase capital requirements to over $100 billion in the case where annual lending capacity is raised to $20 billion.

Table 4.1. Range of IBRD Capital Requirements
($ billion)

	Sustainable Lending Capacity of $16.5 billion	Sustainable Lending Capacity of $20 billion
Terms of Lending		
Present terms	31	53
Selective relaxation	38	60
General relaxation		
-50% return to pre-1977 terms	60	87

4.14 Within the framework of the existing repayment terms, the amount of capital required to support the proposed lending program would be in the range of $31 to $53 billion. The upper end of this range-- representing a capital increase of about 70%--would give the IBRD lending capacity of $20 billion, with up to 20% of that total being fast-disbursingadjustment assistance lending.

4.15 The very wide range in capital requirements is simply a reflection of the range of possibilities that exist with respect to the scale and composition of future IBRD lending. The effective range would be narrower, if one were to assume that the period covered by the capital increase could be adjusted to take account of actual growth. If, for example, a lending capacity of $20 billion were created, it would accommodate five years of growth in the "high" case lending projections and eight years of growth in the "low" case.

4.16 A capital increase of $30 billion, on the other hand, would carry with it a high risk that pressure for a new capital replenishment would re-emerge within five years. If lending were to grow at the mid-point of the range, discussed in Section 2, the sustainable level of lending would be reached in FY89, and agreement on a further capital increase would be required for lending to advance beyond that point. Were lending to be at the upper end of the range, the SLL would be reached by FY88, and perhaps even sooner if adjustment assistance were to become a larger share of IBRD operations (as might happen, for instance, if the recovery in world trade were to be less robust than assumed).

4.17 The share of adjustment-support lending is not a dominant determinant of future capital requirements. Providing the IBRD with the capacity to provide 20% of a $20 billion lending program in the form of SALs and sector adjustment loans rather than 15%, for example, raises capital requirements by about $3 to $4 billion.

4.18 It is premature to draw any firm conclusions about future IBRD capital requirements until such time as member governments have had an opportunity to decide on the range of operational capacity that they wish the Bank to have.10/ Nevertheless, Management believes that it would be reasonable to plan for a commitment capacity toward the upper end of the range of $16.5 to $20 billion per annum, with up to 20% of those amounts on average being in the form of fast-disbursing adjustment-support lending. The discussion of repayment terms points to the need to give the IBRD somewhat more capacity to adjust the terms of its lending to country and project circumstances than it presently has. It is important to reiterate, however, that additional capital would create a multi-faceted capacity for the IBRD, a capacity which the shareholders could subsequently use to increase new commitments, to support an increased share of fast-disbursing loans, or to modify repayment terms on new loans according to the evolving circumstances of the borrowers.

Section 5. Summary of Points for Discussion

5.01 At the next meeting of the Development Committee the subject of the Bank's lending prospects over the next five years--and the capital requirements needed to support that lending--will be on the agenda. The present memorandum has provided a framework for considering those lending prospects and for beginning discussion of the parameters which influence the scale of IBRD capital requirements.

5.02 The analysis of lending prospects has focused on the next three years. Over that period there are well-defined lending prospects totalling $40 to $45 billion. Management believes that the IBRD should be positioned to lend at the upper end of this range--that is, it should have the capital base and budgetary resources consistent with this scale of lending--so that borrowing members can count on sustained support from the Bank.

5.03 If the IBRD does not obtain additional capital, then its net disbursements will begin to decline within just a few years, and will become insignificant by the mid-1990s. In this case the IBRD may still have a catalytic effect on resource flows from other sources, but its role as a net supplier of long-term development finance will steadily erode in the aggregate. Such a prospect would make it very difficult indeed for the IBRD to be a credible partner either with other sources of finance or with borrowing countries themselves.

5.04 The link between capital and net disbursements from the IBRD arises because the Articles require that the cumulative total of net disbursements (and outstanding guarantees) not exceed the sum of capital and reserves. An increase in net disbursements over what can be supported with currently available capital, such as the amount illustrated in the

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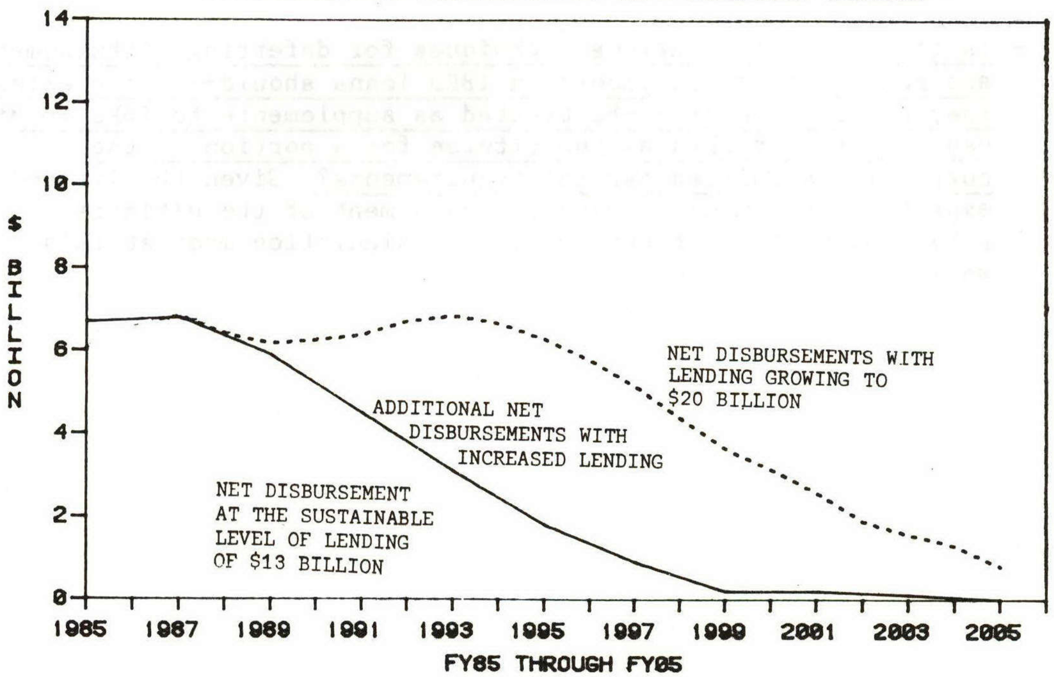
10/ In addition, the feasibility of borrowing the funds implied by various operational plans will need to be considered. A separate paper on this subject is scheduled for distribution to the Executive Directors figure below, must be matched by an increase in capital and reserves. Only a small part of the backing required for additional net disbursements can come from increased reserves. The bulk of the support to maintain the flow of IBRD net disbursements thus has to come from an increase in capital.

ADDITIONAL NET DISBURSEMENTS WITH INCREASED LENDING



5.05 In light of the foregoing, the next step is to seek a consensus on the range of operational capacities that the IBRD should have for the remainder of this decade. The main issues can be summed up as follows:

- What level of commitment capacity do the shareholders believe would be appropriate for the IBRD, in view of the future role which has been outlined for it? Over the next five years, there is a specific country-based case for IBRD lending to grow to a level somewhere between \$16.5 billion and \$20 billion. Planning for the lower end of this range would run substantial risks of hindering the Bank's capacity to respond to the needs of its member countries and/or compel a reconsideration of the IBRD capital requirements in less than five years. Planning for the upper end of the range would build lending capacity that might not be fully utilized each year over the FY86-90 period. The consequence of planning for a capacity to commit \$20 billion and then experiencing a lower outcome is that the capital would support future IBRD lending for seven to eight years rather than five.

- What allowance should be made for enhanced flexibility in repayment terms? Full restoration of pre-FY77 terms would represent a major enhancement of the Bank's ability to reflect country and project circumstances in its repayment terms, but it would also substantially raise IBRD capital requirements. Selective reversion to annuity-style repayments for the lower-income group of borrowers and for selected middle-income countries deserves careful consideration.

- Is it agreed that various techniques for deferring disbursements and accelerating repayments on IBRD loans should--to the extent they prove successful--be treated as supplements to IBRD lending capacity rather than as substitutes for a portion of the currently calculated capital requirements? Given the limited experience on which to base an assessment of the ultimate potential of these techniques, any calculation made at this stage would be quite speculative.

FPA
June 1985

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Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

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Withdrawn by	Date
Salma Berrada El Azizi	June 27, 2025

FUTURE BORROWING
REQUIREMENTS

SecM85-940

FROM: Vice President and Secretary

August 7, 1985

FUTURE BORROWING REQUIREMENTS OF THE BANK

The attached paper on "Future Borrowing Requirements of the Bank" has been prepared as a supplement to the paper entitled "Resource Implications of the Bank's Future Role" (R85-193) which will be considered at the meeting of the Executive Directors to be held September 3, 1985.

Questions on this document may be referred to Mr. Weigel (ext. 74751) and to Mr. Karsenti (ext. 72705).

Distribution

- Executive Directors and Alternates
- President
- Senior Vice Presidents
- Senior Management Council

FUTURE BORROWING REQUIREMENTS OF THE BANK

Section 1. Introduction

1.01 During the recent Development Committee Meeting, Ministers endorsed the broad outlines of the Bank's future role as set out in "The Future Role of the Bank" (SecM85-247, dated March 6, 1985). The Committee urged Management to present a report to the Seoul Meeting that would "include projections of Bank lending over the next five years, together with their implications in terms of resources...."

1.02 The Bank's future lending program and the associated capital requirements have been reviewed in a recent memorandum to the Executive Directors (Resource Implications of the Bank's Future Role, R85-193 dated June 14, 1985), on which an initial discussion was held on June 28, 1985. The present memorandum is intended to provide a basis for discussion of the implications of future growth in IBRD lending for the Bank's borrowing requirements. The key question addressed in the memorandum is whether it is reasonable to expect that the Bank can continue to fund a growing lending program on acceptable terms.

1.03 In discussing this question, this memorandum presents neither definitive borrowing plans nor policy recommendations. Nonetheless, the discussion makes clear that the composition of future borrowings is likely to contain more interest-sensitive liabilities than was the case in the past and that modifications in policy guidelines are likely to be required in the future to allow for this change. Section 2 of the memorandum describes the range of future borrowing requirements that emerges from prospective future lending. The section notes that the volume of outstanding IBRD borrowings will continue to grow from $50 to $82 billion over the next ten years even if lending is held to the present sustainable level of lending (SLL)--which is the lagged effect of growth in lending in earlier years. Expansion of IBRD commitments to $16.5 billion (with up to 20% in the form of quick-disbursing adjustment support lending) will add an additional $22 billion to the total net amount that must be borrowed over the coming ten-year period. An increase in commitments to $20 billion in FY90 will add a further $18 billion to this figure. In other words, outstanding borrowings will need to grow by about 5% per annum (in nominal terms) to fund commitments held constant at the SLL, by about 7.5% if commitments increase to $16.5 billion, and by about 9% if they increase to $20 billion.

1.04 While substantial, this growth is a moderation of the pace of the last ten years. From FY75 to FY85, the Bank's outstanding borrowings grew from about $12.5 billion to about $50 billion, or by 15% per annum. The Bank's past success in expanding its borrowings--even in periods of considerable stress in world capital markets--gives grounds for cautious optimism about its ability to fund a program that will be growing somewhat more slowly in the future. And while savings and capital flows in the industrial countries themselves may be expected to grow more slowly in nominal terms in the future, there is little evidence to suggest that the Bank's borrowings would represent an increasing share in the aggregate of those resources. *Annual* net borrowings will in fact increase only slightly in the future from the average level achieved in FY83-85 ($7.2 billion), remaining at about $8 billion per annum or less, even if annual commitments are expanded to $20 billion. However, this overall picture is subject to substantial qualification with respect to the composition and form of the Bank's future borrowing programs, particularly since annual *gross* borrowing requirements--which are what matter from the standpoint of operational fund raising--will continue to grow substantially over the next five to ten years.

1.05 Section 3 reviews the Bank's borrowing experience in particular markets and draws out some of the implications of this experience for future borrowing prospects and strategy. In at least two of its major markets--Switzerland and Germany--the Bank has reached a size and has so diversified its sources of funds that its future growth is likely to be more modest and geared to the overall growth of investor portfolios. The Japanese market is less well-penetrated by the Bank, and is undergoing structural changes to which the Bank will need to adapt. The US domestic bond market continues to suffer from the effects of interest rate volatility; many participants believe that permanent structural change has taken place in this market segment that will limit its growth for the foreseeable future. The prospects for overall growth in official holdings of IBRD obligations are modest. As has been noted on previous occasions, the main untapped potential for the Bank, and the general direction of all markets, is in the area of interest-sensitive liabilities. The overall conclusion to be drawn is that an increasing share of future borrowings seems likely to be in these non-traditional forms.

1.06 Section 4 considers the implication of this development for the Bank's financial structure and for its borrowers. Increased lending rate volatility seems likely, but even under reasonably conservative assumptions about the availability of fixed-rate funds, it is expected to be manageable. Cost considerations are likely to continue to give the Bank strong incentives to tap short-term markets, while separately securing liquidity backstops and term commitments.

1.07 In considering the financial feasibility of embarking on a growing lending program, it is important at the outset to note three key points. First, any positive conclusion about the Bank's future ability to borrow must presume continued strong support for the Bank by its shareholders. This support takes several forms: subscribed capital that provides backing for the Bank's obligations; approval of policies on lending, income, liquidity and borrowing strategy and a posture towards rescheduling that maintains IBRD's premier credit rating in the financial markets; and--perhaps most importantly--sustained and uninterrupted access to the financial markets of the capital-exporting countries, particularly those of the United States, Japan, Germany and Switzerland. The Bank's past success in raising funds for development has depended on its conservative financial management and strong shareholder support. Future success will similarly depend on these same factors.

Shareholder support

1.08 Uncertainty of market access is a major risk for a non-resident borrower such as IBRD. While many governments often have given the IBRD preferential access to their markets and currencies, there have also been disruptions in planned borrowings on occasions when governments have limited or denied access for all non-resident borrowers or even singled out IBRD for limitation or exclusion. Markets have been closed to non-resident borrowers on several occasions by some countries in recent years. The level of IBRD borrowing in some of the largest capital markets is limited even today, despite the complete absence of entry restrictions for any foreign corporations, sovereigns and other supranational entities. Some markets are still completely closed and others are just now being opened.

1.09 These restrictions on IBRD access have proven manageable in the past in the context of smaller borrowing requirements. The present and future scale of IBRD borrowings, however, no longer permits the Bank to remain out of any of its major markets for any prolonged period of time. It cannot recoup borrowing opportunities foregone by "doubling up" in later periods. Nor is it prudent to rely on a major run-down in liquid holdings for this purpose, given their role in reassuring private investors of the Bank's financial well-being and more important, given the fact that the Bank's liquidity is already "mortgaged"--representing as it does a partial funding of commitments already made.

1.10 It is important to recognize that the requirement for funding lags the lending commitments that generate those requirements. Thus, in the growing lending program the annual net cash outflow (i.e. net disbursements plus debt retirement minus cash from operations) over the next five years is projected to be about $12 billion rising to about $17 billion over the period FY91-95. These are contractual obligations of the Bank relating to commitments and borrowings in prior years. It is in this sense that the liquid holdings--which equal only about 1-1/2 years net cash outflow--are "mortgaged."

1.11 Second, given access to capital markets, the future will in all probability call for a greater degree of flexibility in how the Bank borrows than has been the case in the past. World capital markets continue to experience the effects of interest and exchange rate volatility, and the general liberalization and international integration of capital markets will generate rapid innovation and structural change in these markets. Some traditional forms and sources of borrowing may diminish or even disappear; others will emerge. The Bank needs to be able to adjust its own borrowing program to these changes. Correspondingly, it is not possible to project with any certainty how the Bank will be borrowing five or ten years from now. While one can be reasonably confident that global savings and capital flows may expand at a rate adequate to support growth in IBRD borrowings, the ultimate composition of the future borrowing programs is uncertain and dependent on market conditions as they exist at that time.

1.12 This volatility and structural change has particularly affected the role of fixed-rate bond markets--the Bank's traditional funding source--in overall savings and investment flows. The table below shows the changing character of international credit and bond markets from 1972 to 1985. In 1972, more than half of the total funds raised were in the form of fixed interest rate bonds; some international credits also carried fixed rates. By 1981, the peak borrowing year before the period of financial turmoil, the share of fixed-rate bonds fell to below 20% of total international borrowing. In the early 1980s, many new variable rate instruments emerged as investors tried to avoid the risk of continued interest rate volatility. Not until 1985 have investors again shown some confidence in fixed-rate instruments, although two-thirds of total borrowing was done through variable rate instruments.

Table 1.1: Composition of International Capital Markets
($ billions)

	1972	1981	1982	1983	1984	1985*
International Bonds	11.2	52.9	77.5	77.0	111.5	158.7
Fixed rate		37.2	55.2	49.2	58.4	80.2
Floating rate (FRN) a/		11.3	15.3	19.5	38.2	63.0
Equity related bonds		4.3	3.6	8.0	11.0	10.9
Zero coupons b/			1.4	0.3	3.9	4.7
International Credits (Net)	8.7	147.7	106.1	76.7	84.4	64.1
Syndicated bank credit c/		133.7	96.4	52.9	44.1	32.2
"Managed" loans d/		-	-	14.3	11.4	2.5
Note Issuance Facilities and similar backup facilities			9.7	9.5	21.3	25.2
Multiple-Component Credit Facilities		14.0	-	-	7.6	4.2
Total Bonds and Credits	19.9	200.6	181.6	153.7	195.9	222.8

* January-May at annual rate.
a/ Including medium-term floating rate CDs.
b/ Including deep discount bonds and bond offerings not included elsewhere.
c/ Excluding "managed" loans and loan renegotiations.
d/ Syndicated new money under the umbrella of IMF-supported restructurings.

1.13 The reason for this change is that volatile interest rates during the 1970s and 1980s have reduced the willingness and ability of investors to accept the risk of losses in fixed-rate bond markets. At the same time, deregulation of the money markets (particularly in the US) and the ease with which transnational financial operations can be conducted have permitted the proliferation of investment vehicles offering investors and intermediaries more protection from interest and exchange rate volatility than is available in the fixed-rate bond market. Short-term and floating rate instruments, which transfer interest rate risk from lenders to borrowers, have grown in popularity, and fixed-interest rate lending has accounted for a declining share of international capital flows. In the US dollar markets, these developments have occurred earlier than elsewhere, but deregulation in Germany and Japan is likely to produce similar changes in those markets.

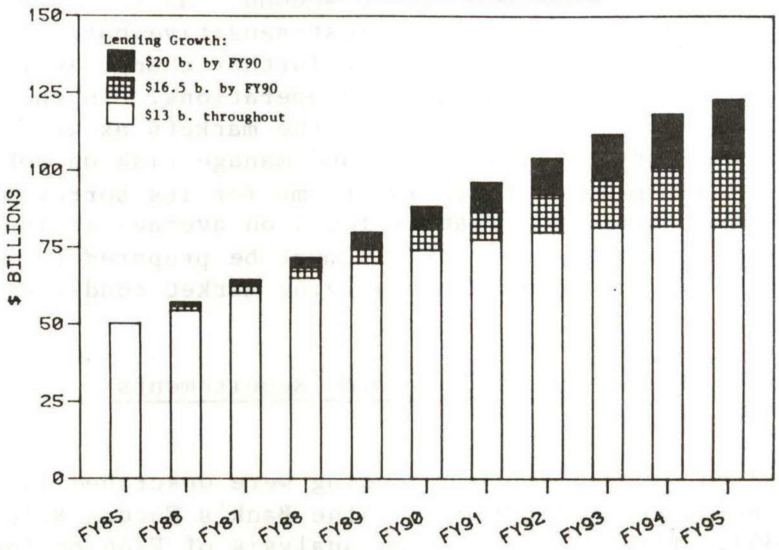
1.14 The third point is related to the second: as a consequence of the need to increase the share of its interest-sensitive borrowings, the Bank and its shareholders may have to accept further change in the character of its own financial structure and operations. In the final analysis, the Bank has to be a reflection of the markets as it finds them. As a financial intermediary, it may buffer and manage risk on behalf of its borrowers, but it cannot provide financial terms for its borrowers that are markedly different over time from what is found on average in the markets. The Bank is a large, global borrower and it must be prepared to adapt its own lending policies and instruments to evolving market conditions.

Section 2. Future Borrowing Requirements

2.01 The broad outlines of future lending were described in the recent memorandum on the Resource Implications of the Bank's Future Role (R85-193 dated June 14, 1985). Based on a detailed analysis of FY86-88 lending prospects, and an extension of these prospects to FY90, that memorandum concluded that a reasonable range of future lending capacity would be between $16.5 and $20 billion, with up to 20% of lending being in the form of fast-disbursing adjustment assistance. The consequences for borrowing of lending programs of this size and composition are shown in the following three charts. These charts show future borrowing required to fund: (a) a lending program at the sustainable level of lending i.e. $13 billion per annum; (b) the incremental borrowing required to fund a lending program that grows to $16.5 billion; and (c) the additional amount required by a $20 billion lending program. The charts show borrowings outstanding, net borrowing and gross borrowing extending to FY95, despite the uncertainty of projections that far into the future, in order to indicate more fully the consequences of planning for significant growth in commitments over the next five years.

2.02 Chart 1 shows the growth in borrowings outstanding. If the lending program remains at the SLL, borrowings outstanding will grow relatively slowly from about $50 billion at the end of FY85 to $82 billion at the end of FY95, or at about 5% per annum in nominal terms. An increase in lending to $16.5 billion (and an increase in the share of fast-disbursing adjustment assistance to 20% of total lending) will add about $22 billion to outstanding debt. Adding another $3.5 billion to the FY90 lending level will add an additional $18 billion to total net borrowing requirements over this ten-year period. The incremental borrowing requirements would raise the required growth rate of the Bank's outstanding liabilities from 5% to about 7-1/2% and 9%, respectively.

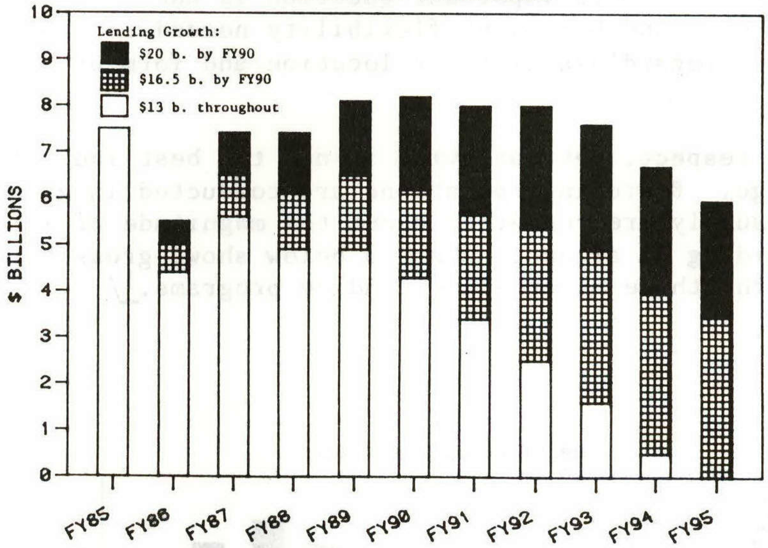
Chart 1
IBRD OUTSTANDING BORROWINGS a/



a/ See Annex 1 for detailed figures.

2.03 The claim on the global flow of savings represented by these borrowing requirements is perhaps best measured by annual net borrowings. Chart 2 shows the annual net borrowings required to fund the alternative lending programs. If lending were held to the SLL, net borrowing would drop steadily (particularly in FY86, because of the need to reduce the liquidity ratio.) Even if lending were to grow to $16.5 billion, net borrowing still would remain below the FY85 level. Only if the lending program grows to $20 billion would net borrowing grow modestly to FY90 (at an annual rate of 2.6% per year) after which it would decline.

Chart 2
ANNUAL NET BORROWINGS[a/]



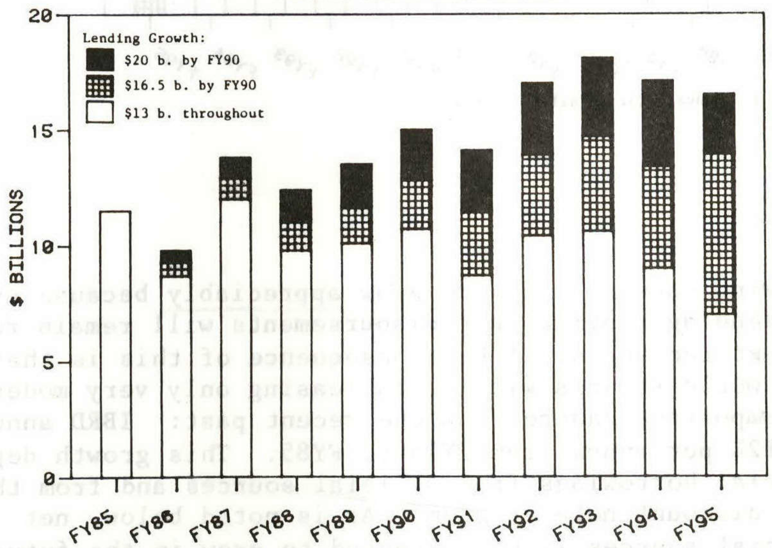
a/ See Annex 1 for detailed figures.

2.04 Net borrowing does not need to grow appreciably because even with the most ambitious lending program, net disbursements will remain roughly constant over the next ten years. A key consequence of this is that the Bank's claim on world savings will be increasing only very modestly. This represents an important change from the recent past: IBRD annual net borrowings grew by 12% per annum from FY75 to FY85. This growth depended, however, on substantial borrowings from official sources and from the introduction of the discount note program. As is noted below, net borrowing from official sources is not expected to grow in the future, and in fact will probably decline, so that there will have to be substantial growth in net borrowing from market sources. Accordingly, the maintenance of net borrowings in the future will require a substantial increase in market borrowings.

2.05 From the point of view of the availability of aggregate savings, there is little reason to conclude that the Bank cannot successfully fund a lending program on the scale envisaged--assuming, of course, that the Bank continues to enjoy the sort of shareholder support and creditworthiness noted in Section 1. The more important question is whether the Bank will have the market access and borrowing flexibility needed to enable it to tap world savings flows regardless of their location and form of intermediation.

2.06 In this respect, net borrowing is not the best indicator of the borrowing challenge. Borrowing operations are conducted in gross terms, and governments usually are concerned about the magnitude of IBRD gross borrowings in deciding on access. Chart 3 below shows gross borrowing required to fund the three alternative lending programs.[1]

Chart 3
ANNUAL GROSS BORROWINGS[a]



a/ See Annex 1 for detailed figures.

2.07 As Chart 3 shows, gross borrowings will remain at about the present level if the lending program is held to the SLL, even though net

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1/ Gross borrowings are sensitive to the assumptions made about the maturities of borrowing, and the projections shown in Chart 3 assume that the profile of maturities on new borrowings will be the same as was achieved on average over FY83-85. Extending maturities on all medium- and long-term borrowings by approximately one year would reduce gross borrowings over the ten-year period by $6 billion. The reduction would be concentrated in the five-year period FY91-95.

borrowings decline sharply. The reason is that debt retirement will continue to rise, reflecting the rapid growth of the Bank's balance sheet in recent years. Gross borrowings will need to increase substantially in the case of the growing lending programs, and as net disbursements will be higher, there will be some build-up in liquidity to partially fund future net cash requirements and, of course, debt retirement will increase. Gross borrowings would need to rise to a peak of about $18 billion by FY93--implying an average annual growth rate of about 6.3%--if lending also expands to $20 billion. It should be noted that this is an annualized growth rate and the failure to achieve it in any given year for any reason will require that it must be made up in the subsequent year(s).

2.08 In the memorandum on the Resource Implications of the Bank's Future Role, consideration was given to the possibility of creating a capacity to ease repayment terms on IBRD loans. The impact of shifting to alternative loan repayment terms is shown in the table below (assumptions correspond to the figures on net disbursements shown in the Resource Implications paper). As the table shows, terms relaxation would add $1.0 billion to $3.0 billion per annum to net and gross borrowing requirements over the next 10 years. Annuity-style repayment terms only begin to affect net disbursements in the late 1980s because of the grace period on Bank loans, but have a growing impact thereafter.

Table 2.1: Impact of Terms Relaxation on Annual IBRD Borrowing Requirements a/ ($ billion)

	FY90		FY95	
	Gross	Net	Gross	Net
Present Terms	15.0	8.2	16.5	6.0
Selective Relaxation	15.5	8.7	17.5	7.0
50% Return to Pre-77 Terms	16.0	9.2	19.5	8.5

a/ Assumes that commitments expand to $20 billion by FY90 with 20% in fast disbursing lending.

2.09 The challenge of borrowing up to $19.5 billion per annum should not be underestimated, even allowing for future growth in world capital markets. It entails a constant presence in every major market, regardless of market conditions. It also means relentless pressure to diversify sources of funds by tapping new markets and expanding the base of investors in IBRD obligations. The Bank is no longer a "new" borrower and its securities have no so-called rarity value. The problems of the Bank's own borrowers are well-known, as are those of commercial lenders with major exposures in developing countries. Because of the size of its borrowing program, the Bank has to remain an Aaa-rated borrower. Otherwise, its access to funds would drop dramatically; paying higher spreads would be counterproductive in terms of its impact on the Bank's appeal to quality-conscious investors. The Bank must therefore continue to tread carefully and circumspectly as it moves forward with a growing borrowing program, presenting a strong image to the markets, avoiding overburdening any particular market segment, and developing new capacity in advance of need.

2.10 This challenge would be substantial in stable and growing markets. However, as the next section discusses, the Bank confronts a rapidly evolving set of financial markets. For this reason, a positive conclusion about the achievability of the required future gross borrowing programs is conditioned to a large extent on having adequate market access and flexibility in borrowing technique.

Section 3. IBRD Borrowing Prospects in Major Markets

3.01 The Bank has been able to fund growing borrowing requirements in the past primarily by borrowing at fixed interest rates. It has been able to do this, despite the relative decline in fixed-rate lending, by diversifying its source of funds among currencies and markets, and by emphasizing those markets in which structural changes and deregulation have been least pronounced. The IBRD has increasingly tapped official sources of funds, and more recently it has increased short-term and variable rate borrowing as fixed rate sources of funds have proven volatile and inadequate to meet funding requirements at an acceptable cost.

3.02 In considering the prospects for individual markets discussed below, it is important to remember that world capital markets are increasingly integrated. The integration of capital markets erodes the congruence between national markets and currencies. It is possible, for example, to borrow fixed-rate dollars in Japan as well as in the United States. It is becoming more difficult, therefore, to analyze prospects in individual capital markets as one international capital market in multiple currencies comes to dominate international capital flows. Nevertheless, capital markets in individual currencies still retain a distinct identity, guided by the monetary authorities of the countries whose currency is being used.

3.03 The table below summarizes IBRD borrowing in the US dollar market over the past six fiscal years. Except for the two-year central bank bonds and other official borrowings, the Bank was absent from these markets entirely in FY80, as it had been in FY79. As borrowing requirements expanded rapidly in the early 1980s, the Bank was forced to rely on the US dollar markets in a major way despite the unprecedented high cost of such borrowings both relative to other currencies and historically. During FY81-83, the Bank borrowed some $4 billion at fixed interest rates in excess of 14%; although a substantial portion was swapped out into other currencies, the Bank's heavy use of the market that accompanied this level of borrowing came at a time when the markets themselves were undergoing structural change. As exchange, interest and inflation rates became volatile during the 1970s and early 1980s, suppliers of funds--investors--became both less willing to risk losses in the fixed-rate bond markets and, more sensitive to the foreign exchange risks associated with dollar instruments. Accordingly, use of short-term and floating rate instruments has grown significantly; fixed-rate lending has accounted for a smaller share of US dollar capital flows. Even within the fixed-rate sector, the proliferation of competing instruments--most particularly tax-exempt municipal securities and mortgage-backed instruments--has constrained the growth of the market for taxable corporate paper.

Table 3.1: IBRD Borrowing in Domestic and Offshore US Dollar Market: FY80-85 (Million US$)

	FY80	FY81	FY82	FY83	FY84	FY85
Private Sector	-	1,000	2,820	4,745	1,850	2,481
Domestic Market	-	-	1,550	1,950	-	611
Euro/Asian Market	-	1,000	1,270	1,295	950	750
Floating Rate Notes	-	-	-	-	400	800
Discount Notes	-	-	-	1,500	500*	320
Official	703	612	538	521	1,332	1,118
Total	703	1,612	3,358	5,266	3,182	3,599
Swaps	-	-	(758)	(1,731)	(1,001)	(908)
Total After Swaps	703	1,612	2,600	3,535	2,181	2,691

* Excludes $1,500 million of refinancings.

3.04 A few key statistics illustrate these developments. Since 1975, short-term debt as a proportion of total debt in the US credit markets has risen from about 35% to more than 50% of total debt outstanding. The corollary to this phenomenon has been the shortening maturity of corporate debt even in the medium- and long-term end of the market. From 1978 to 1983, the share of straight US corporate debt longer than five years declined from 80% to 47% of the total bond market. An ever-greater share of total issues is being represented by variable-rate instruments, particularly in Europe, where floating rate notes (FRNs) grew from 33% of the market in 1981 to 47% in 1984. More recently, a Euronote market has developed that offers investors a short-term dollar investment while providing assured term funding to borrowers through back-up credit lines with commercial banks. There is evidence that this trend is accelerating and represents a further step in the process of disintermediation that spurred the development of the LIBOR-based FRN market at the expense of syndicated lending. Euronote mkt

3.05 The implication of these developments for our US dollar funding strategy is that IBRD cannot prudently rely on having available increasing volumes of medium- and long-term, fixed-rate borrowing on a continuous basis. In the last two years, the Bank's use of the fixed-rate dollar market has been scaled back to a level that is sustainable without giving rise to the stresses experienced in FY82-83. An assumption of growth in the dollar component of IBRD's borrowings is thus prudent, but only if it is understood that this will likely require significant diversification in the financial tools available to the Bank and an enhanced ability to time borrowings to take advantage of market opportunities as and when they arise. On the fixed-rate side, the Bank may be able to develop techniques, such as serial zero coupon instruments, that can compete more effectively with equities, municipals and mortgage-backed instruments for retail and institutional pension investment. It can also take steps to enhance its ongoing presence in the US market by developing programs to continuously offer fixed-rate paper that can be tailored to the needs of specific institutional portfolios.

3.06 Significant growth in dollar borrowings must allow for the IBRD to increase its use of interest-sensitive instruments. Here the volume of new issuance is less of a concern given the size of these markets and the Bank's limited use of them. However, the form of such liabilities will have important cost implications. The discount note program continues to be the least expensive way of tapping the interest-sensitive market segments. Large volumes of medium- and long-term FRNs can only be issued in today's market by accepting LIBOR-based pricing, a step the Bank has been reluctant to take thus far. Cost considerations thus continue to provide strong incentives to find other pricing bases or ways of securing term commitments from financial institutions.

Swiss Franc Market

3.07 To date the Bank has been afforded maximum flexibility by the Swiss authorities of its access to the Swiss market, the structuring of its SwF borrowings and apportioning total borrowings between direct borrowings and swaps. Since FY82, when the Swiss National Bank introduced the "25% rule"--for SwF borrowings and swaps, relative to total borrowings in any one fiscal year--the Swiss franc has become the principal component of the Bank's annual borrowing programs. Growth in IBRD borrowings in Swiss francs is shown in Table 3.2. As the table shows, direct borrowings (i.e. excluding swaps) doubled from FY80 to FY82 and increased by a further 50% by FY85.

Table 3.2: Swiss Franc Borrowings FY80-85
(Millions SWF)

	FY80	FY81	FY82	FY83	FY84	FY85
Private Sector	1,200	1,100	2,205	2,050	2,295	3,640
Public Issues	450	500	300	300	550	550
Other	750	600	1,905	1,750	1,745	3,090
Official	500	732	1,030	921	1,295	1,286
Total	1,700	1,832	3,235	2,971	3,590	4,926
Swaps	-	-	1,097	2,364	1,906	2,209
Total After Swaps	1,700	1,832	4,332	5,335	5,496	7,135

3.08 This substantial growth of the Swiss franc in the Bank's borrowings (from an average of less than 18% of annual borrowings prior to FY82 to around 25% in the last four fiscal years), as well as its market share in Switzerland, is attributable to several factors: first, to the rapid growth of the Swiss capital market as a whole; second, to the continued appeal of the Swiss franc as one of the major international investment currencies; third, to the pragmatism of the Swiss National Bank in relation to capital market regulations and, fourth, the implementation and growth of the swap market. The Swiss market has remained open even during periods of intense currency depreciation or financial uncertainty. Moreover, its size has more than trebled over the past decade and recently has grown by more than 20%.

3.09 These facts, together with the experience in the refinancing of maturing SwF liabilities, have made the Swiss market one of the Bank's most reliable sources of borrowings. This successful past experience, together with its projected continued growth and the fact that some new market sources can be tapped by the Bank--notably from smaller and regional Swiss Banks, through regular syndicates--lead to a reasonably positive assessment of the future availability of SwF borrowings.

3.10 A number of caveats should nevertheless be made. First, automatic extrapolation of Swiss National Bank's "25% rule" also implies automatic consent additionality; this, in turn, assumes that the financial environment in the Swiss market, and the international appeal of the Swiss franc will not be adversely affected by extraneous economic factors. Secondly, past experience has already pointed to occasional signs of "market stress" in relation to the volume of World Bank borrowings. IBRD borrowings in recent years have accounted for a substantial share of the total market (9% in FY85). Conditions have improved significantly since the introduction of the swap program which enabled the Bank to continue raising increasing volumes of Swiss francs while moderating the growth of its own direct placements. The Bank's position in the market has if anything strengthened in recent years, making the swaps program in SwF one of the most successful innovations ever undertaken. The growth rate of traditional borrowing techniques will, nonetheless, have to remain more moderate in the future. Thirdly, and following from the above, future market borrowings in Switzerland may have to incorporate an increasing proportion of "targeted" transactions--on hitherto little-used market segments--as well as new instruments, including certain interest-sensitive techniques such as FRNs and short-term tap stock facilities.

Deutsche Mark Market

3.11 Through current borrowing techniques virtually all traditional segments of the DM markets are tapped by the Bank. Present instruments include public issues, private placements with IBRD principal underwriters, private placements with the savings banks and cooperative sector, both domestically and internationally, direct loans from commercial banks, the savings banks and cooperative sector, and loans in the form of "Schuldscheine" from institutional investors (through the intermediation of banks). This diversification in DM borrowings has taken place particularly in recent years. Consequently, IBRD borrowing, after slowing in the early 1980s, has risen noticeably during the past several years, as the following table shows.

Table 3.3: Deutsche Mark Borrowings FY80-85
(Million DM)

	FY80	FY81	FY82	FY83	FY84	FY85
Private Sector	3,200	2,050	1,428	2,250	3,150	4,050
Public Issues	1,000	900	650	1,350	1,400	2,000
Other	2,200	1,150	778	900	1,750	2,050
Official	900	702	990	700	940	1,050
Total	4,100	2,752	2,418	2,950	4,090	5,100
Swaps	-	-	500	811	824	809
Total After Swaps	4,100	2,752	2,918	3,761	4,914	5,909

3.12 It is important to note that the recent repeal of the withholding tax on domestic bonds has had particularly adverse consequences, both for the relative cost structure of the Bank's public issues and for the future growth of borrowings in this currency. Prior to the repeal there was no competition between the domestic and non-resident segments of the bond market. Now, the domestic market is attracting substantial funds from foreign investors. As a result the comparative advantage of the IBRD vis-a-vis domestic bond issuers has been eroded.

3.13 In light of the foregoing, the growth potential of DM borrowings is likely to remain modest, except through part-substitution of market borrowings for swaps into DM. Implementing new borrowing techniques could be one way of expanding the Bank's access to DM although the German authorities are moving cautiously in allowing access to variable-rate debt and other new instruments. Expansion into hitherto untapped domestic fixed-rate market segments is doubtful.

3.14 Efforts also will have to be made to substantially improve the secondary market for IBRD bonds, as a key to maintaining and enlarging access to the German market. This may be done through larger size issues and through encouraging IBRD underwriters to intervene more systematically in the secondary market for IBRD bonds. Recently, the Bank has changed the composition of its syndicate for public issues by including foreign banks. Through this move recognition is given to the fact that often as much as 50-60% of IBRD's public DM issues are sold outside of Germany.

Dutch Guilder Market

3.15 Though this is the smallest of IBRD's five "core" markets, the volume of guilder borrowings has grown very sharply during recent fiscal years as shown in Table 3.4. Dutch guilder borrowings from domestic and official sources currently represent around 7% of the Bank's annual borrowing program. Moreover, currency swaps into Dutch guilders have been expanded to add to guilder availability. The importance of the Dutch guilder as a borrowing currency bears witness to the broadening and increasing sophistication of the guilder markets and to the Dutch authorities' willingness to stimulate capital exports to offset rising current-account surpluses and, specifically, to support the borrowing activities of the Bank and other multilateral agencies.

Table 3.4: Dutch Guilder Borrowings FY80-85
(Million DFL)

	FY80	FY81	FY82	FY83	FY84	FY85
Private Sector	-	500	1,200	1,353	1,660	1,960
Public Issues	-	200	250	550	600	600
Other	-	300	950	803	1,060	1,360
Official	-	100	475	600	600	650
Total	-	600	1,675	1,953	2,320	2,610
Swaps	-	-	-	244	178	336
Total After Swaps	-	600	1,675	2,197	2,498	2,946

3.16 Based on recent experience, further growth in the volume of the Bank's guilder borrowings may be achieved through increased direct private placements with institutional investors (by far the main source of supply in the Dutch capital market) and through increases in the size and/or frequency of traditional guilder bond and note issues. However, in present market conditions new borrowing instruments such as FRNs or zero-coupons cannot be used to increase guilder borrowings, as the Dutch authorities have not yet followed Germany in deregulating capital markets. As a result, the financing focus for expanded borrowings will be through existing techniques and instruments with further additionality through currency swaps.

3.17 In order to support increased borrowing, it is necessary to assume that market expansion will result from sustained economic growth in the Netherlands, stability in the relative value of the guilder and continued growth in the country's current account surplus. Of equal importance is that budget deficits and public sector borrowing requirements have started to decline significantly, relative to GNP and in absolute terms, thereby lessening their past "crowding out" effects.

Japanese Yen Market

3.18 The yen accounts currently for around 20% of the Bank's annual borrowing program and the recent structure of borrowing is shown in Table 3.5. Yen denominated borrowing is of particular appeal to the Bank because of its relatively low nominal cost, which averaged 7.54% in the last fiscal year, and because of its potential volume--Japan being historically a major source of funds as well as a growing capital exporter. The bulk of the Bank's yen borrowings consists of domestic ("Samurai") bond issues and syndicated loans. The yen market also is one of the most important currencies for longer-term fixed-rate borrowing with 10- to 15-year maturities commonly available.

Table 3.5: Yen Borrowings FY80-85
(Billion Yen)

	FY80	FY81	FY82	FY83	FY84	FY85
Private Sector	230	160	260	295	380	475
Public Issues	30	60	90	100	130	220
Other	200	100	170	195	250	225
Official	60	74	60	30	15	45
Swaps	-	-	-	-	-	25
Total	290	234	320	325	395	545

3.19 Over the coming years, the Bank's borrowing program in yen will have to adapt to the structural changes that are taking place in the Japanese financial markets. Japan's policy to deregulate financial markets involves, first, the liberalization of the interest rate structure of yen markets to make rates less rigid and more sensitive to market conditions. Second, the segmentation of financial institutions according to the scope of their banking services is being reduced, thereby altering the current institutional structure of the Japanese financial system. These elements are manifesting themselves through a gradual development of the money markets, on the one hand, and through more intense price competition among various categories of institutions, on the other hand. Thus, liberalization is likely to have far-reaching implications for the Bank's traditional reliance on fixed-rate borrowings and on established fincancial partners. The Bank's basic strategy will therefore entail greater flexibility in the choice of financial instruments and in the timing, size and maturity of individual transactions.

3.20 As market segmentation is reduced, interest-rate deregulation proceeds, and internationalization of the yen takes place, international borrowers, including the Bank, are likely to gain access to a wider array of suppliers of yen credit. In the short run, the Bank may continue to benefit from its competitive edge in negotiating with some financial institutions. In the longer run, however, these liberalizing trends are likely to intensify the competition between the Bank and other foreign borrowers, with possibly adverse consequences on the Bank's yen borrowing costs and access.

3.21 Within this framework, the Bank may consider discussing with its traditional loan syndicates ways of making their credit more price competitive. The Bank may decide to diversify further its yen funding sources to include less expensive forms of credit, including Samurai and Euroyen bond issues, swaps, and possibly private placement and Euroyen loans.

3.22 In addition, there are good prospects for widening the Bank's access to new market segments. Pension funds, for example, are likely to become a major, independent source of funds: at present they are authorized to invest in funds only through trust banks and insurance companies. Investment trusts, too, are expected to increase their investments in the Samurai market. By the same token, the Bank may gauge the potential of borrowing directly from major depository institutions such as the cooperative savings banks.

3.23 In responding to the structural changes taking place in the Japanese financial markets, the Bank is likely also to adopt new borrowing techniques. It may explore the attractiveness of newly authorized instruments, such as Euroyen loans, floating rate notes, and zero-coupon bonds, and in particular assess the extent to which such instruments could lead to long-term cost savings or access to new sources of funds.

Other Markets

3.24 IBRD also has been continuing its currency diversification efforts, aided by developments in the currency swap market that allow it to ameliorate the high nominal cost of borrowing in certain markets. In sterling the question is essentially one of official consent to access; the market itself has substantial appetite for long-term paper. The ECU market poses the fewest access constraints and is a particularly promising new source of funds. IBRD's reentry in the Canadian dollar and Italian lira markets in 1983 and 1985, respectively, are also examples of currency diversification, as are recent issues in Belgian francs, Luxembourg francs and the domestic French francs. The Nordic currencies continue to offer promising opportunities for new sources of funds, and markets in Australia, New Zealand and Hong Kong dollars may become available to IBRD. Although the volumes obtainable are likely to be modest and subject to substantial uncertainty, an active IBRD presence as a borrower in these markets is important for the cushioning effect it can have in the event of shortfalls elsewhere, and because they present opportunities for ongoing additions to the fixed-rate program.

3.25 The substantial growth of net borrowings over the last decade was due in significant part to accelerated "official" borrowings. The outlook for future growth in official borrowings, however, is limited. There is upside potential in the Central Bank Facility, but it is difficult to foresee significant expansion in the Bank's two-year SwF and dollar borrowings beyond the requirements of refinancing. On the downside, shrinking OPEC surpluses suggest no increases in official borrowings from these sources. Finally, and more generally, the unpredictability of central banks' foreign exchange positions, and reservations concerning their role in financing development, do not bode well for material increases in our official borrowings.

Concluding Remarks

3.26 To summarize, it may be concluded that for medium- and long-term, fixed-rate borrowings, US dollars, Japanese yen, sterling and ECU offer the greatest potential for growth. In US dollars, the potential for growth in borrowing is principally in the domestic market and in Japan. The supply of fixed-rate dollars, however, is volatile. When conditions are right, available volume could dwarf any other source, whereas even modest volume can be difficult to achieve at other times. For this reason the Bank will not be able to take advantage of fixed-rate borrowing opportunities in the dollar markets unless it can enter the markets in substantial amounts when favorable conditions appear.

3.27 Because of the structural changes in world credit markets noted earlier, interest-sensitive borrowings offer the greatest potential for growth. In US dollars, IBRD has only begun to tap the massive short-term money market, and techniques now available can provide certainty of funding for five years or more at moderate cost. This is true both in the domestic market and offshore, where significant demand exists for short-term dollar paper, particularly among Swiss and Japanese investors. The outlook for interest-sensitive finance has been further enhanced in yen and DM with the deregulation of the Japanese and German capital markets, while sterling, Canadian dollars and ECU offer additional opportunities to diversify sources of variable-rate funding.

Section 4. Implications for IBRD Financial Management

4.01 Prior to the Bank's initial use of interest-sensitive liabilities in 1982, it was necessary to change the Bank's lending rate system to the present pool-based variable rate system. Change was necessary because of the lag between fixed rate lending and the cost of later funding. The Bank found itself in a position of making fixed-rate loans at one rate, and later funding itself to finance disbursements at quite different--often higher--rates. The change also permitted the Bank to borrow through the use of interest rate sensitive liabilities and pass on, through the pool, the variability in cost associated with interest-sensitive borrowings. It was thus necessary to develop a mechanism whereby this rate variability, even though minimal in a pool-based system with substantial fixed-rate borrowings, could be managed without harming the Bank or imposing excessive fluctuations in the Bank's lending rate.

4.02 These issues were reviewed in the 1983 Funding Strategy Paper, out of which emerged the present funding guidelines under which all interest-sensitive liabilities are to be held to 15% of total outstanding borrowings (short-term and variable rate fixed maturity), while short-term liabilities are to be limited to 10% of outstandings. Underpinning these limits was a judgment as to the appropriate balance between the risk of not being able to effectively fund a growing lending program and the effects of interest rate variability on the Bank's net income and borrowers' debt service obligations. The key conclusion of the preceding section--i.e., that interest-sensitive liabilities are likely to account for a larger share of total borrowings in the future--thus raises again questions about this potential "cost" to the Bank and its clientele of continued growth in commitments. Specifically, is the composition of borrowing needed to fund a growing IBRD commitment program likely to result in unacceptable net income or lending rate volatility?

4.03 In order to give some indication of what is involved, the table below shows the composition of borrowings that would result under two different future borrowing scenarios. Both scenarios use the gross borrowing requirements associated with an increase in commitments to $20 billion, with 20% of lending in fast-disbursing adjustment support. Both scenarios also reflect the caution expressed earlier about prospects for official borrowings and assume no growth in gross borrowings from these sources. The scenarios differ in the growth of fixed-rate market borrowings: the first scenario is built up on the basis of judgments as to what constitutes a reasonable--though not risk-free--set of assumptions about fixed-rate market borrowings; this results in a growth in annual gross fixed-rate borrowings of about 4% per annum.2/ Interest-sensitive borrowings are then treated as a residual. The second scenario is intended only to show the sensitivity of the interest-sensitive borrowing requirement to different assumptions. Here fixed-rate market borrowings are assumed to grow at 6%, with interest-sensitive borrowings again treated as the residual. Within the interest-sensitive category, both scenarios assume a ceiling of $6 billion on outstanding short-term borrowings (see para 4.13 below) Beyond FY90, both scenarios are simple extrapolations of the FY86-90 growth rates.

2/ The specific assumptions underlying this scenario are shown in Annex 2.

Table 4.1: Alternative Gross Borrowing Scenarios: FY86-95[a]
(US$ Billions & %)

		Scenario 1		Scenario 2	
	FY81-85	FY86-90	FY91-95	FY86-90	FY91-95
Average Annual Amounts					
Total	9.1	12.9	16.6	12.9	16.6
Fixed Rate	8.0	10.1	12	10.9	13.9
- Official[a]	1.9	2.0	2.0	2.0	2.0
- Market	6.1	8.1	10.2	8.9	11.9
Interest Sensitive	1.1	2.8	4.4	2.0	2.7
- Official	0.3	0.3	0.3	0.3	0.3
- Market	0.8	2.5	4.1	1.7	2.4
End of Period Outstanding Amounts					
- Total	50.3	86.9	121.8	86.9	121.8
- Fixed Rate	45.3	70.9	88.7	74.8	98.7
- Interest Sensitive	5.0	16.0	33.1	12.1	23.1
Memo					
Interest-sensitive as % of total outstandings	9.9	18.4	27.2	13.9	19.0

a/ To fund commitments growing to $20 billion by FY90.
b/ Fixed rate with initial maturity of more than one year.

4.04 As the table shows, under scenario 1 interest-sensitive borrowings rise from about 10% of total outstandings at the end of FY85 to about 18% and 27% at end-FY90 and FY95, respectively. Even under reasonably conservative assumptions about fixed-rate markets, therefore, interest-sensitive liabilities would remain within recommended guidelines through FY90.[3] Under the assumptions in scenario 2, about $4 billion in net borrowing between FY85 and FY90 would be shifted from variable- to fixed-rate markets. Hence, interest-sensitive liabilities would be only about 14% of total outstandings by FY90 and 19% by FY95.

4.05 The following table provides a more detailed picture of what is entailed by the first scenario. It shows specific assumptions about borrowings in medium- and long-term fixed-rate instruments in specific currencies. Official borrowings are somewhat variable in terms of currency composition but may be expected to be largely in US dollars (the CBF, two-year bonds and some private placements) and SwF. Interest sensitive liabilities are for the immediate future likely to be predominantly in US dollars.

3/ Management originally proposed a ceiling of 20% for interest-sensitive liabilities; this was subsequently reduced to 15% on the grounds that the higher figure was not likely to be reached for several years.

Table 4.2: Currency Composition of Future Borrowings[a/]
($ billion & %)

	Annual Averages					
	FY81-85		FY86-90		FY 91-95	
	Amount	%	Amount	%	Amount	%
Medium- & Long-term Fixed-rate Market Borrowing	6.1	68	8.1	63	10.2	61
US dollar	1.8	20	1.5	12	1.7	10
Swiss francs	1.0	11	1.5	12	1.8	11
DM	1.0	11	1.4	10	1.8	11
Yen	1.3	15	1.9	14	2.4	14
Dutch guilder	0.4	5	0.6	5	0.8	5
Sterling	0.3	3	0.4	3	0.6	4
Canadian dollar	0.1	1	0.2	2	0.3	2
Other	0.2	2	0.6	5	0.7	4
Official Borrowings	2.2	24	2.3	18	2.3	14
Fixed-rate	1.9	21	2.0	16	2.0	12
Interest sensitive (CBF)	0.3	3	0.3	2	0.3	2
Interest Sensitive from Markets	0.8	8	2.5	19	4.1	25
Total	9.1	100	12.9	100	16.6	100

a/ To fund commitments growing to $20 billion by FY90.

4.06 While the precise composition of future borrowing cannot be decided other than in the context of ongoing market operations, the figures in the table underscore the point made earlier about the need for access to the major capital markets. The four largest currencies will still account for about four-fifths of fixed-rate market borrowings and one-half of total borrowings, even with the diversification indicated in the table. The figures also indicate the limited scope for increasing fixed-rate borrowings other than in US dollars, where the assumption is that market volatility will continue to discourage extensive fixed-rate borrowing, thereby making it necessary to continue developing the interest sensitive segments of the dollar markets. The flexibility to do this is thus a necessary component of the Bank's future financial strategy. While the figures shown for FY91-95 are extrapolations based on the FY86-90 assumptions, they point to further shifts in the composition of future borrowing programs. || X

4.07 As noted above, the change in the Bank's lending rate policy removed an important obstacle to the use of interest-sensitive liabilities by the Bank. Over time, this new system will give the Bank a close match between the interest-sensitivity of the Bank's assets and liabilities. Even during the transition to the new system, growth in interest-sensitive liabilities along the lines suggested by the preceding scenarios is unlikely to create problems for the Bank. Indeed, within limits, greater interest-sensitive liabilities will tend to stabilize net income as they provide an offset to the large volume of interest-sensitive assets held by the Bank (i.e. its liquid holdings).

4.08 With respect to the potential variability of the Bank's lending rate, the Funding Strategy paper drew the conclusion that a share of interest-sensitive liabilities as high as 30% would still leave the Bank with a reasonably stable lending rate. Only about one-third of any change in market interest rates would be passed through immediately; the balance would be filtered through only over time. In addition, it should be noted that borrowers stand to benefit from lower borrowing costs. Even during the turbulent 1970s and early 1980s, the cost of borrowing at variable rates was lower on average than borrowing at fixed rates, despite the higher volatility of short-term interest rates.

4.09 More importantly, there are several ways in which the Bank can manage interest rate risk on behalf of its borrowers. One, which may be limited, is to lengthen the maturities of its fixed-rate borrowing. This would slow down the rate of turnover of fixed-rate borrowings within the borrowing pool and hence further "filter" market interest rate movements. Extending maturities of all borrowings, including interest-sensitive instruments, would reduce total borrowing, and hence, the amount of interest-sensitive borrowing required.4/ A second option would be to make use of futures markets and interest-rate swaps to "lock-in" attractive market rate levels. This might entail higher costs but could nonetheless be used to reduce volatility of the lending rate should it become excessive. Finally, the Bank might offer variable rate, constant debt service loans on a selective basis.5/ While such loans do not protect borrowers against interest rate risk, they mitigate its effects.

4.10 In the final analysis, however, the issue of the composition of the Bank's future borrowings must take second place to the Bank's funding security itself. A decision to embark on a growing program of commitments, given the Bank's policy of only partially funding loans at the time of commitment, implies a need to increase borrowings at some future date. The Bank's ability to adjust its future borrowing requirements to market conditions is limited, due to the lags between commitment and disbursement and the importance of not allowing liquidity to deteriorate in a way that provokes a crisis of confidence with investors. Thus, the Bank's "safety valve" in the event of unforeseen difficulties in raising the amount of its borrowings will increasingly be the use of instruments and markets that offer greater liquidity and depth than the traditional fixed-rate bond markets do today--in other words, interest-sensitive liabilities.

4/ See Annex 3.

5/ Also known as a variable maturity loan, this lending instrument provides a fixed debt service payment, the interest and principal proportions of which are variable depending on interest rate movements. Hence the loan amortizes slower or faster as rates change, i.e. the final maturity lengthens or shortens.

Short-term Borrowing

4.11 The preceding discussion of "interest-sensitive" borrowing has not distinguished between short-term and medium- to long-term variable rate borrowing. This approach, to encompass both types of borrowing under one heading, has been taken in order to focus on the key issue of interest rate sensitivity. It has also been taken because the distinction between short- and medium- and long-term markets has become blurred in recent years with the emergence of new techniques of borrowing such as note issuance facilities and other forms of short-term borrowing. These are money markets with a separate back-up facility provided by financial institutions such as commercial banks. The back-up facility provides insurance, that if the borrower is not able to issue notes in the agreed amounts, the funds will be provided by (e.g.) the commercial banks.

4.12 The arguments in favor of the Bank's discount note program have been discussed extensively before and need not be repeated here. Discount notes offer an easily expandable form of borrowing, which is likely to be available even when other forms of borrowing are not. The discount note program also offers a degree of flexibility in the management of the Bank's cash flow and liquidity that cannot be achieved elsewhere. And the program provides the least-cost source of interest-sensitive US dollar borrowings available. Indeed, even adding the cost of providing a separate back-up facility from financial institutions, discount notes are commonly less expensive than other forms of term floating rate finance such as FRNs.

4.13 No decision on the future division of interest-sensitive liabilities between short- and medium-to long-term sources is required at this time. If need be, the requirements for interest-sensitive borrowing required to fund a growing lending program can be obtained entirely from medium- and long-term sources or from back-up facilities. In fact, the projections of borrowing requirements discussed in Section 2 have been based on the assumption that short-term borrowing is capped at $6 billion. However, it is important to bear in mind that the advantages of the discount note program are strong and will continue to offer the Bank opportunities for greater funding flexibility at lower cost.

Conclusion

4.14 To sum up, it is possible to be cautiously optimistic about the Bank's ability to finance a growing lending program, provided that it has access to member countries' credit markets in amounts commensurate with the growth in lending, it continues to follow policies that maintain its premier credit standing and has flexibility with respect to the form and operational management of the borrowing program. Moreover, the preceding discussion suggests that even under reasonably conservative assumptions, the interest rate volatility potentially implied by a higher future share of interest sensitive liabilities is manageable.

4.15 Nonetheless, despite these generally positive conclusions, we must be mindful of the fact that fixed rate market borrowings in the period FY91 to FY95 are projected to be 70% higher than during FY81 to FY85. There are substantial risks inherent in fixed rate borrowing, and it is not certain that such an increase can be achieved. The risks to the fixed rate market borrowing program may be related to matters within a Bank member's control, i.e., constrained access from one or more countries arising from, for example, balance of payment considerations, exchange rate concerns, or domestic deficits which, past experience has shown, has limited Bank access to markets. Other risks arise from concerns about the Bank's role, its activities or policies, or its status as a preferred creditor. Or, markets simply can be saturated with World Bank obligations depending upon, among other things, the growth in fixed rate markets, structural changes, e.g., deregulation in the markets, regulatory or fiscal changes. Finally, inflation, or the fear of inflation, at various times is likely to further put pressure on the fixed rate bond markets, or make costs so prohibitive that the costs cannot be borne by developing countries to whom we would on-lend those funds.

4.16 These risks are particularly acute for the Bank since it must borrow continuously in all major markets regardless of market circumstances in order to meet the future funding requirements. Therefore, to cope with these market risks, the Bank will need access to funds, a sustained record of excellent debt service performance on the part of its borrowers and a strong financial structure and performance. All of these requirements are within the purview of the Bank's shareholders. The major capital-market countries have the opportunity of reviewing the Bank's lending plans and are fully aware of the need to provide access to their markets and currencies as and when required to fund lending decisions made over a period of years. Similarly, the Bank's borrowers are also shareholders and have a stake in the continued financial health of the institution and appreciate the need for it to receive a preferred creditor treatment in order to be able to fulfill its role as a financial intermediary and development institution. In concluding, therefore, that the Bank can fund a growing lending program, we are mindful of the role played by the shareholders themselves in making this possible. The support of the shareholders is fundamental: without access, premier credit standing and appropriate financial policies and operational flexibility, it would be difficult to be positive about the Bank's borrowing prospects.

4.17 The volume of projected borrowing is substantial. Based on our past experience and given the prospects of future volatility in the world financial markets it is likely that we will be subject to the events described earlier (c.f. para. 4.15). Member governments should recognize that their approval of lending commitment program is tantamount to providing the flexibility that is needed in later years to meet the Bank's financial requirements. This flows from the fact that unlike commercial institutions, the Bank has legally binding commitments set in train years before which must be financed after they are made, rather than contemporaneously with those commitments. It is the awareness of these considerations and the member governments' response to the inevitable, but basically unpredictable events that will occur, which is at the heart of the Bank's "ability" to fund an increasing lending program. With the support of governments, a program growing along the lines discussed in Section 2 seems well within the range of what the Bank can raise from private and official sources of borrowing.

FPA
08/07/85

Alternative Borrowing Requirements
($ Billions, 20% Fast-Disbursing Loans)

	FY85	FY86	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95
Gross Borrowing	11.1										
$20 b. by FY90		9.8	13.8	12.4	13.5	15.0	14.1	17.0	18.1	17.1	16.5
$16.5 b. by FY90		9.3	12.9	11.1	11.7	12.9	11.5	13.9	14.7	13.4	14.0
$13 b. throughout		8.7	12.0	9.8	10.1	10.7	8.7	10.4	10.6	9.0	7.0
Net Borrowing	7.2										
$20 b. by FY90		5.5	7.4	7.4	8.1	8.2	8.0	8.0	7.6	6.7	5.0
$16.5 b. by FY90		5.0	6.5	6.1	6.5	6.2	5.7	5.4	4.9	4.0	3.0
$13 b. throughout		4.4	5.7	4.9	4.9	4.3	3.4	2.5	1.6	0.5	-0.5
Outstanding Borrowings	50.3										
$20 b. by FY90		55.8	63.1	70.5	78.7	86.9	94.9	102.9	110.5	117.2	122.0
$16.5 b. by FY90		55.2	61.8	67.9	74.3	80.5	86.3	91.7	96.5	100.5	103.5
$13 b. throughout		54.6	60.3	65.2	71.1	74.4	77.8	80.3	81.9	82.4	82.0

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*Includes countries and IFC.

ANNEX 2

FY81-95 Gross Borrowings for a $20 Billion Commitment Program
(Before Currency Swaps)
(US$ million equivalent)

	Actual					Projected									
	FY81	FY82	FY83	FY84	FY85	FY86	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95
Medium- & Long-term Fixed-rate Market Borrowing															
US dollar	1,000	2,820	3,245	950	1,211	1,650	1,400	1,400	1,450	1,500	1,568	1,617	1,683	1,749	1,815
Swiss francs	637	1,031	965	1,045	1,455	1,133	1,400	1,500	1,600	1,650	1,720	1,774	1,846	1,919	1,991
DM	1,134	612	910	1,182	1,316	1,103	1,400	1,450	1,600	1,650	1,720	1,774	1,846	1,919	1,991
Yen	743	1,128	1,200	1,633	1,911	1,400	1,850	1,900	2,000	2,150	2,242	2,313	2,407	2,502	2,596
Dutch guilder	125	464	484	550	571	400	600	600	700	700	732	755	785	816	847
Sterling	216	258	129	453	365	250	400	450	500	550	570	588	612	636	660
Canadian dollar	0	0	0	141	114	74	150	200	250	250	266	274	286	297	308
Others	0	223	61	148	469	531	700	600	600	650	684	706	734	763	792
S/Total	3,855	6,536	6,994	6,102	7,412	6,541	7,900	8,100	8,700	9,100	9,500	9,800	10,200	10,600	11,000
Official Borrowings															
Over 1 year	1,860	1,985	1,797	2,081	1,863	2,050	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Under 1 year (CBF)	0	0	0	749	501	250	250	250	250	250	250	250	250	250	250
S/Total	1,860	1,985	1,797	2,830	2,364	2,300	2,250	2,250	2,250	2,250	2,250	2,250	2,250	2,250	2,250
Increase in Interest Sensitive Instruments (Market) a/															
MLT Variable b/	0	0	0	400	1,102	820									
Discount Notes	0	0	1,500	500	320	180									
S/Total	0	0	1,500	900	1,422	1,000	3,650	2,050	2,550	3,650	2,350	4,950	5,650	4,250	3,250
TOTAL PROGRAM	5,715	8,521	10,291	9,832	11,198	9,841	13,800	12,400	13,500	15,000	14,100	17,000	18,100	17,100	16,500

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a/ Predominantly denominated in US dollars.
b/ Includes interest rates swaps.

Impact on Borrowing Requirement of Extending Maturities

Extending maturities on both fixed and interest-sensitive borrowing would have an additional beneficial effect by reducing gross borrowing required. The effect is illustrated in the table below, where gross borrowing requirements in scenario 1 are compared with those obtained by assuming that medium- and long-term borrowing is at the longer maturities obtained in FY85, (rather than the average of maturities over FY83-85 as assumed in scenarios 1 and 2). The increase in average maturities is only one year, but the impact on the amount and composition of borrowing is substantial: total borrowing is reduced by about $5 billion, and since interest sensitive borrowing is reduced by an equal amount, the proportion of interest sensitive outstanding in FY95 declines from 27% to 23%.

Impact of Lengthening Maturities on Medium- and Long-Term Borrowings[a/]
(US$ Billion)

		Scenario 1		Extended Maturity	
	FY81-85	FY86-90	FY91-95	FY86-90	FY91-95
Average Annual Amounts					
Total	9.1	12.9	16.6	13.1	15.3
Fixed Rate	8.0	10.1	12.2	10.1	12.2
- Official b/	1.9	2.0	2.0	2.0	2.0
- Market	6.1	8.1	10.2	8.1	10.2
Interest Sensitive	1.1	2.8	4.4	3.0	3.1
- Official	0.3	0.3	0.3	0.3	0.3
- Market	0.8	2.5	4.1	2.7	2.8
End of Period Outstanding Amounts					
Total	50.3	86.9	121.8	86.2	116.7
Fixed Rate	45.3	70.9	88.7	70.0	90.3
Interest Sensitive	5.0	16.0	33.1	16.2	26.4
Memo					
Interest-sensitive as % of total outstandings	9.9	18.4	27.2	18.8	22.6

a/ To fund commitments growing to $20 billion by FY90.
b/ Fixed rate with initial maturity of more than one year.

The following table shows the actual average maturity of new borrowings over the period FY75-85.

Average Maturity of New Borrowings
(Years)

	Gross New Borrowing	New Medium- and Long-Term
FY75	8.0	8.0
FY76	6.8	6.8
FY77	8.1	8.1
FY78	8.2	8.2
FY79	8.1	8.1
FY80	9.2	9.2
FY81	7.5	7.5
FY82	6.9	6.9
FY83	7.0	7.0
FY84	6.1	6.5
FY85	7.1	9.3

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FROM: Vice President and Secretary

August 29, 1985

TECHNICAL NOTE

Bank Lending to Lower-Middle Income Countries

The attached paper on "Bank Lending to Lower-Middle Income Countries" has been prepared as a supplement to the paper entitled "Resource Implications of the Bank's Future Role (R85-193)."

Questions on this document may be referred to Mr. Jansen (ext. 72601) or Ms. Artus (ext. 74743).

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TECHNICAL NOTE

Bank Lending to Lower-Middle Income Countries

Introduction

1. This note supplements the analysis contained in the Resource Implications paper.[1]

2. Under current guidelines, 48 Bank members are classified in the lower-middle income group, on the basis of having 1983 GNP per capita between \$400 and \$1635. Ten of these countries--mainly small economies--are currently not regarded as fully creditworthy for IBRD lending.[2] For purposes of analyzing IBRD lending prospects, it is possible to separate the remaining 38 countries into two groups:

(a) Countries where IBRD lending is at present not constrained by special creditworthiness or performance concerns. These countries are considered to have relatively good medium-term growth and creditworthiness prospects. A few of them have suffered or continue to face short-term liquidity problems, but in most of such countries adjustment programs are either in place or developing satisfactorily. The Bank is providing significant adjustment support in a number of these countries. IBRD commitments to these countries are expected to total about \$14 billion in FY86-FY88.

(b) Countries where IBRD lending may be constrained by economic performance and related concerns. Over the past few years, these countries have generally faced declines in per capita income, serious imbalances in the balance of payments and recurring debt servicing difficulties. Most of them depend heavily for foreign exchange earnings on exportation of a small number of primary commodities, for which the price prospects are poor over the medium-term. In some countries, however, adjustment policies are in place or planned. Bank lending, partly designed to support such adjustment efforts, is currently programmed to reach about \$5 billion in FY86-FY88. However, much of the lending to this group depends on satisfactory progress in the adjustment efforts; the likely volume of future lending is thus more uncertain and there could be slippages if the countries' economic and political conditions were to deteriorate.

1/ Resource Implications of the Bank's Future Role (R85-193, dated June 14, 1985).

2/ Moreover, not all of these countries of this sub-group are currently receiving IDA credits. A separate paper is being prepared, for Board consideration later this year, on the type of financial assistance the Bank Group might provide to these countries.

3. Table 1 below sets out Bank lending to these groups of lower-middle income countries in the past and the growth envisaged over the next three years. As the table shows, IBRD commitments to the lower-middle income countries are programmed to expand at a rate of 11% over the next three years, compared to 8% for the rest of the IBRD recipients. Growth is somewhat faster for the potentially constrained countries although this is from a base of lending in FY83-85 that was lower than FY80-82.

Table 1: IBRD Commitments: Actual and Potential

	Commitment Level ($ B)			Increase in Lending by Period: Amount ($ B)		Increase in Lending by Period: % p.a.	
	FY80-FY82	FY83-FY85	FY86-FY88	FY83-FY85	FY86-FY88	FY83-FY85	FY86-FY88
Lower Middle Income Countries							
(a) Unconstrained Programs	10.1	10.2	13.8	0.1	3.6	0.4%	11%
(b) Potentially Constrained	4.3	3.6	5.1	-0.7	1.5	-6%	13%
Subtotal	14.3	13.8	18.9	-0.6	5.2	-1%	11%
Other Countries	12.4	20.7	26.1	8.2	5.4	18%	8%
Total	26.7	34.5	45.0	7.8	10.5	9%	9%

Possible Relaxation of Repayment Terms

4. The paper on Resource Implications discussed the possibility of restoring the pre-1977 loan repayment terms, and noted that "even a partial restoration of the pre-1977 terms would enable the Bank to contribute to an improvement in the debt service profiles of borrowers in the late 1980s and early 1990s."

5. Table 2 illustrates how the debt service associated with future lending would be affected if all of the "potentially constrained" IBRD borrowers were eligible for the pre-1977 repayment terms.3/ These countries might be singled out for such treatment on grounds of their somewhat weaker debt-servicing capacity. Because existing grace periods for this group of countries are at least four years, the pre-1977 terms have no effect until FY90.

3/ For purposes of consistency with the figures in the Resource Implications paper, the calculations assume that the pre-1977 terms are applied to all loans committed to these countries from the beginning of FY86.

Table 2: Effect of Applying the Pre-1977 Repayment Terms to "Constrained" Lower-Middle Income Countries ($ million)

	FY90	FY91	FY92	FY93	FY94	Cumulative Thru FY94
Loan Repayments						
Present Terms	10	80	210	350	510	1160
Pre-1977 Terms	0	10	60	110	170	350
Difference	10	70	150	240	340	810
Total Debt Service						
Present Terms	240	450	710	1000	1320	3960 a/
Pre-1977 Terms	230	380	580	790	1040	3260 a/
Difference	10	70	130	210	280	700

a/ Including loan charges payable in FY86-FY89, which are not affected by the change in the repayment terms.

6. As the table shows, the pre-1977 terms would reduce cumulative repayments--and hence increase cumulative net disbursements to these countries--by about $800 million through FY94. IBRD capital requirements would be increased by about $8-1/2 billion if these more liberal lending terms were to be continued indefinitely to all of these countries.

7. Table 3 below shows the changes in debt service and loan repayments that would result if all of the lower-middle income IBRD borrowers were eligible for the pre-1977 repayment terms. Such a change in lending terms would require an additional capital of about $22 billion compared with the alternative of maintaining present terms for the group of lower middle-income countries to whom lending is relatively unconstrained.

Table 3: Effect of Applying the Pre-1977 Repayment Terms to Lower-Middle Income Countries
($ million)

	FY90	FY91	FY92	FY93	FY94	Cumulative Thru FY94
Loan Repayments						
Present Terms	130	470	930	1450	2040	5020
Pre-1977 Terms	20	110	280	470	710	1590
Difference	110	360	650	980	1330	3430
Total Debt Service						
Present Terms	1020	1800	2760	3810	4940	15280 a/
Pre-1977 Terms	910	1470	2180	2980	3870	12360 a/
Difference	110	330	580	830	1070	2920

a/ Including loan charges payable in FY86-FY89, which are not affected by the change in the repayment terms.

REPAYMENT TERMS

SecM85-848

FROM: Vice President and Secretary

July 16, 1985

REPAYMENT TERMS

The attached paper on "Repayment Terms" has been prepared at the request of the Executive Directors made at the meeting of June 28, 1985.

This paper will constitute a background document for the paper entitled "Resource Implications of the Bank's Future Role (R85-193)" which will be considered at the meeting of the Executive Directors to be held on July 23, 1985.

Questions on this document may be referred to Mr. Weigel (ext. 74751).

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

RESOURCE IMPLICATIONS OF THE BANK'S FUTURE ROLE

Supplementary Information on Repayment Terms

Introduction

1. The purpose of this note is to respond to several of the questions concerning repayment terms which were raised during the Board discussion on June 28, 1985.

- Section A describes how a change from current repayment terms to annuity-style repayment terms would affect the debt-service profile for a typical IBRD loan. It also explains how an annuity-style repayment system could allow for periodic changes in the IBRD lending rate.

- Section B analyzes the impact of alternative repayment terms on IBRD capital requirements. The information is presented in such a way that one can readily determine the trade-off between changes in repayment terms and the level of new commitments that can be sustained with a given capital base.

- Section C examines the implications of a change in repayment terms on the net flows of capital between the IBRD and individual borrowing countries.

- Section D presents data on the grace periods and final maturities that were approved for IBRD loans in the period prior to the adoption of a country-based system for repayment terms. The data - which is disaggregated by sector - throws some light on the scope for differentiating repayment terms by type of operation.

The material presented in this note is technical in nature. No policy recommendations are made.

A. Characteristics of an Annuity-Style Repayment System

2. Table 1 shows how an annuity repayment system would alter the debt service due the IBRD on a typical loan. Under the current system the loan (assumed to be equal to 100) is repaid in 16 equal installments of 6.67 each. Under the annuity system the repayment is adjusted so as to keep the total debt service payment constant (at 12.28 per payment) after the loan is fully disbursed. In the early years the bulk of the debt service payment is interest, with only small amounts of principal repaid. In the later years, as the outstanding and disbursed balance of the loan declines, the proportions shift until towards the end of the loan the bulk of the payment is principal.

Table 1. Debt Service Projections with Alternative Repayment Terms
(Loan Amount = 100)

	Current Terms				Annuity Terms				Difference			
	Principal Payments	Charges	Total Payments	Disbursed & Outstanding	Principal Payments	Charges	Total Payments	Disbursed & Outstanding	Principal Payments	Charges	Total Payments	Disbursed & Outstanding
Year 1	0.00	0.87	0.87	3.00	0.00	0.87	0.87	3.00	0.00	0.00	0.00	0.00
Year 2	0.00	1.41	1.41	13.00	0.00	1.41	1.41	13.00	0.00	0.00	0.00	0.00
Year 3	0.00	2.40	2.40	27.00	0.00	2.40	2.40	27.00	0.00	0.00	0.00	0.00
Year 4	0.00	3.68	3.68	44.00	0.00	3.68	3.68	44.00	0.00	0.00	0.00	0.00
Year 5	0.00	5.04	5.04	60.00	0.00	5.04	5.04	60.00	0.00	0.00	0.00	0.00
Year 6	3.33	6.16	9.49	69.67	1.68	6.20	7.87	71.32	-1.66	0.04	-1.62	1.66
Year 7	6.67	6.69	13.36	72.00	3.51	6.91	10.42	76.82	-3.16	0.22	-2.94	4.82
Year 8	6.67	6.80	13.46	73.33	3.83	7.29	11.12	80.99	-2.84	0.50	-2.34	7.66
Year 9	6.67	6.73	13.40	71.67	4.18	7.48	11.66	81.81	-2.49	0.74	-1.74	10.14
Year 10	6.67	6.46	13.13	68.00	4.57	7.42	11.99	80.24	-2.10	0.96	-1.14	12.24
Year 11	6.67	6.07	12.73	63.33	4.99	7.21	12.19	77.25	-1.68	1.14	-0.54	13.92
Year 12	6.67	5.55	12.22	56.67	5.45	6.83	12.28	71.81	-1.22	1.28	0.06	15.14
Year 13	6.67	4.95	11.62	50.00	5.95	6.33	12.28	65.86	-0.72	1.38	0.66	15.86
Year 14	6.67	4.35	11.02	43.33	6.49	5.78	12.28	59.37	-0.17	1.43	1.26	16.04
Year 15	6.67	3.75	10.42	36.67	7.09	5.18	12.27	52.28	0.42	1.43	1.86	15.61
Year 16	6.67	3.15	9.82	30.00	7.74	4.53	12.27	[illegible].54	1.08	1.38	2.46	14.54
Year 17	6.67	2.55	9.22	23.33	8.46	3.82	12.27	[illegible]6.08	1.79	1.27	3.06	12.75
Year 18	6.67	1.95	8.62	16.67	9.23	3.04	12.27	26.84	2.57	1.09	3.66	10.18
Year 19	6.67	1.35	8.02	10.00	10.08	2.19	12.27	16.76	3.42	0.84	4.26	6.76
Year 20	6.67	0.75	7.42	3.33	11.01	1.26	12.27	5.75	4.35	0.51	4.86	2.41
Year 21	3.33	0.22	3.56	.00	5.75	0.39	6.14	.00	2.41	0.16	2.58	.00
Total	100.00	80.89	180.89	835.00	100.00	95.26	195.26	994.72	.00	14.38	14.38	15[illegible]
Gross Capital Ratio				8.35				9.95				

Assumptions:

Grace Period: 5 Years.
Final Maturity: 20 Years
Interest Rate: 9.00%
Commitment Fee: 0.75%
Disbursement Schedule: Average IBRD Profile
Loan Approval in the Middle of the Fiscal Year

3. Because principal is repaid more slowly under an annuity system, loan charges over the life of the loan are greater than under the current repayment system (95 vs. 81). The advantage, however, is that the total debt service payment is lower in years 6 through 11.

4. Several Executive Directors expressed interest in knowing how an annuity-style repayment system would be affected by changes in the IBRD lending rate. During the period prior to FY77 when an annuity system was in operation, the IBRD had a fixed lending rate. Now, under the pool-based lending rate system, the lending rate is readjusted every six months.

5. The example in Table 1 assumes that the IBRD lending rate is 9% throughout the life of the loan. If the lending rate changes, there are a number of ways in which the annuity system might be adapted. One way would be to fix the repayment schedule on the basis of the lending rate prevailing at the time the loan is committéd. Subsequent changes in the lending rate would then be reflected in changes in the interest component of the debt service due at each payment date. This option is illustrated in Table 2, where the assumption is made that the lending rate increases from 9% to nearly 11% over the life of the loan. The total debt service payment is no longer constant at 12.28, but instead fluctuates in the range of $12.5 million to $13.0 million.

Table 2. Impact of Lending Rate Variability with Unchanged Principal Payments (Loan Amount = 100)

	Lending Rate	Principal Payments	Charges	Total Payments	Disbursed & Outstanding
Year 1	9.00%	0.00	0.87	0.87	3.00
Year 2	9.00%	0.00	1.41	1.41	13.00
Year 3	9.00%	0.00	2.40	2.40	27.00
Year 4	9.00%	0.00	3.68	3.68	44.00
Year 5	9.00%	0.00	5.04	5.04	60.00
Year 6	9.12%	1.68	6.28	7.95	71.32
Year 7	9.24%	3.51	7.09	10.60	76.82
Year 8	9.35%	3.83	7.57	11.40	80.99
Year 9	9.47%	4.18	7.86	12.05	81.81
Year 10	9.59%	4.57	7.90	12.47	80.24
Year 11	9.71%	4.99	7.77	12.76	77.25
Year 12	9.82%	5.45	7.46	12.90	71.81
Year 13	9.94%	5.95	6.99	12.94	65.86
Year 14	10.06%	6.49	6.46	12.96	59.37
Year 15	10.18%	7.09	5.86	12.95	52.28
Year 16	10.29%	7.74	5.18	12.93	44.54
Year 17	10.41%	8.46	4.42	12.87	36.08
Year 18	10.53%	9.23	3.56	12.79	26.84
Year 19	10.65%	10.08	2.59	12.67	16.76
Year 20	10.76%	11.01	1.51	12.52	5.75
Year 21	10.88%	5.75	0.47	6.22	.00
Total		100.00	102.38	202.38	994.72
Gross Capital Ratio					9.95

Assumptions:

Grace Period: 5 Years.
Final Maturity: 20 Years
Interest Rate: 9.00% at Commitment
Commitment Fee: 0.75%
Disbursement Schedule: Average IBRD Profile
Loan Approval in the Middle of the Fiscal Year

6. Another option would be to maintain the fixed debt service payment and to adjust the principal payments. Under the assumption of an increasing IBRD lending rate this results in an extension of maturity from 20 years to 22 years, as illustrated in Table 3. If the IBRD lending rate were to decrease, the loan would be repaid in less than 20 years.

Table 3. Impact of Lending Rate Variability with Unchanged Total Debt Service Payments
(Loan Amount = 100)

	Lending Rate	Principal Payments	Charges	Total Payments	Disbursed & Outstanding
Year 1	9.00%	0.00	0.87	0.87	3.00
Year 2	9.00%	0.00	1.41	1.41	13.00
Year 3	9.00%	0.00	2.40	2.40	27.00
Year 4	9.00%	0.00	3.68	3.68	44.00
Year 5	9.00%	0.00	5.04	5.04	60.00
Year 6	9.12%	1.60	6.28	7.87	71.40
Year 7	9.24%	3.32	7.10	10.42	77.09
Year 8	9.35%	3.51	7.61	11.12	81.57
Year 9	9.47%	3.73	7.93	11.66	82.84
Year 10	9.59%	3.97	8.02	11.99	81.87
Year 11	9.71%	4.25	7.95	12.19	79.63
Year 12	9.82%	4.57	7.71	12.28	75.06
Year 13	9.94%	4.94	7.34	12.28	70.12
Year 14	10.06%	5.36	6.92	12.28	64.76
Year 15	10.18%	5.84	6.44	12.28	58.93
Year 16	10.29%	6.38	5.90	12.28	52.55
Year 17	10.41%	6.99	5.29	12.28	45.56
Year 18	10.53%	7.68	4.59	12.28	37.88
Year 19	10.65%	8.47	3.81	12.28	29.41
Year 20	10.76%	9.36	2.91	12.28	20.04
Year 21	10.88%	10.38	1.90	12.28	9.66
Year 22	11.00%	9.66	0.80	10.46	0.00
Total		100.00	111.90	211.90	1085.36
Capital Ratio					10.85

Assumptions:

Grace Period: 5 Years.
Final Maturity: 20 Years
Interest Rate: 9.00% at Commitment
Commitment Fee: 0.75%
Disbursement Schedule: Average IBRD Profile
Loan Approval in the Middle of the Fiscal Year

7. Other options would fall somewhere between these two cases. For example, the annuity payment could be readjusted periodically (e.g., every three to five years) as is the practice in mortgage lending in some countries. While the choice among these options can affect the detailed differences between an annuity system and the IBRD's current repayment

system, the broad differences will remain. An annuity system will involve lower total payments in the early years of the loan, but somewhat higher total interest payments over the life of the loan.

B. Implications of Repayment Terms for Capital Requirements

8. Any modification in the repayment terms of IBRD loans will have an impact on capital requirements because sucn a change will affect the amount of disbursed and outstanding loans that ultimately will build up from a series of annual commitments. A single loan, such as that illustrated in Table 1 above, generates a pattern of disbursed and outstanding amounts that depends both on the disbursement profile and the repayment terms assumed. If a sequence of such loans is made, then a so-called "steady state" will eventually be reached in which the total amount disbursed and outstanding will equal the sum of the amounts shown in the column for disbursed and outstanding amounts (in Table 1, this amount is labelled the "gross capital ratio" and equals $835 per $100 of annual lending for a loan with current repayment terms, or $8.35 per dollar of annual lending). For a loan with an annuity repayment, the gross capital ratio is $9.95 per dollar of annual lending.

9. The gross capital ratio will obviously be affected by both the disbursement profile and the repayment terms assumed. All of the illustrations in Section A assumed that the loan was disbursed in line with average experience for the Bank. If a faster profile for disbursements is used, then the amount outstanding and disbursed in the early years of the loan is higher, and the gross capital ratio will increase correspondingly. Similarly, if the disbursement rate is slower, the gross capital ratio will be smaller. The gross capital ratio is thus directly proportional to the average length of time the borrower has the use of IBRD funds.

10. The gross capital ratio is a convenient measure of the impact of changes in repayment terms (or of disbursement rates) on IBRD capital requirements. The greater the amount of loans outstanding and disbursed, the greater is the IBRD's need for capital. The relationship is not necessarily 1:1, however, because outstanding loans can also be covered through the accumulation of reserves.1/ In the special case in which the reserve level is not sensitive to the volume of loans outstanding and disbursed, then the difference between the gross capital ratios for two types of loans is also a measure of the difference in capital requirements associated with the two types of terms.

11. In the more general case in which there is some relationship between the volume of loans outstanding and the IBRD reserve level, the comparison requires that each gross capital ratio be adjusted to take account of the reserve accumulation expected to be associated with lending

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1/ In practice, a number of other factors (e.g. cancellations; loans to IFC) complicate the precise calculation of capital requirements, but the gross capital ratio gives a useful first approximation.

on those terms. If, for example, reserves were expected to equal 10% of the loans outstanding at the "steady state", then the gross capital ratio would have to be reduced by 10% to obtain the net capital ratio.

12. The net capital ratio can be used directly to describe the trade-off between a change in the volume of IBRD commitments and the terms on which loans are committed. The capital required to sustain a commitment level of 100 with terms which give a net capital ratio of, say, 8.20 would only support commitments of 96.5 if the repayment terms are modified so as to yield a net capital ratio of 8.50 (8.20 x 100 = 8.50 x 96.5).

13. Table 4 below presents the gross capital ratios for various combinations of repayment terms. The first block analyzes the impact of changes in grace period and final maturity, given the current pattern of amortization (i.e. equal payments of principal). The second block does the same thing on the basis of an annuity-style system, assuming an IBRD lending rate of 9%. The third block explores the sensitivity of the annuity system to alternative assumptions regarding the IBRD lending rate.

Table 4: Capital Ratios Resulting from Alternative Repayment Terms

With Equal Principal Payments

Final Maturity	Grace Period 2	3	4	5	6
12.5	3.10	3.60	4.10	4.60	5.10
15.0	4.35	4.85	5.35	5.85	6.35
17.0	5.35	5.85	6.35	6.85	7.35
20.0	6.85	7.35	7.85	8.35	8.85
22.5	8.10	8.60	9.10	9.60	10.10

Level Annuity Payments (Interest Rate @ 9.0%)

Final Maturity	Grace Period 2	3	4	5	6
12.5	3.90	4.25	4.62	5.01	5.41
15.0	5.56	5.89	6.22	6.57	6.94
17.0	6.95	7.25	7.56	7.89	8.22
20.0	9.13	9.39	9.67	9.95	10.25
22.5	11.02	11.26	11.51	11.76	12.03

Level Annuity Payments with Alternative Interest Rates

Final Maturity	Years Grace	Interest Rate 7%	8%	9%	10%	11%
12.5	2	3.73	3.81	3.90	3.98	4.06
15.0	3	5.67	5.78	5.89	5.99	6.10
17.0	4	7.31	7.43	7.56	7.69	7.81
20.0	5	9.62	9.79	9.95	10.12	10.27
22.5	6	11.63	11.83	12.03	12.22	12.41

14. The meaning of these figures may be illustrated with a few examples. Under the current system of repayments, a change in the repayment period by two years alters the capital ratio by 1.0 regardless of whether this change is brought about through a change in the grace period or a change in the final maturity. Under the annuity system the relationships are not linear. A change of two years in the grace period alters the capital ratio by 0.5 to 0.7, depending upon the initial conditions assumed. A comparable change in the final maturity alters the capital ratio by a larger amount, roughly by 1.2 to 1.5, again depending upon the initial conditions. The capital ratio under an annuity system is

also slightly sensitive to the level of the IBRD lending rate. With higher lending rates, principal is repaid more slowly and hence the capital ratio is higher. The impact is, however, relatively modest: the difference between an average lending rate of 7% and an average rate of 11% is in the range of 0.4 to 0.65 for current grace periods and maturities.

C. Impact of Changed Repayment Terms on Net Capital Flows

15. A number of Executive Directors expressed interest in knowing more about how a reversion to an annuity system would affect the net flow of capital between the IBRD and individual borrowing countries. The impact can be illustrated by comparing two series of loan commitments. The first series assumes current repayment terms and the second assumes an annuity system (lending rate = 9%). The difference between the two shows the impact both on net disbursements and on net transfers of changing repayment terms.

16. The calculations have been done for two series of commitments; first, a series that remains constant at 100 per annum and, secondly, a series that grows at the same rate as is projected for IBRD lending as a whole (i.e. about 9% per annum). Table 5 summarizes the impact factors for both low-income and middle-income countries. Through use of these factors, the impact for any individual country may be assessed on the basis of whatever assumption one wishes to make regarding future commitment levels to that country. If, for instance, one assumes an annual commitment program of $200 million per annum, then the impact of a reversion to an annuity system for a low income country in, say, year 10 is to increase net disbursements by $25.2 million and to increase net transfers by $19.4 million ($200/100 multiplied by 12.6 and 9.7, respectively). If one assumes that commitments begin at $200 million but then increase by 9% per annum, then the corresponding impacts in year 10 are $30.2 million and $23.8 million. Details of the calculations are shown in Attachment 1, pages 1 through 4.

Table 5. Impact Factors for Reversion to an Annuity System
(per 100 committed in initial year)

	Low Income Countries (5/20)				Middle-Income Countries (4/17) b/			
	Commitments Constant		Commitments Growth at 9%		Commitments Constant		Commitments Growth at 9%	
	Net Disb	Net Transfer	Net Disb	Net Transfer	Net Disb	Net Transfer	Net Disb	Net Transfer
Year 4	-	-	-	-	-	-	-	-
Year 5	-	-	-	-	2.2	2.1	2.2	2.1
Year 6	2.2	2.1	2.2	2.1	5.4	4.9	5.6	5.1
Year 7	5.3	4.9	5.5	5.0	8.1	7.0	8.8	7.7
Year 8	8.1	7.0	8.8	7.7	8.1	6.3	9.0	7.1
Year 9	10.5	8.6	12.0	10.0	6.7	4.3	7.5	4.8
Year 10	12.6	9.7	15.1	11.9 a/	5.2	2.3	5.8	2.6
Year 11	14.2	10.9	18.1	13.4	3.6	0.2	4.0	0.4
Year 12	15.3	9.9	20.9	14.4	1.8	-1.8	2.1	-1.9
Year 13	16.0	9.1	23.4	14.9	-0.1	-3.9	-	-4.1
Year 14	16.1	7.8	25.6	14.9	-2.3	-5.9	-2.4	-6.3
Year 15	15.6	5.8	27.4	14.3	-4.6	-7.9	-4.9	-8.5
Year 16	14.4	3.3	28.7	13.1	-7.2	-9.9	-7.7	-10.7
Year 17	12.5	0.2	29.4	11.2	-9.9	-11.9	-10.7	-12.9
Year 18	9.8	-3.5	29.3	8.5	-9.3	-10.4	-10.3	-11.6
Year 19	6.3	-7.7	28.4	5.0	-6.0	-6.5	-7.0	-7.5
Year 20	1.8	-12.6	26.5	0.6	-1.7	-1.8	-2.1	-2.1
Year 21	-	-14.4	27.1	-1.2	-	-	-	-
Year 22	-	-14.4	29.6	-1.3	-	-	-	-
Year 23	-	-14.4	32.2	-1.5	-	-	-	-
Year 24	-	-14.4	35.1	-1.6	-	-	-	-

a/ Basis for sample calculation described in para. 16
b/ Reversion to annuity is assumed to last only for three years (cf. Resource Implications Paper (R85-193 dated June 14, 1985)).

D. Scope for Differentiation of Repayment Terms

17. Some Directors also inquired into the scope for differentiating repayment terms on project grounds. The idea would be to tailor grace periods and amortization patterns to the time profile of project benefits. As noted in the memorandum on Resource Implications, such differentiation is permitted under the current system. The country averages are, however, sufficiently stringent that very little actual differentiation takes place.

18. Country averages are the starting point for the Bank's current system. A basic issue is whether to continue on this course - that is, to

require that differentiation be constrained so as to produce average repayment terms appropriate to the country. This is not a technical issue, but rather an issue of broad policy. In the early years of the Bank's operations, the focus of attention was on individual investment projects, so it was natural to have repayment terms reflect the cost and benefit profile of the individual operation. With the advent of IDA financing in the early 1960s a distinction was made between the terms appropriate for the country and the terms appropriate for the project. This distinction was further reinforced in the mid-1970s when the repayment periods for IBRD loans were linked to the per capita income of the borrowing country.

19. Prior to the introduction of this country-based differentiation, grace periods and final maturities were determined by reference to project characteristics without any requirement with regard to country averages. The following tables (Tables 6, 7 and 8), extracted from an earlier review of the repayment system, show that there was considerable variation by sector during this period.

20. Were the Bank to revert to this approach today, there would be a major question to be addressed in setting repayment terms for structural adjustment and sectoral adjustment loans. These operations tend to be fast-disbursing and the time profile of benefits is typically difficult to determine with any precision. If these loans were to have shorter than average repayment terms, this would tend to reduce the Bank-wide average (because of the greater prominence of this type of lending now as compared to the early 1970s). It should be noted, however, that the circumstances in which structural adjustment and sectoral adjustment loans are a significant part of a country lending program are typically ones in which the Bank is concerned not to exacerbate the repayment burden in the near and medium-term. Hence shorter repayment periods (especially shorter grace periods) would be difficult to reconcile with the Bank's overall assistance strategy vis-a-vis the borrowing country.

21. Apart from this dilemma, the Bank could also be put into a difficult position vis-a-vis co-financing partners. For country reasons the Bank has strongly endorsed debt restructurings and new commercial financings that involve a longer than customary average life (that is, the interval between disbursement and repayment) for the commercial banks. The average life of some of these commercial bank financings is noticeably longer than that provided by current IBRD terms. To shorten the repayment period further for IBRD operations would only heighten the disparity.

22. As a next step in pursuing the issues related to possible differentiation of terms, the Executive Directors may wish to consider whether the average repayment terms should continue to be set on country grounds. If so, then additional material can be presented on ways in which greater flexibility can be introduced within such a system.

Table 6. SECTORAL DISTRIBUTION OF LENDING, FY71-81

Sector	Percent of Total Commitments in:						
	FY71	FY72	FY73	FY74	FY75	FY76	FY81
Agriculture	10.0	5.2	22.2	21.9	26.9	27.7	33.9
Power	20.5	24.5	9.7	21.6	9.1	9.9	10.1
Transportation	30.4	22.2	28.6	21.0	22.0	22.9	18.0
Communication	5.5	3.8	4.8	4.3	2.5	1.3	2.4
Industry	1.7	17.9	-	8.8	15.8	10.9	9.4
DFC	13.3	11.3	13.8	9.6	9.0	13.4	7.6
Industrial Imports	4.2	-	1.7	.2	5.0	1.6	-
Education	3.6	7.0	6.0	5.5	2.9	4.4	4.6
Water Supply	9.8	2.8	11.2	3.7	3.4	5.3	7.0
Population	.2	-	.3	.5	.7	.1	1.1
Urban Development	.3	-	.9	2.0	1.8	1.8	3.5
Project Preparation	-	-	-	.2	-	.3	-
Tourism	.5	2.2	.8	.7	.9	.4	1.4
General Development	-	3.1	-	-	-	-	-
Unallocated	-	-	-	-	-	-	1.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table 7. SECTORAL WEIGHTED AVERAGE FINAL MATURITIES OVER THE PAST SIX YEARS a/

Sector	Final Maturity (Years) FY71	FY72	FY73	FY74	FY75	FY76
Agriculture	19.08	20.08	20.17	21.67	22.67	21.92
Power	22.67	22.08	21.83	23.83	24.08	22.58
Transportation	23.08	22.25	22.58	22.92	23.08	21.92
Communication	18.33	19.58	22.08	19.58	21.17	19.83
Industry	24.92	15.33	-	14.58	15.67	15.25
DFC	15.17	16.75	16.92	17.08	15.92	16.17
Industrial Imports	19.83	-	19.58	-	23.92	20.17
Education	24.08	20.67	24.75	24.50	21.92	24.08
Water Supply	28.08	24.83	24.08	23.75	23.83	22.83
Population	24.92	-	24.50	24.50	25.00	24.83
Urban Development	24.67	-	24.83	17.75	23.08	22.25
Project Preparation	-	-	-	15.83	-	19.75
Tourism	24.58	23.42	24.50	24.83	26.33	19.67
General Development	-	19.83	-	19.67	-	-
Overall Average	21.67	20.17	21.42	21.42	21.33	20.58

a/ Weighted by amount; rounded to nearest whole month.

Table 8. SECTORAL WEIGHTED AVERAGE GRACE PERIOD OVER THE PAST SIX YEARS a/

Sector	Grace Period (Years)					
	FY71	FY72	FY73	FY74	FY75	FY76
Agriculture	4.25	4.92	5.17	5.42	5.42	5.17
Power	4.83	4.83	4.08	4.83	4.42	4.00
Transportation	4.08	4.17	5.25	4.42	4.17	4.00
Communication	4.58	4.83	4.17	3.75	4.33	3.92
Industry	3.92	3.92	-	4.17	3.75	3.83
DFC	1.67	2.08	1.83	3.00	2.33	2.58
Industrial Imports	4.83	-	4.58	-	6.25	5.17
Education	8.50	6.42	7.83	7.92	6.83	6.33
Water Supply	5.75	4.75	4.25	4.25	3.92	4.58
Population	9.92	-	9.50	4.50	5.00	4.83
Urban Development	4.67	-	4.83	3.42	4.83	4.75
Project Preparation	-	-	-	3.58	-	5.75
Tourism	4.58	4.83	4.50	6.83	7.67	4.67
General Development	-	4.83	-	4.67	-	-
Overall Average	4.33	4.33	4.67	4.75	4.58	4.25

a/ Weighted by amount; rounded to the nearest month.

Impact of Change in Repayment Terms on Low Income Countries

Computation of Change in Debt Service Payments for Various Repayment Schemes

	FY86	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97
Commitments: 0.0% Growth	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Principal Repayments												
- Equal Principal Terms	0.0	0.0	0.0	0.0	0.0	4.3	11.0	17.7	24.3	31.0	37.7	44.3
- Level Annuity Terms	0.0	0.0	0.0	0.0	0.0	2.2	5.7	9.6	13.8	18.4	23.5	29.0
Difference	0.0	0.0	0.0	0.0	0.0	-2.2	-5.3	-8.1	-10.5	-12.6	-14.2	-15.3
Outstanding Balance												
- Equal Principal Terms	100.0	200.0	300.0	400.0	500.0	595.7	684.7	767.0	842.7	911.7	974.0	1029.7
- Level Annuity Terms	100.0	200.0	300.0	400.0	500.0	597.8	692.1	782.6	868.7	950.3	102[illegible].8	1097.8
Difference	0.0	0.0	0.0	0.0	0.0	2.2	7.5	15.6	26.1	38.6	52.8	68.2
Interest Payments Difference.												
- 9.0% p.a.	0.0	0.0	0.0	0.0	0.0	0.1	0.4	1.0	1.9	2.9	4.1	5.4
Debt Service Payments Difference.	0.0	0.0	0.0	0.0	0.0	-2.1	-4.9	-7.0	-8.6	-9.7	-10.1	-9.9

	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY86-FY09
Commitments: 0.0% Growth	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	2400.000
Principal Repayments													
- Equal Principal Terms	51.0	57.7	64.3	71.0	77.7	84.3	91.0	97.7	100.0	100.0	100.0	100.0	1165.000
- Level Annuity Terms	35.0	41.6	48.8	56.6	65.2	74.5	84.7	95.9	100.0	100.0	100.0	100.0	1004.506
Difference	-16.0	-16.1	-15.6	-14.4	-12.5	-9.8	-6.3	-1.8	.0	.0	.0	.0	-160.494
Outstanding Balance													
- Equal Principal Terms	1078.7	1121.0	1156.7	1185.7	1208.0	1223.7	1232.7	1235.0	1235.0	1235.0	1235.0	1235.0	
- Level Annuity Terms	1162.8	1221.2	1272.4	1315.8	1350.6	1376.1	1391.4	1395.5	1395.5	1395.5	1395.5	1395.5	
Difference	84.1	100.2	115.8	130.2	142.6	152.5	158.7	160.5	160.5	160.5	160.5	160.5	
Interest Payments Difference.													
- 9.0% p.a.	[illegible].9	8.3	9.7	11.1	12.3	13.3	14.0	14.4	14.4	14.4	14.4	14.4	163.553
Debt Service Payments Difference.	-9.1	-7.8	-5.8	-3.3	-0.2	3.5	7.7	12.6	14.4	14.4	14.4	14.4	3.059

* Annual interest rate of 0% implies Equal Principal Payments.

Attachment I
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Impact of Change in Repayment Terms on Low Income Countries

Computation of Change in Debt Service Payments for Various Repayment Schemes

	FY86	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY86-FY09
Commitments: 9.0% Growth	100.0	109.0	118.8	129.5	141.2	153.9	167.7	182.8	199.3	217.2	236.7	258.0	281.3	306.6	334.2	364.2	397.0	432.8	471.7	514.2	560.4	610.9	665.9	725.8	7678.981
Principal Repayments																									
- Equal Principal Terms	0.0	0.0	0.0	0.0	0.0	4.3	11.4	19.1	27.5	36.6	46.6	57.4	69.3	82.2	96.2	111.5	128.3	146.5	166.3	187.9	207.2	225.8	246.2	268.3	2138.510
- Level Annuity Terms	0.0	0.0	0.0	0.0	0.0	2.2	5.9	10.3	15.5	21.5	28.5	36.5	45.8	56.5	68.8	82.9	98.9	117.1	137.9	161.4	180.1	196.3	213.9	233.2	1713.130
Difference	0.0	0.0	0.0	0.0	0.0	-2.2	-5.5	-8.8	-12.0	-15.1	-18.1	-20.9	-23.4	-25.6	-27.4	-28.7	-29.4	-29.3	-28.4	-26.5	-27.1	-29.6	-32.2	-35.1	-425.380
Outstanding Balance																									
- Equal Principal Terms	100.0	209.0	327.8	457.3	598.5	748.0	904.3	1068.0	1239.8	1420.4	1610.6	1811.2	2023.2	2247.6	2485.6	2738.3	3007.1	3293.4	3598.8	3925.0	4278.3	4663.3	5083.0	5540.5	
- Level Annuity Terms	100.0	209.0	327.8	457.3	598.5	750.2	912.0	1084.5	1268.3	1464.0	1672.3	1893.8	2129.2	2379.2	2644.6	2926.0	3224.1	3539.8	3873.6	4226.4	4606.7	5021.3	5473.3	5965.9	
Difference	0.0	0.0	0.0	0.0	0.0	2.2	7.7	16.5	28.5	43.6	61.7	82.6	106.0	131.6	159.0	187.7	217.1	246.4	274.8	301.3	328.5	358.0	390.3	425.4	
Interest Payments Difference.																									
- 9.0% p.a.	0.0	0.0	0.0	0.0	0.0	0.1	0.4	1.1	2.0	3.2	4.7	6.5	8.5	10.7	13.1	15.6	18.2	20.9	23.5	25.9	28.3	30.9	33.7	36.7	284.028
Debt Service Payments Difference.	0.0	0.0	0.0	0.0	0.0	-2.1	-5.0	-7.7	-10.0	-11.9	-13.4	-14.4	-14.9	-14.9	-14.3	-13.1	-11.2	-8.5	-5.0	-0.6	1.2	1.3	1.5	1.6	-141.352

* Annual interest rate of 0% implies Equal Principal Payments.

Impact of Change in Repayment Terms for 3 Years on Middle Income Countries

Computation of Change in Debt Service Payments for Various Repayment Schemes

	FY86	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY86-FY09
Commitments: 0.0% Growth	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	2400.000
Principal Repayments																									
- Equal Principal Terms	0.0	0.0	0.0	0.0	5.0	12.7	20.4	28.1	35.8	43.5	51.2	58.8	66.5	74.2	81.9	89.6	97.3	100.0	100.0	100.0	100.0	100.0	100.0	100.0	1365.000
- Level Annuity Terms	0.0	0.0	0.0	0.0	2.8	7.3	12.3	20.0	29.0	38.2	47.6	57.0	66.7	76.5	86.5	96.8	107.3	109.3	106.0	101.7	100.0	100.0	100.0	100.0	1365.000
Difference	0.0	0.0	0.0	0.0	-2.2	-5.4	-8.1	-8.1	-6.7	-5.2	-3.6	-1.8	0.1	2.3	4.6	7.2	9.9	9.3	6.0	1.7	0.0	0.0	0.0	0.0	.000
Outstanding Balance																									
- Equal Principal Terms	100.0	200.0	300.0	400.0	495.0	582.3	661.9	733.8	798.1	854.6	903.5	944.6	978.1	1003.8	1021.9	1032.3	1035.0	1035.0	1035.0	1035.0	1035.0	1035.0	1035.0	1035.0	
- Level Annuity Terms	100.0	200.0	300.0	400.0	497.2	589.9	677.6	757.7	828.7	890.4	942.9	985.9	1019.2	1042.7	1056.1	1059.3	1052.1	1042.8	1036.7	1035.0	1035.0	1035.0	1035.0	1035.0	
Difference	0.0	0.0	0.0	0.0	2.2	7.6	15.7	23.8	30.6	35.8	39.4	41.2	41.1	38.8	34.2	27.0	17.1	7.8	1.7	0.0	0.0	0.0	0.0	0.0	
Interest Payments Difference. - 9.0% p.a.	0.0	0.0	0.0	0.0	0.1	0.4	1.0	1.8	2.4	3.0	3.4	3.6	3.7	3.6	3.3	2.8	2.0	1.1	0.4	0.1	0.0	0.0	0.0	0.0	32.776
Debt Service Payments Difference.	0.0	0.0	0.0	0.0	-2.1	-4.9	-7.0	-6.3	-4.3	-2.3	-0.2	1.8	3.9	5.9	7.9	9.9	11.9	10.4	6.5	1.8	0.0	0.0	0.0	0.0	32.776

* Annual interest rate of 0% implies Equal Principal Payments.

Impact of Change in Repayment Terms for 3 Years on Middle Income Countries

Computation of Change in Debt Service Payments for Various Repayment Schemes

	FY86	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY86-FY09
Commitments: 9.0% Growth	100.0	109.0	118.8	129.5	141.2	153.9	167.7	182.8	199.3	217.2	236.7	258.0	281.3	306.6	334.2	364.2	397.0	432.8	471.7	514.2	560.4	610.9	665.9	725.8	7678.981
Principal Repayments																									
- Equal Principal Terms	0.0	0.0	0.0	0.0	5.0	13.1	22.0	31.7	42.2	53.7	66.3	79.9	94.8	111.0	128.7	148.0	169.0	186.9	203.7	222.0	242.0	263.8	287.6	313.4	2684.985
- Level Annuity Terms	0.0	0.0	0.0	0.0	2.8	7.6	13.2	22.7	34.8	47.9	62.2	77.8	94.8	113.4	133.6	155.6	179.7	197.2	210.7	224.1	242.0	263.8	287.6	313.4	2684.985
Difference	0.0	0.0	0.0	0.0	-2.2	-5.6	-8.8	-9.0	-7.5	-5.8	-4.0	-2.1	.0	2.4	4.9	7.7	10.7	10.3	7.0	2.1	0.0	0.0	0.0	0.0	.000
Outstanding Balance																									
- Equal Principal Terms	100.0	209.0	327.8	457.3	593.5	734.2	879.9	1031.0	1188.0	1351.5	1522.0	1700.1	1886.6	2082.1	2287.6	2503.8	2731.9	2977.8	3245.8	3537.9	3856.3	4203.3	4581.6	4994.0	
- Level Annuity Terms	100.0	209.0	327.8	457.3	595.7	742.0	896.5	1056.6	1221.1	1390.3	1564.9	1745.1	1931.5	2124.7	2325.3	2533.9	2751.3	2986.8	3247.8	3537.9	3856.3	4203.3	4581.6	4994.0	
Difference	0.0	0.0	0.0	0.0	2.2	7.8	16.6	25.6	33.0	38.9	42.9	45.0	45.0	42.6	37.7	30.1	19.4	9.0	2.1	.0	.0	.0	.0	.0	
Interest Payments Difference.																									
- 9.0% p.a.	0.0	0.0	0.0	0.0	0.1	0.5	1.1	1.9	2.6	3.2	3.7	4.0	4.0	3.9	3.6	3.1	2.2	1.3	0.5	0.1	.0	.0	.0	.0	35.814
Debt Service Payments Difference.	0.0	0.0	0.0	0.0	-2.1	-5.1	-7.7	-7.1	-4.8	-2.6	-0.4	1.9	4.1	6.3	8.5	10.7	12.9	11.6	7.5	2.1	.0	.0	.0	.0	35.814

* Annual interest rate of 0% implies Equal Principal Payments.

10% EXPOSURE
GUIDELINES

International Bank for Reconstruction and Development

FOR OFFICIAL USE ONLY

SecM85-850

FROM: Vice President and Secretary

July 17, 1985

10% EXPOSURE GUIDELINE

The attached paper on "10% Exposure Guideline" has been prepared at the request of the Executive Directors made at the meeting of June 28, 1985.

This paper will constitute a background document for the paper entitled "Resource Implications of the Bank's Future Role (R85-193)" which will be considered at the meeting of the Executive Directors to be held on July 23, 1985.

Questions on this document may be referred to Mr. Asanuma (ext. 75456).

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

RESOURCE IMPLICATIONS OF THE BANK'S FUTURE ROLE

Supplementary Material on the 10% Exposure Guideline

Introduction

1. The purpose of this note is to explore the implications of the Bank's current practice of limiting exposure in any single borrowing country to 10% of total outstanding loans. As noted in the memorandum on "Resource Implications of the Bank's Future Role" (R85-193, dated June 14, 1985) the current guideline is constraining IBRD lending to two of its largest borrowers (Brazil and India). In forming a judgment about the prospects for IBRD lending over the next few years it is appropriate to re-examine the rationale for this guideline and to consider carefully the consequences of any change in the guideline.

2. Accordingly, this note briefly reviews the manner in which the 10% guideline is presently applied, describes the impact of a change in the guideline on prospective IBRD lending, and then explores the financial and equity aspects of such a change.

3. Based on this review Management recommends that the current guideline remain in force for the time being, pending further clarification of the Bank's resource prospects (both in relation to the GCI and to IDA 8). The matter should be reconsidered in about one year's time.

Present Application of the 10% Guideline

4. The 10% guideline is taken into account when formulating the Bank's multi-year lending plans and assistance strategy for individual borrowers. Based on the level of commitments envisaged, and the disbursement profiles applicable to on-going operations as well as to the types of future operations planned, a projection of disbursed and outstanding loan amounts for future years is prepared. This projection for the individual borrower is then compared with the projection for the IBRD as a whole. If the comparison shows that the borrower's share is expected to exceed 10%, then the guideline comes into play as a constraint on lending plans. Thus the guideline can be a constraint even though a borrower's current share of the IBRD portfolio is well below 10%.

5. This is the case, for example, with India at present. Its share of the IBRD portfolio is currently less than 5%, but it has been rising rapidly due to the surge in IBRD lending which has taken place in recent years. (Part of the explanation for the surge has been the lack of IDA resources.) If the current level of IBRD commitments (about $1.6 billion per annum) is maintained in future years, India's share of total disbursed loans would reach the 10% level at the beginning of the 1990s. While it would be possible in theory to increase commitments beyond the current level for a year or two--and then to cut back sharply on commitments in subsequent years--this is unlikely to be desirable for either the borrower or the Bank. Moreover, it would not alter the fact that the 10% guideline is constraining the average level of commitments over the next few years.

6. The guideline is applied flexibly. This flexibility has two aspects. First, given the inevitable uncertainty that surrounds the projection of disbursements (both for the individual borrower and for the IBRD as a whole), the emphasis in applying the guideline is put on major trends; minor (especially temporary) excesses above 10%--say, in the range of 10% to 10.5%--are not a cause for concern. Secondly, if the borrower's circumstances call for a drawing forward of disbursements, this is also grounds for accepting a portfolio share that exceeds 10% for the period during which that drawing forward of disbursements is in effect.

7. This is the situation in Brazil, which was one of the principal beneficiaries of the Special Action Program. It was recognized at the time the Special Action Program was approved that this drawing forward of disbursements would in due course have to be reversed. Meanwhile, the flexible interpretation of the guideline means that shares in excess of 10% are permissible. Indeed Brazil's current share (as of June 30, 1985) is equal to 10.3% and may increase to 11% or 11.5% before dropping back to the 10% level.

<u>Effects of a Change in the Guideline</u>

8. In the earlier discussion of the guideline there was broad support among the Directors for continued flexibility in its application. What remains a question is whether the 10% figure itself ought to be modified.

9. As noted in the Resource Implications paper the main effect of a change in the 10% guideline would be to permit higher levels of IBRD lending to India and Brazil in the near-term and perhaps higher lending to China in later years. An increase in the permitted portfolio share by one percentage point (e.g., from 10% to 11%) would permit IBRD lending to India and Brazil together to increase by about $600 to $800 million in each of the next few years, or about $2 billion in the FY86-FY88 period. Given the high absorbtive capacity of these two countries, most of this potential for increased lending could be translated quite quickly into actual lending operations.

10. This potential increment in lending may be put in perspective by comparing it with the increase projected for FY86-FY88 for the IBRD as a whole; namely, $5.5 billion to $10.5 billion (corresponding to $40 to $45 billion vs. $34.5 billion in FY83-FY85). This projected increase in overall IBRD lending assumes, of course, that pending resource issues will be successfully resolved so that lending in FY87 and FY88 can proceed at levels above the current sustainable level of lending. Were that not to be the case, then the increment in lending to India and Brazil made possible through a change in the current guideline could only be realized at the expense of lending to other borrowers.

11. The desirability of a change in the guideline can thus not be decided without considering the implications for other borrowers, including in particular the consequences which such a change might have for the IBRD's financial standing and for the equitable distribution of lending among borrowers.

Financial and Equity Considerations

12. The present 10% guideline was developed on the basis of a broad judgment which took account of both financial and equity considerations. On the financial side the 10% limit is but one element of an overall package of financial policy and financial management practices that is designed to assure the highest credit standing for the IBRD.

13. On its own, the 10% guideline is not a critical element in the market's evaluation of the IBRD's credit standing. In fact, the existence of such a guideline is not alluded to in our financial prospectus, nor has it figured in our presentations to the investment community. As long as a change in the guideline is not made into a major issue and, more particularly, does not come to be seen as a relaxation of the Bank's risk management practices that is being pursued in order to boost lending prospects, then a moderate change--say, from 10% to 12% or 12.5%--should have no adverse consequences for the Bank's standing in the markets.

14. While diversification of risk is important for all financial institutions--including the IBRD--the application of that principle needs to take account of the nature of the clientele being served. Commercial banks operate in markets with thousands of potential customers; the IBRD and the other multilateral development banks lend to less than 100 sovereign borrowers--borrowers who also happen to be shareholders in the multilateral banks themselves. A relatively concentrated IBRD portfolio is therefore to be expected by shareholders and debt-holder alike. This phenomenon is even more pronounced for the regional MDBs than for the IBRD because of their more limited groups of borrowers. In the last decade the shares of the Inter-American Development Bank and the Asian Development Bank portfolios in their single largest borrowers have been in the range of 25% to 30%.

15. In judging the adequacy of any particular portfolio concentration limit, account needs to be taken of the structure of the balance sheet, the net income position and the nature of the risks that are to be guarded against. On all of these grounds, the current 10% guideline appears to be conservative. Based on the IBRD's current balance sheet, 10% of loans outstanding is equal to about 40% of primary equity (defined as the sum of paid-in capital plus reserves). Reported concentrations of the major money center banks in Brazil and Mexico typically exceed 50% of their equity. The IBRD's ratio may be expected to increase somewhat in the years ahead, since loans outstanding are projected to grow more rapidly than primary equity. Even so, the IBRD position will remain conservative when account is taken of the existence of callable capital and the co-operative nature of the institution.

16. The adequacy of IBRD income and reserves in relation to debt-servicing risks is considered in the memorandum on "Review of IBRD Net Income Risks and Targets" (R85-220 dated June 28,1985). The reserves target and the portfolio diversification guideline have, as that memorandum notes, "converged into a broad one-to-one relationship between the maximum amount of loans outstanding to any single borrower and the Bank's

reserves. While this one-to-one relationship has obvious appeal insofar as it links the risk...directly to the Bank's risk-bearing capacity..., the particular risk in question is too remote to provide a very compelling anchor for the Bank's financial policy in this area."

17. Moreover, the management of risk in the Bank's loan portfolio must take account of the distribution of amounts outstanding to borrowers with differing degrees of present and prospective debt-servicing difficulties. A greater concentration of amounts outstanding in highly creditworthy countries could result in a more attractive overall risk profile for the loan portfolio.

18. The risk which the 10% guideline is intended to guard against; namely, a repudiation of debt leading to immediate and full write-off of outstanding loan amounts, is much less of a concern than the risk associated with protracted arrears (non-accrual; eventual specific reserves) and the risk of an erosion of the Bank's position as a preferred creditor. Thus, taking a broad view of the management of portfolio risks, one should not see the 10% limit as being the only--or even the most important--safeguard against excessive risk.

19. In turn, the level of risk that is acceptable will be affected by other elements in the IBRD's financial position. The trends in net income and reserve accumulation are obviously relevant in this connection. The posture recommended in the memorandum on "Review of IBRD Net Income Risks and Targets" would, if accepted, stabilize key financial ratios and possibly even lead to some slight improvement in the reserve ratio over the next few years. Successful resolution of the resource issues facing the IBRD, particularly one that involves a substantial increase in capital, would also enhance the IBRD's capacity to take on additional risk.

20. In sum, the financial aspects of a change in the 10% guideline are manageable. Adverse market reaction should be avoidable if the change is not seen as "reaching" for loan volume. The nature of the risk which the guideline guards against is such that a modest liberalization (say, to 12% or 12.5%) would not imply a big increase in overall portfolio risk, particularly when account is taken of other types of debt-servicing risks facing the IBRD.

21. The net increase in portfolio risk needs to be considered in relation to the enhancement of the IBRD's capacity to provide development assistance and this, in turn, leads into the question of how a change in guideline could affect the equitable distribution of the Bank's lending activity.

22. As an international institution, the Bank must be sensitive to the need to avoid an undue concentration of financial and staff resources in only one or a few of its members. At the same time, it cannot ignore the diversity in size, external financial needs, and per capita income of its members. India and China, in particular, with populations of 700 million and 1,000 million respectively, and relatively low per capita incomes, are cases whose unique attributes must be recognized.

23. A judgment on the appropriate distribution of Bank Group resources should also take account of the external financing likely to be available from other sources. In the case of Brazil, this means taking account of the posture of commercial banks and private investors as well as other official sources of capital. In the case of India -and in the future perhaps China- official sources are relatively more important, notably IDA itself.

24. Given the uncertainties about the availability of IDA resources in future years, and about the way in which these resources are likely to be distributed among borrowers, it is very difficult to form a judgment now about the scale of resources which the Bank Group (IBRD and IDA especially) will be in a position to commit in the blend countries. That difficulty is further compounded by the uncertainties about the IBRD's own future resource position.

Management Recommendation

25. In light of these uncertainties, Management believes the most desirable course of action is to retain the current 10% guideline--flexibly applied--for the time being, but to agree to revisit the issue just as soon as the resource prospects for IDA and the IBRD are clarified. Deferral of action until the IDA and IBRD resource issues are clarified will permit the decision to be more firmly grounded, since the financial prospects for the IBRD should be clearer--permitting a more confident assessment of its risk-bearing capacity--and the likely distribution of overall Bank Group resources should be more readily and more accurately assessed.

FPBVP
7/17/85

KEY DATES IN PAST
CAPITAL INCREASES

SecM85-868

FROM: Vice President and Secretary

July 19, 1985

KEY DATES IN PAST CAPITAL INCREASES

The attached paper on "Key Dates in Past Capital Increases" has been prepared at the request of the Executive Directors made at the meeting of June 28, 1985.

This paper will constitute a background document for the paper entitled "Resource Implications of the Bank's Future Role (R85-193)" which will be considered at the meeting of the Executive Directors to be held on July 23, 1985.

Questions on this document may be referred to Mrs. Artus (ext. 74743).

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

RESOURCE IMPLICATIONS OF THE BANK'S FUTURE ROLE

Key Dates in Past Capital Increases

During the discussion of the Resource Implications of the Bank's Future Role on June 28, 1985, the Executive Directors requested information on the procedural time lag associated with past capital increases. In response to that request, the records of major capital increases approved in the past were examined. The results, as summarized below, are that the period between the commencement of negotiations on a capital increase and the first subscription under the new capital increase resolution ranged from one year to three years.

Key Dates in Past Capital Increases

	1959 GCI (Res. No. 128)	1976 SCI (Res. Nos. 314 & 315)	1979 GCI (Res. No. 346)	1984 SCI (Res. No. 395)
Commencement of negotiation	Nov 1958	Jul 1975	Dec 1977	Aug 1983
Board agreement	12/22/58	05/04/76	06/28/79	05/24/84
Approval by the Board of Governors a/	09/01/59	05/13/77 b/	01/04/80	08/30/84
First date on which subscription may be accepted	Sep 1959	05/13/77	10/01/80	10/01/84
First subscription	Sep 1959	Sep 1977	Dec 1981	Dec 1984
Period between commencement of negotiation and first subscription (months)	11	27	37	17

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a/ Date on which the resolution of the Board of Governors came into effect.

b/ Res. No. 315, which authorized an increase in the authorized capital stock. The resolution authorizing the allocation (Res. No. 314) was adopted on February 9, 1977.

FPAPP
7/16/85

GROWTH RATES IN
IBRD LENDING

International Bank for Reconstruction and Development

FOR OFFICIAL USE ONLY

SecM85-876

FROM: Vice President and Secretary

July 19, 1985

GROWTH RATES IN IBRD LENDING

The attached paper on "Growth Rates in IBRD Lending" has been prepared at the request of the Executive Directors made at the meeting of June 28, 1985.

This paper will constitute a background document for the paper entitled "Resource Implications of the Bank's Future Role (R85-193)" which will be considered at the meeting of the Executive Directors to be held on July 23, 1985.

Questions on this document may be referred to Mr. Asanuma (ext. 75456).

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

RESOURCE IMPLICATIONS OF THE BANK'S FUTURE ROLE

Supplementary Information on Growth Rates in IBRD Lending

Introduction

1. The purpose of this note is to respond to the requests from several Executive Directors to put the nominal growth rate for IBRD lending into a broader and somewhat longer-term perspective. In particular, this note:

- describes the adjustments which are made to the nominal IBRD commitment figures in order to allow for changes in the purchasing power of the amounts committed;
- relates the growth in nominal IBRD commitments to the growth in domestic investment in borrowing countries;
- extends the projected growth rate in IBRD lending through FY90 and compares this growth rate with what has been realized over the past decade.

The material presented in this note is technical in nature. No policy recommendations are made.

Adjustments for Changes in Purchasing Power

2. In the decade between FY75 and FY85 the IBRD lending program grew at an average rate of about 10% per annum, rising from $4.3 billion at the beginning of the period to $11.4 billion in FY85. (Year-by-year figures are shown in Attachment 1, page 1). Growth of commitments was positive (in nominal terms) throughout the period, with the notable exception of the decline of about 5% which occurred between FY84 and FY85. If this decline is excluded, nominal growth in lending averaged just under 12% per annum during the decade. This growth rate is in line with what was assumed in the planning for the last General Capital Increase.

3. The 12% planning figure was assumed--at that time--to represent a real growth rate of between 5% and 7%. Our current estimate is that real growth over the period actually amounted to just over 6%, with growth being more rapid in the first half of the period (FY75-FY80) than in the latter half.

4. The adjustments made to nominal IBRD commitment figures to take account of changes in purchasing power are rather complex in their details, but the broad concepts are fairly straightforward. In essence, there are two adjustments: one takes into account the changes in the prices which developing countries pay for imports, and the other takes into account the fact that IBRD commitments are disbursed over a period of several years.

5. The first adjustment uses indices of export prices for manufactured goods exported from OECD countries to developing countries. The indices for export prices do not always show exactly the same year-to-year pattern as broader price indices (e.g. GDP deflators) but the

differences tend to be small. More significant differences arise when the indices for exports from countries other than the United States are converted into U.S. dollars. Suppose, for example, that German export prices have increased by 3% in terms of Deutsche Mark. If the Deutsche Mark has appreciated vis-a-vis the U.S. dollar by 10%, then German export prices have increased by 13% in terms of U.S. dollars. Similarly, if the Deutsche Mark has depreciated by 10%, then German export prices will have actually declined by 7% in terms of U.S. dollars.

6. Because of the major shifts which have occurred in exchange rates over the last 10 years, the index of average export prices has been much affected by this factor. In the last half of the 1970s--when the dollar depreciated vis-a-vis other major OECD countries--the index of export prices rose more rapidly than would have been the case with constant exchange rates. Similarly, in the period since 1980--when the dollar has appreciated vis-a-vis these same currencies--the index rose much more slowly and was indeed negative in several of the years.

7. The Table below presents the growth rates in IBRD commitments for various periods. The first line shows the growth unadjusted for changes in purchasing power. The second line shows the adjustment just described--namely: allowing for changes in the unit price of exports of manufactures to developing countries. The low real growth in the FY75-FY80 period reflects the fact that export prices of manufactures were rising rapidly in terms of U.S. dollars during this period. The much more rapid real growth since FY80--especially in the years FY80-FY84--reflects the opposite phenomenon.

Table 1. Growth Rates in IBRD Lending, FY75-FY85*
(average annual growth: percent per annum)

	FY75-FY80	FY80-FY84	FY84-FY85	FY75-FY85
Nominal Growth	12.1	11.8	-4.9	10.2
Real Growth				
-adjusted for export prices	1.9	14.3	-5.9	5.9
-adjusted for export prices and disbursement lag	9.2	6.7	-8.4	6.3

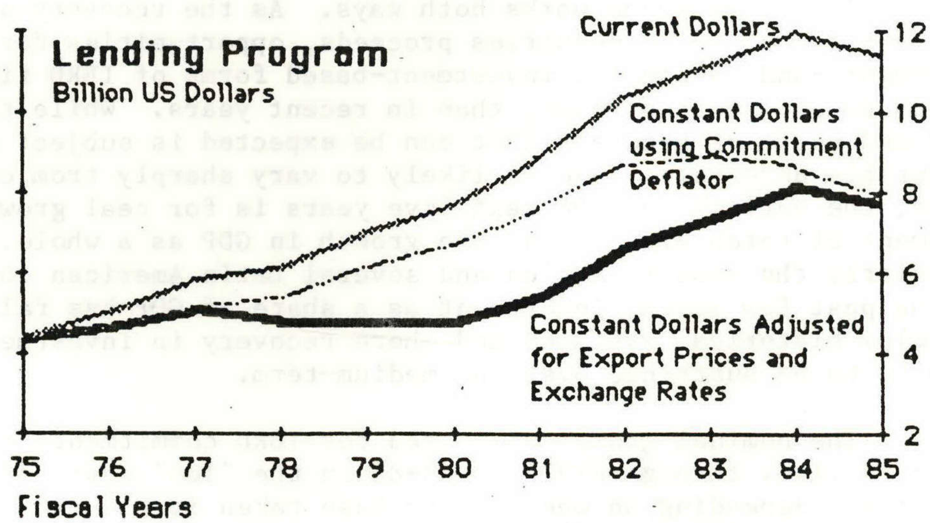
* For annual figures, see Attachment 1, page 2.

8. The third line in the table incorporates the second adjustment: namely, allowance for the lag between commitments and disbursements. The purchasing power of an IBRD commitment will be affected by price changes that occur between the time a loan is committed and the time the loan funds

are actually spent. In comparing the purchasing power of commitments made at different dates, the Bank's so-called "commitment deflator" allows for this lag by taking a weighted average of the export price changes expected in future years.

9. The impact of this adjustment is to make the real value of commitments in a given year mainly dependent on price changes occurring during years 2 through 6 (when the bulk of disbursements occur). In terms of the figures shown in Table 1 real growth in the period up to FY80 is only about 3% lower than the nominal growth rate, because the commitment deflator for these years gives main weight to what happened to export prices in the FY80-FY85 period (a period of low inflation in terms of U.S. dollars). By contrast, real growth after FY80 is substantially less than the nominal growth rate because of the increased weight given to the higher inflation assumed to occur after FY85. This pattern is easier to observe if the growth is presented in a graph (as in Figure 1 below).

Figure 1
IBRD Lending in Perspective



Relationship of IBRD Lending to Domestic Investment

10. Gross domestic investment in Bank borrowers roughly doubled (in U.S. dollar terms) between 1975 and 1981. Between 1981 and 1984 it fell by an estimated 20%, from $514 billion to $415 billion. (Details by year are shown in Attachment 1, page 3). The increase in the 1975-81 period was widely distributed, with the increase by region varying from +92% in EMENA to +111% in Latin America. In contrast, the experience since 1981 has been much more varied. For the 1981-84 period domestic investment in Asia has

registered a small increase (+6%), whereas there has been a moderate decline in EMENA (-13%) and sharp declines in Africa (-43%) and Latin America (-44%).

11. These trends in domestic investment are broadly similar to the trends in IBRD lending over the past decade. IBRD lending also doubled between FY75 and FY81. Financing of investment (both discrete investments and sector operations) has been flat since FY81, especially if the growth in IBRD lending to India and China--which reflected special circumstances--is considered separately. As the Resource Implications paper notes (R85-193, dated June 14, 1985), there was no growth in IBRD lending to Africa between FY80-82 and FY83-85, and growth in lending to Latin America (+5% per annum) was wholly accounted for by Brazil.

12. This similarity in growth pattern needs to be interpreted cautiously. The scale of IBRD lending is affected by a number of other factors as well. Nevertheless, the broad parallelism in trends does underscore the point made in recent discussions of IBRD lending prospects: namely, that the scale of lending can no longer be expected to remain unaffected in the event of major changes in circumstances in borrowing countries, including sharp changes in the levels of domestic investment.

Projected IBRD Lending Growth

13. This dependence works both ways. As the recovery of domestic investment in borrowing countries proceeds, opportunities for IBRD involvement--and demand for investment-based forms of IBRD finance--may be expected to grow more strongly than in recent years. While the precise timing and scale of recovery that can be expected is subject to considerable uncertainty and is likely to vary sharply from country to country, the outlook for the next five years is for real growth in domestic investment at rates higher than the growth in GDP as a whole. This is particularly the case in Africa and several Latin American countries where, over the past few years, investment as a share of GDP has fallen to levels well below historical averages and where recovery in investment is vital if growth is to be sustained over the medium-term.

14. The nominal growth projected for IBRD commitments over the next five years (i.e. through FY90) is 6%-8% in the "low" case and 9%-12% in the "high" case. depending on whether the base taken is the FY83-85 period or the single year FY85. To convert these nominal growth rates into real growth rates it is necessary to make assumptions about future price and exchange rate movements.

15. The internal guidelines issued to Bank staff on these points assume that national inflation rates will remain moderate over the next few years--with GNP deflators in the range of 2.5% to 5% for the major industrial countries for most years. Dollar-denominated prices of manufactured exports are assumed to increase more slowly than the GDP deflators through 1990, owing to continued and intensifying external competitive pressures. However, because a gradual depreciation of the U.S. dollar vis-a-vis other major currencies is also assumed, the index of export prices of manufactures (measured in terms of U.S. dollars) rises at 7.5% to 8% per annum in the 1986-1990 period.

16. As a result, the real growth in IBRD commitments projected through FY90 in the "high" case amounts to 4%-5.5%, again depending upon the base period used. In the "low" case the corresponding figures are 0.5%-1.5%. In comparing these real growth estimates with what was achieved over the past decade (i.e. real growth of about 6%), it may be noted that "high" case lending to all countries other than Brazil and India (where growth in lending is currently constrained by the 10% exposure guideline) is projected to grow by about 7% in real terms (from the FY83-85 base).

17. The conclusion suggested by these estimates is that the growth rate projected for aggregate IBRD lending through FY90—even in the "high" case--is not more ambitious when viewed in real terms or in terms of its relationship to domestic investment than was the growth achieved over the past decade.

FPBVP - 7/19/85

Nominal Growth in IBRD Lending - FY75-FY85

	Nominal Commitments ($m)	Index (FY75 = 100)	Annual Growth (%)
FY75	4,320	100.1	
FY76	4,977	115.2	+15.2
FY77	5,759	132.6	+15.7
FY78	6,098	141.2	+5.9
FY79	6,989	161.8	+14.6
FY80	7,644	176.9	+9.3
FY81	8,809	203.9	+15.2
FY82	10,330	239.1	+17.3
FY83	11,136	257.8	+7.8
FY84	11,949	276.6	+7.3
FY85	11,358	262.9	-4.9

FPBVP - 7/19/85

REAL GROWTH IN IBRD LENDING, FY75-85
(Units as indicated)

	Index of Export Prices of Manufactures 1/ (FY75 = 100)	IBRD Commitment Deflator 2/ (FY75 = 100)	Real IBRD Commitments (Million 1975 U.S. $)	
			Adj. for Export Price	Adj. for Disb. Lag
FY75	100.0	100.0	4320	4320
FY76	107.3	107.0	4638	4651
FY77	112.8	112.2	5105	5133
FY78	128.0	114.2	4764	5340
FY79	146.4	114.2	4774	6120
FY80	160.9	114.2	4751	6694
FY81	163.1	115.4	5401	7633
FY82	157.4	119.0	6593	8681
FY83	152.7	125.0	7293	8909
FY84	147.3	133.3	8111	8662
FY85	148.8	143.1	7633	7937

1/ Index of U.S. dollar unit values of industrial market economies' manufactured exports to developing countries (MUV).
2/ A lagged version of the MUV. For a fuller description, see T.T. Thahane to Executive Directors and Alternates, "Technical Note on the Use of Price Deflators in the World Bank's Work", June 30, 1980.

Planning and Budgeting Department
July 19, 1985

GROSS DOMESTIC INVESTMENT IN BANK BORROWERS, 1975-84
(Billion U.S. dollars at current prices and exchange rates)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Africa	16.7	20.7	25.2	26.3	27.1	35.1	35.3	30.2	24.9	20.1
EMENA	53.2	61.5	74.2	84.3	95.8	102.4	106.1	104.3	93.2	89.3
L A C	84.2	90.3	95.0	111.9	134.6	177.8	184.5	135.4	93.3	100.0
Asia	94.1	97.5	109.0	147.1	175.2	194.3	187.6	191.7	204.2	205.2
Total	248.3	270.1	303.3	369.7	432.8	509.5	513.5	461.6	415.6	414.6

Note: Totals may not add due to rounding; coverage is for current borrowers only.
Source: GDI from data base for Statistical Annex, Table 1, 1985 World Bank Annual Report; data for 1984 preliminary.

nning and Budgeting Department
y 19, 1985

BOARD MEETING
June 28, 1985

Record Removal Notice

File Title	Barcode No.
Future Role of the Bank - Board Meetings - 1984-1985	1660618

Document Date	Document Type
08/28/1985	Board Record

Correspondents / Participants
To: Executive Directors and Alternates
From: Vice President and Secretary

Subject / Title
Summary of Discussion at the Meeting of the Executive Directors of the Bank - June 28, 1985 *

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

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Salma Berrada El Azizi	June 27, 2025

LENDING AND DROPPED OPERATIONS

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International Bank for Reconstruction and Development

FOR EXECUTIVE DIRECTORS' MEETING

FOR OFFICIAL USE ONLY

For consideration on July 9, 1985

R85-211

FROM: Vice President and Secretary

June 25, 1985

IBRD LENDING IN FY86 AND DROPPED OPERATIONS FY80-85

Attached is a paper entitled "IBRD Lending in FY86 and Dropped Operations FY80-85", which supplements the FY86 budget document (R85-197[IDA/R85-90; IFC/R85-75]) and the paper on "Resource Implications of the Bank's Future Role" (R85-193) regarding IBRD lending prospects for FY86.

Questions on this paper may be addressed to Mr. Adler (ext. 75346).

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

IBRD LENDING IN FY86 AND DROPPED OPERATIONS FY80-85

1. This note supplements the material in the FY86 budget document (R85-197(IDA/R85/90); IFC/R85/75) and in the paper on Resource Implications of the Bank's Future Role (R85/193) regarding IBRD lending prospects for FY86. It deals with two aspects on which questions were raised in earlier discussions: (a) the strength of the FY86 pipeline and (b) the nature of operations dropped from the pipeline in FY85 and prior years. The focus of the pipeline discussion is on the Bank's lending program, since the lending prospects for IDA remain constrained only by availability of funds. All available IDA funds were committed in FY85 and demand for FY86 easily exceeds the resources available plus, for Africa, funds available through the Special Facility.

A. FY86 Bank Pipeline

2. The lending program for FY86 is projected to be in the range of $12-13.5 billion, with a best current estimate of $12.5 billion. This would represent a 10% increase over the FY85 lending level. The upper end of the range of the FY86 lending program would mean an increase in lending of almost 19%. As noted in the paper on "Resource Implications of the Bank's Future Role", lending to many borrowers is expected to increase more rapidly than the growth in the total lending program, since lending to major borrowers will grow at a lower rate and little or no increases are foreseen in a few other borrowers.

3. Two basic factors will determine the outcome of the FY86 lending program---the capacity of the Bank to process the program as reflected in the pipeline indicators, and the economic conditions in borrowing countries, reflecting both changes in the global economy and domestic developments.

4. The two most important measures of the strength of the pipeline are the proportion of operations appraised at the beginning of the fiscal year and the extent of the standby program. Both are functions of budgetary resources allocated to lending in previous years. By June 30, 1985, we expect that operations totalling 100% of the FY86 base lending program, i.e., exclusive of the standby program, will have been appraised. This compares to about 60% at the corresponding stage for FY85 and an average of 75% during FY83-84. The standby program consists of those operations under preparation which are likely to be ready for FY87 but which may be ready sooner and could substitute for projects in the FY86 base program in case of unforeseen delays or other changes. The standby program for FY86 is also quite robust, providing a margin of close to 50% over the base program, compared to a margin of 30% in FY83-84 and only 20% in FY85. In view of the greater uncertainties affecting investment programs in borrowing countries, this increased margin is essential to

increase the certainty of delivering the planned lending program. We expect that almost all of the standby program for FY86 will have been appraised by September 30. Thus, on both counts—proportion of operations appraised at the beginning of the fiscal year and the extent of the standby program— the FY86 pipeline is substantially stronger than was the case a year ago and compares favorably with respect to FY83-84.

5. This enhanced position means that the pipeline should not be a constraint on IBRD lending during FY86. Nonetheless, the outcome of the FY86 Bank lending program cannot be predicted with certainty since the utility of the pipeline will depend on developments in the world economy, the pace at which the borrowing countries are able to put in place policies and investment programs which are conducive to efficient resource use and growth in the longer term, and the extent to which investments, public and private, will begin to expand in the next 12 months.

6. Based on a detailed review of the FY86 lending outlook for the major geographic areas, there are important areas of uncertainty of which the principal ones are discussed briefly below.

7. <u>Latin America</u>. Three countries---Argentina, Chile, and Ecuador---account for most of the anticipated increase in lending to Latin America in FY86 over the 1983-1985 levels. But this lending program includes substantial support for programs of structural change which are not yet fully defined in these countries and the program could suffer a significant shortfall if unanticipated delays in the formulation and implementation of programs develop during the year. In addition, almost 40% of lending in LAC is accounted for by Brazil. Both its stabilization and adjustment efforts are under review by the Government and, while we believe that this will not adversely affect either the timing or the priority attached to the investment proposals now under consideration, the possibility exists that it may.

8. <u>Asia</u>. At present we foresee no major uncertainties in the planned lending program for Asia. Substantial increases in lending over the average FY83-85 levels are foreseen for China, Pakistan, and Malaysia, and most operations constituting these programs are well advanced in their processing. A substantial program is again foreseen for Indonesia but the continued slow pace of project implementation, and the consequent growing undisbursed balance on approved operations, may act as a drag on the Indonesia program. Of course, several countries in Asia---e.g., Korea, Malaysia, Thailand---have relatively good access to private capital markets and their demands on the Bank may vary if they find that alternative financing is available even in areas where Bank lending would be desirable for its institutional/policy contributions.

9. EMENA. The lending prospects for most countries in EMENA are seen as reasonably firm. However, it has continued to be difficult to implement the agreed lending program in Portugal and these problems, essentially involving the political decision-making processes, could also affect the FY86 program. The Yugoslav lending program also remains uncertain because of the complex decision-making processes in the country and extensive implementation problems with ongoing operations. The lending program in Egypt remains below what might be feasible due to major unresolved sector and project issues relating to prices and availability of counterpart funds, as well as continued concern by the Government with the appropriate level of borrowing on Bank terms.

10. Africa. IBRD lending to Sub-Saharan Africa is planned to grow considerably in FY86, but the achievement of this program will depend on the resolution of many difficult issues of economic management in Nigeria, the effective implementation of the structural adjustment program in the Ivory Coast, where a third SAL is under preparation, and continued progress in strengthening the still fragile project pipeline in Zimbabwe.

11. Since the details of individual lending operations are still subject to change, and since the program under preparation exceeds the program likely to be delivered by almost 50%, it is not possible at this stage to be precise about the sectoral composition or the distribution of the program by type of lending instrument. Both are expected to be within the ranges indicated in the FY86 Budget document.

B. Operations Dropped From The Lending Program

12. In the course of the February 8-9, 1985 Board discussions on the Prospects for IBRD lending (R/85-4 January 8, 1985), several Executive Directors requested more detailed information on the number of operations dropped from the lending program in recent years and the reasons for such droppage. The extent of droppage and the causes for dropped operations are, of course, also relevant in assessing the robustness of the pipeline. The dropping of projects from the pipeline is a routine procedure, necessary to provide the borrowers and the Bank necessary flexibility. What has been exceptional in recent years is not that projects have been dropped, but the rising number of dropped projects. To put the droppage of projects in context this section begins with a description of the programming of operations, before turning to a discussion of experience in recent years.

Programming of Lending Operations

13. The Bank's lending program evolves from its country assistance planning which is at the heart of the Bank's relationship with its developing member countries. The main features of that process involve

(a) a systematic review of the country economic and financial situation; (b) an assessment of progress made, lessons learned and the effectiveness of Bank assistance; and (c) the formulation of a future assistance strategy.1/ The country assistance planning process is typically repeated at intervals of one to three years. On the basis of this analysis, the Bank, jointly with the borrower, develops an operations-specific lending program.

14. In addition, as part of the preparation of the annual budget, there is a Bank-wide review in which all the country lending programs proposed by the Regions are centrally examined for consistency both with the Bank-wide planning assumptions on IBRD and IDA lending resources and with overall Bank policy objectives. As a result of this process, there is, at any one time, an operations specific lending program for the next five years. The program for the first 2-3 years, for which most operations are already under preparation, is relatively firm, while that for the outer years is inherently more tentative.

15. As discussed more fully below, planning a five-year lending program is subject to many uncertainties. Some operations turn out not to be viable after some preparation has been undertaken, for technical, financial, economic, or institutional reasons; the priority of others may change with changes in a country's economic situation. Droppage of such operations is necessary and desirable to provide Governments and the Bank with sufficient flexibility, and assure the high standards expected in Bank-supported projects. For yet other operations, preparation may be delayed for administrative, technical or financial reasons so that their consideration will be postponed. In order to allow for these uncertainties, the Regions identify certain "standby" operations. These operations are in the regular lending program but have the potential to be advanced if preparation proceeds more rapidly than anticipated. They are moved up either to increase the lending program to a country where this is appropriate, or to substitute for operations which are delayed or dropped. In recent years, about one-third of the operations in any one year were in the standby program; for FY86 this ratio has been raised to 50%.2/ To provide additional insurance against the dropping of operations, the Regions also have a list of "reserve" operations on which initial preparation is undertaken, but which are not appraised unless they are moved into the regular lending program. If the lending program to a country proceeds exactly as planned, the reserve operations would be included in the next planning cycle. The number of such operations is limited at any one time

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1/ A more detailed description of country assistance planning is given in Operational Manual Statement No. 1.12.

2/ See paragraph 4.

to minimize the use of staff resources on operations less likely to lead to Bank lending in the next 2-3 years.

<u>The Number of Dropped Operations</u>

16. Every operation included in the 5-year lending and reserve program is given a code, against which staff time spent is recorded. When an operation is dropped, this is indicated by a notation to the code, and no further staff time is registered against the operation. Dropping an operation signifies either that the operation has been entirely eliminated or that its concept or scope has changed significantly and it is, therefore, given a new code.3/ The data on dropped operations cover those which were dropped entirely and those which were significantly changed and, therefore, given a new code.

17. The system for recording operations in the pipeline, and for identifying those dropped, was reviewed in 1984. As a result of the review, new guidelines were formulated to ensure that operations are reported as dropped in the fiscal year when this decision is made and after which no further work is done on these operations; previously, they had been recorded as dropped in the fiscal year in which they were scheduled for Board approval. The new methodology does not change the total <u>number</u> of dropped operations but the <u>timing</u> of reporting. The memorandum on Prospects for IBRD Lending (R/85-4), using the old methodology, indicated that 1,063 operations (651 IBRD and 412 IDA) were dropped from the pipeline in CY84. The data presented here (a) distributes these operations over FY1980-1984 as if the new methodology had been applicable in those years; (b) includes operations previously recorded as dropped in those years to be consistent with the new methodology; and (c) excludes operations for which less than four hours of staff time had been recorded---the latter account for more than half of the operations dropped.4/ Based on these criteria, a total of 1,186 operations were recorded as dropped between FY80-84.

3/ From the point of view of the borrower, with whom the ideas for operations have been jointly developed, the original operation is merely being redefined, not dropped.

4/ This is a very low cut-off point. If the cut-off were set at one staffweek, the number of projects dropped would be 917 instead of 1186 but the cumulative staffyears spent on dropped projects would be virtually unchanged. See Table 1.

18. Bank-wide Situation. The total number of dropped operations increased from 183 in FY80 to 242 in FY83, and to 315 in FY84 (Table 1). The number of IBRD operations dropped almost doubled during the period. The number of IDA operations dropped increased only modestly; it was particularly high in FY82 when IDA commitment authority was sharply reduced. During FY80-84, 1,217 operations were approved and 1,186 operations on which some work had been done were dropped; the droppage rate for all approved and dropped operations on which some work was done was thus about 50%.

19. The cumulative staff resources involved in dropped operations doubled from 83 to 168 staffyears between FY80 and FY84 (Table 1). This represents an average of 18% of cumulative staffyears spent on all operations either approved or dropped in these years. While on average about one-half a staffyear was spent per dropped operation in FY80-84 (compared to 2.2 staffyears for those approved), there are wide annual fluctuations, reflecting both the type of operations involved as well as the processing stage when they were dropped. The staff resources on dropped IDA operations fluctuated from year to year; they were unusually high in FY82, when IDA commitments were reduced, and low in FY81 but, otherwise, were quite stable.

20. During FY80-84, nearly 80% of dropped operations had not yet been appraised and on average less than one-third of a staffyear had been spent on the preparation of these projects (Table 2). An additional 20% of dropped operations had been appraised but not yet negotiated and 3% were dropped at or after negotiations, though this was somewhat higher (5%) in FY84. Almost all those dropped at negotiations were IBRD operations.

21. Droppage by Region. The number of dropped operations rose in all Regions except East Asia during FY80-84 (Table 3). The number was highest in LAC (294 operations), reflecting the particularly difficult economic and financial problems of the Region. The largest droppage was in Brazil, with 43 operations. The droppage in FY84 was particularly large in the Industry and Energy sectors, reflecting excess capacity and limited demand, and for Water Supply and Urban projects to which the LAC countries gave lower priority when budgetary constraints required reductions in investments.

22. The number of dropped operations in EMENA increased sharply from 35 in FY80 to 83 in FY84. Droppage of Industrial projects, particularly in Turkey, accounted for about a quarter of the total droppage in FY84 and nearly 40% of the droppage in FY83. Droppage of Water Supply and Urban projects was also high in FY84. In the Africa Regions, much of the increase in droppage occurred between FY81 and FY82, reflecting the reduction in IDA commitments. The staff resources per dropped operation were relatively low in the Africa Regions because when IDA commitments were

reduced, some priority operations scheduled for the earlier years, involving considerable preparation, were postponed, while those in the outer years were dropped.

23. Relatively few operations were dropped in South Asia, where the situation in India, the major borrower, did not require major adjustments in the lending program. The sharp increase in FY84 is accounted for by reductions in Oil and Gas projects and in Industrial projects. Because these projects were in the outer years of the lending program, few staff resources had been used. The droppage rate in East Asia has been relatively stable at about 40 operations per year.

24. Droppage by Sector. The increase in droppage during the period affected most sectors (Table 4). Agricultural projects account for about one-third of the droppage in FY80-84, which is about in line with their share of Bank lending. Many Agricultural projects were dropped in Nigeria, Thailand, and Colombia, where considerable stafftime had been spent on them. The droppage was particularly high in the Industrial Sector, reflecting excess industrial capacity in many countries (e.g., Turkey and Brazil). The sharpest increase in droppage was in Energy (Oil, Gas and Coal) and, to a lesser extent, in Power. Much of the droppage occured in LAC, where the demand for Bank assistance in these sectors declined, and in Western Africa where some oil and gas exploration turned out to be less successful than had been expected, while others were taken up by private oil companies. Droppage also increased substantially for Urban projects, to which countries gave lower priority when investment budgets had to be reduced. Droppage remained relatively stable in Transportation, where road maintenance continued to have higher priority, and for IDF projects where DFCs required continuing Bank support in meeting their financial needs.

Reasons for Dropping Operations

25. In order to determine the reasons for droppage, a sample of 179 operations dropped in FY84 were examined in detail. The review of this sample indicated that of the total droppage, 72% took place before appraisal, 23% between appraisal departure and start of negotiations and 5% during or after negotiations. Governments were consulted about the droppage of all operations except those in the outer years of the lending program, which were listed as tentative and had not yet been identified fully, and those which were merged or their scope changed, in which case droppage was merely a technicality on the Bank's records. This latter category accounted for 37 of the 179 sample operations, i.e. 21%. In an additional 22 cases (12%), the original operation was replaced by a related operation. In most of these 59 operations constituting 33% of the total, the work already done on dropped operations could largely be used for the new ones.

27. For the remaining 120 operations dropped, there were frequently multiple reasons for droppage. By far, the most frequent reason, involving about 60 operations (33% of the sample), was that Governments were no longer interested in pursuing the operation because of changes in country economic or political circumstances; Governments were unable or unwilling to meet the conditions attached to the operations in about 20 of these cases or 11% of the total sample. Major issues included public utility tariffs, institutional reforms, and pricing.

28. The most important reason for dropping another 25 operations (14%) was that, as preparation work proceeded, it was found that the proposals were no longer justified primarily because of technical, financial, economic, or institutional reasons. A further 18 operations (10%) were dropped because the country lending program country-wide was reduced as a result of a revised creditworthiness assessment, or experience with the implementation of existing operations was poor. In the remaining 17 cases (9%), financing became available from other sources, including particularly other multilateral banks.

<u>Dropped Operations Appraised in FY84 and FY85</u>

29. In addition to a general review of dropped operations, Executive Directors also asked for information on operations appraised in FY84 and FY85, and subsequently dropped. Of the 219 operations appraised in FY84, 8 were dropped;5/ of the 241 operations appraised in FY85, 3 have been dropped. Of these 11 projects:

Five were dropped because of questions of economic viability;

Three were dropped because the Government withdrew its endorsement;

One was dropped because of riparian issues;

One was taken up by a bilateral donor; and

5/ Of these 8 operations, 3 were included among the 315 operations shown as dropped in FY84 in Table 1, which also includes operations appraised before FY84; the remaining 5 operations appraised in FY84 were dropped in FY85.

One was dropped because the deteriorating country economic situation changed government investment plans.

Conclusions

30. Given the uncertainties in a 5-year planning horizon, the evolution of country development strategies and investment priorities, and the fact that not every operation identified can, on closer analysis, be expected to be sound, the dropping of some operations from the lending program is inevitable and, in fact, desirable, if Governments and the Bank are to have a choice whether to proceed with an operation as it is being formulated and prepared. Since most droppage takes place relatively early in the cycle and at relatively low cost to the Bank and the borrower, the situation is generally satisfactory. Moreover, it is important to emphasize that not all of the time spent on dropped operations is wasted. Some are later revived as new viable operations after their concept or scope has been changed. Furthermore, important lessons have been learned, both by the Bank and the borrower, even in some cases where operations are dropped for good.

31. To minimize droppage, it is important to have a clear understanding with the borrowers of the issues involved in an operation at the identification stage. In addition, the Bank is taking steps to identify problems as early as possible so that the number of dropped operations can be minimized or, if operations should be dropped, that a decision can be reached early in the processing cycle. However, it is clear that some droppage of operations will continue to be inevitable since some operations are found to be unviable on closer examination and the viability of others is affected by changing domestic and external economic conditions.

Table 1

PROJECTS DROPPED FY80-84 a/b/

Summary

	FY80		FY81		FY82		FY83		FY84		FY80-84	
	Number c/	Cumulative Staffyears	Number c/	Cumulative Staffyears	Number c/	Cumulative Staffyears	Number c/	Cumulative Staffyears	Number c/	Cumulative Staffyears	Number c/	Cumulative Staffyears
IBRD	121	52.9	154	83.2	138	90.4	172	91.9	232	133.5	817	452.0
IDA	62	29.9	61	20.7	93	50.7	70	35.2	83	34.1	369	170.6
Bankwide	183	82.8	215	103.9	231	141.1	242	127.1	315	167.6	1,186	622.6

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a/ Excluding time spent by assistant level staff.

b/ Excluding projects with less than 0.1 staffweeks (4 staffhours). A cut-off of 1 staffweek would have reduced the number of dropped projects in FY80-84 from 1,186 to 917, or 23 percent; the reduction in cumulative staffyears, however, would have been very small, from 622.6 to 620.6 staffyears.

c/ Blend projects are counted once, as IBRD projects.

Table 2

PROJECTS DROPPED FY80-84 a/
By Processing Stage

Last Processing Stage Reached		FY80		FY81		FY82		FY83		FY84		FY80-84			
		Number b/	Cumulative Staffyears	Number b/	Cumulative Staffyears	Number b/	Cumulative Staffyears	Number b/	Cumulative Staffyears	Number b/	Cumulative Staffyears	Number b/	%	Cumulative Staffyears	%
Preappraisal	IBRD	91	28.8	117	37.3	101	32.3	138	42.7	190	68.5	637		209.6	
	IDA	42	7.6	50	12.7	68	16.7	52	15.8	63	15.8	275		68.5	
	Total	133	36.4	167	50.0	169	48.9	190	58.5	253	84.3	912	77	278.1	45
During or After Appraisal	IBRD	24	17.5	32	41.1	30	46.8	31	39.4	28	27.6	145		172.4	
	IDA	19	18.8	9	4.3	22	24.5	18	19.4	19	17.3	87		84.3	
	Total	43	36.3	41	45.5	52	71.2	49	58.8	47	44.9	232	20	256.7	41
During or After Negotiations	IBRD	6	6.6	5	4.8	7	11.4	3	9.8	14	37.4	35		70.0	
	IDA	1	3.6	2	3.7	3	9.6	-	-	1	1.0	7		17.7	
	Total	7	10.1	7	8.4	10	21.0	3	9.8	15	38.4	42	3	87.7	14
	IBRD	121	52.9	154	83.2	138	90.4	172	91.9	232	133.5	817		452.0	
	IDA	62	29.9	61	20.7	93	50.7	70	35.2	83	34.1	369		170.6	
	Total	183	82.8	215	103.9	231	141.1	242	127.1	315	167.6	1,186	100	622.6	100

a/ Excluding time spent by assistant level staff.

b/ Excluding projects with less than 0.1 staffweeks (4 staffhours).

Table 3

PROJECTS DROPPED FY80-84 a/
By Region

REGION		FY80 Number b/	FY80 Cumulative Staffyears	FY81 Number b/	FY81 Cumulative Staffyears	FY82 Number b/	FY82 Cumulative Staffyears	FY83 Number b/	FY83 Cumulative Staffyears	FY84 Number b/	FY84 Cumulative Staffyears	FY80-84 Number b/	FY80-84 Cumulative Staffyears
E. Africa	IBRD	6	2.1	8	2.9	10	4.0	12	8.6	11	3.8	47	21.4
	IDA	13	3.8	16	7.2	25	13.3	22	9.0	33	17.3	109	50.6
	Total	19	5.9	24	10.1	35	17.3	34	17.6	44	21.1	156	72.0
W. Africa	IBRD	13	3.1	13	5.1	22	15.7	20	5.9	24	12.0	92	41.8
	IDA	15	4.5	16	4.5	27	17.8	20	7.9	18	7.2	96	41.9
	Total	28	7.7	29	9.6	49	33.5	40	13.8	42	19.2	188	83.7
EMENA	IBRD	25	10.6	40	22.4	32	23.5	40	25.9	76	49.1	213	131.4
	IDA	10	5.5	2	0.6	8	5.0	3	1.2	7	2.0	30	14.4
	Total	35	16.1	42	23.0	40	28.4	43	27.1	83	51.1	243	145.8
LAC	IBRD	41	23.8	52	36.4	46	34.4	60	28.6	79	37.4	285	160.5
	IDA	1	3.3	2	0.1	2	1.4	2	0.1	2	0.2	9	5.0
	Total	42	27.1	61	36.4	48	35.7	62	28.7	81	37.6	294	165.5
E. Asia	IBRD	35	13.0	32	16.1	28	12.9	39	22.8	33	29.1	167	93.9
	IDA	9	5.2	5	0.4	8	3.0	2	2.0	2	0.2	26	10.8
	Total	44	18.2	37	16.5	36	15.8	41	24.8	35	29.3	193	104.6
S. Asia	IBRD	1	0.3	2	0.4	-	-	1	0.2	9	2.1	13	3.0
	IDA	14	7.5	20	7.9	23	10.3	21	15.0	21	7.2	99	47.9
	Total	15	7.8	22	8.3	23	10.3	22	15.2	30	9.3	112	50.9
Bankwide	IBRD	121	52.9	154	83.2	138	90.4	172	91.9	232	133.5	817	452.0
	IDA	62	29.9	61	20.7	93	50.7	70	35.2	83	34.1	369	170.6
	Total	183	82.8	215	103.9	231	141.1	242	127.1	315	167.6	1,186	622.6

a/ Excludi-- time spent by assistant level staff.

b/ Excludi ..rojects with less than 0.1 staffweeks (4 staffhours).

Table 4

PROJECTS DROPPED FY80-84 a/
By Sector

SECTOR	FY80 Number b/	FY80 Cumulative Staffyears	FY81 Number b/	FY81 Cumulative Staffyears	FY82 Number b/	FY82 Cumulative Staffyears	FY83 Number b/	FY83 Cumulative Staffyears	FY84 Number b/	FY84 Cumulative Staffyears	FY80-84 Number b/	FY80-84 Cumulative Staffyears
Agr./Rur. Dev.	78	40.6	80	45.8	92	78.5	69	61.5	93	63.8	412	290.2
IDF c/	16	4.9	19	9.3	17	8.8	14	4.3	18	6.3	84	33.6
Education	3	3.7	3	0.4	13	7.5	7	4.6	7	5.8	33	22.0
Oil, Gas & Coal	4	2.1	9	3.6	14	2.2	27	7.7	37	15.4	91	30.9
Power	9	3.2	10	1.8	9	3.1	13	3.6	17	14.3	58	26.1
Ind./Telecom. d/	21	7.0	35	12.7	29	13.7	46	22.8	56	23.7	187	80.0
Non-Project	4	5.1	7	1.4	1	2.2	6	1.2	13	5.1	31	14.9
PHN	3	0.2	8	7.1	10	3.5	5	0.2	4	1.3	30	12.4
Technical Asst.	2	0.0	1	0.0	1	0.3	2	0.1	9	2.4	15	2.8
Transportation	24	6.1	24	8.5	20	8.7	28	5.4	21	12.7	117	41.4
Urban Dev.	5	4.0	6	4.4	13	8.4	13	11.7	20	8.5	57	37.0
Water Sup./Sew.	14	6.0	13	8.9	12	4.0	12	4.0	20	8.3	71	31.3
Bankwide	183	82.8	215	103.9	231	141.1	242	127.1	315	167.6	1,186	622.6

a/ Excluding time spent by assistant level staff.

b/ Excluding projects with less than 0.1 staffweeks.

c/ Includes Development Finance Companies and Small Scale Enterprises.

d/ Plus Tourism.

CONDITIONS IN LENDING

International Bank for Reconstruction and Development

FOR OFFICIAL USE ONLY

SecM85-518

FROM: Vice President and Secretary

April 30, 1985

BANK'S LENDING INSTRUMENTS: CONDITIONS IN LENDING

1. The attached paper on "Conditions in Bank Lending" has been prepared at the request of the Executive Directors made at the meeting on February 7, 1985.

2. It is proposed not to schedule the paper for formal Board discussion; however, should there be a desire by the Executive Directors for a discussion (to be communicated to the Vice President and Secretary or Deputy Secretary by May 10, 1985), a meeting will be scheduled at a convenient date.

3. Questions on this document should be referred to Mr. Rajagopalan (X73592).

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council
Vice Presidents, IFC
Directors and Department Heads, Bank and IFC

TO: Executive Directors April 29, 1985

SUBJECT: Conditions in Bank Lending

During the discussion of the paper on Bank Lending Instruments,[/1] we were requested to indicate the types of issues which normally might be covered by each of the lending instruments. This information is provided in the attached note. It should be emphasized, as is done in the note, that the description of the issues likely to be dealt with in the various kinds of operations is generic. Specifics will vary depending on country circumstances, including the scope and urgency of the problems, progress in previous operations, activities by other lenders, the managerial and administrative capacity of the government and the borrowing institution. The Bank has no universal set of prescriptions but seeks, in its discussions with Governments, agreement on objectives and frame programs which will help remove obstacles to the efficient achievement of those objectives.

Questions on this paper, if any, may be addressed to Mr. Rajagopalan, Director, PPD, extension 73592.

Ernest Stern
Senior Vice President
Operations

/1 Circulated under cover of Mr. Thahane's memo of December 21, 1984.

CONDITIONS IN BANK LENDING

This paper responds to a request by Board members for information on the conditions attached to different Bank lending instruments.1/ The discussion of conditions below follows the classification of loans set out in the paper Bank Lending Instruments (December 20, 1984). The present paper does not discuss provisions which are standard for all loans (e.g. Bank staff access to the project, reporting, auditing, etc.), nor does it deal with procurement or selection of consultants. Instead, the paper focuses on the conditions specific to each type of Bank lending and the reasoning behind them.

The Bank's objectives in attaching conditions to its loans can be simply stated:

- to ensure, from the viewpoint of the overall economy, that particular operations will be implemented so as to promote efficient mobilization and use of resources consistent with the country's development objectives, enhance long-term creditworthiness, and strengthen the development of manpower and institutions necessary for sustainable long-term development;

- to ensure, from the viewpoint of the implementing agency, efficient management and sound financial policies, thereby safeguarding both the borrower's and the Bank's interests.

The conditions designed to achieve these objectives address, as appropriate, the economic, financial, institutional and technical aspects of the relevant operation. Besides these substantive conditions, another dimension relates to timing. Some conditions are met before the Bank appraises a project, others before negotiation or Board presentation, and still others to make the loan effective, so as to ensure a balance between timely processing of the loan and the proper design and preparation of project or program components. Details on forms of agreement and their documentation are contained in OMS 3.18.

The economic crises of recent years have prompted the development of new forms of lending for structural and sectoral adjustment. As the Bank's operational focus and array of lending instruments have broadened in response to the changing conditions in its member countries, there has been a corresponding evolution of conditions associated with different instruments. This process is necessarily imperfect and incomplete, and requires periodic reassessment and adaptation of lending policies. The economic difficulties have also served to sharpen the Bank's longstanding concern with the impact of the wider economic environment on the productivity of investments, on creditworthiness and the ability to attract external capital (whether commercial or concessional) and hence with the interconnections between project-specific and broader policy issues.

1/ In this paper the terms "Bank" and "loans" should be taken to include IDA and credits.

An instrument-specific summary of conditions is set out below. However, it should be stressed that the description of conditions by lending instrument is a generic one. Specifics will vary depending on country circumstances, including the scope and urgency of the problem, progress in previous operations, activities by other lenders, the managerial and administrative capacity of the government and the borrowing institution, and the frequency of Bank operations in the country. The Bank neither has a universal prescription for problems nor a predetermined package of measures. The objective of each operation is, in the context of an overall strategy, to make as much progress as is politically and economically feasible in resolving a particular set of problems.

It should also be noted that the conditions associated with Bank loans are developed through a process of dialogue with the borrowing country government. Throughout project preparation, appraisal, and negotiation, Bank staff engage in an intensive exchange of information and views with the government staff with whom they work. In this process the Bank staff bring to bear their professional training and their experience in other countries as well as their understanding of the specific circumstances of the operation and the country. The government staff bring to bear not only professional skills but also their greater familiarity with these specific circumstances, including social and political constraints. Through such a process of constructive dialogue, it is the Bank's goal to achieve consensus with the borrowing government about the conditions for a particular operation which will ensure that it makes the maximum possible contribution to development.

Specific Investment Loans

Conditions in this, the largest, category of Bank lending are designed to assure the technical, economic and financial viability of the investment. Economic and financial viability, for example, is safeguarded by covenants relating to financial rates of return, cost recovery, and output prices and tariffs, and by government undertakings to provide budgetary or other financial support where appropriate. Operational agreements typically relate to time-specific output targets (e.g. levels of service delivery, staffing, maintenance, etc.) and especially to institutional arrangements. Understandings on institutional questions may, for instance, cover the organization of the project entity and its mode of operation, and such other issues as senior managerial appointments, the use of external experts, counterparts and training.

While conditions for specific investment loans are mainly focussed on the projects which they support, they may also address sector-wide issues where an effective use of resources by project agencies or their financial position is affected crucially by the economic and financial policies of the government.

Sector Operations

(a) Sector Investment and Maintenance Loans. The major objective of these loans is to improve the capacity of the borrower to formulate and implement sound sectoral policies and to manage the relevant sector's capital and human resources effectively. Loan conditions thus tend to concentrate on three issues. First, sector loans are usually conditional on the borrower establishing satisfactory criteria and methods for project identification, selection and appraisal, thereby using the loan to improve the allocation of public expenditure for rehabilitation, maintenance or new investment throughout the sector. Second, most loans have understandings regarding the policy framework of the sector. These may include issues such as tariffs and user charges, and the level and composition of sectoral public investment and financing. Third, these loans characteristically incorporate detailed agreements about the institutional arrangements for key public institutions in the sector -- for example about organization of executing agencies, project preparation capacity, monitoring and evaluation, and in particular staff development and training for the sector as a whole.

(b) Loans to Financial Intermediaries. Conditions for this category of lending are similar to those described above, but typically focus on the institution channeling the funds to the investor. Thus financial and economic criteria and clientele definition (size of farm or enterprise, for example) are emphasized in project selection for on-lending. Policy issues addressed relate to matters such as on-lending interest rates, since financial intermediaries supported by Bank loans complement other financial institutions in the country. Institutional conditions concentrate on strengthening particular development finance companies or rural credit agencies, for example, or in the case of "apex" loans may be aimed at the structure and interrelationship of institutions in relevant financial sub-sectors.

(c) Sector Adjustment Loans. Sector adjustment loans are the most comprehensive Bank vehicles for addressing sector policy and institutional constraints. A sequence of such loans would address the government's medium-term program of sectoral policy and institutional reform in the sector. The first loan in the series is likely to concentrate on the most urgent issues and on the initial measures to be taken as part of the multi-year program. Compared to sector investment loans, sector adjustment conditions place greater emphasis on policies and economic incentives affecting all economic participants in the sector. The sectoral coverage characteristically is broad, covering, for example, policies and institutions in the entire industrial sector, in contrast to a sectoral investment and maintenance loan which might concentrate on public investment in a particular industrial sub-sector such as fertilizers or telecommunications.

Such loans support programs whereby the key elements of sectoral reform are implemented according to a specific timetable of monitorable actions. Bank conditions are thus linked to successive stages of reform, for example by gearing Board presentation, loan effectiveness, tranche release and the processing of subsequent loans to the attainment of specific agreed reform objectives.

As with other loans, conditions for sector adjustment loans reflect differences in their sector- and country-specific content. However, the approach tends to be similar. Particular attention usually is focused on the incentives facing producers in the sector: specific agreements are therefore sought on matters such as procedures and policies affecting producer prices and links with international markets. Specific actions supported by such loans often also address key institutional problems, for example re-structuring programs for public enterprises in the sector, strengthening of marketing and credit institutions and associated policies, and reform of excessive administrative regulation and the competitive environment. Finally, loan conditions typically address the level, composition and phasing of public investment in the sector as well as the maintenance effort and the level of recurrent expenditure. In some cases, the institution of suitable mechanisms for programming, allocating and monitoring such investment are included.

In some cases the "sector" in question may not be a branch of productive activity in the usual sense. For instance, a loan may deal with the public sector as a whole, or a series of particular public enterprises. Here, appropriate conditions would concentrate on investment issues, on the efficiency of operations on a commercial basis, on the government's policy framework for public enterprise and on restructuring proposals for specific important enterprises. Or, the loan may deal with the trade regime where the focus is on eliminating biases against exports, increased efficiency of import substituting industries, reductions in excessive levels of protection and disparity of protection as between sectors.

Structural Adjustment Loans

Structural adjustment loans have been extensively discussed in recent documents.[2/] Given the economy-wide coverage of SALs, program design and specification of appropriate conditions are exceptionally demanding. As in the case of sector adjustment loans, conditions in SALs are based on a medium-term program of change and translate the structural reform objectives into concrete actions, to be taken during loan implementation. Specific macroeconomic and sectoral reform measures are therefore carefully chosen and phased over the duration of the SAL, and appropriately linked to the stages of loan processing and disbursement. In particular, clear links are demonstrated between the major economic objectives and policy reforms supported by the loan and the detailed measures through which these can be implemented and monitored. These loans thus require particularly close and detailed consultation with the borrower in analyzing the measures necessary for success.

The reform strategy embodied in the government's Letter of Development Policy thus characteristically focuses on broad issues of trade policy, resource mobilization and allocation, efficiency and institutional reform, but also sets out specific measures such as adjustment of leading prices in the economy (for example for energy or agricultural production); agreements on trade regimes in order to improve the capacity of the domestic economy to respond to changing circumstances; and action on key fiscal, monetary and public investment issues. Where there is inadequate

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2/ See e.g. the Progress Report on Structural Adjustment Lending, R84-150, May 1984; and Institutional Reform: Some Lessons From Structural Adjustment Lending, Projects Policy Department, November 1984, a background paper for the Tenth Annual Report on Project Implementation and Supervision, R85-48, February 1985.

information or analysis to merit specific actions, terms of reference are agreed upon for studies as a basis for subsequent operations. On the institutional side, the concentration is on improving government capacity to make and execute economic policy, and may include measures to strengthen debt management, public investment programming and implementation, budgeting, public enterprise performance and the administration of the trade regime.

Technical Assistance Loans

For these loans, conditions are relevant mainly in institution-related technical assistance, where the Bank is supporting improvements in the policy-making and managerial capacity of borrower governments' institutions. Conditions are directed towards two linked objectives: to ensure that the technical services are efficiently used and supervised, and to ensure that improvements in policy analysis and managerial capacity are made permanent. The first objective is covered by agreements specifying qualifications, terms of reference and reporting relationships for personnel, terms of reference and timetables for studies, and allocation of responsibilities for project management. The second objective is pursued by conditions specifying training programs and the appointment and qualifications of nationals as counterparts to expatriate personnel so as to ensure transfer of skills, and by agreements to effect organizational and procedural changes in order to institutionalize the improved policies and management which the TA loan has supported. In a number of cases, technical assistance loans are in direct support of structural adjustment programs and are designed to support a wider process of economic reform.

Emergency Reconstruction Loans

Since these operations are specifically tailored to highly unusual circumstances, conditions are generally limited to assuring efficient implementation of the project, and few longer-run objectives are sought. However, these loans may where appropriate include conditions aimed at improving the response to recurrences of the emergency, for example by requiring the adoption of a seismic resistance building code.

Conclusion

As the foregoing discussion makes clear, the Bank tries to ensure that conditions are appropriate to the objectives and scope of each lending instrument. This is rarely simple and requires the closest possible collaboration with the borrower in analyzing what is needed. The newer types of lending such as SALs and sector adjustment loans present particular challenges, since they involve the design of specific, monitorable conditions to support programs of reform which are broad-gauged and long-term, and in which some results are difficult to quantify. Continuity of relations and close dialogue between government and Bank are therefore a requirement for the design of effective and feasible conditionality. It is also important for the Bank, in its country assistance strategy, to pay close attention to the consistency of conditions attached to the different loans in its lending program for each country, as well as between countries, and to avoid inconsistencies with Fund programs in those countries where Fund arrangements are in operation.

Projects Policy Department
April 29, 1985

Conditions by Lending Instruments 1/

Product	Typical Conditions
1. Specific investment loan	Economic and financial (e.g., rates of return, output prices and tariffs, counterpart funds); operational, such as service levels, maintenance standards, etc.; and institutional requirements, e.g., structure of project entity, relationship to other agencies, senior management qualifications and appointment.
2. Sector operations	
(a) Sector investment and maintenance loan	Establishment by government of appropriate public investment project selection and appraisal criteria; improvements in policy framework, esp. sectoral public investment and financial policies, and tariffs or user charges; institutional development measures, particularly organizational framework for sector, project preparation capacity, staff development and training.
(b) Financial intermediary loan	Financial and economic criteria for on-lending, definition of on-lending clientele; interest rate policy; for "apex" loans, structure of relevant financial sub-sectors.
(c) Sector adjustment loan	Specific program designed to improve sector-wide incentives, esp. producer prices, trade protection, taxation; to strengthen institutions, esp. public enterprise performance, marketing and credit institutions and policies, re-examination of administrative controls; and to rationalize public investment, particularly through conditions attached to level, composition and phasing, and allocation process.

1/ Matches Attachment I of memorandum distributed on December 21, 1984.

3. Structural adjustment loans	Specific reform program tackling major economy- or sector-wide incentive issues (adjustment of leading prices, import tariffs, quantitative trade restrictions, etc.); macroeconomic policies affecting resource mobilization and efficiency (e.g., financial and budgetary policies, debt management); institutional improvements in economic management, sector institutions, para-public enterprises and trade regime.
4. Technical assistance loan	Agreements on terms of reference, qualifications and management of TA personnel; terms of reference and timetables for studies; arrangements for project management. Conditions are also agreed for training, counterpart personnel and organizational changes to institutionalize improved policies and management.
5. Emergency reconstruction loan	Conditions aim at improving future response to recurrence of emergency, and at ensuring efficient implementation of reconstruction activities.

Board Seminar
January 24, 1985

Record Removal Notice

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File Title	Barcode No.
Future Role of the Bank - Board Meetings - 1984-1985	1660618

Document Date	Document Type
12/28/1984	Board Record

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To: Executive Directors and Alternates
From: Serena Han Clarke, Deputy Secretary

Subject / Title
Future Role of the Bank - Bank Lending Instruments

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

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From: T. T. Thahane, Vice President and Secretary

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Withdrawn by	Date
Salma Berrada El Azizi	June 27, 2025

THE FUTURE OPERATIONS OF THE BANK: AN OVERVIEW

Introduction

1. Over the past few months the Executive Directors have held a series of informal discussions on the Bank's future role in various groups of developing countries. At the conclusion of the last discussion on September 12, the Chairman proposed--as a next step--to provide the Executive Directors with a brief overview note on the Bank's operations as a whole.

2. In presenting this overview Management hopes to lay the basis for subsequent discussion of the Bank's resource requirements. The aim, in other words, is to identify the broad features of Bank operations which should guide the commitment of resources in the years ahead.

3. If there is one aspect of Bank operations that stands out above others, it is the need for the Bank to continue to adapt in a flexible manner to the changing circumstances of its borrowing member countries. Accordingly, this note makes no attempt to set forth a detailed blueprint for future Bank operations, but rather concentrates on the principles which should guide the future process of adaptation.

4. To provide a perspective for consideration of these principles the first section of this note provides a very brief summary of past Bank operations. The second section goes on to present Management's views on future operations, drawing upon the discussions held with the Board thus far. The final section then introduces the subject of the scale of future Bank operations, indicating the issues that need to be addressed in deciding upon the level of future lending. These initial comments on the scale of Bank operations are intended to lay the groundwork for a subsequent discussion of Bank borrowing and capital requirements.

Historical Perspective

5. The history of the Bank since its creation has been characterized by an ability to respond to the development issues of its borrowers against the background of a changing world environment and an evolving understanding of the development process itself. The types of investment which the Bank helps to finance have steadily broadened over the years. After an initial set of general purpose loans in support of reconstruction efforts, Bank lending in the early years tended to concentrate mainly on infrastructure investments in the power and transport sectors. Throughout the next three decades lending gradually expanded in the directly productive sectors of agriculture and industry, and--as appreciation of the importance of investment in human capital became more widespread--operations in education, health and other social sectors grew as well. Lending for urban development and the establishment of an expanded Bank program in the energy sector are further illustrations of continuing adaptation to changing needs.

6. From its earliest days the Bank has been concerned to ensure that economically and financially sound criteria were used to evaluate projects and that the technical and managerial aspects of investments were adequately addressed. This structured and disciplined approach applies also to the implementation phase (in the form of regular supervision) and has been extended in recent years to include what may well be a uniquely intensive system of monitoring and evaluation.

7. Concern with the quality of investment has compelled the Bank—again from its earliest days—to be concerned about the policy and institutional environment within which the investments operate. Debates about appropriate interest rates and prices for energy, water and public services are not new; they have been an integral part of the Bank's discussion with governments for three decades or more. To support these discussions, country and sector economic work has expanded from an initial concentration on country creditworthiness issues to include more general analysis of constraints on development, assessments of investment priorities and--especially in recent years—consideration of specific policy options that can aid governments decide how best to pursue agreed objectives.

8. An evolving understanding of the development process has also helped shape and focus Bank operations. Reference has already been made to the increased attention paid to human resource issues since the 1960s. Population issues, in particular, have come in for special attention on a number of occasions. The realization that sustained development requires a concern with the distribution of the benefits of growth gave impetus to a more explicit concentration on poverty alleviation and was an important underpinning for the expansion in Bank lending for agricultural and rural development--an emphasis which remains a priority for the Bank today. Similarly, a recognition of the importance of strong institutions has prompted a number of Bank initiatives over the years, including the establishment of EDI in the early 1960s, the expansion of free-standing technical assistance operations, and--more recently--intensified work on the management of public sector institutions.

9. Just as the focus of Bank operations has continually adapted to the shifting development priorities and growing capabilities of its borrowers the lending instruments and operational policies of the Bank have undergone comparable modifications and extensions. Loans made directly to borrowers were augmented by Bank financing of financial intermediaries which on-lend funds to farmers and small to medium-scale enterprises. As capacities in member countries expanded, loans were also made to other types of apex institutions which had the ability to appraise and supervise subloans according to criteria agreed with the Bank. As its knowledge of sectoral and sub-sectoral activites has deepened the Bank has been able in some cases to proceed on the basis of time-slice operations that provide support to an agreed sub-sectoral investment program (e.g. in irrigation). This involves a reliance on borrowers for the appraisal of subprojects and for the provision of finance to complete these subprojects should the Bank decline to make a follow-up loan. In addition, a modest amount of lending has been devoted over the years to program loans in countries such as India, Colombia and Bangladesh.

10. Thus, even prior to the emergence of structural adjustment lending, a broad array of lending techniques had been devised which gave the Bank considerable flexibility to address the varying circumstances of individual borrowing countries. This flexibility has been further enhanced by the ability the Bank has to combine different components within the same operation. Loans for the highway sector, for example, might include finance both for new investment and for strengthening of maintenance work; rehabilitation of industrial plants might be combined with a component for the provision of inputs as well as for the restructuring of management and finances. The rich variety of operational techniques already in use has made the conventional distinctions between "project" and "non-project" lending increasingly irrelevant as a description of what the Bank actually does.

11. The strength of the Bank's operations resides precisely in the combination of services which it provides to borrowers: in financing appropriate investments, in assisting countries to identify and implement sound policies, and in helping them to institutionalize the process of adaptation through improvements in organization, management and strengthened analytical capacity.

Principles Guiding Future Operations

12. The discussions of Bank operations which have taken place to date have not involved any basic questioning of the Bank's broad objectives as a development institution. There continues to be strong support for combining an emphasis on growth with a continuing commitment to assist governments alleviate poverty through enhancing the productivity of all segments of their population, especially that of the poorest.

13. Nor has there been any serious dissent from the proposition that, to be effective, the Bank must continue to involve itself with policy and institutional issues as they bear upon the productivity of investment and the prospects for successful growth-oriented development over the medium term. Where the debate has concentrated is on the relative emphasis to be given to the various aspects of Bank operations, particularly the balance to be struck between "traditional" project financing and the various forms of sector and non-project lending. In addition, questions have been raised concerning the way the Bank assists governments to deal with policy and institutional issues.

14. As should be clear from the brief summary that has been given of Bank operations in the past, Bank involvement in policy and institutional issues grows out of a concern that the resources it provides be used for productive purposes and that the benefits be sustained over time. There is no question--in Management's view--of the Bank drifting away from this traditional emphasis. Investment-oriented operations will and should remain the mainstay of Bank operations in the future.

15. The instruments which the Bank uses to pursue this objective should continue to evolve in line with the capacities of the borrowing countries. Reference has been made to the increased reliance on domestic institutions to appraise specific investment proposals on the basis of

agreed criteria. This is a trend which Management believes should be encouraged both in the interest of efficiency and—perhaps even more important--in the interest of strengthening institutions which will foster development generally. Similarly, time-slice operations ought to be encouraged when the policy and instituional circumstances are such as to give confidence that the resources provided will be used productively. A continuing emphasis on investment is thus perfectly compatible with a growing use of operational techniques that extend beyond the direct financing of discrete investment projects.

16. While the Bank's original involvement with policy and institutional issues focussed mainly on assessments of country creditworthiness and matters rather directly related to the implementation of the investments being financed, this involvement has broadened and deepened over the years. In part this evolution has reflected a growing recognition of the complexity of the development process itself, particularly the critical importance of the interactions among various sectors of the economy. Policies on trade, interest rates, prices of energy and public services—all these have very widespread effects on the productivity of investment (including Bank-financed investments) and indeed on the efficiency of resource use generally. To be in a position to give responsible advice to borrowing countries, the Bank has had to consider the impact of policies not just on the investments it finances, but on the economy more generally. Moreover, as the range of sectors in which the Bank is active has grown, the scope of relevant policy and institutional concerns has broadened as well.

17. Both these factors were at work in the 1960s and 1970s. Over the last few years they have been re-inforced by the dramatic changes which have taken place in the external environment. These events have confronted both low- and middle-income countries with the need to undertake very substantial structural changes in their economies. The significant structural adjustments, on which many borrowers have already embarked, will continue. Though such adjustments are inherent in the development process, the required pace and content are likely to be qualitatively different from the past. A domestic policy environment that, while not promoting the most efficient investments, was tolerable in the past, may well be unsustainable in the future. Consequently, given the Bank's fundamental objective of promoting sustained development, it has had to place considerable emphasis on helping countries shape the most suitable policy and institutional framework at the project, sector and economy-wide level.

18. The specific issues which the Bank addresses will of course depend upon the circumstances facing each particular country. In considering the framework for Bank planning, Management has concluded that no typology of countries by income level or by geographical region offers a reliable guide to the nature of Bank operations that will be most appropriate in the future. The unit for determining what issues are most critical—and for deciding on the operational techniques that are likely to be most useful—is the individual country. A "country focus" has long characterized Bank operations. In Management's view this focus remains appropriate and indeed may usefully be strengthened in the years ahead. In practical terms this will mean being prepared--as we have in the past two or three years—to substantially revise the program of Bank operations in order to

keep it focussed on the key issues facing the country. It will also mean adapting the lending instruments used by the Bank to take account of the evolving institutional capacities of borrowers.

19. It is this desire to tailor Bank operations to the specific circumstances of countries that prompted the proposal--included in the paper describing the Bank's response to the problems of the major debtors--that "the level and composition of Bank financial support for agreed policy actions should be country based." The guidelines which currently exist relate to only one form of Bank involvement; namely, SALs. It has long been recognized that the volume of SALs is a very imperfect measure of the Bank's involvement in policy and institutional issues, either at the country level or on a Bank-wide basis. Agreement on a suitable policy framework is the logical starting point for any Bank operation.

20. Given that the Bank's "product" now includes a rich array of services and technical assistance which culminate in a wide variety of lending operations, a ceiling on one particular instrument is no longer a very relevant concept. The recognition of this reality does not imply that a rapid growth in SALs is envisaged. On the contrary, if the recovery in the world economy is sustained, and the policy performance in the developing countries responds favorably, the trend could well be in the other direction.

21. If one accepts the notion that Bank involvement in policy and institutional issues is not confined to a small subset of Bank operations, but is in fact an integral part of its on-going relationship with borrowing countries, then the critical issue is not the choice of lending instrument but rather they way in which that overall relationship is approached. The choice of lending instruments becomes a derivative of a process in which the borrower and the Bank agree upon a framework for assistance which enables the Bank to play the most effective role both as lender and advisor.

22. Management has strongly emphasized the collaborative character of the relationship, one built upon a two-way dialogue. The Bank's posture is one of advising governments on the adequacy of the means chosen to pursue the country's own development objectives. While accepting these objectives, the Bank has a responsibility to share candidly its assessment of obstacles which may prevent or impede their realization.

23. Increasingly in recent years the Bank has sought to assist governments in the elaboration of specific steps that may be taken to deal with the obstacles identified and to stand ready to provide financial and other assistance in implementing reform. This process is subtle and complex. Governments are not monolithic, and support for change can vary considerably across ministries and over time. The Bank's approach must therefore be flexible, taking account of the conflicts and compromises that mark government decision-making. Expectations of progress must also be realistic, allowing for variations in the pace of implementing even fully agreed policy and institutional reforms.

24. Continuity of relationship and reliability as a source of finance does not, however, imply that a pre-determined volume of lending should be forthcoming each year. This has not been the case in the past; nor should it be so in the future.

25. The assurance of continuity in the relationship needs to have its foundation in a well articulated medium-term Bank assistance strategy which is itself clearly related to the country's own development objectives and takes account of the country's specific external circumstances and institutional capacities. Increasingly close and early collaboration with governments can help assure a genuinely joint approach. The smooth implementation of a medium-term assistance strategy can be fostered by a more structured and systematic approach on the Bank's part. Identification of the issues to be addressed needs to be clearly related to the development problems facing the country and to the assistance which the Bank can provide in tackling those issues. It is important that the policy and institutional objectives to be addressed in Bank operations be specific and that the interim steps are fully discussed with the borrower. Finally, the design of any particular Bank operation should be such that it can be effectively implemented by the country concerned and that this implementation can be credibly monitored by the borrowing country and the Bank.

26. A more sharply focussed country economic and sector work (CESW) program geared to the Bank's lending operations will be essential in this connection. Such a program should not only support an active policy dialogue and related Bank operations, but also monitor policy changes and their effects. In addition, the Bank's research program will need to complement and reinforce the CESW work as, for example, through comparative country studies that analyze and evaluate experience with alternative approaches to policy and institutional change.

Bank/Fund Collaboration

27. On the general issues of Bank/Fund collaboration, Management believes that the approach followed in recent years—an approach which emphasizes the need for active co-ordination while continuing to recognize the differing mandates and perspectives of the two institutions—is the correct one. Over the next decade the success of development efforts in many countries will hinge upon their ability to promote growth within a framework that avoids the recurrence of external and internal imbalances. Thus issues of stabilization and growth-oriented adjustment will need to be addressed jointly by the governments concerned. This underlines the importance of ensuring that the advice provided to countries from the separate perspectives of the Bank and the Fund be complementary and consistent.

28. This will require a continuation of the program of active collaboration between the Bank and the Fund which has been intensified in recent years, including a fuller exchange of information, regional seminars, joint missions and so on. In addition, regular discussions of forward work programs may be helpful in order to permit both institutions to provide timely response when advice is required on short notice.

Catalytic Role

29. Since borrowing countries obtain finance, technical assistance and policy advice from a number of sources, it is important that the Bank's operations be structured so as to take maximum advantage of what is available from others. This is commonly referred to as the Bank's catalytic role.

30. As with direct lending operations, the Bank's catalytic role has a long history of adaptation to changing circumstances. In the 1950s and 1960s, when the bulk of external capital came from official sources (either as aid or officially-supported export credits) and private direct investment, the Bank's response emphasized aid co-ordination (via consortia and consultative groups), joint financing with export credits, and--in 1956--the establishment of IFC. During the 1970s co-financing arrangements were strengthened with bilateral donors (including, among others, ties with OPEC donors), with export credit agencies, and of course with commercial banks which emerged as a major source of finance during the period.

31. Looking to the future, Management believes that the availability of foreign capital of all sorts is likely to be more constrained than in the past, and that this adds to the importance of making the best possible use of these resources. The contribution the Bank can make toward this end is somewhat different for official sources than for private sources, so it may be convenient to consider the two aspects of the Bank's role separately.

32. Relations with Sources of Official Capital. The proposed action program for Sub-Saharan Africa elaborates in considerable detail the issues which need to be addressed with respect to official capital. Particular attention is drawn to the need for more closely co-ordinated donor assistance to support national priorities and programs. Increased donor flexibility is also called for, including such steps as the provision of financial support for major reform programs and a willingness to accord higher priority to funding for operation and maintenance activities.

33. The effectiveness of the Bank's future role in aid co-ordination will depend upon the commitment of all parties to a more disciplined process. The analysis of the problems facing these countries indicates how critical it is that an integrated approach be adopted--one that goes well beyond the traditional focus on new investment projects to consider the factors inhibiting the fully productive use of existing capacity. Such an approach will need to draw heavily on the policy dialogue that the Bank maintains with borrowing countries and will require that the staff resources devoted to this work be strengthened.

34. The proposals for a more active Bank role along these lines were strongly endorsed at the recent Development Committee and Annual Meetings. Management intends to follow through vigorously on these proposals in the months ahead.

35. Relations with the Private Sector. There appears to be a growing recognition among both Part I and Part II countries of the important role which the private sector--both foreign and domestic--can play in restoring growth and development momentum in the years ahead. Thus, strengthened collaboration with the private sector is one of the key challenges which the Bank, including IFC, faces.

36. It should be emphasized, in this connection, that much of the infrastructure which the Bank helps to finance is an essential complement to investment by the private sector. Without the roads, power supply and other similar infrastructure and support services which the Bank helps to

finance, many private investments would simply not be viable. Moreover, the Bank's policy dialogue often focuses on issues that are essential in creating the environment necessary for productive private investment and efficiency in the use of resources generally.

37. Both the Bank's and IFC's catalytic role in mobilizing resources from private sources take on added importance in the current environment. In a period when commercial bank lending is growing much more slowly than in the past, both institutions need to increase their efforts and develop new initiatives to promote private capital flows on a sustainable basis.

38. Co-financing with commercial banks has received considerable emphasis in recent years. An interim review of the "B-Loan" program will be presented to the Executive Directors shortly. While the details of this program can be left for separate discussion, the aim of the Bank's operations is clear; namely, to facilitate the flow of capital into productive uses. If countries are clearly not creditworthy--or if they have ample access to capital--the Bank cannot expect co-financing techniques to have much impact. But when creditors' risk perceptions are not based on full knowledge or when these perceptions are in flux, the Bank can and should seek to help mobilize finance or improve its terms through co-financing.

39. The particular instruments used to encourage the flow of commercial bank finance into productive uses will continue to be reviewed and adapted. The consultative group mechanism, for example, may--with suitable modifications--be helpful as a means of improving communication between borrowing countries and their commercial creditors. The information available to creditors concerning medium-term prospects is much less adequate than information relating to near-term prospects. Similarly, creditors tend to know more about the level of resource use (e.g. level of imports, investment of government expenditure) than about the efficiency with which those resources are being allocated and used. This suggests a potential role for the Bank, working in conjunction with the borrowing governments, in improving the information base on which credit decisions are based.

40. In the case of IFC, the Corporation's syndication activities have mobilized substantial investment funds from a large number of commercial banks--many of whom would have not provided this type of project finance to the LDCs without the IFC role. The Corporation will build on these efforts, taking advantage of the positive experience that participants in its loans enjoyed during the most difficult debt-servicing period for the large Latin American countries. In addition, the Corporation has been able to mobilize direct foreign investment in the form of equity from private, as well as public sources (Saudi Fund). Further applications of this approach are under review.

41. In addition, improvements in domestic economic management can affect the incentives which lead to capital flight. In some countries, even partial reversal of the private outflows which have occurred in recent years could add importantly to overall resource availability. Bank and IFC operations that address weaknesses in the domestic financial sectors of developing countries are particularly promising in this regard. IFC's plans for the next few years envisage giving increased importance to operations and technical assistance addressed to improvements in domestic capital markets.

42. During the recent Development Committee and Annual Meetings, a number of Governors urged that increased attention be paid to the potential role which private direct investment can play in the developing countries. In terms of specific actions, several Governors expressed willingness to move ahead with consideration of a Multilateral Investment Agency (MIGA). Accordingly, Management intends to present a draft convention for consideration in the near future.

43. While IFC's expansion plans and the proposals for a new multilateral investment guarantee agency have quite properly received a good deal of attention, they by no means represent the whole of the effort made by the Bank Group to act as a catalyst with respect to private investment, both foreign and domestic. Consistent with its general posture of operating within the framework of development objectives set by the country, the Bank Group has also helped a number of countries revise the codes which set the groundrules for foreign investment. The work done in the energy sector in recent years has provided some notable examples of this type of assistance. Based upon the interest now being shown by many developing countries in making fuller use of the technology, marketing contacts and risk capital potentially available from collaboration with foreign investors, further expansion of Bank and IFC activity in this area is expected. In addition, Bank and IFC assistance may be provided on a selective basis to countries wishing to "privatise" certain activities previously carried out by the public sector.

44. As with other facets of Bank and IFC operations, the catalytic role vis-a-vis the private sector needs to adapt to the changing needs and conditions of the borrowing countries. A number of new operational techniques are currently under review (e.g. portfolio investment trusts; industrial restructuring operations). While it is too early to judge the potential of particular techniques, the general guideline for future operations is clear: the Bank and IFC should stand ready to assist countries make full use of the resources available from private investors, both foreign and domestic.

45. When reference is made to the Bank's catalytic role, it is not only the qualitative aspects of operations which are meant. There is also the issue of the scale of Bank operations and whether there may be ways in which the Bank's financial involvement in an operation can be reduced without damage to its qualitative contribution. The Executive Directors have been given a separate note on the prospects for sale of loans from the Bank's portfolio. Other aspects of Bank leverage (e.g. use of guarantee powers; possible revisions in loan terms; potential role for a World Bank Bank) will be taken up in the forthcoming analysis of the resource implications of the Bank's future role. In order to lay the basis for consideration of these issues it may be helpful, in concluding this overview of Bank operations, to address the link between the principles which guide the commitment of Bank resources and the scale of lending that is envisaged for the future.

Scale of Future Operations

46. A number of Directors have suggested that the scale of Bank lending should be addressed in the context of the overall resource requirements of the developing countries. Others have called attention to the arbitrary character of medium or long-term projections of overall resource

requirements. Management agrees that the uncertainties with respect to the future do severely limit the usefulness of estimates of long-term financing "gaps". Moreover, as should be clear from the preceding discussion of the principles governing Bank operations, the rationale for future Bank operations is not simply to transfer a certain pre-determined volume of resources, but rather to promote development through a combination of actions that includes much more than just finance.

47. This does not mean, however, that the prospects for overall capital flows have no bearing on the scale or character of future Bank operations. In the case of the low income countries that are critically dependent on official capital flows, the Bank has concerned itself with the broad compatibility of prospective resource flows and financing requirements. For Subsaharan Africa as a whole the prospect that external capital will decline (in net terms) to less than half the level of the early 1980s, has been flagged as a critical obstacle to achieving a satisfactory outcome for the region. Given the constraints on IDA direct lending set by the size of the 7th Replenishment, the Bank's response has had to emphasize the need for all parties (including bilateral aid agencies, export credit agencies, other multilateral sources) to contribute to a more adequate resource flow. The Bank has agreed to take the lead in encouraging actions toward this end.

48. The situation for countries that rely primarily on commercial capital is different. Prospective capital flows for these countries are much more sensitive to the state of the world economy (eg. growth in trade; levels of interest rates) and the progress made by the borrowing countries themselves in restoring and enhancing the creditworthiness which is the basis upon which capital is attracted. Accordingly, judgments about their prospective capital requirements and the outlook for various sources of finance are more tentative. Nevertheless, there is broad agreement that the rate of growth in commercial bank lending which prevailed in the 1970s will not--and should not--be continued in the years ahead. Future financing should involve a better balance between long-term official capital and more volatile private capital. Moreover, within the component supplied from private sources, the role of direct investment should be encouraged.

49. Translating these broad judgments into specific proposals for future IBRD lending cannot be done mechanically. Ultimately a political decision will be required. Nevertheless, in making that decision, certain reference points may be helpful as guides. It seems clear, for instance, that commercial bank exposure will grow by something less than 10% per annum at least for the next few years. A range of 5% to 10% is not implausible. (This compares with growth rates nearer to 20% per annum in the 1970s.) Decisions taken over the past two years with respect to the ordinary capital operations of the Asian Development Bank and the Inter-American Development Bank have allowed for lending growth rates of 12% to 15% per annum—levels broadly compatible with a shift toward somewhat greater reliance on long-term official finance.

50. A second perspective which is also relevant in forming a judgment on the appropriate scale of future Bank lending is one that takes account of the linkage between the Bank's effectiveness as an advisor and its

ability to commit resources in support of that advice. A number of Directors have commented upon this linkage in earlier discussions. While most accept some linkage, views differ on how strong or direct it should be.

51. Management is very sensitive to the wide range of factors that contribute to a constructive relationship between the Bank and a borrowing country. It would be wrong to see this relationship as simply a matter of how much money the Bank can contribute, either in absolute terms or as a percentage of total capital inflows. But it would be equally wrong to suppose that the Bank's effectiveness is unaffected by the scale of resources it can commit to a country over a period of years in support of an agreed assistance strategy.

52. Just what the linkage is in quantitative terms is of course extremely difficult to determine, particularly if the issue is approached in the abstract. Perhaps a more useful approach is to take as a point of departure the current IBRD lending plans which are based upon country by country assessments of medium-term development issues and related Bank assistance strategies. These plans--which cover the period FY85-FY88--imply an aggregate growth rate of about 10% per annum. As has been emphasized on a number of occasions, these plans are not unconstrained estimates of the volume of IBRD lending that would be appropriate in each country. Rather the plans take account of a number of constraints.

53. IBRD lending to the four largest borrowers is limited to about one-third of total lending. Creditworthiness concerns rule out, or sharply limit, planned IBRD lending to most countries in Subsaharan Africa and a number of countries in other regions. In addition, there are a few countries that are creditworthy but where it has not proved possible to establish a workable dialogue as a basis for lending operations.

54. As long as these constraints continue to apply, the patterns of lending described in the recent Review of World Bank/IFC Financial and Operating Programs (R84-152, dated June 1, 1984) are reasonable estimates of what is likely to result from the application of the principles articulated in this note (see Attachments 1 and 2). Management would not expect the application of these principles to result in any significant shift in regional, sectoral or per capita income distribution of lending as compared to the patterns which the Board has already reviewed.

55. Where some differences may be anticipated is in the year to year fluctuation of lending commitments, both to individual countries and in the aggregate. Partly this is a consequence of the constraints on lending to large borrowers. In the past, variations in lending to these countries have moderated fluctuations in aggregate lending. But, equally if not more important, is the greater emphasis which would be given to ensuring that operations are focussed on issues that are central to the borrower's development prospects, even if this means dropping some operations that are less critical or delaying implementation of operations in order to adapt to the pace of government decision-making. While this approach should not diminish the reliability of the Bank as a financing source over a medium-term perspective, it may mean greater variations in annual lending totals.

56. Judged in a medium-term perspective, a decision to limit IBRD operations to what can be sustained on the basis of its current capital base (i.e. without a new GCI) would eventually require important changes in the patterns of lending envisaged in the FY85-FY88 operating program. The Bank would have to reduce operational commitments so as to accommodate a reduction of about one-quarter (in real terms) over a five year period. The principal impact would be felt on the Bank's ability to hold out the prospect of sustained support for policy and institutional reform over the next few years.

57. Difficult choices would have to be made concerning the manner in which such a reduction would be distributed. Lending to upper middle-income developing countries (i.e. those with per capita incomes over $2440 per annum) is already projected to decline from 12% of IBRD lending in FY79-FY83 to 7% in FY84-FY88, so significant further reductions in lending to this group would mean limiting the number of countries in which the Bank is active and/or sharply circumscribing the scope of its operations. In addition, there would have to be reductions in the scale of assistance envisaged over the medium-term in countries with lower per capita incomes.

58. Management recognizes that a decision on the scale of future Bank operations must take account not only of what is desirable in an operational sense, but also what is achievable in terms of resource availability and prudent financial management. Accordingly, no recommendation on the scale of lending will be put forward until those latter issues are discussed. There is no doubt, however, that, taking a multi-year perspective, the general principles for future Bank operations articulated in this note can only be implemented effectively across the entire range of active borrowers on the basis an eventual increase in commitment authority over current levels.

Attachment 1

(Extract from "Review of World Bank/IFC Financial and Operating Programs and FY85 Budgets" (R84-152) dated June 1, 1984 - Page 26)

DISTRIBUTION OF IBRD AND IDA COMMITMENTS BY INCOME GROUP a/
(Amounts in FY84 Commitment $m)

1982 Per Capita GNP a/		Actual FY79-83 Amount	Actual FY79-83 %	Current Program FY84-88 Amount	Current Program FY84-88 %
Group I	IBRD	5315	10	13249	21
(Up to $410)	IDA	16167	84	15095	93
	Total	21482	30	28344	36
Group II	IBRD	9654	19	9128	15
($411-$805)	IDA	2646	14	1191	7
	Total	12300	17	10319	13
Group III	IBRD	14312	27	17418	28
($806-$1410)	IDA	424	2	5	-
	Total	14736	21	17423	22
Group IV	IBRD	16928	32	18670	30
($1411-$2440)	IDA	-	-	-	-
	Total	16928	24	18670	24
Group V	IBRD	6053	12	4643	7
(Over $2440)	IDA	-	-	-	-
	Total	6053	9	4643	6
All Groups	IBRD	52262	100	63108	100
	IDA	19238	100	16291	100
	Total	71500	100	79399	100

Note: Amounts and percentages may not add to totals due to rounding.

a/ Per capita GNP in 1982 dollars according to preliminary figures for the 1984 World Bank Atlas. No allowance has been made for country movements from one income group to another over time.

Attachment 2

(Extract from "Review of World Bank/IFC Financial and Operating Programs and FY85 Budgets" (R84-152) dated June 1, 1984 - Page 29)

DISTRIBUTION OF IBRD AND IDA COMMITMENTS BY SECTOR
(Amounts in FY84 Commitment $m)

Sector	Actual FY79-83		Current Program FY84-88	
	Amount	%	Amount	%
Agriculture & Rural Devt. a/	20425	29	21824	28
Energy b/	15233	21	17324	22
Transportation & Telecommunication c/	9401	13	9444	12
Program & Structural Adjustment Lending	5308	7	5229	7
Social Sectors	10193	14	12541	16
Water Supply & Sewerage	4045	6	3680	5
Education	3218	5	3955	5
Pop., Health & Nutrition	499	1	1330	2
Urbanization	2430	3	3576	5
Industry & Mining d/	3361	5	3270	4
DFC, Small-Scale Industry & Other e/	7579	11	9767	12
TOTAL	71500	100	79399	100

Note: Amounts and percentages may not add to totals due to rounding.

a/ Includes feeder and rural road transportation projects.
b/ Includes oil, gas, coal, power, and energy-related industry.
c/ Excludes feeder and rural road transportation projects.
d/ Includes non-fuel minerals only; excludes energy-related industry.
e/ Other includes multi-sectoral technical assistance loans and credits.

Informal Meetings
July 18 + Aug.3

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Future Role of the Bank - Board Meetings - 1984-1985	1660618

Document Date	Document Type
07/11/1984	Memorandum

Correspondents / Participants
To: Executive Directors and Alternates
From: T. T. Thahane

Subject / Title
Future Role of the Bank

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Salma Berrada El Azizi	June 27, 2025

Archives 01 (March 2017)

Mr. Qureshi

OFFICE MEMORANDUM

FIS/MC84-40
CONFIDENTIAL

DATE July 17, 1984

TO Mr. A. W. Clausen

FROM Joe Wood

EXTENSION 72784

SUBJECT July 18th Discussion: Emerging Themes

1. Although the Executive Directors have only had the documentation for this meeting for a few days, it is already clear that we can expect some strong reactions. Moeen asked me to send you a summary of the themes which appear to be emerging and to suggest that a brief meeting of the Managing Committee be held prior to the 10.00 a.m. opening of the discussions tomorrow to orchestrate our response.

2. From some of the developing country Directors we can expect a very suspicious and even hostile response. Underlying the questions which El Naggar, Ray and possibly others will raise is a deep suspicion that the Bank is bowing to pressure from the major industrial countries (particularly the United States) to join forces with the IMF and the commercial banks to impose policy conditions on the developing countries. In private conversations some of these Directors have reacted quite emotionally, arguing for instance

- that the Bank is becoming another IMF with 25% of its lending unconditional (as with the first credit tranche at the IMF) but additional sums being dependent upon increasingly burdensome policy conditions

- that the traditional collaborative relationship between the Bank and borrowers will be lost if the Bank moves in the direction indicated

- that the Bank should focus more attention on changing the "rules of the game" (e.g. the prospects for trade and capital flows) than on promoting developing country adjustment to these "rules".

These concerns are also shared by some Directors from developed countries (e.g. Miller).

3. By contrast, we can expect rather supportive statements from at least a few Directors. Nigel Wicks may have already circulated a statement (which he showed to Shahid Husain and me in draft) to his EEC colleagues that is very consistent with the approach we have taken. A copy of this draft is attached.

Line of Response

4. In responding to the queries and criticisms of the developing country Directors, it may be useful to underline the following points:

(a) acceptance of the "rules of the game". The Bank does not passively accept the policies of developed countries. This year's WDR illustrates the point quite well. Moreover, the note itself (paragraph 12) draws attention to the Bank's work on trade restrictions and calls for continued efforts "with particular emphasis on the links between successful debtor country adjustment and the trading opportunities made available to them."

(b) threat to the traditional collaborative relationship. The treatment of "conditionality" in paragraphs 17-19 of the note is explicit in its rejection of a confrontational approach. Moreover, there are frequent references in the text to the uncertain "demand" for lending in support of macro-economic or sectoral policy changes.

It is obvious, however, that the Directors' concerns on conditionality are addressed not to what appears in the management note, but rather to what they think (or fear) lies behind the note. In particular, El Naggar and Phaichitr (who will not be present tomorrow) mentioned the idea of a "core/non-core" approach to Bank lending as an illustration of what they are afraid of.

5. If this subject comes up directly--it is bound to come up indirectly--we can state unambiguously that management has neither considered nor endorsed such an approach to IBRD lending in general. We have of course declined to lend at all when the policy environment has been so unsatisfactory that credit-worthiness is undermined, but that is nothing new. Management has also declined to lend for particular purposes when the relevant sector policies are blatantly unsatisfactory (e.g. energy lending in Egypt). What is really at issue is the extent to which the lack of an agreed basis for lending in one sector should be allowed to affect the overall level of lending to the country concerned.

6. The posture taken in the note itself is not precise on this point. It does suggest (in para. 17) that the pipeline of "traditional" projects (i.e. those that emphasize physical investment rather than sectoral or economy-wide policy and institutional measures) may not be sufficient to justify a lending program of desirable size over the next year or two. But there is no clear statement that management would, in the longer-term, be willing to constrain lending in cases where policy progress is slow or non-existent in order to be able to lend more in cases where policy progress is faster or more promising. The hope--expressed in paragraph 36--is that sufficient resources would be put at the Bank's disposal to prevent this sort of trade-off from becoming a serious issue.

7. My recommendation is to respond to questions in this area by emphasizing the following three points:

(a) flexibility/adaptability to country conditions. The note asserts (in para. 19) that finding the right relationship between analytic and advisory work, on the one hand, and lending operations on the other is "one of the key challenges to management." We should try to preserve management flexibility in this area rather than to seek hard and fast rules.

(b) "demand driven" policy work. Our posture is one of supporting governments that accept the need for change, although we can and should seek to influence the "demand" for this kind of operation through persuasion, through enhancements of the quality and timeliness of policy advice, and through a willingness to provide fast-disbursing funds when called for (paras. 29-32).

(c) need for additionality. Precisely because a confrontational relationship with borrowers should be avoided, it is important that the Bank be able to offer additionality at the country level without penalizing other borrowers (para. 35-36).

Resource Constraints

7. The references to the volume of IBRD borrowing (para. 34 and 62) were drafted before the "hard line" adopted by the United States on U.S. dollar borrowings was known. While we don't want the discussion tomorrow to focus on what may turn out to be a short-term problem, it may be useful for Moeen to flag to the Directors the rather obvious point that future growth in lending is only feasible if the Bank can count on gradually expanding access to capital markets.

Bank/Fund Relationships

8. A copy of the documentation for tomorrow's meeting was given informally to David Finch. He offered no direct comment on the substance of the notes, although he reiterated a position he had taken when commenting on the Debt and Adjustment paper: namely, that the Fund favors "co-ordinated or complementary" programs rather than "joint" programs. The idea is to keep the accountabilities of the two institutions distinct.

9. I also attach a proposed agenda for the discussions and a list of Bank staff who have been invited to attend.

cc: Members of the Managing Committee
Mr. S. Husain

DJWood:edec

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Future Role of the Bank - Board Meetings - 1984-1985	1660618

Document Date	Document Type
07/10/1984	Memorandum

Correspondents / Participants
To: Mr. J. Wood, Vice President and Mr. S. Shahid Husain, Vice President
From: Nigel Wicks

Subject / Title
The Future Role of the Bank

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

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Correspondents / Participants
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From: T. T. Thahane

Subject / Title
Informal Meeting on the Bank's Future Role in Major Debtor Countries

Exception(s)

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Salma Berrada El Azizi	June 27, 2025

List of Task Forces
June 28, 1984

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Correspondents / Participants
To: Executive Directors and Alternates
From: T. T. Thahane

Subject / Title
Future Role of the Bank : Staff Task Forces

Exception(s)

Additional Comments
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Archives 01 (March 2017)

INFORMAL MEETING
June 21, 1984

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Correspondents / Participants
To: Executive Directors and Alternates
From: Serena Han Clarke

Subject / Title
June 21, 1984 - Informal Meeting on the Future Role of the Bank

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