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L.B. Rist: Bank and IDA Financial Policy  
1963-01/1963-12 (2)

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Leonard B. Rist - Bank and IDA Financial Policy - Correspondence - Volume 2 - January  
1963 - October 1963

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## OFFICE MEMORANDUM

TO: Mr. Leonard Rist

DATE: October 29, 1963

FROM: K. S. Venkatraman *K. S. Venkatraman*SUBJECT: Documents on Bank Policy and Procedure

Please find attached the following documents relating to the formulation of Policies and Procedures of Bank loans:

<u>Document No.</u>	<u>Date</u>	<u>Subject</u>
<u>Loan Policy</u>		
R-97 ✓	April 9, 1947	Draft Memo on Loan Policy
R-97 ✓ (First Rev.)	Jan. 23, 1948	Modification of system of charging interest and commitment fee on loans
R-97 ✓ (First Rev.)	Jan. 28, 1948	Memorandum on loan policy (as revised January 28, 1948)
R-97 ✓ (Second Rev.)	Feb. 6, 1948	Memorandum on loan policy (as revised January 29, 1948)

Organization and Loan Procedure

R-106	May 22, 1947	Report by President re matters of organization and loan procedure
R-106 (Final)	June 4, 1947	Ditto
R-106/2	March 16, 1949	Memorandum re organization and loan procedure (Confidential Draft)
R-106/3	March 25, 1949	Memorandum re organization and loan procedure (Confidential Draft)
R-106/4	May 24, 1950	Memorandum re organization and loan procedure (Rev.)
R-106/5	October 16, 1952	Ditto
R-106/6	August 10, 1955	Ditto
R-106/7	September 7, 1956	Amendments to R-106/6
R-106/8	September 14, 1956	Memorandum re organization and loan procedure

INTEREST, RATE

....4

Reference by Mr. Machado to new ceiling imposed by Pakistan Government of 7.5% on foreign exchange loans to be made in future by PICIC -- comments by Messrs. Apar and Diamond.

2/12/63

M-354v

✓ Mr. Garland does not feel reduction in loan charges by Bank would distort interest rate mechanism.

1/17/63 Jt. Mtg. FPC 63-4 ✓

✓ Remarks by Mr. Garland and Chairman on Bank influencing interest rates.

2/12/63

FPC-63 7 v ✓



LOAN POLICY 518

.3.

Use of foreign exchange to finance local currency expenditures (Belgian Loan) 4/5/49 M-172  
M-176 V

X ✓ Report (R-106/2) - approval of change. M-174  
✓ (R-106/3) - approval M-175

Discussion of use of counterpart in connection with Colombian loan "Caja". 8/18/49 M-190 V

IBRD should establish policy on what kind of loans she should make to underdeveloped countries.  
Statement by Mr. Hoppenot using El Salvador as example. Size of loan granted to a member not dependent on subscription; projects to be considered on own merit, etc. 10/13/49 788  
M-195 V

LOAN POLICY

.... 11

X Mr. Lieftinck suggests possible need for reconsidering  
lending policies - mentions feeling that continued  
increase in reserves presents some problem.

2/12/63

FPC 63-7 ✓



✓ Mr. Lieftinck does not feel present charges unreasonable-  
sees possible need to study loan policy not excluding  
loan charges. Miss Brun favors reduction of commission  
as useful to combine with payment of dividend. Mr.  
Machado favor reduction only if way could be found to  
pass benefit to member countries without hurting and  
impairing Bank's facilities of access to market and  
for selling portfolio.

2/12/63

FPC 63-7 ✓

**DECLASSIFIED**CONFIDENTIAL

Date: 11/15/2010

FPC 63-15

SRB

September 23, 1963

\*Memorandum of Meeting of Bank Financial Policy Committee on "BANK FINANCIAL POLICY" (Report FPC63-8), Tuesday, September 17, 1963, at 10:00 a.m.

1. There were present:

Chairman

George D. Woods

Management

Geoffrey M. Wilson

Executive Directors and Alternates  
acting as Executive Directors

Alice Brun  
John C. Bullitt  
Reignson C. Chen  
Otto Donner  
John M. Garland  
Joaquin Gutierrez Cano  
L. Denis Hudon (Alternate)  
Fernando Illanes  
Ali Akbar Khosropur (Alternate)  
Rene Larre  
Pieter Liefstinck  
Luis Machado  
Jorge Mejia-Palacio  
F. Oellerer (Alternate)  
D. B. Pitblado  
K.S.S. Rajan  
Gengo Suzuki  
Abderrahman Tazi

Alternates not acting as  
Executive Directors

H. Abramowski  
A. Bogoev  
Lempira E. Bonilla  
C. Brignone  
Erle Cocke, Jr.  
A. K. Ghosh  
Ismail Khelil  
M. Kumashiro  
N.M.P. Reilly  
Sergio Siglienti  
Eino Suomela  
A.J.J. van Vuuren  
J. Waitzenegger

Staff

M. M. Mendels  
A. Broches  
Richard H. Demuth

Francis R. Poore  
Mrs. Shirley Boskey  
Cyril H. Davies

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

Distribution:

Members of the Financial Policy Committee  
President  
Vice Presidents  
Department Heads



2. Mr. Khosropur said he joined with other Executive Directors in congratulating the Chairman on the financial policy proposals. They responded to changes in the financial and economic situation in the less developed countries. He particularly welcomed the proposals for expansion of technical assistance in project preparation, training programs, lengthening of the maturities and grace periods, and for financing of agricultural projects and private industry. He supported the proposal for a reduction of the commitment charge. At the same time, if reserves, especially the Supplemental Reserve, were now considered adequate, he would prefer a reduction of, say, 1/4 of 1 per cent in the commission; perhaps both the commitment charge and the commission might be reduced. As regards a transfer of Bank earnings to IDA, he hoped it might be possible to reconsider that question at an appropriate time. While the proposals concerning financing of agricultural projects and pioneer industries would assist very important sectors of most of the less developed countries, he thought an interest rate of  $6\frac{1}{2}$  to 8 per cent for such loans was high; it would certainly increase the foreign exchange burden of the less developed countries. He also thought that to assure that such demands on a country's foreign exchange resources were in line with its economic policy, prior agreement of the government concerned should be required. With respect to technical assistance for education and financing for school buildings, he commented that vocational training and assistance or grants for the foundation of technical schools were two other areas in which there was great need of assistance. The Chairman said that the Financial Policy paper had not proposed  $6\frac{1}{2}$  to 8 per cent interest rates for any agricultural loans. He had had in mind that if the Bank should be authorized to lend without government guarantee of repayment, it was probably reasonable to expect that borrowers under non-guaranteed loans should pay something more than would be asked of borrowers whose loans were fully guaranteed. The suggested possible interest rates related entirely to loans to private industry without government guarantee.

3. Miss Brun said she had received views from the governments she represented on the various proposals for Bank financial policy, although some of the countries had reserved their final position. While some difference of opinion existed among those countries, there was a remarkable degree of agreement among them. Some new course of action for the Bank might result from the Committee's deliberations, but on the whole she thought it would be wise to let any change in well-established Bank policy develop slowly and, perhaps even more important, not to take any step which might impede a disposition which might later, under changed circumstances, appear desirable. The discussions took place against the background of an excess of funds for Bank operations, at least for the time being, and a shortage of funds for operations of IDA. The amounts accumulated by the Bank were a consequence of the fact that the paid-up capital carried no interest obligations; therefore the net income situation was not transitory, but could be expected to continue. In this situation most of her authorities had expressed the view that the earned surplus



would probably be more usefully spent for development purposes by IDA than by the Bank, even if new ways were found for Bank financing. It was also their view that if a transfer of a moderate amount from the Bank to IDA were considered detrimental to the good standing of the Bank, the same might be said of the proposal, now under consideration, to introduce IDA-like operations within the Bank itself. At present, it seemed difficult to obtain majority support for such a transfer and, furthermore, a replenishment of IDA resources was now in sight. However, she wanted to associate herself with those Directors who had expressed the hope that the idea of a transfer to IDA, even though not practicable at present, had not been abandoned. Whether a transfer should be accomplished directly or by way or in lieu of a dividend was a matter for consideration.

4. Miss Brun said her governments thought that present loan charges should be reduced, preferably by a reduction of the rate of commission but alternatively by the proposed reduction of the commitment charge. The commitment charge functioned as a penalty on borrowers who did not carry out their projects within a reasonable time. But it was also a burdensome payment for those borrowers whose projects had to be carried out over a number of years. For the latter reason, a reduction would be desirable.

5. Miss Brun said her countries did not favor establishment of an earned surplus account. She noted that the proposal before the Directors was for the establishment of a different account, and she welcomed a further discussion of that proposal the following week. But if some such account were to be established, she thought most of her countries would prefer in the meantime that no IDA-like operations be introduced in the Bank. It should be possible to achieve greater flexibility in Bank lending some other way. What might be called the more improvident credits should continue to be left to IDA; the Bank should be very hesitant to take steps along the IDA way. Some countries, which were not within the group eligible for IDA credits, even some rather industrialized countries, might be in need of investment capital. This could justify greater flexibility in Bank lending without going so far as IDA. The proposed long-term loans might be extended to projects with a very long economic life, but she wondered whether a 40-year repayment period and a 10-year period of grace might not be going too far. These should certainly be the maximum. In addition to agriculture and pioneer industry as recipients of longer-term loans, forestry and forest improvement might be considered, as well as continued financing of infrastructure. It was true that loans on such terms could be made under the Bank charter. However, long-term loans at normal interest rates could become a heavy burden on the developing countries. Therefore, in principle, such loans seemed more appropriate to IDA. This was particularly so in the case of lending in the educational field; the Bank must move very cautiously in this area.

6. Miss Brun said that a negative attitude predominated among her countries toward the proposal for high-interest loans to private industry without a government guarantee; they thought such loans should be left to IFC. It did not seem advisable for the Bank to make any loans at rates



considerably higher than its normal rate. Moreover, her authorities found no justification for amending the Bank charter to authorize the making of non-guaranteed loans. To the extent that private industry could not satisfy its capital needs either through the market or through IFC, that problem should be considered in connection with IFC, not in connection with the Bank.

7. As far as the maintenance import loan proposal was concerned, Miss Brun said this had been received with understanding by her countries. At the same time, loans of that type seemed rather far removed from the requirement of the Bank charter that loans should normally be made for specific projects. It might even be doubtful whether that type of loan was properly within the field of Bank activity. If the difficulty to which such loans would be addressed were due to a general balance of payments problem, it seemed to be more a matter for the Fund than the Bank.

8. Miss Brun said she would favor an expansion of the Bank's technical assistance on two conditions. First, it should not become so extensive as to call for expenditure of such substantial amounts that a later transfer of earned surplus to IDA might be prejudiced. Second, any activity in a field which was the primary concern of the United Nations, FAO, UNESCO, etc., should be performed in very close cooperation with that other organization. The Bank had special expertise in project study and project preparation; it was in these fields that it should preferably provide technical assistance. Industrial research, insofar as that was not being done by United Nations, was also appropriate. She would also recommend that project preparation go beyond those projects likely to be financed by the Bank itself. Sweden had emphasized the importance of having the Bank's special knowledge available for preparation of projects to be financed by other multilateral organizations or from national sources.

9. Mr. Chen congratulated the Chairman on the constructive paper. His personal views had been presented at an earlier meeting, and he was glad to say that he had been informed that they were shared by his principal. He supported the recommendation to extend the period of grace and amortization of loans for long-term projects. But he thought that the benefit of this liberalization should pass to the government of the end-user's country as was the case under IDA credits, to avoid giving the end-user a great advantage, in the form of subsidy, over competitors who might not have the benefit of a Bank loan. Mr. Chen also supported Mr. Machado's proposal for Bank assistance to countries having difficulty in raising the local currency costs of Bank-financed development projects. He would go even further, by recommending that the Bank explore the practicability and desirability of creating a supply of local currency by converting dollars or other convertible currency remittances under Bank loans into local currency, or employing some other method similar to AID program loans to finance imports of commodities required for a development project.



10. The Chairman said that if there were no other comments by Directors on the Financial Policy paper at present, then with the understanding that there might be many more comments as the discussion continued in the future, he would like to run through the memoranda of the two earlier Financial Policy Committee meetings (FPC 63-11 and FPC 63-12) to express his own views on a few points, in the hope that that might contribute to a clearer understanding of his intentions and purposes in submitting the Financial Policy paper to the Directors.

11. The Chairman referred to the comment of Mr. Pitblado, on page 3 of FPC 63-11, expressing concern that the officers or the staff of the Bank might find themselves competing or getting into areas in which other international institutions had the major responsibility or in which Bank staff had no special expertise. Other Directors had apparently shared this concern and so did the Chairman. He hoped in his speech to the Annual Meeting to make it clear that his intention was to cooperate to the maximum with other international bodies. If there was any implication in the paper that there would be any competition with other international bodies, it was not intended. On the contrary, he thought the Bank should find more ways of assisting, with its knowledge, experience and funds, other international agencies in the fields of agriculture, health, education, to achieve their ends where they might find themselves frustrated for one reason or another. Perhaps the health area was a little doubtful; it was not touched on in the Financial Policy paper for that reason. But in the agricultural and the educational area the basic intention was to become thoroughly familiar with other agencies in the field and to see if the Bank could supplement, collaborate and cooperate with them.

12. The Chairman noted that on page 9 of FPC 63-11 Mr. Khelil referred to the development of tourism. This was an area in which the Chairman had a great interest. Unquestionably in many of less developed countries the development of tourism offered great possibilities of foreign exchange earnings. However, a foundation piece of tourism was hotel financing. The Bank had financed highways and railroads for years and would continue to. But when it came to hotels or air lines, his experience in the private financial field was such that he was not quite ready to recommend to the Board activity in those areas except in rare and unusual circumstances. It was for that reason that the Financial Policy paper did not comment on tourism. As far as he was concerned, hotel financing should be left for an indefinite time.

13. The Chairman noted that Mr. Plumptre on page 10 of FPC 63-11 referred to the question of a transfer to IDA. Since his return, several Directors had asked whether the expression "at this time" in connection with IDA was a diplomatic way of putting the question of a transfer off indefinitely or whether in the measurable future he expected to raise it again. He had been replying that it was not his intention to put the IDA question off into the indefinite future. The first replenishment



of IDA was now in process and there was no particular need for the Bank to take any steps with regard to IDA at present. When the IDA question became pressing, it would receive attention promptly; the situation would be reviewed with an open mind. He was persuaded that a preponderance of the Bank's shareholders felt that in some way a conservative part of the Bank's earnings could and should be used in the IDA operation. He was aware of that feeling and could not disregard it. Therefore, as he had said, the expression "at this time" was not intended to be an indefinite postponement.

14. The Chairman noted that on several occasions reference had been made to the possibility of a change in the interest rate. As to this, he would repeat what he had said in the Financial Policy paper. The Bank's rates were fair and reasonable. It could not disregard the rate of interest charged in the countries where it made loans. He understood and sympathized with the viewpoint of the representatives of the capital-importing countries: the lower the cost of money, the better. But some rationale, some balance, was necessary. If anything, the Bank's  $5\frac{1}{2}$  per cent was already on the low side. He was not suggesting an increase, but he believed it was unrealistic to consider decreasing it under the present circumstances.

15. The Chairman noted that Mr. Garland on page 17 of FPC 63-11 had referred to the matter of additions to reserves. He repeated his statement, made during the earlier part of the meeting, that his recommendation concerning disposition of the \$80 million-odd of net income for fiscal 1962-63 and his view that there was no present need to increase the Supplemental Reserve, carried no implication with respect to income for 1963-64 or later years. He contemplated that the matter of allocation of income would be reviewed and reconsidered each year.

16. Turning to page 19 of FPC 63-11, the Chairman noted the reference to Dr. Branscomb and a report. As Mr. Knapp had said, there was no formal report. A paper proposing Bank/IDA policies in the field of education was being prepared for submission to the Directors. Mr. Black had asked Dr. Branscomb to investigate the possibility of intelligently using up to \$10 million a year in the field of education. The Chairman, when he succeeded Mr. Black, talked with Dr. Branscomb himself. Together they concluded that the Bank's activity in this area should be related to the Bank's business of lending for constructive, forward-looking purposes in the developing countries. He and Dr. Branscomb also agreed that it would be unfortunate if the Bank, its officers and its Executive Directors became involved with such controversial questions as curricula, faculty, and educational policies. It would, of course, want to satisfy itself, beyond the bricks and mortar question, that the management of the educational institution was satisfactory. Dr. Branscomb had made a thorough investigation but had not been asked to put the results down in a report. Perhaps if there had been an affirmative recommendation for a grant program there would have been a report.



17. On page 22 of FPC 63-11, the Chairman noted, Mr. Machado referred to his paper. The Chairman thought the paper raised a very important question. The problem had existed for a long time, but had never been squarely faced up to by competent persons instructed to do something about it. Bank staff and officers were inclined to think the question was not exclusively one for the Bank ; it was perhaps more within the purview of the Fund. Some conversations had already been had with the Fund and there would be further explorations to see whether there was some feasible, practical answer. A great service would be performed if fugitive or expatriate capital could be brought back to the home country. Not only would it add to local resources but the owners would again have a financial interest in their country and would have a reason to participate in national political and economic affairs. Mr. Wilson added that the intention was to take Mr. Machado's paper as a starting point and, recognizing the importance of the issue raised, look at his suggestions and any other possibilities to see whether there was some way in which the Bank could help to solve the problem. Mr. Machado commented that he represented a number of small countries which had not yet developed a capital market; he had had those countries particularly in mind. He had of course limited his suggestions to areas in which the Bank might act. No doubt the Fund could be helpful, and he certainly did not object to the possibility of a joint Bank/Fund committee to study the problem. He thought it likely that a number of Governors would express interest in the question. The Chairman added that he wanted to assure that the basic problem, the reason for capital flight, was examined and he thought that this raised some questions as to which the Fund perhaps had a greater competence than the Bank. In any event, Mr. Machado could be assured that the problem would not be dropped.

18. The Chairman turned to FPC 63-12 and to the comments of Mr. Ghosh on page 5, concerning the possibility of financing imports of fertilizers into India. This raised a fundamental question which he thought would be of increasing concern to the Bank. There was no reason why fertilizers could not be produced in India except that ready and willing producers had not found it possible to come to terms with the government. Similar situations prevailed elsewhere. Where there were raw material resources and interested foreign capital, he would be opposed to the Bank's stepping in to finance imports. He planned to touch on the basic question of attitudes toward private capital in his Annual Meeting address. Government-to-government aid would no doubt continue but it could never be the whole answer. Eventually private people had to deal with private people; that was where the real money was. The only way to encourage that was to give them a fair chance to make a profit. Mr. Ghosh said that even where there were proposals for manufacturing, say, fertilizers, it took time to get a project going. He had had in mind merely that the proposal to lend for agricultural development could with great benefit be extended to such development of agricultural production as might be made possible through import of fertilizers for a short period. The Chairman agreed that if



the stage were set, and arrangements concluded and it was just a question of the time required to build the plant, that was an entirely different question.

19. The Chairman then referred to Mr. Waitzenegger's comment on page 10 of FPC 63-12 that he doubted that the Bank should enter such fields as teacher training and improvement of school administration. The Chairman agreed entirely as far as teacher training was concerned. Improvement of school administration perhaps came under the head of technical assistance. If a country lacked the foreign exchange to engage administrators and the Bank could find these talents, perhaps it should help.

20. The Chairman noted that Miss Brun, on page 13 of FPC 63-12, had urged cooperation with FAO and other specialized agencies. He agreed.

21. On page 19 of FPC 63-12, the Chairman noted, Mr. Donner had commented that some Directors had expressed misgivings concerning the tendency in the management paper, as they interpreted it, to blur the distinctions between the Bank, IFC, and IDA in certain respects. They had expressed doubt about the wisdom of the Bank's moving into fields for which conventional loans or almost conventional loans seemed to be inappropriate. Miss Brun had touched on this point earlier and referred to the possibility of the Bank's making "IDA-like loans." The Chairman said he did not understand how it was possible to infer from the Financial Policy paper that the Bank might engage in IDA-type business. IDA-type business was the making of loans on extremely soft terms, nothing else. The Technical Operations Department, in vetting a project, paid no attention to whether it would be financed by the Bank or by IDA. It was the foreign exchange situation of the recipient country, not the type of project, which determined whether the financing would come from the Bank or IDA. He really did not know what the expression "IDA-type" meant. He would like to discuss this further at the resumed meeting. He believed that the Bank ought to learn more about certain areas in which it had not been particularly active in the past, agriculture and education, for example. He believed that with the Bank's experience and with its reserves it could be more flexible with respect to grace periods and maturities. Certainly it was good banking practice to keep a certain relationship between the maturities of the Bank's debt and repayments due to it. But the Bank had reached the point at which, while not disregarding that factor, it could afford to give it less weight than it did ten or even five years ago. Where once, as the Bank's banker, he had advised that the Bank ought to have cash or its equivalent almost equal to its outstanding commitments to borrowers, now the Bank's obligations were well regarded and highly acceptable not only to central banks but insurance companies and top investment institutions of all kinds, and there could be a little more elbow room in the relationship between maturities of the Bank's own debt and the maturities of its portfolio. The Bank could, he thought, run more risks. He did not mean unreasonable risks or risks of the kind assumed by commercial banks. He meant that it was



not necessary to have mathematical equality either between the term of Bank loans in relation to the term of its debt, or between the term of the Bank's loan and the life of the project. As for so-called IDA-like loan business, he disclaimed it. There was no tendency for the Bank to move into fields for which conventional loans or almost conventional loans seemed inappropriate. He intended to guard the Bank's standing jealously, and would not advocate any action that would adversely affect the Bank's credit standing with investors.

22. The Chairman then turned to Mr. Lieftinck's point, in paragraph 56 of FPC 63-12, as to whether the Bank should lend for maintenance supplies and spare parts, whether that really constituted the building up of new productive capacity. This was, the Chairman recognized, a basic question. But if, in a given country, existing productive capacity, some of which the Bank might have financed, was operating at less than capacity by reason of the unavailability of components and spare parts, was it right to ignore that situation in favor of a brand new project which in ten years might find itself in a similar situation? Stated otherwise, should the Bank as a matter of policy dedicate itself to the proposition of financing new productive capacity? In the Chairman's view, the Bank should feel some responsibility, within the range of common sense, of course, to do what it could to assure that existing capacity was operating reasonably to the maximum. He appreciated Mr. Lieftinck's argument that this field should be left to the bilateral aid agencies. In fact, those agencies would have to provide the great bulk of such financing. The Bank did not have the resources to do it. The Chairman had put forward the proposal because, unfortunately, prices of commodities purchased under tied aid were not always what they would be if there were international competition. To the extent that the Bank could supply a percentage of the funds required for these items, it could be used judiciously to give an element of competition vis-a-vis the tied funds, which would always be the bulk of the moneys made available for the purpose.

23. Mr. Cocke said that the Chairman's commentary had been exceptionally constructive, and that the Directors welcomed and appreciated his frank statement of views on these issues.

24. Mr. Mejia asked what schedule of future discussions on the paper was contemplated. The Chairman said he thought discussions would go over until after the Annual Meeting, although perhaps there might be a little time after the Directors' meeting the following Tuesday.

25. At 1:10 p.m., the meeting adjourned.



**DECLASSIFIED**

Date: 11/15/2010 STB

CONFIDENTIAL

IDA/SecM63-42

FROM: The Secretary

September 19, 1963

IDA

There is attached a paper entitled "IDA Lending Policy", dated September 19, 1963. The Statistical Appendix to this paper will be distributed at a later date.

Distribution:

Executive Directors and Alternates  
President  
Vice Presidents  
Department Heads

INTERNATIONAL DEVELOPMENT ASSOCIATION

FROM: The President

September 19, 1963

IDA

Questions have been raised from time to time about the general principles which should be followed by the International Development Association in considering requests for assistance from member countries. I am therefore circulating for the information of Executive Directors a background paper prepared by the staff which reviews the development of IDA operations to date, sets out the economic considerations relevant to decisions on lending policy and discusses some of the problems which have emerged.



RESTRICTED

Report No. EC-119a

**DECLASSIFIED**

Date: 11/15/2010 STB

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
INTERNATIONAL DEVELOPMENT ASSOCIATION

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IDA LENDING POLICY

September 19, 1963

Economic Staff



## IDA LENDING POLICY

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## PART I - HISTORICAL BACKGROUND

### Establishment of IDA

1. The International Development Association was authorized to begin operations on November 8, 1960, and made its first credit on May 12, 1961. Its initial resources in the form of gold and freely convertible currencies, mostly subscribed by Part I members, consisted of \$765 million, subsequently raised to \$775 million by a supplementary contribution from Sweden.
2. The purposes of IDA, as described in the first of its Articles of Agreement, are "to promote economic development, increase productivity and thus raise standards of living in the less-developed areas of the world included within the Association's membership, in particular by providing finance to meet their important developmental requirements on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans, thereby furthering the developmental objectives of the International Bank for Reconstruction and Development (hereinafter called 'the Bank') and supplementing its activities."
3. In its first fiscal year (up to June 30, 1961), IDA committed \$101 million, in its second year (July 1961-June 1962) \$134 million and in its third year (July 1962-June 1963) \$260 million. Thus total commitments during the three years amounted to \$495 million. During this period credits were made to 18 countries in 39 loan operations. Subsequently, to August 31, 1963, Pakistan has received three additional credits totalling \$59 million. The size of the credits has varied from \$350,000 for Haitian roads to \$67.5 million for Indian railways. The average size of IDA credits has been about \$13 million.

### Pattern of IDA Operations

4. IDA operations to date have been heavily concentrated in India (\$300 million), which has accounted for 54 per cent of the total commitments. The two next largest recipients have been Pakistan (\$91.5 million) and Turkey (\$26.7 million). Eight Latin American countries between them have received \$70 million (13 per cent of total commitments) and the remaining credits of \$66 million have been divided between China and Korea in the Far East, Ethiopia, Sudan, Tunisia and Swaziland in Africa and Jordan in the Middle East. Details are given in the following table.



Distribution of IDA Credits January 1961 - August 31, 1963

<u>Country &amp; Region</u>	<u>Amount</u> (million US dollars)	<u>Percent</u> <u>of Total</u> <u>Credits</u>	<u>Number of</u> <u>Operations</u>
<u>South Asia &amp; Middle East</u>	<u>393.5</u>	<u>71.0</u>	<u>22</u>
India	300.0	54.1	13
Pakistan	91.5	16.5	8
Jordan	2.0	0.4	1
 <u>Western Hemisphere</u>	 <u>70.35</u>	 <u>12.7</u>	 <u>8</u>
Colombia	19.5	3.5	1
Chile	19.0	3.4	1
Honduras	9.0	1.6	1
El Salvador	8.0	1.4	1
Paraguay	6.0	1.1	1
Costa Rica	5.5	1.0	1
Nicaragua	3.0	0.5	1
Haiti	0.35	0.1	1
 <u>Africa</u>	 <u>34.3</u>	 <u>6.2</u>	 <u>4</u>
Ethiopia	13.5	2.4	1
Sudan	13.0	2.3	1
Tunisia	5.0	0.9	1
Swaziland	2.8	0.5	1
 <u>Far East</u>	 <u>29.3</u>	 <u>5.3</u>	 <u>5</u>
China	15.3	2.8	4
South Korea	14.0	2.5	1
 <u>Europe</u>	 <u>26.7</u>	 <u>4.8</u>	 <u>3</u>
Turkey	26.7	4.8	3
 <u>TOTAL</u>	 <u>554.15</u>	 <u>100.0</u>	 <u>42</u>



5. IDA wanted to set its money to work quickly, while maintaining strict standards in project selection and execution. Countries which were early in joining the organization got off to a head start. This helps to explain in part the initial concentration of IDA commitments in South Asia and the relatively small proportion of credits going to Africa. Countries accounting for 96 per cent of the total population of South Asia and the Middle East had joined by mid-1961, as compared with 48 per cent for the Far East, 37 per cent for the Western Hemisphere and 26 per cent for Africa (see Table 1).<sup>1/</sup> El Salvador is the only country that has received a credit in spite of joining late. In Africa, IDA is still at the beginning of its operations. Only four African countries had become IDA members in their own right by mid-1961, and three of these have since received credits. Much of the continent was in the transitional phase between gaining independence and joining IDA. Metropolitan countries for the most part continued to accept responsibility for development finance during this interregnum.

6. Given the importance attached to the productive use of IDA's resources, preference has naturally been given to countries ready with acceptable projects. This applies particularly to India. In addition, the fact that aid to India and Pakistan has to a large extent been channelled through consortia sponsored by the Bank has lent a special urgency to decisions on the allocation of IDA funds to these two countries. The existence of the consortia may have resulted in their receiving somewhat larger pledges than they otherwise would have during the first three years. However, as much the most populous of the Part II members, India and Pakistan would anyhow have qualified for a large share of the resources available.

7. On the basis of total population, South Asia and the Middle East has obtained more than its "per capita share" of IDA credits, while Africa and the Far East have received somewhat less. Latin America has received slightly less than its per capita share. The population of this region accounts for 15 per cent of the total population of actual and potential Part II countries, and countries in this region obtained some 13 per cent of IDA credits up to August 31, 1963.

8. Different impressions are given if attention is focused on countries which had joined IDA by mid-1961, on countries which had joined by mid-1963, or on the member countries which have received credits. For example, the per capita share of the Western Hemisphere has been (a) slightly lower than the average when both actual and potential Part II countries are considered, (b) somewhat lower than the average if only actual Part II countries are considered, (c) much higher than the average if we consider only countries which joined before mid-1961 and (d) almost two-and-a-half times the average if we consider only countries which have obtained IDA credits (see Tables 2 and 11).

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<sup>1/</sup> All tables and charts referred to in the text are contained in the Statistical Appendix, which is a separate volume.



9. There has been a natural and perhaps inevitable tendency for the smaller countries receiving credits to obtain a larger per capita share than the larger countries. This is illustrated in Tables 3 and 4 which show that on a per capita basis Swaziland has received 14 times as much from IDA as India, while Honduras, Costa Rica, Paraguay and El Salvador have all received roughly five to seven times as much. Taking all the countries which have received credits, the average size of credits going to those with populations of less than 3 million works out at \$3.33 per capita, as against \$0.73 per capita for countries with populations over 25 million. One reason for this is that there is normally a lower limit to the size of loan operation which it is considered worthwhile for IDA to undertake. Given this limit, it is difficult, within a short period of time, to equate actual assistance to small countries with whatever may be considered their "fair per capita share".

10. The competing demands for IDA resources would have been larger if IDA had been prepared to finance a wider range of projects or had agreed to less stringent standards of project appraisal. In practice, IDA has demanded the same standards of project appraisal as the Bank and has confined its operations almost entirely to the same type of project as the Bank has been accustomed to finance. The only possible exceptions have been three credits for water supply projects (in China, Jordan and Nicaragua) and one for school construction (in Tunisia), and these four credits together account for less than 3 per cent of all lending to date.

11. The relative concentration of IDA credits on highways and irrigation, which between them have accounted for 52 per cent of total portfolio compared to 21 per cent in the case of the Bank during the same period (see Table 5, figures to March 31, 1963), can be explained in terms of two factors. First, IDA has been more liberal than the Bank in financing local currency expenditure and has thus been readier to consider road and irrigation projects, where the direct foreign exchange component is usually comparatively small. Secondly, in the case of "blend countries", the Bank has tended to give preference to self-liquidating projects (electric power, industry, ports and railways) leaving IDA to finance projects which seldom yield much in the way of a direct financial return.

#### Criteria of Country Eligibility

12. IDA, as a matter of principle, has not lent money to countries which are debarred from receiving Bank loans by reason of poor international financial behavior, particularly with respect to default on debt and compensation claims. Several Part II members must at present be regarded as ineligible for IDA assistance on these grounds.



13. Apart from this and the factors previously mentioned, there have been certain general economic criteria which have been followed in deciding whether or not a country is eligible for IDA credits. In the first place, it was laid down in the Articles of Agreement that "the Association shall not provide financing if in its opinion such financing is available from private sources on terms which are reasonable for the recipient or could be provided by a loan of the type made by the Bank" (Article V, 1(c)). Major emphasis has accordingly been laid on lack of creditworthiness as a factor qualifying countries for IDA assistance.

14. Some flexibility has nevertheless been maintained in applying this criterion by the doctrine that countries may be considered eligible for IDA credits even when their creditworthiness for Bank loans has not been completely exhausted. In a report to a Meeting of Executive Directors in February 1961 (IDA/R61-3 Addendum), the President indicated that it was not feasible to make absolute judgments on creditworthiness. "In a country where substantial uncertainties exist, IDA loans could be made even though some further Bank lending might still be appropriate. The blending of loans might be achieved by financing some projects in the country wholly with IDA funds. Or it might be achieved by joint Bank-IDA financing of a single project."

15. The Bank is still lending, or considering lending in the near future to the majority of the eighteen countries that had received IDA credits up to August 31, 1963. There have been several cases of joint Bank/IDA financing of a single project (e.g., the Roseires Dam in Sudan).

16. Difficult issues of judgment have arisen over countries reckoned to have some remaining margin of creditworthiness, but expected to exhaust this margin so soon that a blending of IDA credits with Bank loans is held to be justified.

17. A second criterion used in determining a country's eligibility for IDA assistance has been its relative poverty. From the beginning, Executive Directors have taken the view that the claims of the poorer Part II countries are stronger than the claims of those at higher levels of income. However, no attempt has been made to draw a hard and fast line. The countries with the highest per capita income that have so far received IDA credits are Costa Rica (per capita GNP estimated at \$380 in 1958-60), Chile (\$345), Colombia (\$285) and Turkey (\$220). Over three-quarters of IDA credits have gone to the lowest income group consisting of Part II countries with a per capita income of less than \$100 a year - a group in which India and Pakistan predominate (see Chart I).

18. Chart II shows the distribution of IDA credits for all Part II countries which joined before mid-1961 (and which have therefore had substantially equal chances of receiving IDA credits, all other things being equal), making allowances for population and for the preponderant weight of India. For purposes of comparison, the distribution of total net capital inflow on soft terms from bilateral and multilateral sources has also been



plotted (Chart III). The solid line, "Including India", on Chart II indicates that the poorest countries (income level not in excess of \$105 per head) with 66 per cent of the total population of the group received 81 per cent of the total credits, so that the highest income countries with 34 per cent of the total population received only 19 per cent of the credits. The curve lies for the most part above and to the left of the 45° line, the line which would apply if the poorest 20 per cent of the population received 20 per cent of the credits and so on. This is a measure of the extent to which IDA credits have been concentrated on the poorer countries. By contrast, the curve for soft assistance from all public sources (Chart III) lies to a considerable degree below and to the right of the 45° line, indicating that the poorer countries have received less than their per capita share of such assistance. The curve for all assistance from all public sources, including hard loans, is very similar.

19. The tendency for IDA credits to be concentrated to some degree on the poorer countries has been due not to larger per capita credits for poor countries than for higher-income countries but rather to the fact that more of the lower-income than of the higher-income countries have received credits. Eight out of ten Part II countries with per capita income below \$105 received credits, as compared with only eight out of twenty-six higher-income countries (see Table 6).

20. A country's economic performance is another factor which has been taken into account in considering requests for IDA assistance, but there has not been a precise interpretation of this criterion. On the negative side, certain countries have been judged ineligible for IDA credits primarily on the grounds that they have been following "unsound" economic or financial policies. In other cases a record of good performance has been regarded as a positive reason for extending a credit.

21. The most authoritative pronouncement on economic performance as a test of eligibility was made by the President in his speech at the 1961 Annual Meeting when he said: "A necessary condition in all cases is evidence that the borrowing government is making a real effort to mobilize its own resources and to gear its financial policies to development." It has been left to the Bank's economic missions to apply this and other tests of performance in individual cases.

#### Demand for and Supply of IDA Funds

22. There have been considerable difficulties in the past in finding projects suitable for IDA financing in a number of countries. Of course, this was not universally true: limits had to be set on the amount of lending to some countries which might otherwise have received what was regarded on population or other grounds as an unreasonable share of the funds available - for example, Jordan at one extreme and India at the other. Also, more recently, Part II countries with relatively high per



capita incomes have been discouraged from submitting projects. Nevertheless, as a general rule, one credit has not been regarded as being at the expense of another, and this has allowed considerable latitude in the application of the criteria for IDA assistance, at least in the initial stage.

23. For the next phase, IDA will have a specified and limited commitment authority, probably a minimum of \$250 million and a maximum of \$300 million a year. The pledges given at the recent Indian and Pakistan consortia amount to \$190 million for 1963/64, thus leaving \$110 million for all other countries. In a number of countries, it may be difficult to find suitable projects. Even so, the effective demand for IDA credits in countries other than India and Pakistan may well be larger than this, if not during the present year, at any rate in subsequent years.

24. Taking a somewhat longer view, the increase in technical assistance, both on the part of the Bank and other agencies, should result in a larger number of eligible projects coming forward than in the past. Moreover, more countries will have joined IDA and have had time to become familiar with its project requirements. It seems highly probable therefore that in the future the effective demand for IDA funds will exceed what now appears to be the likely supply.

25. It has to be borne in mind that IDA financing has a number of attractive features lacking in other sources of funds. In particular, the lenient terms of IDA credits put them in a class apart from most other forms of external assistance. Furthermore, most bilateral aid is tied, and this tends to reduce its attractiveness to the borrowing countries. The multilateral character of IDA assistance may be expected to enhance the demand for IDA funds. More generally, the fact that the "quality" of IDA funds is much better than that of international assistance on the average, accentuates the problem of sharing out a scarce resource, which will become more acute as project limitations are overcome.

26. IDA is a small-size institution compared to the aggregate of economic assistance programs to underdeveloped countries, which now total about \$6 billion per year (see Table 7).<sup>1/</sup> The minority status of IDA imposes certain limitations on the role which IDA can play, and these have to be taken into account in deciding on the distribution of IDA funds.

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<sup>1/</sup> Admittedly, it is somewhat misleading to compare directly the prospective commitment authority of IDA with the total of assistance programs. Some capital flows that are conventionally classed as aid may be more correctly viewed as payments for political and military services rendered, and some types of aid are directed, at least in part, towards meeting consumption requirements rather than those of investment.



## PART II - PROBLEMS OF FUTURE LENDING POLICY

### Objectives and Limitations of IDA Lending Policy

27. In most general terms, the question to be considered is how IDA can most effectively employ the resources at its disposal to fulfill the purposes it was set up to serve. The same question might be more succinctly phrased: "How can IDA get the best value for its money in terms of economic development?"

28. In comparing the amount of development which IDA can promote in different countries, allowance should presumably be made for the value judgment that it is more desirable to increase income in poorer countries than in countries that are not so poor. Thus income streams in different countries should be "utility weighted" in order to compare them: an increase in income in a poorer country is given a higher "utility weight" than an equal increase in income in a less poor country. Further, it should be recognized that the long-term impact of an IDA credit depends not only on the income stream generated by the original investment, but also on the proportion of income which is saved and reinvested in the future. Priority may be given to increasing income in a country where a large part is saved and reinvested, as opposed to the case in which income is immediately consumed, and how much priority is given depends on a value judgment regarding time preference. One possible definition of the optimum distribution of international development assistance might be that which maximizes the total value of "utility weighted" income streams, discounted to the present by means of an interest rate which reflects a time preference judgment. Essentially, the ideal distribution of aid is similar in principle to an ideal national investment program; both attempt to maximize future development by the deployment of scarce resources.

29. The analogy between a national and an international situation is, however, not complete. Redistribution of income and movement of population in search of economic opportunities are very much less restricted within countries than between countries. A formula for maximizing development on an international scale does not by itself pay attention to what happens in any individual country. It might thus appear necessary to introduce another value judgment that all countries should receive capital inflow necessary to secure growth of, say, one per cent per year; only after this would the residual funds be distributed so as to maximize developmental impact, irrespective of where this occurs. However, such a judgment would involve providing large sums to countries which are inefficient in translating capital inflow into development. Alternatively, considerable preference in the distribution of assistance could be given to countries which are making great development efforts starting from a low base and in the face of adverse circumstances.



30. Application of the theory is handicapped both by the minority status of Bank/IDA and by limitations of present economic technique. Ideally, it might be argued that IDA should form some idea of the optimum distribution of assistance to underdeveloped countries, and should use its resources to rectify the divergencies from this pattern left by assistance from other sources. In practice, however, the divergencies might be much larger than could be smoothed out with the resources at IDA's disposal. IDA cannot reduce the assistance which particular countries presently receive from other sources, even if it considers such assistance excessive. It can, however, refrain from lending to countries which are already receiving more capital than they can use with reasonable efficiency.

31. The second constraint is that it is extremely difficult to measure the over-all developmental impact of specific units of external assistance. In other words, problems of making appropriate value judgments and difficulties arising from the minority status of IDA/Bank are compounded by the difficulties of making adequate technical judgments. While judgments of the effects in different countries of different amounts, terms and conditions of capital inflow can be improved over time, it is necessary to rely on provisional rules of thumb to approximate, however crudely, the optimum solution. The history of IDA operations to date provides certain pointers to practical criteria that can be adopted in evaluating competing claims for IDA resources.

#### Lending Criteria

32. There would be little disagreement as to the ideal claimant for IDA credits. It would be a country which has an excellent record of economic performance and a stable government determined to maintain it; which has suitable projects ready for financing and a proven capacity to implement them; which has relatively high savings rates (both average and marginal) but is also poor and unable to mobilize all the capital it needs to finance the level of investment that would otherwise be practicable; and finally which has exhausted its creditworthiness for Bank loans and cannot obtain sufficient external capital from other sources. Like most ideals, this one probably exists only in the imagination, but it serves to illustrate the nature of the problem.

33. There are thus the criterion of need or poverty (see paragraphs 37-43), the criterion of economic performance (paragraphs 44-49), the project criterion (paragraphs 50-56) and the criterion of creditworthiness (paragraphs 57-60). How are these criteria to be interpreted in practice? And what are the relative weights to be given to each in determining the pattern of IDA operations? For example, should a poor country with an indifferent record of economic performance and a rather unstable government be given preference over a considerably richer and better governed country in which a higher economic return can be expected from the investment of additional external capital? Should IDA be prepared to finance a "sound" project in an "unsound" country? If IDA lending is judged necessary to enable the Bank to exercise a useful influence on a country's economic performance, can such lending be justified on appropriate conditions even though the past record of performance is unsatisfactory? If an IDA credit is likely to have a useful impact on the particular sector of the economy to which it is directed (e.g., by bringing about the better organization of electric power supply), is this by itself an acceptable reason for extending the credit?



34. This paper proceeds from the assumption that the only countries that should be excluded a priori are (a) Part I members and (b) countries which are debarred from borrowing from the Bank by reason of poor international financial behavior (e.g., external debt default or expropriation of foreign assets without compensation). The reason for excluding all Part I members is simply that there appears to have been from the start a general consensus of opinion amongst all member countries that this should be done. The question whether some of the richer Part II members should not also be excluded from access to IDA funds is discussed later.

35. If the criteria mentioned above are adopted as a basis for IDA lending policy, the rate of commitment of IDA funds can be brought into balance with commitment authority by:

- (a) applying the "means test" more or less severely, if necessary to the point of excluding altogether Part II countries with per capita income above a certain level;
- (b) varying the stringency of "performance criteria";
- (c) varying the range of projects which IDA is prepared to consider;
- (d) varying the degree of stringency of project appraisal; and
- (e) varying the terms and amounts of IBRD lending, thereby increasing or reducing the claims for IDA assistance.

36. To some extent, future IDA policy may be looked on as a question of which of the criteria of country and project eligibility should be tightened up or relaxed in order to bring the actual rate of commitments into line with the limited commitment authority. The shape of IDA operations will be different according to which criteria are applied more rigorously and which less rigorously. Admittedly, supply of and demand for IDA resources will not have to be equated very exactly in the short run. It will be no great matter whether in any particular year IDA fails to make credits up to its full commitment authority, or has not got enough funds to make all the credits which satisfy the criteria. Credits which cannot be made in one year can be held over until the next. Some potential borrowers for whom IDA has no money will turn to other lenders. However, gross imbalance in either direction would be unsatisfactory. If IDA consistently fails to lend up to the level of its commitment authority, it will be failing in its assigned task. On the other hand, if IDA falls progressively behind the amount of credits which it would make according to its accepted lending criteria, then the credits made will by definition be an arbitrary selection. The lending criteria will not be doing their work in any significant sense.

#### The Test of Need

37. A country's "need" or "poverty" has to be measured primarily in terms of per capita income. International comparisons of per capita income are notoriously difficult to make, and any precise ranking of individual countries in accordance with income levels will be subject to areas of doubt and dispute. But it is still practicable - and necessary - to classify Part II members into significant income groups indicating their degree of poverty. (See Table 1).



38. One method of applying a "means test" would be to exclude altogether from IDA assistance Part II countries with per capita income above a certain level. The richest country which has so far received an IDA credit is Costa Rica (see paragraph 17 above). An income cut-off which admits Costa Rica is not very drastic, since the only Part II countries and territories of Part I members with a higher per capita income are Argentina, Cyprus, Gibraltar, Iceland, Ireland, Israel, Malta, Singapore and Uruguay. If the cut-off level were reduced to around \$250 (as against \$380 for Costa Rica), the following Part II members would also be excluded: Chile, Colombia, Greece, Lebanon, Malaya, Mexico, Panama, Spain and Yugoslavia.

39. It is possible to apply the idea of a "cut-off" without being too precise about the level of income at which it should be applied. The matter of principle involved is whether any Part II country should be completely excluded on the grounds that it is too rich to receive an IDA credit. The alternative is to admit all Part II countries as potentially eligible for IDA assistance, but to adopt progressively stricter standards of performance and creditworthiness as we evaluate the claims of countries with higher per capita incomes.

40. The test of need will frequently conflict with the test of economic performance, and the balancing of one against the other will always in the last resort be a matter of judgment in borderline cases. IDA will increasingly be faced in future with requests for assistance from extremely poor countries with a poor record of performance. Should these claims be wholly ignored?

41. Strictly speaking, we should recognize that the importance of increasing incomes applies to individuals, and not to statistical aggregates such as per capita income in a member country. It might therefore be judged proper for development policy to take into account the extent to which an IDA credit will help to raise incomes in the more backward areas of a country. Here again, however, we are liable to run into a straight conflict between performance and need. The phenomenon of the "dual economy" is well exemplified today in many of the underdeveloped countries. Should IDA concentrate in such countries on helping to develop the most backward regions? Conversely, should it invest only in those regions where the marginal productivity of capital is likely to be highest? This is a problem as between regions in the same country as much as it is a problem between countries in the same region.

42. There is the related question of disparities in income between different income groups in the same country, regardless of the part of the country in which they live. Many countries which may qualify for IDA assistance are saddled with regressive systems of public finance. In such cases it could be argued that the adoption of appropriate measures of income redistribution should be made a condition of IDA lending.

43. The amount of external assistance a country is already receiving, as a proportion of national income and investment, is relevant in judging its need.<sup>1/</sup> It does not, however, follow that, because this proportion is high, the country should not receive further assistance. This will depend on how efficient its performance is in translating aid into development.

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<sup>1/</sup> The variations in the size of total capital inflows received by various countries from all public sources in 1960, per head of population and as a percentage of GNP, are shown in Chart IV.



### The Test of Economic Performance

44. There are many possible tests of a country's economic performance and of its capacity to make fruitful use of additional external capital to promote economic growth. Perhaps most important of all is evidence of a will to develop, whether reflected in government policies or in the verdict of the electorate at the polls. Efforts to mobilize domestic savings through taxation or other means are a singular test of a country's determination to put economic development high on its list of priorities. At the same time, the prevailing rates of saving have an important bearing on the long-run value of aid received. In a "free enterprise" economy the emphasis may be on profits rather than on taxation, but those who make the profits must have proved themselves willing to reinvest in the expansion of the economy. The large-scale flight of private capital abroad may be regarded in most cases as a mark of poor economic performance which denies the whole purpose of external assistance.

45. The proven ability to draw up and carry out a well-conceived development program is another conventional test which has obvious validity. A more or less capable government administration is important everywhere. Another factor is whether the institutional framework, e.g., the pattern of land ownership, is helpful or detrimental to economic growth. The problems of financial policy pose a serious dilemma. Inflation is often an obstacle to growth, and runaway inflation almost invariably so. But deflation, and the lack of confidence which it engenders, can be even more harmful.

46. Judgments about such matters are so variable, and prejudices so strong, that it may often be better to rely on the record. Barring recognizable changes, there is at least a reasonable presumption that a country which has maintained a high rate of growth over the past five or ten years will continue to do well in future - and vice versa. Past growth rates of selected Part II IDA countries are set out in Table 8, along with other indicators of economic progress.

47. Two kinds of problems arise in deriving conclusions about performance from historical data. First, there is the question of which past period is relevant, and this is frequently a political and sociological question which can scarcely be answered by statistical information. It can be argued, for example, that many African countries which have just attained independence have no relevant history on which any defensible conclusion about future performance can be based. Elsewhere, observations encompassing the whole post-war period may suggest conclusions which are not borne out by a shorter and more recent period such as the last five or six years.

48. Second, there is the question of how to interpret indications of future change. It is one of the principal tasks of Bank economic missions to identify and analyze the factors upon which future performance will depend, but this is not always done as systematically as it should be. All such



missions should try to form some estimate of how the course of development in countries to which IDA may lend would be affected by varying amounts of capital inflow. The factors involved in each country in "limited absorptive capacity" - i.e., diminishing returns to capital inflow - should be carefully studied. The objective should be to secure as much consistency as possible in the treatment of different country cases - a task which may call for periodic reviews by the staff of the performance of all existing or potential IDA borrowers. Relevant statistics should be used, wherever possible, as a basis for comparison, thus helping to reduce the area of purely subjective judgment.

49. An important distinction may be made between absolute levels of performance and changes in the levels over time. A country which has not done well in the past, but is obviously trying hard and shows signs of improving its performance, may have a stronger claim to IDA assistance than a country with good records of savings and growth which are not being maintained. The very poor and backward country which is making a real effort to do better deserves special consideration. Provided that progress is being made in the right direction, IDA should perhaps be ready to take a fairly lenient view of the actual level of performance at present. Moreover, given the technical difficulties of comparing levels of performance in different countries - e.g., savings and their effect on the attainable rate of growth of output - practical judgments may have to rest to some degree on the expectation that the developmental returns to capital inflow will in the long haul be greater in a country where there is rapid improvement than in a country where there is little or no improvement. Possibilities of influencing significant aspects of performance as a by-product of IDA operations should also be taken into account.

#### The Project Test

50. The severity of the rationing problem with which IDA will be faced in future (i.e., equating the supply of and demand for IDA funds) will depend in part on the range of projects which IDA is prepared to consider and on the strictness of the standards laid down for project appraisal. The relative emphasis placed on country criteria and project criteria is a choice always implicit in IDA lending policy. It can be argued on the one hand that the amount of IDA funds to go to a given country should be decided on broad country economic grounds and that then a range of projects should be selected to absorb the amount of credits decided upon. Against this, the view may be taken that IDA activities should be confined to given types of projects with given standards of project appraisal, so that the first element in assessing a country's claim to receive IDA credits should be the availability of the type of project which IDA is prepared to consider, with preference given to those projects which can be expected to have the greatest impact on development.

51. Complaints about inequitable distribution of IDA credits not infrequently hinge on the fact that a member country has not been able to present a project considered suitable for IDA financing. Certainly, a number of applications for IDA credits have been turned down - or the extension of the credit has been indefinitely delayed - because the project requirements could not be fulfilled.



52. As pointed out in the first part of this paper, IDA has demanded the same standards of project appraisal as the Bank and has confined its operations almost entirely to the same type of project as the Bank has been accustomed to finance. IDA has adopted a more liberal approach to the financing of local currency expenditures. The President's new proposals on Bank financial policy envisage an extension of the range of projects which the Bank should be prepared to finance. These proposals, if endorsed and applied equally to IDA, could increase the potential demand for IDA funds. This is particularly true of the proposal that the Bank should be ready in selected countries to make loans for miscellaneous items of capital equipment, including components and spare parts. Conversely, the demand for IDA funds would be severely restricted if there were to be any going back on the policy of allowing IDA a large measure of freedom in financing local currency expenditures.

53. Granted some extension of the range of projects which IDA might finance, certain countries will still have difficulty in preparing projects in a form suitable for IDA financing. What positive steps should the Bank take, and in what conditions, to assist such countries in preparing projects? Does association of IDA financing with a project offering a high rate of return in itself justify an IDA credit, irrespective of the broader aspects of a country's economic performance? For example, what if poor economic performance leads to a reduction in domestic savings or capital flight which more than offsets the inflow of IDA funds? Alternatively, under what conditions should a project which promises a specially high rate of return, with large export earnings or import savings, be considered as qualifying for a Bank loan, even though the general creditworthiness appraisal for the country is unfavorable?

54. These questions all have an important bearing on future IDA operations. While it would probably be generally accepted that strict standards should be maintained in the appraisal of projects, it can be argued that more weight should be given in future to economic (as distinct from financial) considerations in the selection and evaluation of projects for IDA financing. Directly revenue-producing projects constitute a smaller part of IDA's business than of the Bank's, and financial tests are frequently difficult to apply in some of the underdeveloped countries which may be ruled eligible for IDA (but not for Bank) assistance.

55. The acceptable minimum rate of economic return for an IDA project in a very poor country may need to be set at a somewhat lower level than in a more advanced country if IDA is to operate in the former type of country at all. The degree to which IDA should be prepared to vary its project standards from one country to another must depend in part on the relative values attached to "performance" and "need". Acceptance of the view that the poorer countries have special claims on IDA assistance may be held to imply a judgment that, the poorer a country is, the more valuable a given increase in income will be - with the corollary that IDA may be justified in accepting a lower developmental return, or a less certain return, on its investment in a poor country than in one that is not so poor. But this argument ought not to be pushed too far.



56. It may be argued at the other extreme that, if IDA is out to "buy as much development as possible", it should always finance the project which is expected to have the greatest developmental impact. This would in effect be to give primacy to the project approach over the country approach and to disregard entirely the criterion of need. But projects can not in any case be assessed in isolation from the national development programs of which they are a part. We are thus driven back to the conclusion that any policy for determining the allocation of IDA credits must start with the country rather than with the project.

#### The Test of Creditworthiness

57. The test prescribed in Article V 1(c) suggests that all Part I countries and some Part II countries should be considered ineligible for IDA assistance because they still have an ample margin of creditworthiness and are thus able to borrow all the external capital they need on conventional terms. There is, however, a category of IDA members - the "blend" countries referred to in the first part of this paper - which are still regarded as creditworthy for a limited amount of borrowing from the Bank, but are unable to satisfy all their external capital requirements in this way.

58. An appraisal of creditworthiness involves a complex set of economic and political judgments, and it is not proposed in this paper to recapitulate all the factors which have to be taken into account in deciding whether a country is creditworthy for Bank loans. It has been customary in the Bank to use the ratio of external public debt service to foreign exchange receipts on current account as a first indicator of creditworthiness, though it has never been suggested that this is by itself an adequate test. The structure of a country's external debt, the degree to which its exports are vulnerable because they are concentrated on a few commodities, the relationship between its monetary reserves and imports, its IMF position and the extent to which its imports can be compressed without endangering economic growth are other relevant economic indicators (see Table 9). A distinction has to be made between short-term risks and long-term risks. From the long-term viewpoint relevant measures of creditworthiness are the over-all rate of income growth, rate of savings, rate of growth of export earnings and the capacity to achieve efficient import substitution (see Tables 8 and 10). The view taken of the present and prospective stability of the government, of its external debt record and of its economic and financial policies has been important in assessing creditworthiness for Bank loans. However, adverse creditworthiness judgments on these grounds do not make a case for IDA credits. Estimates of creditworthiness must also take into account the prospects of a country continuing to receive sufficient aid to enable it to cover its debt service obligations and at the same time maintain imports at an acceptable level. The existence of a consortium may encourage the presumption that a country will in the last resort always be saved from default, but there can be no guarantee of this.

59. Very poor underdeveloped countries present an especially difficult problem. They may have contracted little or no external debt and yet be a poor long-term credit risk, if only because they probably require decades of continuous external support from public sources. Should such countries be considered eligible for IDA credits, even though the debt service ratio at present is low and is likely to remain low in the near future?



60. The main point to be made here is that creditworthiness appraisals can not be reduced to a formula but are very much a matter of judgment. Furthermore, a change in the terms of Bank lending could enlarge the scope for Part II countries to borrow from the Bank and thereby reduce the claims on IDA resources.

#### Some Concluding Observations

61. In practice, the application of the economic tests prescribed above may be qualified to some extent by other considerations. There may, for example, be circumstances in which a small token credit can be justified for a Part II country in the lowest income group, even though the country is so lacking in economic, administrative and technical expertise that it cannot possibly measure up in the foreseeable future to the standards of economic performance normally required. More important, regard has always to be paid to the size of a country's population in deciding the appropriate scale of IDA lending. Again, the influence which the deployment of IDA funds may have on attracting funds from other sources is an important factor that has to be taken into account in arriving at decisions on IDA lending policy.

62. If the promotion of economic development is accepted as IDA's primary objective, the performance test must inevitably carry great weight. Admittedly, performance is more difficult to measure than poverty or population. Equally, some may feel that the project test is easier to apply than the test of economic performance, at any rate from the point of view of turning down an application. But this makes it all the more important that every effort should be made by IDA to improve its present standards of economic analysis and to carry out regular and systematic reviews of the factors by which the performance of Part II countries and their creditworthiness can be judged, so that competing claims on IDA resources can be properly and fairly evaluated.

63. The problem of the optimum employment of IDA resources will become increasingly difficult to resolve as underdeveloped countries gain experience in the preparation and execution of investment projects. Whatever criteria are adopted as a guide to lending policy, their application must in the last resort be a matter of judgment, not of precise calculation. No perfect solution is possible. This paper has simply tried to spell out the main questions that have to be faced in any attempt to establish a consistent policy.







INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

**DECLASSIFIED**

Date: 11/15/2010 STB

CONFIDENTIAL

FPC63-10

FROM: The Secretary

August 2, 1963

STATEMENT BY MR. KNAPP TO RESUMED FINANCIAL  
POLICY COMMITTEE MEETING - AUGUST 1, 1963

I think it would be useful if I tried to clarify a couple of points in the paper about which there seems to be some misunderstanding, judging by some of the comments made on Tuesday.

First, with respect to the proposed new "earned surplus" account, this would be, as one of the Directors suggested, essentially a change in nomenclature. The funds allocated to earned surplus would serve largely the same purposes as those hitherto allocated to the Supplemental Reserve. They would continue to be employed in the regular operations of the Bank, and they would strengthen the financial position of the Bank by improving its "debt-equity ratio". The retention of the Bank's earnings in any form gives additional confidence to purchasers of the Bank's obligations, and — since the Bank need pay no interest or amortization charges on these retained funds — gives the Bank a greater measure of flexibility in fixing interest and amortization charges on its own loans.

The proposal to establish an earned surplus account merely reflects the Management's judgment that the June 30, 1962 level of the Supplemental Reserve is in fact adequate, taken together with the Special Reserve and barring any adverse change in circumstances, to give the Bank reasonable protection against losses which would impair its capital. The allocation of net earnings since June 30, 1962 to an account described as "surplus" rather than to one labeled "reserve" would avoid giving the erroneous impression that we still regard our reserves as inadequate.

As I stated at our last meeting, there is no intention of segregating the earned surplus (any more than in the case of the Supplemental Reserve) for any special lending operation. I would rather say, to adopt the phrase of our Canadian colleague, that the increased financial strength of the Bank which would result from the retention of our earnings "permeates" all of the recommendations which follow in the paper for bolder and more enterprising Bank activities.

A further matter as to which some clarification of our intentions may be useful is technical assistance. Several Directors expressed what I thought was undue concern regarding the scope of the technical assistance proposals in the paper and in particular expressed the fear that, in some fields, the activities proposed for the Bank might duplicate or compete with

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Members of the Financial Policy Committee  
President  
Vice Presidents  
Department Heads



those of other international agencies, such as FAO or UNESCO. We tried to make it clear in Section D of the paper that we did not propose to take on technical assistance functions indiscriminately but only in order to facilitate and give support to the investment activities of the Bank, IDA and IFC. You will find that thought, expressly or by implication, in each of the paragraphs dealing with technical assistance in the agricultural, industrial and educational fields. This criterion has always governed our technical assistance activities and we have no thought of any change in that respect.

As for the avoidance of duplication of the efforts of other international organizations, we have in the past endeavored to coordinate our technical assistance work with those of the other specialized agencies and here again we have no thought of any change. If another organization is providing or can be persuaded to provide the technical services which are needed to support the projects in which we are interested, so much the better. We had in mind instances where such arrangements may not be possible, or where special considerations would indicate the desirability of the Bank taking the initiative, after consultation with such other organizations as might have an interest.

J. Burke Knapp  
August 1, 1963



(not for public use)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

**DECLASSIFIED**

Date: 11/15/2010 STB

FPC63-9

FROM: The Secretary

July 30, 1963

LOAN SALES DURING LAST  
FIVE FISCAL YEARS

As stated by the Chairman at today's meeting of the Committee on Financial Policy, there is attached for information a table showing loan sales during the last five fiscal years.

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Department Heads



July 30, 1963

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Loan Sales During Last Five Fiscal Years

(In millions of United States dollars)

	<u>Gross Sales</u>			<u>Loans Repaid</u>			<u>Net Sales</u>		
	<u>In</u> <u>U. S.</u>	<u>Other</u> <u>Countries</u>	<u>Total</u>	<u>In</u> <u>U. S.</u>	<u>Other</u> <u>Countries</u>	<u>Total</u>	<u>In</u> <u>U. S.</u>	<u>Other</u> <u>Countries</u>	<u>Total</u>
1958 - 59	\$ 29	\$ 119	\$ 148	\$ 25	\$ 38	\$ 63	\$ 4	\$ 81	\$ 85
1959 - 60	92	151	243	13	71	84	79	80	159
1960 - 61	27	175	202	36	54	90	(9)	121	112
1961 - 62	98	221	319	32	90	122	66	131	197
1962 - 63	118	155	273	43	87	130	75	68	143

<u>Gross Sales in United States <sup>1/</sup></u>		<u>Fiscal</u> <u>Year</u>	<u>Total</u>
<u>Loans to</u> <u>Developed</u> <u>Countries</u>	<u>Loans to</u> <u>Less Developed</u> <u>Countries</u>		
\$ 9	\$ 20	1958 - 59	\$ 29
6	86	1959 - 60	92
7	20	1960 - 61	27
58	40	1961 - 62	98
51	67	1962 - 63	118

<u>Gross Sales in United States <sup>2/</sup></u>	
<u>Loans to</u> <u>Developed</u> <u>Countries</u>	<u>Loans to</u> <u>Less Developed</u> <u>Countries</u>
\$ 9	\$ 20
81	11
23	4
79	19
94	24

<sup>1/</sup> Sales of loans to less developed countries guaranteed by developed countries included in totals for less developed countries.

<sup>2/</sup> Sales of loans to less developed countries guaranteed by developed countries included in totals for developed countries.

Treasurer's Department



INTERNATIONAL BANK FOR RECONSTRUCTION  
AND DEVELOPMENT

DECLASSIFIED

Date: 11/15/2010 STB

CONFIDENTIAL

FROM: Dr. Luis Machado

July 26, 1963

BANK FINANCIAL POLICY

In connection with the forthcoming meeting on July 30, 1963 of the Financial Policy Committee of the Bank to discuss the memorandum circulated by the President on July 18, 1963 (FPC63-8), I have prepared the attached memorandum which I think my colleagues will find interesting.

To: Members of the Financial Policy Committee  
President  
Vice Presidents  
Department Heads



July 25, 1963

Memorandum on possible World Bank assistance to help the less developed member countries raise the local currency required to complete financing of development projects

1.- As an Executive Director representing ten of the Bank's less developed member countries, I welcome the clear and thoughtful memorandum circulated by the Bank's President to the Financial Policy Committee (FPC63-3, dated July 8, 1963), on future courses that might be followed by the Bank to accelerate the economic and social progress of member countries.

2.- One of the stumbling blocks to the economic development of most underdeveloped countries is their inability to raise the necessary local currency to match the foreign exchange obtainable from the Bank or IDA for their projects. This deficiency obstructs development in two ways:

- (a) By retarding the execution of projects already financed by the Bank or IDA, where the foreign exchange is available after the signing of the loan or credit agreement, but where the borrower is unable to raise the required local currency, thereby also contributing to the lag in Bank and IDA disbursements;
- (b) By delaying the presentation to the Bank or IDA of projects of high developmental priority,



because of the uncertainty and difficulty of raising the local funds required for their completion.

In both instances, the benefits that would be derived from the completed projects are denied or postponed to developing countries.

3.- To assist developing countries in solving this problem, the Bank has through the years liberalized its original orthodox policy of lending only the strict foreign exchange required by a project, and has, by various formulae, made available to member countries larger amounts of foreign exchange, beyond what the projects really required in foreign exchange for their execution.

4.- This policy, although justified by the special circumstances of the developing countries, is not, in the long run, in the best interests of the Bank or of the country concerned. It imposes on a developing country, generally faced with a difficult balance-of-payments situation, the obligation to repay in foreign exchange expenses incurred and paid for in local currency (e.g. wages, local services and materials, etc.) thus taking care of the present but impairing the future.

This policy, moreover, forces the Bank to stretch its interpretation of Section 3 of Article IV of the Articles of Agreement,



which defines the currency to be lent; this being the only practical way found, so far, to clear the bottleneck.

5.- In many developing countries there are fairly large amounts of local private capital available for investment which are presently being diverted into real estate or invested abroad in foreign securities or time deposits. These local savings could be channelled into high priority developmental projects, and, thereby, eliminate the paradoxical situation where foreign exchange is available for development from the Bank or IDA, but no investors will put up the corresponding local currency necessary to make feasible projects that, when completed, would redound to their own benefit.

6.- The main reason why at times no local currency can be raised at home for a development project, is because, whether justified or not, investors are afraid of possible future currency devaluation. Investors are not inclined to lend pesos now, that at the time of repayment may be worth only a fraction of their present monetary value, either by a gradual depreciation in which the investor has no voice or by deliberate governmental devaluation against which there is no recourse. I need not elaborate on the many recent sad experiences in this field.

7.- This problem is, in my opinion, the most serious obstacle in the way of rapid economic and social development in many



less developed member countries. And it is a problem that, in my opinion, we can no longer dodge. No matter how liberal the Bank decides to become; regardless of the unquestionable benefit to developing countries of extending the amortization of future loans over a longer period of years to assist borrowing countries in their balance of payments, the fact remains that, unless developing countries can raise, without undue delay, the local currency required to make projects operative, the process of development will drag along; and the benefits of development will unnecessarily be delayed or denied to rapidly increasing populations.

8.- The Bank, whose resources and credit are now at a high peak, might well render an invaluable service to developing member countries in helping them to overcome this bottleneck. At the present time, in development projects financed by the Bank or IDA, the Bank or IDA provide the foreign exchange needed. The provision of the local currency part of the project is, naturally, left up to the Government of the borrowing country. In the absence of a local capital market, the Government usually has to finance it by appropriations in the national budget included as part of the governmental expenditures over one or several fiscal years during the construction period.



9.- The system of raising these local currency funds by budgetary appropriations in one or a few fiscal years during the construction period, when the local funds are mostly needed, actually amounts to an accelerated amortization of a substantial part of the cost of a project, usually involving a large investment. It imposes a heavy burden and strain on the national finances of a developing country; and often involves sacrificing or neglecting other important and urgent public needs that can be financed only by expenditures from the national budget. The attempt to pay in a short time for what should normally be financed over a long period is perhaps the largest contributing factor to the dangerous inflation plaguing many developing countries.

10.- Faced with the need to execute development projects that can no longer be postponed and are essential to their economic growth; faced with the lack of a domestic capital market to raise the local currency needed to complete financing; faced also with the inability to reduce or eliminate other expenditures needed in their budgets for public or social services of equal high priority; developing countries often follow the line of least resistance and recur to the dangerous practice of using the currency printing press, thus opening their weak economies to the cancer of inflation, which will eventually reduce the purchasing power of their currency,



wipe out the accumulated savings of generations and destroy the very benefits of the economic growth they are seeking.

11.- This serious problem would be solved if a developing country could finance in each case the local currency part of the cost of projects through medium and long-term bond issues, payable in local currency but with an appropriate amortization schedule, according to the nature and financial returns of the project; and if these local currency bond issues could, in turn, be marketed.

12.- In order to induce the frightened private investor in a less developed country to part with his savings now and buy bonds repayable in local currency with medium and long-term maturities, the fear of future currency devaluation during the period of his investment, must, to the extent possible, be removed. I suggest that this can be done by the Government of the developing country offering to prospective purchasers of such bonds the payments of principal and interest at maturity in local currency - but at the then prevailing value of the currency vis-a-vis the original monetary value at the time the bonds were issued. In other words, if by the time of repayment a peso had been devalued to half its original value, the bondholder would receive two pesos for each peso originally invested in purchasing the bond.



13.- To strengthen further and to assist in the development of a local capital market for bonds, the World Bank should be prepared, if requested by the Government concerned, to guarantee this undertaking to maintain the monetary parity in local currency of the bonds thus issued. This guarantee can be given by the World Bank which, in addition to the authority to make direct loans, has the power under the Articles of Agreement to guarantee bonds issued in the market of a member country.

14.- This idea is not as revolutionary as it might sound. The maintenance at all times of monetary parity is a principle recognized and accepted by all member countries in joining the Monetary Fund and the World Bank. My proposal is merely to extend the same principle, on a voluntary basis, to the flotation of bonds denominated and payable in local currency to facilitate raising locally long and medium-term funds, where a member country has no other way of obtaining the necessary local currency to complete a project.

15.- Now, let us examine how this type of operation would affect the position of the Bank and of a member country voluntarily adopting this system. The Bank would charge a commission for stamping its guarantee on the local currency bond issue and,



thus, obtain an income for its intervention without using its own funds or having to borrow - just by the use of its credit. The Bank's risk of a possible future currency devaluation would be covered by the member government voluntarily undertaking to maintain parity on the loan obligation on the same basis as its existing obligation to maintain parity on the value of its Bank capital subscription and Fund quota.

16.- From the point of view of the member country, the possibility of having to deliver in the future more local currency than it originally received would not be an unbearable burden. A devaluation would proportionally increase the relative value of its foreign exchange and monetary reserves in terms of local currency. By the same token, the capital value in local currency terms of the new assets acquired by the country as a result of the execution of the project, like all other capital investments, would be similarly enhanced. The system might, in some cases, act as a deterrent against manipulations of currency monetary values for temporary gains at the expense of public confidence in future monetary stability.

17.- From the point of view of the local investor, the proposal would remove the fear of losing his capital savings invested in



Government bonds by a later currency devaluation against which he has today no protection.

18.- Our experience in recent successful International Finance Corporation underwritings of stocks payable in local currency clearly shows that a local currency bond issue of a member country, protected against devaluation and guaranteed by the Bank, should be attractive and would find a ready market among private investors, commercial and savings banks, insurance companies, foundations and social security institutions in the very countries where the development projects are to be executed.

19.- If successful, the system would assist in developing local capital markets and may enable Governments to borrow locally at more advantageous rates of interest than at present. It might also encourage the repatriation of capital that has fled from many developing countries to foreign markets seeking greater monetary stability, though at the price of much lower yields. It is possible that, after one or more successful local currency bond issues, the World Bank's guarantee might no longer be necessary, as public confidence by investors will have been built-up by the creation of a sound bond market.



20.- My proposal would not impose on the Bank the obligation to guarantee every bond issue floated by a member country in its domestic market. It would only do so,

- (a) When requested by the Government of a member country, prepared and willing to give the Bank the undertaking to maintain parity of the local currency monetary value of the bond issue;
- (b) When the issue is limited to the local currency required to complete a project financed by the Bank; and
- (c) When the Bank is satisfied that the developing country cannot, without resorting to inflationary practices, raise otherwise the local currency required for the project.

21.- Now that the Bank after its period of initial and vigorous growth, is examining new ways and means to expand its operations to assist member countries in their economic and social development, I submit this idea in the hope that something of value may be found in its study and discussion by the Financial Policy Committee.

Respectfully submitted,

Luis Machado  
Executive Director



INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

**DECLASSIFIED**

CONFIDENTIAL

Date: 11/15/2010 STB

FPC63-7

February 19, 1963

\*Memorandum of Meeting of Bank Financial Policy Committee Regarding Reserves,  
Loan Charges and Dividends, Tuesday, February 12, 1963, at 11:35 a.m.

1. There were present:

Chairman

George D. Woods

Management

J. Burke Knapp  
Geoffrey M. Wilson

Executive Directors and Alternates  
acting as Executive Directors

Alice Brun  
John C. Bullitt  
Jose Camacho (Alternate)  
Reignson C. Chen  
Otto Donner  
John M. Garland  
L. Denis Hudon (Alternate)  
Fernando Illanes  
Ali Akbar Khosropur (Alternate)  
C. S. Krishna Moorthi  
Rene Larre  
Pieter Liefstinck  
Luis Machado  
F. Oellerer (Alternate)  
D. B. Pitblado  
Sergio Siglienti (Alternate)  
Gengo Suzuki  
Abderrahman Tazi

Alternates not acting as  
Executive Directors

H. Abramowski  
A. Bogoev  
Lempira E. Bonilla  
C. Brignone  
Erle Cocke, Jr.  
A. K. Ghosh  
Ismail Khelil  
N.M.P. Reilly  
Eino Suomela  
A.J.J. van Vuuren  
J. Waitzenegger

Staff

A. Broches  
Robert W. Cavanaugh  
Richard H. Demuth  
Lester Nurick

Lyell Doucet  
Mrs. Shirley Boskey  
C. H. Davies

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

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Department Heads



2. The Chairman invited the comments of the Executive Directors on the staff paper on the Bank's financial policy (FPC 63-5).

3. Mr. Donner commented that all the Directors agreed that a change in the Bank's financial policy was justifiable only if it did not hurt the Bank, by withdrawing resources which the Bank urgently needed to maintain its credit standing or its lending capacity. The first question to be decided was therefore whether the Bank could afford to accumulate reserves at a rate slower than would probably prevail if no change were made in present policies. He was not convinced by any of the arguments set forth in the staff paper for accumulating reserves at the fastest possible rate. According to the Treasurer's projections, the Bank's reserves would be equal to 24% of loans outstanding and about 32% of borrowings outstanding by the middle of 1963. He agreed that these ratios would seem adequate in relation to probable risk, barring a major international calamity. He also agreed that a new assessment would have to be made should circumstances change significantly. Since the withdrawal of \$50-60 million a year would not, according to the projections, cause an adverse change in these ratios, he concluded that the Bank could afford to part with that amount.

4. It was then necessary, Mr. Donner said, to decide what was the best use to which the \$50-\$60 million might be put. Those who recommended a dividend payment and those who favored a rebate to borrowers had approached this question as a purely distributional problem. This was a legitimate way to proceed, but distributive equity was not the only relevant consideration. The Bank was established to assist its member governments in their development efforts, and any decision concerning use of the Bank's net earnings should be consistent with this broad developmental purpose. The object should be to achieve a maximum developmental effect. The application of this criterion would lead to rejection of a proposal to reduce loan charges. To the extent that the reduction applied to existing loans it would be tantamount to a rebate to borrowers. Roughly half the benefits which might be realized would accrue to countries which were comparatively well off. Moreover, in every case, irrespective of the economic position of the particular borrower, the rebate would go into general budgetary receipts; it was unlikely to be earmarked in full for developmental purposes. Thus a rebate would have little direct impact on the amount of resources available for developmental purposes.

5. In contrast, Mr. Donner noted, a direct transfer of Bank earnings to IDA would be, to quote the argument set forth in the staff paper, an effective and tidy way of assuring that the funds withdrawn from the Bank would continue to be used for the promotion of economic development on the kind of terms for which there was great need. Some concern had been expressed that a transfer would be improper and might endanger the Bank's financial standing. For example, although a transfer was not expressly prohibited



by the Articles of either the Bank or IDA, there were those who thought that in view of the ban on IDA's borrowing from the Bank, a direct transfer would violate the spirit even if not the letter of the Articles. Mr. Donner did not agree. The prohibition did not apply to every kind of financial transaction between the two organizations. It was a very specific limitation, meant to preclude the possibility that IDA's "softness" might detract from the Bank's "hardness." It was intended to prohibit the establishment of a creditor-debtor relationship. But a transfer would not establish that kind of relationship. It would not make an inroad into the Bank's assets. It would withdraw only that amount of net earnings which, if the transfer were not made, would in all probability be distributed as a dividend to shareholders, or as a rebate to borrowers. It had also been suggested that a transfer might appear objectionable to the market as an indication that the Bank intended to engage in giveaways. If this were a valid objection to a transfer, Mr. Donner thought it must be equally applicable to other instances of Bank grants. Yet the Directors had been told by Mr. Black that Wall Street had been enthusiastic about the possibility that the Bank might undertake a program of educational grants. It seemed unlikely that the fact that in one case the Bank would be administering its grants under its own name and in the other case under the name of one of its affiliates could make a material difference. Another objection mentioned in the staff paper was that if the Bank's members wished to dispose of earnings in a way not contemplated, if not actually prohibited, by the Articles specifically, the Articles should be amended to authorize that action and the action should not be taken in the absence of amendment. By this criterion, an amendment should have preceded the undertaking to make a grant to the Educational Planning Institute as well as the other grants already made by the Bank. Finally, there was the objection that a transfer would be unfair to those Bank members which did not belong to IDA. This was an illustration of what Mr. Donner had described as the distributional approach. If the Directors accepted the broader developmental approach which he had proposed, this objection would be precluded. Moreover, he doubted that Belgium, Brazil, Indonesia, Luxembourg, Uruguay and Venezuela, the only older members of the Bank which had not joined IDA, would feel discriminated against if all the other Bank members were to agree that the distributive approach should not be adopted and instead that net earnings should be applied to the promotion of economic development in those countries which needed development assistance most urgently.

6. Turning to the alternative of a dividend, Mr. Donner said he agreed that a dividend was permitted by the Articles, that it would not unduly burden the Bank, and that it would probably enhance the Bank's standing in the business and financial communities. He did not agree that it would facilitate or might even generate additional subscriptions for IDA. Nearly all the governments to which IDA must look for the bulk of its resources were experiencing budgetary or balance of payments difficulties or both. They were willing to contribute to IDA, but their capacity to do so was limited. The decisions concerning their IDA subscriptions must be a result of many cross-currents,



internal as well as external. Thus it was illusory to assume that a Bank dividend would generate a larger IDA subscription. At best, governments might turn over to IDA, as a supplementary contribution, any dividend payments they received. But even then the developmental effect of a dividend payment would be clearly far less than that of a direct transfer. Not all of the dividends received would be passed on to IDA: some governments might not be successful in obtaining the necessary legislative authorization, and others might not even approach legislatures, either because this would be a cumbersome and time-consuming process or because they would regard the dividend as a windfall for their treasuries. Should it be necessary to combine the dividend with a rebate to borrowers, perhaps as much as half of the funds thus withdrawn from the Bank might remain in the treasuries of recipients and be lost for developmental purposes.

7. Mr. Donner added that he would consider it unfortunate if, as a result of the discussions, it should be concluded that no action should be taken. This would leave the Bank in a very prosperous position. This could lead to a search for other opportunities to make use of excess earnings, and might well result in a program of expenditures less consistent with the Bank's purposes than a transfer of earnings to IDA would be. It might be thought that the Bank could continue to retain its net earnings, without prejudice to IDA's needs, because these could and would be met through increased subscriptions or contributions made by IDA members. He did not believe this was realistic. He welcomed the suggestions in the concluding pages of the staff paper, not so much for their substantive merits, concerning which he was not very enthusiastic, but because they indicated the possibility that some compromise might be feasible. His own view continued to be that a direct transfer would be the simplest and most effective use of net earnings.

8. Mr. Broches commented that it should be borne in mind that the staff paper had set forth all the arguments which had been or might be made for or against each course of action discussed, without making any judgment concerning the merits of any particular argument. He had prepared a paper, which was being distributed, on the question of the amendment of the Articles. It expressed his opinion that Section 14 of Article V was not a bar to a possible transfer of funds. Whether a transfer should be made was accordingly a matter of policy: from the legal point of view the Executive Directors were in his opinion free to go either way. If the Executive Directors decided that a transfer should be made, this decision called for another paper, an interpretation that such action was legally unobjectionable. Should it be decided not to make the transfer, the decision should be based on policy considerations, not on the ground that the Articles precluded a transfer.

9. Mr. Pitblado said that he had not yet consulted his authorities again. He thought consultation might be deferred until after the current round of discussion, to see whether any consensus might develop. He was in agreement with much, although not all, of what Mr. Donner had said. On the question of reserves, Mr. Pitblado thought that the analysis in the first pages of



the staff paper brought out clearly the different factors bearing on the question of reserves. He would not draw from those pages the conclusion that Mr. Donner had. He thought the conclusion indicated was that reserves were high but not excessively high at present. He endorsed particularly the arguments (b) and (c) on pages 6 and 7 which showed the value of the Bank's reserves for other wider purposes than that of protecting against the impairment of capital. He also strongly endorsed the sentence at the top of page 6 concerning the importance of the continued accumulation of reserves at a satisfactory rate. His feeling was that there might now be a case for reducing the rate of accumulation of reserves, not necessarily holding reserves to their present relationship to loans and borrowings, since that ratio had no intrinsic merit, but nevertheless moderating the rate at which reserves were built up. This would mean that there would be resources available to be put to the best use consistent with the purposes of the Bank

10. Mr. Pitblado thought, on balance, there should be no reduction of loan charges. However, if there were to be a dividend, which did not greatly appeal to him, he would be attracted by the suggestion mentioned in the staff paper that consideration be given to some relief to borrowers.

11. Mr. Pitblado said he was still very impressed by the arguments against paying a dividend, in particular the argument that once the Bank started to pay dividends, it would have taken an irrevocable step. The basis of the Bank's relationships with governments and its picture in the world would thereby be significantly altered. The market would take note of the fact that a dividend had been paid, although he had never heard any suggestion that the markets of the world expected the Bank to pay a dividend. The financial community in the United Kingdom had no such expectation or desire. He doubted the validity of the argument cited in the staff paper that the payment of a significant dividend would enhance the Bank's standing. If it did in fact do so in some quarters, the need to pay attention to those considerations in future would not necessarily work to the advantage of the Bank. He thought the argument that the Bank might be criticised for paying a dividend was particularly strong. Payment of a dividend, legal as it was under the Articles, might lead to misconception of the Bank's role around the world.

12. As regards a direct transfer to IDA, Mr. Pitblado agreed with Mr. Donner that this raised a number of historical and psychological difficulties. The question of the use of surplus resources of the Bank through IDA was not discussed during the negotiations on IDA's establishment. Certainly there was then no discussion ruling out the possibility. He, like Mr. Donner, would interpret the Articles as relating to the Bank's credit in a specific way and not to the general atmosphere. On the other hand, it did seem that at least in one country psychological difficulties might arise and there was also the factor of the views expressed by the management in earlier years. Accordingly, while Mr. Pitblado was of the opinion that it would be proper to transfer part of the Bank's earnings to IDA and that that might be their best use, he would not necessarily care to press that course now. If the



issue were approached over the next few years in other ways, it might be possible to arrive at a more satisfactory position. A dividend related to the replenishment of IDA would avoid some of the disadvantages. He was not sure that it was necessary for the Bank to devise other ways of using \$50 or \$60 million of its resources. He was attracted by some of the ideas hinted at in the staff paper, and would like in the course of the discussions to hear more from the management about them. He had in mind the reference to the effect of a high reserve level in keeping down loan charges and, in particular, the suggestion that a high level of reserves could enable the Bank to use its resources more flexibly. While there could be difficulties in the Bank's modifying its present practice of not varying terms as among borrowers, if there were ways in which this could be done it would be well worth considering, and in a sense would be as useful from the standpoint of development as the disbursement of funds through IDA. A thought which he had not yet had an opportunity to discuss with the staff was whether the Bank's services to member countries, in the various forms these had taken, might not henceforth be handled not as expenses of the Bank but as charges against the Bank's profits. Instead of putting all profits to reserves, some portion might be allocated to a fund within the Bank for services to member countries. This would not raise emotions about the Bank and IDA and might lead to a broader use of surplus resources in developmental ways. He agreed with Mr. Donner that first it must be decided what reserves were surplus to the Bank's needs, whether the Bank was in a position to use some in other ways, and then the excess portion should be used in ways consistent with the spirit of the Articles, for developmental purposes.

13. Mr. Tazi commented that the questions relating to the Bank's financial policy were being considered at a time when the increase in IDA resources was being examined, together with the question of the possible declaration of a dividend in the light of such an increase. The Part II countries attached great importance to the increase, although it was not for them to specify either the size of the increase or the period that it should cover; they had neither the means nor the freedom of action enabling them to do so. The decision was a matter for the industrialized nations. The Part II countries could only give unqualified approval to the proposal for \$2.5 billion for a period of five years. This was reasonable in view of the ever-increasing needs of the countries in course of development, the majority of which could not undertake the obligations imposed by the Bank's conventional lending terms and required assistance on the terms of IDA credits. There should be no compromise on the amount, nor should there be a redistribution of voting power between the Part I and Part II groups, whether or not the Part II countries contributed to the new resources. He thought they should be left free to do so.

14. In Mr. Tazi's view, the proposal that the Bank might pay a dividend tended to make the Bank appear a commercial institution inspired by the desire to make profits. He would have preferred a proposal to use a large part of earnings for educational projects; trained workers were in short supply. However, if the declaration of a dividend facilitated a solution in the matter



of IDA resources, he would agree to it, provided it was accompanied by a declaration of intent by both Part I and Part II members to remit to IDA the amount of the dividend. It was only fair that Part II countries receiving a dividend should also contribute on a voluntary basis, and up to the amount of the dividend, to the IDA increase. Should the dividend thus become a supplementary source of funds for IDA, the rate of commission on outstanding and future loans might later be reduced. This would not have an undue effect on the level of the Special Reserve and could in no way injure the Bank's reputation or its position in the international financial markets. The distribution of a dividend intended, in the last resort, to increase the resources of IDA and a reduction in the rate of commission would serve the same purpose, to provide countries in course of development with low-cost money. The investment of that capital would help to raise these countries' standards of living and reduce the ever-increasing gap between them and the industrialized world.

15. Mr. Larre said he was in general agreement with both Mr. Donner and Mr. Pitblado. He had been struck by the fact that no one seemed to have a notion of what was a proper level for Bank reserves. Perhaps this was because there was a close connection between the amount of reserves necessary and the balance of payments situation. When the world balance of payments situation was good, the reserves might seem unnecessarily high; when it deteriorated, the reserves were not high enough. He thought that there was likewise a close connection between the development of reserves and the replenishment of IDA. IDA was in essence a fund to prevent balance of payment difficulties from jeopardizing the development programs of the underdeveloped countries, and to be used as a substitute for hard loans which could cause a further deterioration in the balance of payments situation. In this sense the creation of IDA was the equivalent of an increase in the Bank's reserves, or, put another way, it had the effect of freeing for other uses a part of the Bank's reserves which would otherwise have been frozen to protect against possible defaults. A new round of resources for IDA would thus be the equivalent of an addition to reserves. This led him to support the possibility of changing the management of the Bank's reserves, moving from a static to a dynamic approach. Perhaps instead of the cure of balance of payments difficulties, the prevention of these difficulties should be the objective. The resources to be contributed to IDA should perhaps be supplemented by some part of the Bank's reserves, to be put at the disposal of the management for use in helping to achieve a balance of payments equilibrium in the underdeveloped world. This was a very tentative proposal. Meantime, however, he would like to suggest that when discussion on the staff paper had been completed, the Directors turn to the question of the amount of governmental contributions to IDA, before considering what might be the other sources of funds. He agreed with Mr. Donner that as long as there was the expectation that governments would contribute whatever was required, it was not likely that the other issues would be resolved. It would be better to establish first exactly how far governments were prepared to go.



16. Mr. Siglienti suggested that it might be useful to compare the Bank's reserve policy and the policy followed by similar international financial institutions. He appreciated that none was exactly like the Bank, but they did borrow funds in international markets and made loans on conventional terms. In his judgment the policy with respect to reserves was the basic issue to be resolved. He thought that the principal argument against a further accumulation of reserves was that Bank loans were guaranteed by governments and the unpaid capital was a second line of reserve. Among arguments in favor of continuing to put all net earnings to reserves, he was struck by the reference to the possibility of lending a mixture of borrowed funds and reserves, thus keeping loan charges down. In Europe the financial community was very sensitive on the reserve question. If a comparison of the reserve policies of various institutions should indicate that the Bank's policy was no more conservative than that of the European financial institutions, this would serve to justify present policy. It might on the other hand suggest that the Bank's policy was too conservative. In particular the analysis might reveal whether the present ratio of reserves to outstanding loans was reasonable compared to what was done by other institutions.

17. The Chairman replied that the difficulty with Mr. Siglienti's suggestion was that there was only one World Bank. It was not really feasible to make the kind of comparisons Mr. Siglienti proposed. The question of the reserve policy of the Bank involved a certain amount of crystal ball gazing. He would explore the possibility of comparison once again with the staff, but he did not hold out much hope of its practicability. The determination of the charges to be paid by the Bank's borrowers was made on a basis which had stood the test of time, and the very fact that proposals for reducing charges had contemplated a reduction of only a quarter of one percent, hardly a drastic reduction, indicated that present charges were about right. Operating costs were followed quite carefully. There was a certain amount of expenditure for what might be called research and development, special studies for which grants were made. With a rate of interest proven by time, with operating costs that were watched and were not excessive, with a certain amount of research and development grants for purposes that might lead to loans, the Bank had net earnings annually. It seemed that in the circumstances the Bank was doing the best it could, if the surplus funds were put in reserves, special or extraordinary or supplemental, or any other kind. It was true that the staff paper did not comment on the adequacy or inadequacy of the reserves. That was because the question was not susceptible of a mathematical determination. It was a question of judgment. If the Bank's lending charges were fair, its expenses reasonable, and if it did a certain amount of good works, including educational grants, it was much easier to say that the level of reserves should be whatever it turned out to be as a result of the ordinary conduct of business than to try to be precise about what the reserves ought to be. Perhaps, as Mr. Pitblado and Mr. Larre had suggested, the Bank should look at the conduct of its business and consider whether there were areas in which it could be more forward-looking.



18. Mr. Siglienti asked whether it was the Chairman's experience that investors thought that the Bank's risks were higher than those of the other institutions whose bonds were offered on the market, and therefore that the Bank's reserves should be larger or that the reserve ratio should be higher. The Chairman replied that this was not his experience. He thought the professional bond buyers both in the United States and in financial centers abroad did not make the comparison. In the case of the Bank, the ability to call on shareholders to meet obligations was a relevant factor.

19. The meeting was adjourned at 12:50 p.m., and reconvened at 2:50 p.m.

20. Mr. Krishna Moorthi agreed with Mr. Pitblado that the reserve situation was satisfactory and not necessarily excessive. It was the fact that the reserve position was satisfactory which made the Directors' discussion possible. All the steps discussed in the staff paper--namely, reducing loan charges directly or by giving a rebate to borrowers after determination of net earnings; declaring a dividend; or a transfer of monies from the Bank to IDA--basically involved a decrease in funds accruing to the Bank; the consequence of any one of these was that there would be that much less to add to surplus. Thus whatever step was taken, to the extent that the issue was the withdrawal of some \$50 or \$60 million from the Bank, whether for disposition to shareholders or borrowers or IDA, the effect upon the market's view of the Bank would be the same. This appraisal would be affected by the amount of surplus and net earnings remaining in the Bank. The next question was how the funds were to be given away. The more useful the purpose, the more palatable it would be, and the easier it would be to explain to the capital markets.

21. Mr. Krishna Moorthi thought that almost the sole merit of the proposal for a dividend was that it would give Part I countries an additional source out of which to make more money available to IDA. Yet even that was subject to "leakage." The fact that perhaps not all the money given out as dividends would come to IDA, that in reality what did come might in fact not be additional money but merely part of a predetermined maximum for an individual country's IDA contribution, and that, once a dividend in a given aggregate amount had been declared, payment of a smaller aggregate in the future would certainly affect market judgment about the Bank, all made Mr. Krishna Moorthi view the dividend proposal with the greatest disfavor. Moreover, he felt that declaration of a dividend was such an important step, involving a host of psychological, financial and other factors, that it would be a pity to decide to pay a dividend merely because that was one way of balancing the affluence of the Bank with the penury of IDA.

22. Concerning the proposal for a reduction of the impact of loan charges on borrowers, Mr. Krishna Moorthi recognized that a straightforward reduction of the commission or the lending rate would reduce earnings. However, the burden on borrowers could be reduced by retaining the level of charges and declaring an annual rebate to borrowers on loans outstanding. Mr. Donner had made the point that out of the \$8 million "saving" that a quarter percent



reduction in the commission would bring, a substantial portion would go to countries already well off. There was, however, nothing sacrosanct about one-quarter percent or \$8 million. If at the end of a year, the Bank should be in a position to declare a rebate, all borrowers should benefit, whatever their relative prosperity or poverty. Mr. Donner had also commented that the rebate would be a windfall and might not be made available for developmental purposes. But, in Mr. Krishna Moorthi's view, it was perhaps unjust to suggest that the windfall might be wasted. The staff paper mentioned the argument that to reduce loan charges would be to prejudice the prospects for loans by the private market for similar purposes. But the Bank's lending was in a sense completely different from that of private lenders. Its loans were made to governments or government-guaranteed borrowers. Maturities were much longer than those carried by private money market loans. And the bulk of the Bank's loans was for infrastructure and long-term activities that did not always attract the private market. Thus, to the extent that the Bank was not competing with the private capital market for the same business and on the same terms, Mr. Krishna Moorthi doubted the force of the argument cited in the staff paper. A rebate had the positive merit of making readily available to borrowers increased resources to help them in their balance of payments difficulties. Moreover, in contrast to a dividend, whose subsequent curtailment could affect the Bank's standing in the money market, the rebate could be related to the actual results of each financial year, being as high or as low as circumstances warranted. Accordingly, his preference would be for a rebate. He was opposed to a dividend. If for any reason a rebate was not acceptable, he would prefer a direct transfer from Bank to IDA over a dividend.

23. Mr. Krishna Moorthi had little to add to what Mr. Donner had said concerning the transfer, except that there could be no better recipient of a grant than IDA, which had the same approach to its objectives as the Bank. If the Bank's relative affluence was not to make it a target of raids, it was necessary that a good channel for its good deeds be adopted. Education had been said to be a good purpose. IDA was an equally good purpose. It had been argued that the prohibition against Bank loans to IDA morally precluded grants from the Bank to IDA. He could not see the logic of this position. IDA as a borrower could hardly be regarded as more creditworthy than the countries which borrowed from it. Its own terms were so soft that it could not be normally expected to service a Bank loan on Bank terms. Hence, the prohibition on Bank lending to IDA was logical. But this reasoning had no application to grants, which raised no question of debt-servicing capacity. There would be some justification for drawing an analogy between a Bank loan and a Bank grant to IDA if the money were to be obtained at the expense of some prior purpose of the Bank. Mr. Pitblado had suggested that perhaps all grants by the Bank should be regarded not as expenses but as debitable to net earnings. If this were made clear, the capital market was unlikely to argue that Bank resources were being siphoned off to IDA.



24. Mr. Lieftinck said that he agreed with Mr. Donner's point that more attention should be paid to the development aspect than to the distributive aspect. However, he did not draw the same conclusions from that general thesis; he felt closer to Mr. Pitblado in this respect. The main question was whether the Bank's reserves were adequate and whether there was a margin for disposal in some way or other. He was more inclined to support the arguments cited in the staff paper in favor of continued accumulation of reserves than those cited in support of some other disposition of net earnings. He agreed that the most important consideration with respect to the proper level of Bank reserves appeared to be the preservation of the Bank's borrowing ability. The Bank was unique in many respects, most importantly in its ability to draw funds from the private capital market. That unique position should be preserved. There was a direct relationship between the Bank's capacity to borrow and its reserve position. The level of reserves should also be considered in terms of the preservation of the Bank's lending rate. This was perhaps the most important point made by the paper in the discussion of reserves.

25. Mr. Lieftinck referred to the statements in the paper that the Bank could not ignore the possibility that one or another of its borrowers might run into payments crises or that several borrowers might simultaneously find themselves in difficulties, and that the very urgency and intensification of the development effort would tend, in the absence of an adequate volume of assistance on lenient terms, to increase rather than decrease this possibility. The staff paper on the need for an increased "soft credit" component in development aid (IDA/FPC 62-4) made clear that the debt-service burden on the Bank's principal borrowers was already very high and was likely to rise. Even on the assumptions made in that paper, a very considerable step-up of credits not calling for service in convertible currency would be required to avoid a further deterioration of the debt-service ratio. As Mr. Larre had observed, the existence of IDA did permit smaller reserves to be built up by the Bank, but this was true only by comparison with the situation which would prevail if IDA did not exist. Without IDA the situation would be worse and the need for reserves would be still greater. Even if the Bank declined to lend beyond what it considered to be the limits of a country's creditworthiness, there were so many other lenders on short- and medium- and perhaps long-term prepared to risk further credits to the less developed countries that the latter were likely to become more and more burdened by foreign debt. In view of these developments, the risks which the Bank ran were real and the Bank must be prepared to meet them. He did not mean to suggest that there was no limit to the legitimate accumulation of reserves. An unlimited accumulation would certainly not be justified if reserves were wholly or to a large extent sterilized and unavailable for use in the Bank's general activities. However, this was the situation with respect to the Special Reserve only. The bulk of the Bank's accumulated net earnings was not sterilized at all. These funds were used just as Mr. Donner had urged, in the field of development. Mr. Lieftinck wished to underline this point. Accumulated net earnings constituted part of the Bank's operating capital.



They had not thus far been used for any distributive purpose; they were used to expand the activities of the Bank. To the extent that they enabled the Bank to place less reliance on the capital market, they left greater scope to attract capital for development, either in the form of direct private loans or by governmental borrowing, for instance in order to put up a sufficient contribution to IDA. Therefore he did not think it could be said that funds would be lost for development purposes if net earnings were not distributed or passed on to IDA. The alternatives were whether, on the one hand, they should be used by the Bank in the field of Bank operations or be so disposed of that they would be wholly or partly reserved for that kind of effort or whether, on the other hand, they should be used for some other purpose.

26. Turning to the question of the ways in which the Bank might dispose of part of its net earnings, Mr. Lieftinck said that his position on a possible change in lending conditions was flexible. A reduction of the commission by a quarter of one percent would not be greatly at variance with what he had said in support of building up reserves. At the same time, he believed that the maintenance of the rate of increase of reserves was actually a better protection for borrowers, through the possibility it offered for keeping the Bank's loan charges down even if the Bank's costs for borrowed money rose. He thought the present charge was not unreasonable compared to what usually must be paid for long-term loans in underdeveloped countries, although here too his view was flexible. However, since some Directors felt that the continued accumulation of reserves presented a problem, perhaps lending policies might be re-examined. This examination should extend to the interest rate, although his own preference would be for a critical appraisal of the other terms of Bank loans. He had in mind particularly the possibility of extending the grace periods. This could have a very beneficial effect on borrowers, and would slow the rate of growth of reserves without adversely affecting the position of the Bank.

27. With respect to the payment of the dividend, advocated by those who saw difficulty in continued accumulation of reserves, Mr. Lieftinck thought this presented a difficult psychological problem. The Netherlands Government would in principle not be opposed to a dividend of 2% on the 18%, but his other countries felt strongly that payment of a dividend would not be right. This was apparently not only because the dividend would benefit mostly the creditor countries, but also because payment of a dividend would reduce the funds readily available for the general purposes of the Bank.

28. With respect to the direct transfer of Bank profits to IDA, Mr. Lieftinck noted that he had expressed his views on earlier occasions. His position was not based on legal considerations--at least not on the consideration that the Articles of the Bank did not allow a transfer. In addition to the arguments against a direct transfer mentioned in the staff paper, there was the argument, which he strongly supported, that a transfer might be regarded by a number of countries as a circumvention of the budgetary powers of the



legislature. It would certainly raise serious doubts in at least a few countries concerning the constitutionality of agreeing to a distribution of Bank earnings directly to an independent institution.

29. Mr. Lieftinck said he agreed in many respects with the conclusions reached by Mr. Pitblado. He hoped that if the continued rapid accumulation of reserves was thought to create a problem, consideration would be given to ways of either reducing the rate of earnings by revision of lending policies or of using some part of net earnings in non-lending activities. Mr. Pitblado had made some suggestions to that end. Some of Mr. Lieftinck's countries had expressed a strong preference for an increase in the amount and scope of so-called beneficial expenditures. The proposal for a grant program of perhaps as much as \$10 million for educational purposes had been received with some misgivings. That was not his position. He thought the Bank could usefully spend at least that amount, if not more, for educational purposes or for other purposes which could increase the effectiveness of the Bank's lending operations.

30. Mr. Garland said that in his opinion the level of reserves was satisfactory at present. He would support a conservative approach to further accumulations. The level was higher than necessary to cover normal risks of default; it was not high enough if the Bank were confronted by a cataclysm. He agreed with the statement in the staff paper that in the normal course of Bank operations, even short of a world depression or a world war, there might be periods during which the Bank would be faced with service suspensions on a substantial scale, without any assurance as to the terms on which, or the time after which, debt service might be resumed. The aim should be to build a level of reserves more or less adequate in the light of that conclusion: accumulation should continue, but the rate of accumulation could taper off. The major point of reference for judging the adequacy of reserves should be loans outstanding rather than borrowings outstanding. Cover for borrowings was mainly a matter of liquidity.

31. Mr. Garland supported as a general proposition, and on balance, the proposal for a dividend, although if he had to choose between a reduction of commission and a dividend he would consider the dividend less desirable. As to the amount of dividend, he thought that once the Bank started declaring a dividend, the tendency would be to increase the amount, never to pass a dividend. There might be a temptation to raise the dividend even at the expense of a prudent reserve policy, to maintain the Bank's market image. Therefore he believed it advantageous, if a dividend was declared, to start at a low level. Perhaps this might be regarded by the market as a surprising move, given the size and success of the Bank, but the special circumstances confronting the Bank would probably be taken into account. If payment of a dividend was to be considered, he would favor confining it to 2% on the 18%. Since this would amount to approximately \$30 million, it could be considered together with a reduction in commission charges. If a more substantial dividend were to be paid, countries which had recently joined the Bank would also benefit. In that event consideration might be



given to arrangements to insure that those countries would make at least an equivalent part of their second-round contributions to IDA available in convertible currencies. There would no doubt be some advantage to the major recipients of dividends in making a declaration of intent at the time that the dividend was declared, in contrast to a direct transfer of the equivalent of a dividend from the Bank to IDA. While the latter would not of itself weaken confidence in the Bank's standing, it could appear to be the beginning of a change in relations between the Bank and IDA, with a direct channel being opened between the two institutions. He agreed with the view expressed by the management that it would be better to avoid any financial connection between the two institutions, direct or indirect. Otherwise, there would appear to be a chance the Bank might be drawn into handouts on a significant scale.

32. As to the reduction of commission, Mr. Garland had on an earlier occasion indicated the considerations in favor of a reduction: that a relatively small distribution would conform to long-held expectations; it would help, in association with a dividend, to assure equity between borrowers and lenders and a more equitable distribution generally; and it would be more in harmony with the general purpose of international cooperation. He was not persuaded by Mr. Donner's argument that a commission rebate was not likely to be used for developmental purposes. He thought the rebate would be received by countries whose propensity for development expenditure was high: in both Part I and Part II borrowing countries a marginal increment to budgetary receipts would almost always be used for some form of development expenditure. In contrast, a dividend payment would be received principally by Part I countries whose propensity for development expenditure would not be so high.

33. Mr. Garland noted that the staff paper cited among the arguments against a reduction of loan charges, the argument that Bank charges were low in comparison to the interest rate which the Bank's most creditworthy members must pay to borrow at long term in the principal capital markets of the world. Yet effective yields to maturity for purchases during 1962 in the New York market ranged from 5.4 to 5.7 for Denmark, Belgium and Australia, and in the last two years, in the Swiss market, were 4.5 and 5 for Denmark, Austria, Finland and Australia. He did not find it unnatural that the Bank's charges should be below the market rate. It could be argued that the Bank should use its influence, its marginal competitive position, to keep long-term borrowing rates down to a reasonable level. Perhaps it was not that the Bank's rate was low; perhaps the market rate was a bit high. In the long run, it would be a good thing if the major capital markets gradually reduced their rate for long-term capital, and perhaps the Bank had a function to serve in encouraging a drop in the market rate by keeping its own charges a little under the market. The staff paper also referred to the difficulties which would result if the gap between the Bank's loan charge and the cost of borrowing in the market were substantially widened. He did not find this comparison convincing. If the Bank and the market both had plentiful funds and were able to meet the demand from prospective



borrowers, the rates would gradually tend to come into some sort of relationship. However, the Bank was a special lender, a marginal lender, with limited funds.

At the same time, funds available in the market were limited. A policy of transferring borrowers from the Bank to the market would not be well received by particular borrowers, not so much because of the high cost of borrowing in the market as because this would reduce the funds available there. At present, there was a wide fringe of unsatisfied borrowers. Recipients of Bank loans would be prepared within reasonable limits also to borrow from the market. He doubted that the market feared a loss of borrowers by reason of a slightly more favorable Bank rate. Turning to the other arguments cited, he doubted that a reduction of loan charges achieved by way of a rebate of commission out of net income would adversely affect the Bank's market image or make the Bank's bonds less acceptable. Nor was he convinced by the argument that the Bank's ability to sell portions of its loans might be impaired: the Bank could always sell at a discount. In any event, all these difficulties would be avoided by the payment of annual rebates. In this connection, Mr. Garland noted that the Bank had recently been selling considerable of its maturities. He wondered whether the Bank might not be selling rather too much out of its portfolio, that is, whether the terms might not be too favorable.

34. Mr. Garland added that he wanted to express his views on the question of uniformity of loan charges as among borrowers. He thought uniformity was very important. It was a kind of compromise between two principles, the economic and the welfare principles. If there were to be discrimination between borrowers, the economic principle would call for discrimination against weak borrowers because they were weak; the welfare principle, on the other hand, would call for discrimination in favor of weak borrowers because of their weakness. If there were to be a departure from the principle of uniformity he would favor acceptance of the economic principle. To do otherwise would risk adversely affecting the Bank's market image as an institution run along sound business lines and making the Bank's bonds less acceptable. Any discrimination should be tried out in IDA before being tried in the Bank; even there, he thought, the discrimination should take the form of a hardening of terms against the weaker borrowers.

Mr. Knapp commented that the references in the staff paper to the possibility of revising lending terms were not intended to suggest the possibility of introducing discrimination in interest rates. There was no thought of doing that.

35. Mr. Garland alluded to the reference in the staff paper to an opinion of the General Counsel that, if the commission were reduced, it would not be mandatory for the Bank to apply the reduced rate to outstanding portions of existing loans. It had been his understanding that any such reduction would in fact be applied to existing as well as to future loans. As a matter of equity, he thought any rebate should be proportional to the loan charges paid to the Bank during the given year, and therefore should be paid both to old and new borrowers. An annual rebate on loan charges



perhaps of the order of \$15 million or \$16 million might well be associated with a dividend, making a total distribution, assuming a dividend of \$30 million, of some \$45 million. This would seem to leave an ample amount to be put to reserves.

36. Mr. Garland was of the opinion that a reduction in commission, on both new and outstanding obligations, was preferable to a dividend. If there was to be a dividend, it should be accompanied by reduction of the commission. If there was to be a dividend without a reduction in the commission, payment to members was preferable to a transfer of the equivalent of the dividend to IDA. Should neither the commission reduction nor the dividend be approved, it would be helpful to receive an undertaking from the management that the general question would be considered again within a year or two. In that event he would also suggest that examination be given, along the lines suggested by Mr. Pitblado, to an arrangement whereby any proposed major beneficial expenditure should be submitted for approval of the Board of Governors.

37. The Chairman said, in response to Mr. Garland's suggestion, that he would have great difficulty in adopting any principle of operation designed to affect the interest rates in the private market, or in reaching decisions on making recommendations with that end in view. He did not conceive that to be a duty or objective of the Bank. He would welcome a reduction in the market rate as a by-product of Bank operations.

38. Mr. Hudon noted that he had, on an earlier occasion, stated the views of his authorities on most of the issues raised in the staff paper. Their views remained essentially unchanged. He thought that decision on the issues raised in Parts B, C and D of the paper should be postponed until a reserve policy for the Bank had been agreed upon. Any judgment on the adequacy of the Bank's reserves was bound to be subjective and intuitive. It was difficult to assess the risks confronting the Bank and the reaction of the market to a particular level of reserves. For that reason he was prepared to rely rather heavily on the judgment of the management.

However, while the risks confronting the Bank could not be measured, it was possible to arrive at a judgment as to whether the over-all risk was increasing; he thought it clear that this was the case. Accordingly, he believed that reserves as a percentage of loans outstanding should at the very least not fall below their present level and preferably should rise. He hoped that the management could formulate a reserve policy along those lines for consideration by the Directors. A number of projections would be useful in that connection. He would be interested to know what maintenance of the 24% reserve ratio would involve, and what a 30% ratio would imply. If a reserve policy could be formulated along these lines which would hold for perhaps the next five years, this would to some extent meet a problem to which Mr. Donner had referred: it would be at least a partial counter to any pressure which might be exerted if the Bank's earnings continued to be high. Once a general reserve policy had been adopted, consideration could



be given to ways of disposing of any earnings in excess of the amount required for reserves themselves.

39. Mr. Hudon had found the moral arguments against a transfer, derived from the Articles, quite convincing, almost conclusive. Since he was not in contact with the market, he found it hard to judge the possible effect of a transfer on the Bank's image. If he were an investor in the Bank, he would be made uneasy by any suggestion that the Bank should remit approximately 50% of its earnings to IDA for the next five years before those earnings were realized. It would also make him uneasy if he heard that the management thought that the Bank prudently could dispose of some \$50 or \$60 million of earnings, whether by way of dividend distribution or a reduction in loan charges. Mr. Donner commented that it had never been suggested that either a transfer or a dividend be decided upon for five years in advance. Any decision would have to be made on an annual basis, in the light of earnings and other relevant circumstances.

40. Mr. Hudon also found the arguments against a reduction in loan charges convincing. At the same time, he thought that the case against a reduction of one-quarter of one percent was not as strong as the case against a reduction of, say, one percent.

41. Payment of a dividend, Mr. Hudon said, was still preferred by his authorities, as the best way of safeguarding the Bank's financial integrity. However, they would welcome a study of the proposals made by Mr. Pitblado. Mr. Hudon was particularly interested in the suggestion in the staff paper of the possibility of a longer grace or amortization period.

42. Mr. Suzuki referred to the interpretation of Article V, Section 14 of the Bank's Articles, prepared by the General Counsel (FPC 63-6), to the effect that grants made by the Bank constitute expenditures which are charged against income along with all other expenditures and are deducted from gross income in order to arrive at net income. From this he concluded that if a grant were to be given to IDA, it would be an expenditure, and would not be charged to net income. The technical assistance grants made thus far could be considered somewhat incidental by reason of their relatively small aggregate. If a program were to be approved for \$10 million in educational grants or if a \$50 million grant were to be made to IDA, these could not be regarded as incidental. It might be necessary to establish two categories of expenditures, ordinary and special. He had not reached any conclusion concerning proposed special expenditures of \$50 or \$60 million. However, his government's position was that the decision on a possible grant to IDA or on the payment of a dividend, or on a reduction in loan charges was not a prerequisite to the increase of IDA's resources. His government was prepared to contribute to the increase whether or not a dividend was paid or loan charges reduced. The matter of the increase should be resolved as quickly as possible, and the question of the best use of the Bank's net income should not be decided hastily.



43. Mr. Khosropur noted that Mr. Shoaib had earlier expressed his views on the declaration of dividends and the transfer. With regard to a reduction of commission, Mr. Khosropur agreed with Mr. Garland, Mr. Krishna Moorthi and those other Directors who favored it. If payment of a dividend was thought likely to facilitate contributions to IDA and the Board agreed to recommend a dividend, this should be accompanied by a reduction of the commission. To assure equity between Part I and Part II countries, that reduction should be at least half of one percent, assuming that it was not feasible to eliminate the commission entirely for the present. That reduction would amount to \$15 million, not a very considerable amount and not likely to affect the Bank's financial position. The reduction should be applied to both outstanding and future loans, so as not to discriminate between the older and the more recent borrowers.

44. Miss Brun referred to Schedules A and B in Annex 2 of the staff paper, showing the size of reserves with and without payment of a dividend of \$50 million. She agreed with Mr. Hudon that it would be useful to have the projections worked out to show the consequence of paying a larger or a smaller dividend, and of combining a dividend with a reduction of the commission. Her countries still favored a dividend, although the amount was still a matter for discussion. But she also supported Mr. Garland's view that reduction of the commission might accompany a dividend. The real question was the size of both a dividend and the amount of any reduction in loan charges. The additional data she had proposed might help in reaching a conclusion on these points.

45. Mr. Donner said he would like to clarify his position on reserves. He was not of the opinion that present reserves were excessive; he thought they were comfortable. The present reserve ratio was acceptable. Accumulation of reserves should continue but there was probably a strong case for accumulation at a slower rate than at present. In this he agreed with Mr. Garland. The arguments cited in the staff paper with regard to further accumulation of reserves which he had not found convincing were arguments for accumulating reserves "at the fastest possible rate." He took that to mean a rate which was not reduced by devoting any part of earnings to any other use. That would mean, on the basis of the projections in Schedule A of Annex 2 to the staff paper, that the ratio of reserves to loans outstanding would increase from 24% in 1963 to 36% in 1973, and that the ratio of reserves to borrowings outstanding would increase from 32% to about 56%. Although the arguments set forth in the staff paper purported to justify accumulations "at the fastest possible rate," he doubted that they contemplated so rapid a rate of increase as was in fact projected in Annex 2. It should also be noted that if some \$50 or \$60 million of earnings were put to another use, the projection indicated that the ratios which would prevail in the middle of 1963, and which were said to be adequate in the absence of a calamity, would nevertheless be roughly maintained through 1973.



46. Taking the arguments in order, Mr. Donner agreed that history afforded little guidance in the appraisal of the risks confronting the Bank. But account should be taken of a countervailing consideration: the priority position governments had granted the Bank with regard to its debt-service claims. That priority, while only de facto, was nevertheless effective. If the Bank followed conservative reserve policies and accumulated reserves at the fastest possible rate, this might in effect invite governments to take away from the Bank the advantages of this privileged position. The next argument was that a high level of reserves--reserves accumulated at the fastest possible rate--supported the Bank's credit standing and enabled the Bank to borrow at favorable rates. However, the Bank's bonds already had the highest possible rating. To maintain that rating it was surely not necessary to increase the Bank's reserve ratios beyond their present level. Mr. Donner added, in support of this view, that the bonds of the Inter-American Development Bank were also rated AAA, although the IADB's reserve ratio was considerably below that of the Bank. The third argument cited for accumulating reserves at the fastest possible rate was that this would enable the Bank to expand its operations and consider modifications of its lending terms. This seemed to imply the possibility that the Bank's operations might be hampered by an insufficiency of available resources. Thus far, however, the Bank had not had difficulty in obtaining all the funds it could usefully employ. The recent doubling of its capital had given the Bank an even wider base for its borrowing activities. The argument also seemed to suggest that with higher reserves the Bank could feel free to lower its loan charges and could, without regard to the type of project, adopt longer grace periods or longer amortization periods for its loans. The Chairman interposed the comment that there was no implication, in the argument Mr. Donner had cited, that loan charges would be reduced. The reference was to a modification of lending terms such as period of grace and amortization. This was most important. Mr. Donner said he realized that, and had not intended to mention interest rates. In any event, he had understood that the terms of Bank loans, apart from interest, took account of the economic life of the project being financed. If on the basis of a high level of reserves the Bank were to lengthen the grace and amortization periods, then assuming that the present periods were economically justified, he wondered whether any such "softening" of terms might not adversely affect the Bank's market image as an institution conducted along sound business lines.

47. The Chairman replied that there was no precise point at which a period of grace or an amortization period became or ceased to be economically sound. There was a range of economic soundness. It was relevant to consider whether, in view of the demand from commercial banks in Europe and the United States for the early maturities of the Bank's loans, those loans were really being made on terms less favorable than those attractive to normal commercial sources. In the light of such clear, continuing and uninterrupted evidence that the early maturities were attractive to the commercial sources, perhaps the Bank had a duty to examine the period of grace question. He did not think that a modification of that period or the amortization period would constitute a departure from sound policy.



48. Mr. Donner said perhaps these matters might be more fully explored in a paper of the kind Mr. Hudon had suggested. He also thought the proposal of Mr. Pitblado and other Directors that beneficial expenditures be separately accounted for had merit. The Chairman said it would be considered. Mr. Donner was not sure he would go so far as to support Mr. Garland's suggestion that all beneficial expenditures of large magnitude be submitted for approval of the Board of Governors.

49. Mr. Chen said that he agreed with Mr. Garland that in principle it was desirable to continue accumulation of reserves and to aim at a high level of reserves. Schedule B of Annex 2 to the staff paper indicated that even after payment of a \$50 million dividend the reserve ratio, which was already reasonably high, would continue to rise from 1963 to 1973, although at a slower pace. Accordingly, since a dividend could be paid without impairing the Bank's reserve position, he was in favor of doing so. However, he also supported Mr. Garland's proposal that a 2% dividend be accompanied by a reduction in loan charges. Mr. Krosropur had proposed a reduction of half of one percent in the commission. Mr. Chen would begin with one-quarter percent, which would mean a drop of only \$8 million in income.

50. Mr. Chen said his government was opposed to a direct transfer, notwithstanding the legal opinion referred to earlier.

51. Mr. Chen would favor a recommendation for a 2% dividend, with a string attached: all recipients would declare their intention to contribute to IDA the amount of dividend received.

52. Mr. Machado noted that Directors representing Part I countries, those which really had a stake in a dividend, had expressed, though in varying degree, opposition to a dividend. In his own view, the dividend route was the most clumsy and least efficient way of transferring development funds from one institution to another. Altogether, about \$8.7 million of a \$50 million Bank dividend would immediately be lost to IDA, either because some of the recipients were not members of IDA or because, as had been proposed, Part II members would not be called upon to subscribe to new resources and were unlikely to make voluntary contributions. A similar situation might prevail in subsequent years. The arguments against a direct transfer had already been stated. All but one Part I country seemed to prefer some other course of action.

53. Concerning reserves, Mr. Machado commented that the Bank's reserves were not like the reserves of other organizations. The \$250 million in the Special Reserve was a true reserve, segregated and not available for lending operations. But the other half billion had been put out on loan. It was helping to keep down the cost of the Bank's resources for lending, by reducing the Bank's need to go to the market and by strengthening the Bank's general credit. While there was thus no reason to reduce the present level of reserves, it was also the case that reserves appeared sufficient for the time being although, as Mr. Larre had said, if serious balance of payments situations arose reserves could not be high enough.



54. Mr. Machado thought a separate session should be devoted to loan charges. Each of his countries had borrowed from the Bank. While each had also made available its 18%, and would participate in a dividend, they were more interested in a reduction of loan charges. The difficulty was that a reduction in the commission would not be of any long-range benefit to the debtors. Besides, assuming continuation of the "gross" interest charge, he wondered whether commercial banks or insurance companies would be interested in taking up maturities on loans if the commission were eliminated. He thought it much more important to have funds available for development than to have low cost money. If there were a way to reduce loan charges and pass the benefit on to member countries without impairing the Bank's access to the market and its ability to sell from its portfolio, he would support it. The present system not only relieved the Bank from having to go to the market in competition with other borrowers, but also established the direct credit of borrowers' countries with the capital market, when the market purchased part of the Bank's portfolio without the Bank's guarantee.

55. Mr. Machado added that in any case, as far as IDA was concerned, whether a part of Bank net income was to be transferred directly or via a dividend, and whatever the merits or disadvantages of either technique, only a very small part of IDA's need for new funds could possibly be provided from this source. The target proposed by Mr. Black had been \$500 million a year; in Paris \$250 - \$300 million had been discussed. He agreed with what Mr. Larre had said, that it was necessary to know first what governments were prepared to contribute; then the Bank could decide what to do. The Governors had asked for a report by the end of 1962 on how IDA's resources should be replenished.

56. The Chairman referred to Mr. Donner's comment that Inter-American Development Bank bonds were rated AAA, although that institution's reserves were lower than the Bank's. He wanted to remind the Executive Directors that Mr. Black and Mr. Garner had convinced the investment fraternity that the total dollar debt of the Bank should not be limited to the United States obligation on its unpaid subscription. In contrast, the Inter-American Development Bank never really argued for that position. It agreed to accept a limitation: the aggregate amount of its dollar debt could not exceed the liability of the United States. For that reason, the reserve situations of the two institutions could not be compared. He wanted to commend the attitude of the Government of Japan, as expressed by Mr. Suzuki. He entirely concurred that any decision on a dividend or a transfer or loan charges should be divorced to the extent possible from the decision of governments with respect to the IDA replenishment.

57. There was a point about reserves which the Chairman hoped the Directors would keep in mind. As the staff paper pointed out, there was a difference between the Special Reserve and the Supplemental Reserve. The Special Reserve, as required by the Articles, must be kept in liquid form and was available only for meeting the Bank's obligations. It could not be used in the regular



operations of the Bank. The Supplemental Reserve, on the other hand, was in the nature of a bookkeeping account and the net earnings allocated to it became part of the Bank's resources available for lending. The Supplemental Reserve had now reached a level which might be considered to justify regarding some or all of future net earnings, over and above those allocated to the Special Reserve, as constituting in effect a special investment account; this would perhaps facilitate consideration of the suggestion implicit in the reference in the staff paper to a possible expansion of the Bank's activities and a review of certain lending terms.

58. The Chairman recalled that he had on an earlier occasion expressed his feeling that there should be no direct transfer of Bank earnings to IDA; he wanted to reiterate and emphasize that viewpoint. He had also, at an earlier meeting, said that he concurred in the recommendation previously made that a dividend be considered. However, it was now his impression, derived from discussions in the Board room and informal conversations with Directors, that the majority of the Executive Directors were opposed to a dividend. He wanted to make clear that he had no intention of trying to change the inclination of the Directors in that regard. He realized that some Directors had earlier acquiesced in a dividend partly because of the viewpoint of management. But the consensus did not favor a dividend. He was grateful for the exchange of views and the comments that had been made. It was now the duty and the obligation of the management to put forward for consideration by the Committee a clear, precise and brief suggestion with respect to all the related questions: dividend, loan charges and a philosophy with respect to the reserves.

59. The meeting was adjourned at 5:15 p.m.

60. Following the meeting of the Financial Policy Committee, there was an informal discussion. The Chairman undertook to answer a question by Mr. Chen concerning progress being made on the question of the total of new IDA resources. He agreed with Mr. Machado that the real question was how much money was to be made available to continue the IDA operation, and when that figure would be known. Mr. Bullitt had told the Chairman that the recent meeting in Paris was inconclusive, and that the chances were that there would be no further Paris meetings. A representative of the German Ministry would be meeting soon with the Chancellor of the Exchequer to discuss various matters and from that meeting there might emerge some new ideas on the IDA question. The impression the Chairman received was that the United States, the United Kingdom, the French and the West Germans all wanted to continue the IDA operation. The debate was on the division of the aggregate. It was his view that this was a matter for the contributing countries to settle among themselves. The management of the Bank should not participate in such a discussion. On the other hand, it might be that at some point a fresh viewpoint could be helpful. He sensed, although Mr. Bullitt had not said this, that the initiative



for discussions about amount and timing might come back to Washington as a result of the impasse in Paris. The Directors representing Part I countries might increasingly find themselves in a position to be constructively helpful.

61. Mr. Lieftinck said that he agreed that the distribution of the total amount was a matter for the Part I countries to settle among themselves. He did not believe that the management should remain aloof insofar as the total amount was concerned. The Chairman agreed that the management should have a view on the total amount. In fact a view had been expressed. There had been a concurrence in the \$400 million figure. The management believed that IDA could intelligently commit more than that, but if that seemed to be the limit which countries were willing to contemplate, it would have to be accepted. Now the figure being discussed was \$250 million. At the proper time, the Chairman or Mr. Wilson would comment on that figure.

62. Mr. Wilson referred to Mr. Machado's comment that it was already considerably after the time which the Governors had set in their resolution. There was a further reason for urgency. Meetings had been scheduled in April and May for the India and Pakistan consortia. In the past, the Bank and IDA had indicated, subject to approval of the Directors, what amounts they might be able to contribute. At the moment it was not possible to say what the carryover after June 30 out of initial IDA resources would be. It looked as though it would be somewhere between \$150 and \$200 million. But unless some decision on new resources had been reached by the time of the consortium meetings, that would be the maximum of IDA resources from which an allocation could be made to those two countries over the coming year. The Chairman added that it would be helpful if Directors could call that point to the attention of their governments as an additional reason for coming to a decision soon on the matter of relative participations.

63. At 5:27 p.m., the informal discussion was concluded.



## OFFICE MEMORANDUM

TO: Heads of Departments and Offices

DATE: February 15, 1963

FROM: Henry G. Hilken

SUBJECT: Use of Initial Resources of IDA

Mr. Knapp's memorandum to Mr. Woods on "Use of Initial Resources of IDA," referred to at the Bank Staff Meeting on February 14, is attached for your information.

TO: Mr. Aldewereld

Broches

Cargill

Cavanaugh

Cope

Demuth

de Wilde

Graves

Howell

Martin

Mendels

Miller

Moussa

Reid

Rist

Schmidt



February 14, 1963

To: Mr. George D. Woods

From: J. Burke Knapp

Subject: Use of Initial Resources of IDA.

The initial subscriptions to IDA in convertible currencies amount, as you know, to about \$760 million, to which may be added the \$10 million of supplementary contributions from Sweden. The attached table shows the progress to date in committing this \$770 million and the way in which the balance may be expected to be committed over the balance of this calendar year.

The period January 1 to June 30 will be characterized by continued large credits to India (mainly the \$67.5 million credit to the Indian Railways which will be coming up soon), and a rapid acceleration of our credits to Pakistan as IDA projects there are finally being brought to the stage of execution. In other areas, progress is still rather slow so that the total figure for 1962-63 now looks like about \$370 million as compared with our last estimate of \$400 million. This would leave a "carry-over" of \$165 million to be committed during the next fiscal year.

The figures in column 6 show how this \$165 million might be used up by the end of 1963. The figures in this column have been compiled (a) by taking, for countries other than India and Pakistan, our present realistic estimates of what can be done there before the end of 1963, on the basis of specific projects now before us, (b) allocating the balance to India and Pakistan - in effect this would mean that IDA assistance to these countries could be continued through 1963 at about the level of the last two years, (c) making no allocation toward two important uses of IDA funds which might develop during 1963, namely assistance to the U.A.R. and participation in the second-round of the Indus Basin contributions. (The Bank carried the Indus Basin load on the first-round but we have been planning to shift most, if not all, of the load to IDA on the second-round).

These figures should not be regarded as any final "allocation"; however, as we approach the Indian and Pakistan Consortium meetings in April we shall have to make up our minds on what to say at these meetings on behalf of IDA (and the Bank). In this connection, I may remind you that we had been hoping to step up IDA aid to India and Pakistan in future years and to reduce the Bank contribution to these countries. If in fact IDA assistance to India and Pakistan had to be rationed as severely as indicated in the attached table, either the total Bank/IDA contribution would have to be reduced in future years, or the Bank would have to assume much greater risks in these countries than we have previously contemplated.



As for the figures in column 6 for countries other than India and Pakistan, you will see that IDA business still continues slow although the pace in Africa may step up a bit as some of the preparatory work which we have been doing there bears fruit. In the Far East, on the other hand, the only country listed for action in the second half of 1963 is the Philippines; we have recently ruled out both Ceylon and Korea on the grounds of their unsatisfactory financial policies, and in Taiwan we have turned in the direction of Bank loans. Similarly, in the Western Hemisphere we have slowed up on IDA credits to a number of countries and are now contemplating credits only to Ecuador, Bolivia and Paraguay during the whole of 1963.



Actual and Estimated IDA Credit Commitments  
May 1961 - December 1963

(US\$ millions)

Area	1	2	3	4	5	6	7
	May 1961 to June 1962 (Actual)	July 1 - Dec. 31 (Actual)	Fiscal 1962/63 Jan. 1 - June 30 (Est.)	Total 1962/63 (Est.)	Total through June 1963 (Est.)	July 1 - Dec. 31 1963 (Est.)	Total through Dec. 1963 (Est.)
India	122	90	88	178	300	45 <sup>1/</sup>	345
Pakistan	21	7	100	107	128	30 <sup>2/</sup>	158
Middle East (incl. Turkey)	2	5	23	28	30	20	50
Far East	15	14	-	14	29	10	39
Africa	16	5	15	20	36	40	76
Western Hemis.	59	11	12	23	82	20	102
Total, by periods	235	132	238	370	605	165	770

<sup>1/</sup> Assumes annual rate of \$125 million. This would mean about \$95 million for the nine months of the Indian fiscal year which will elapse by December 31, 1963, from which must be deducted the \$50 million "advance commitment" which has recently been made to India.

<sup>2/</sup> Assumes annual rate of \$50 million. This would mean about \$25 million for the six months of the Pakistan fiscal year which will elapse by December 31, 1963, to which must be added a \$5 million "carry-over" of uncommitted funds from the previous fiscal year.



(not for public use)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

**DECLASSIFIED**

Date: 11/15/2005 SB

CONFIDENTIAL

FPC 63-6

FROM: The Acting Secretary

February 12, 1963

INTERPRETATION OF ARTICLE V, SECTION 14  
OF THE ARTICLES OF AGREEMENT

Attached is a note prepared by the General Counsel in response to a request made at the Financial Policy Committee Meeting held on January 17, 1963.

Distribution:

Members of the Financial Policy Committee  
President  
Vice Presidents  
Department Heads



INTERPRETATION OF ARTICLE V, SECTION 14  
OF THE ARTICLES OF AGREEMENT

At the Financial Policy Committee meeting on January 17, 1963 the question was asked whether, apart from any other legal or policy considerations, the suggested transfer of a portion of the Bank's current income to IDA by way of grant would be barred by Section 14 of Article V of the Bank's Articles of Agreement regarding allocation of net income.

This Section provides that the Board of Governors shall determine annually what part of the Bank's net income, after making provision for reserves, shall be allocated to surplus and what part, if any, shall be distributed. As is clear from the remainder of the Section, what is meant by distribution is a dividend. It would therefore seem to be inconsistent with the Articles for the Board of Governors to "distribute" net income by making a grant, whether to IDA or for any other purpose. This does not mean, however, that the Bank may not make grants, or that in deciding on the amount of a grant it may not take into account the size of its income. But such grants constitute expenditures which are charged against income along with all other expenditures and are deducted from gross income in order to arrive at net income. This is in fact what the Bank has done in respect of technical assistance grants and is presumably the course the Bank would follow in regard to the suggested educational grants of up to \$10 million.

Article V, Section 14, of the Bank's Articles would therefore not be a bar to the suggested grant by the Bank to IDA.



DECLASSIFIED

Date: 11/15/2010 SJB

CONFIDENTIAL

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
INTERNATIONAL DEVELOPMENT ASSOCIATION

Office Memorandum

To: Staff Economic Committee

From: Doreen E. Crompton

Subject: IDA Lending Policy  
(Meeting of August 9, 1963)

The authors of the paper explained that its original purpose had been to review IDA lending policy to date, with particular reference to the criteria according to which countries are considered eligible or ineligible to receive IDA credits. This review showed up a range of problems, new or remaining unresolved, and it had seemed desirable to continue the study with an analysis of the policy issues at the present stage of IDA's history. Latterly, the Management had specified that the paper should raise questions about these issues rather than attempt to provide final answers.

Review of Past Policies

The Committee queried the implication in the study that no shortage of IDA funds had existed in the past, when, in fact, a ceiling had been placed on lending to India, Pakistan and Jordan and the submission of projects from relatively high income countries had been discouraged.

The Committee was hesitant about the statement that 'a country's economic performance has invariably been taken into account', in considering requests for IDA assistance. In a few cases, economic performance had mainly referred to performance in the sector where a project was submitted for financing, rather than to overall economic performance in the country. It was mentioned that credits had been given to Ethiopia, Haiti, Jordan and Paraguay even though reservations about their economic performance had been expressed at SEC meetings.

Committee members challenged the statement in the study that 'population had been one of the principal factors taken into account in deciding how much assistance a country should receive'. The size of the population of India, Pakistan and Jordan had determined their share of IDA resources in relation to other Part II countries, but, in the case of other Part II countries, the indivisibility of projects had tended to determine the size of the credit. The result was that there were wide differences in the per capita credits received by different countries.

There was some discussion regarding salient differences in the loan portfolios of IBRD and IDA. Where countries were eligible for both IBRD and IDA lending, i.e., blend cases, self-liquidating projects were financed by IBRD while IDA financed highways and irrigation projects. Some members felt that in a few cases the nature of the project, rather than the overall economic position of the borrowing country, had determined the source of finance. For example, electric power in Swaziland and petroleum pipelines in Algeria had



been financed by IBRD, although the overall economic position of the countries might have justified IDA credits.

### Rationing

The Committee discussed whether demand for IDA funds is likely to exceed IDA's commitment authority. One view in the Bank was that suitable projects were scarce. The majority of the Committee however, agreed that, even given existing economic standards and availability of projects, there was a rationing problem, although this was probably a growing rather than an immediate problem. The evidence cited for the existence of a rationing problem was the estimate by the Bank's Area Departments of the projects likely to be available for financing in the immediate future. As further evidence it was suggested that estimates of capital inflows required by underdeveloped countries be calculated from development plans both directly and by analogy where plans did not exist. Any analysis of demand for IDA funds should be related to the pattern of overall capital inflows: because IDA resources formed only a very small part of total capital assistance and the terms of IDA credits were highly desirable a rationing problem could always be said to exist, whatever the level of other inflows. The Committee suggested that the rationing problem be discussed in the paper rather than merely assumed.

### Criteria for Making the Best Use of IDA Resources

The authors suggested that the relatively small size of IDA's operations made for very great difficulties in deciding the proper basis for IDA lending policy. It might seem artificial to look at IDA policy in the light of a theory of the "optimum" distribution of assistance to underdeveloped countries, since such a theory would have to apply to assistance from all sources. On the other hand, to consider IDA policy as a division of labor with other lenders, IDA picking out those operations which it considers most appropriate for its own role in this division of labor without consideration of the shape of total capital flows from all sources, would appear economically arbitrary. Thus it seemed worth while to set down a formula for the "optimum" distribution of assistance: this should be regarded as a beacon light on the horizon from which IDA policy could take its bearings rather than as the immediate foundation for practical policy.

It was objected that the formula in the draft was not the only possible definition of the "optimum". For instance, it did not allow for the judgment that assistance should be given to some countries because they were making particularly valiant development efforts, even if the efforts were likely to give poor returns because of natural, economic or social obstacles. The authors pointed out that this view introduced an additional value judgment in specifying the end to be promoted. The essential point was that assistance policy should be conceived as a maximization problem, i.e., a problem of getting the most out of scarce resources. As with all planning operations, it is possible to make a wide range of value judgments in defining what is to be maximized or in setting constraints to the maximization exercise. For clarity of discussion it is important to distinguish between those differences of policy judgments which spring from



different interpretations of fact or forecast and those which spring from differences of value judgments.

#### Poverty

The question was raised whether a per capita income level of about \$200-\$250 should be established as a cut-off point for eligibility; or should all Part II members be considered eligible but the performance criteria be applied successively more rigorously at increasing levels of per capita income.

Members of the Committee pointed out that the implications of a cut-off point were that some countries could be totally excluded from both Bank and IDA financing: despite good economic performance, creditworthiness considerations (which would probably be caused by bad debt structure) could preclude Bank financing. There was general agreement that the solution based on an income cut-off was theoretically inferior but might be necessary from an operational point of view.

#### Performance Criterion

Certain members drew a distinction, in interpreting the performance criterion, between financial and monetary policies, and performance measured by growth and savings rates. According to one school of thought, satisfactory financial and monetary policies should be considered an indispensable condition for eligibility. Others felt that these policies should be taken into account as a part, only, of the numerous factors influencing the efficiency with which the various countries might be expected to translate capital inflow into development.

The view was expressed that ideally the performance criterion should be concerned with the prospective effects of various amounts, conditions and terms of capital inflow on the pace and pattern of development in each country. Some of those present felt that judgments along these lines could be progressively improved in the future, but it was agreed that in the meantime performance judgments will have to be based on less sharply focussed impressions of factors affecting mobilization and use of developmental resources.

There was general agreement that the relevant measure of performance referred to the economy as a whole and not to any calculation of the returns to be expected from an individual project. However, in some countries "the economy as a whole" was a meaningless concept and in others there were no adequate indicators of overall performance, so that there were cases where judgment would have to rest on returns from individual projects.

Members of the Committee questioned the adequacy of statistical indicators - as shown in Table 7 of the Statistical Annex - to support the kind of performance judgments needed in shaping IDA policy. The authors replied that in the original draft the judgments of Area Department missions on the institutional framework of countries had been used to supplement the statistical data, and it was agreed that this kind of qualitative information ought to be taken into account.



Subject to this qualification, it was agreed that statistical indicators provided a valuable factual basis to performance judgments, provided that they are interpreted with due care. However, it was recognized that formidable difficulties arise in comparing growth rates, savings and investment rates and other relevant indicators between countries. Given the quality and coverage of the data and the difficulties of interpretation, it was impossible to arrive at a quantitative appraisal of overall country performance. Even a qualitative ranking of countries would not be feasible. Nevertheless, it should be possible to classify countries into three rough groups, according to whether their performance is good, medium or poor.

#### Creditworthiness

The question was raised how imminent the exhaustion of creditworthiness should be to justify an IDA credit. Should credits be made to a country with a considerable margin of creditworthiness, but which must be expected to rely on substantial net capital inflows for a long time to come, so that eventual exhaustion of creditworthiness is to be expected? Several members of the Committee felt that, if there is a rationing problem for IDA funds, the countries with a substantial margin of creditworthiness should use their borrowing capacity.

Others, however, felt that the continued availability of soft funds was not to be relied on, and that this course might penalize, over the long run, countries which have only recently begun to borrow.

#### Distribution of IDA Credits by Size

Until more work could be done in interpreting the performance criterion in terms of the developmental impact of various amounts of capital inflow, it was agreed that decisions as to the amount of IDA funds to go to each country would have to be made separately from decisions of eligibility. Some of those present considered that decisions on amounts would have to be based in major degree on size of population. Others felt that considerations of "absorptive capacity", and of the amounts and terms of assistance likely to be available from other sources, should be taken into account.

#### Rates of Return on Projects

Some members of the Committee opposed the view expressed in the report that IDA should be prepared to accept relatively low rates of return on projects in certain countries. Other members questioned the significance of comparisons of rates of return in different countries. It was suggested that the question of minimum acceptable rates of return on individual projects in countries of different income levels and different resource endowments needed further theoretical consideration.

#### Simultaneous Evaluation of Claims

The Committee recommended that reviews of the prospective geographical pattern of IDA should be carried out for future periods of both one and three



years. Annual reviews of the operations in the coming year would be desirable because a longer-term view would prejudice the existence of projects not yet available and possibly lead to tying up funds for countries which would not in fact submit suitable projects. Furthermore, a view longer than one year ahead was required so that IDA funds would not be committed only on the basis of projects in the pipeline and therefore to countries at a better stage of project preparation. Such periodic reviews would be based on a simultaneous evaluation of all Part II member countries' performance: the ensuing grouping of countries would be modified according to estimates of the size of the resource gap of each country. This method would not only establish a grouping of countries according to eligibility, but, by taking account of residual absorptive capacity, would also help to establish the amount of IDA resources to be allocated to each country.

In Attendance:

Committee Members: Messrs. Avramovic, J.H. Adler, Gilmartin, Gordon, McDiarmid, Sadove and Wright.

Others: Messrs. Billington, Bohr, Edelman, Gulhati, Hayes, Lipkowitz, Lowenstein, Nelson, van der Tak and Miss Zafirliou.\*\*

cc: Staff Loan Committee

Staff Economic Committee: Messrs. Avramovic, J.H. Adler, Alter, Gilmartin, Gordon, Kamarck, McDiarmid, Sadove, Thompson and Wright.

Others in Attendance: (as 'Others' above)\*\*



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IDA/FPC63-1

FROM: The President

January 4, 1963

PROPOSED INCREASE IN IDA RESOURCES

1. I suggest that at the next meeting of the IDA Financial Policy Committee on the proposed increase in IDA resources, to be held on Tuesday, January 15, immediately following the Regular Meeting of the Executive Directors of the Bank, the discussion be concentrated on the following topics:

- (a) the aggregate in freely usable resources to be made available for commitment beginning July 1, 1963, and the period which those resources should be intended to cover;
- (b) the sources of the new resources, including whether second-round subscriptions should come from both Part I and Part II countries and whether any of the new resources should derive from Bank earnings.

2. Attached for the information of the Executive Directors is a copy of a memorandum to me from Mr. Wilson, reporting on the discussions at the recent Paris meetings.

Distribution:

Members of the Financial Policy Committee  
President  
Vice Presidents  
Department Heads



DECLASSIFIED

Date: 10/15/2010

CONFIDENTIAL

January 3, 1963

To: Mr. George D. Woods

From: Geoffrey M. Wilson

Subject: Increase in IDA Resources - Meetings in Paris

1. In connection with the increase of IDA's resources, three informal meetings were held in Paris of representatives of France, Germany, Italy, the United Kingdom and the United States. The first and second meetings, which were held on November 20 and December 6, were at the level of senior officials; the third meeting, held on December 13, was at ministerial level. Mr. John D. Miller, the Bank's Special Representative in Paris, and I were present at these meetings as observers for the Bank.
2. The purpose of the meetings was to enable the participating countries, which include the four largest subscribers to IDA's initial resources, to exchange views as to the amounts that they might be prepared to subscribe to IDA on the second round. Discussion was concentrated on (a) the size of the total subscriptions which it appeared feasible to raise in view of the positions taken by the participating countries, and (b) what portion of the total might be subscribed by each of the participating countries.
3. It was the consensus of the participating countries that, provided their proportionate shares of the total were satisfactory, it was feasible to envisage that, as from July 1, 1963, IDA should have freely usable resources in the amount of \$1,200 million available for commitment. There was some divergence of views as to the period over which resources in this amount should be committed; it was variously suggested that they should



be intended for commitment over a three-, three-and-a-half-, and four-year period. These suggestions translate into average annual commitment rates of \$400 million, about \$350 million and \$300 million.

4. The \$1,200 million total amount was conceived of by the participating countries as consisting of three components:

- |  |                         |
|--|-------------------------|
| (a) Balance of initial subscriptions payable in freely convertible currencies which is estimated to remain uncommitted as of June 30, 1963   | \$ 150 million          |
| (b) Second-round subscriptions by Part I members to be paid in 1965, 1966 and 1967 at the rate of \$250 million per year   | \$ 750 million          |
| (c) Additional resources to be derived in the first instance from IBRD earnings (and provided to IDA) at the rate of \$60 million per year in each of the five years 1963 through 1967 | \$ <u>300 million</u>   |
| Total  | \$ <u>1,200 million</u> |

5. The participating countries pointed out that payments by Part I members, pursuant to their initial subscriptions, aggregated approximately \$150 million per year for the five years 1960 through 1964. They were all of the view that the aggregate amount of these annual payments should be increased for the three years 1965 through 1967 and it was the consensus that, subject to agreement on the share to be provided by each contributing country, an increase to a level of \$250 million per year would be feasible.

6. The participating countries were also inclined to share Mr. Black's view that the level of the Bank's earnings and reserves was now such that it should no longer be necessary to apply all of the Bank's future earnings to reserves. The opinion was generally held that the Bank should be in a position, provided its earnings are maintained, to



distribute some \$60 million of its earnings each year, commencing with earnings realized during the current fiscal year. Over the period to 1967, i.e. 5 years, such distributions would aggregate \$300 million. The view was expressed that this \$60 million should be transferred direct from the Bank to IDA in each of these five years. But it was realized that, if there were no direct transfer of funds to IDA and if this amount were distributed in the form of dividends, then the Government subscriptions in freely convertible currencies would have to be increased from \$750 million to \$1,050 million in order to make a total of \$1,200 million available for commitment.\*

7. On behalf of the Bank's Management, I reminded the participating countries of Mr. Black's view that \$2.5 billion for five years was a reasonable minimum target. I reminded them also of the firm position which he had taken against any direct transfer of Bank earnings to IDA, and against making Bank dividend payments conditional on the conclusion of a previous agreement to transfer the payments to IDA. Furthermore, I pointed out that, while the President had recommended to the Executive Directors of the Bank that they now declare their intention

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\* It should be noted that three different time periods are involved in the suggested arrangements described in this memorandum. There is first the period for IDA commitments, of from three to four years, commencing July 1, 1963. However, because payments on the initial subscriptions will suffice to cover disbursements through 1965, IDA will not need actually to receive new funds until that year. Accordingly, the suggested arrangements contemplate a period for Governments' payments to IDA of three years, commencing in 1965 (the year following completion of payments on the initial subscription) and running to 1967. Finally, there is involved a five-year period for the suggested transfers from the Bank to IDA or dividends by the Bank, commencing in 1963 and running to 1967.



to pay a dividend out of earnings realized during this fiscal year, the amount of the dividend he had proposed was \$50 million, not \$60 million.

8. The participating countries did not reach agreement on the proportion of the total amount which each of them would be prepared to contribute. Another meeting of officials is scheduled to be held in Paris in January to discuss this problem further.