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L.B. Rist: Market Loans, 1964-1967

L. Rist 7th February 1967.

## I.B.R.D. Loans to "Market Eligible" Countries

1. On February 9th 1965 the Executive Directors approved the new policy proposed by the President which consists of charging so-called "market eligible" (ME) countries an interest one point higher than the standard rate. Two years have now gone by and a number of questions have arisen in the meantime.

A. Question of Definition

2. The definition "market eligible" for the countries to which the higher rates apply does not seem to fit all the cases. Operational Memorandum 2.02 defines them as "those economically stronger countries which are able to cover their external needs mainly in the private market". In one case, Finland 1/, it was found that although strong economically, the country did not have easy access to the private market and it was decided to treat Finland as ME only after the roads loan of April 1966. In another case, Jamaica 2/, it was found that although in the past the country had had access to the London market it was not likely that this favourable situation could continue in the future, and it was decided not to treat Jamaica as ME (subject to revision in the future). Finally, Portugal, which has been able to float several issues both in New York and in the international market in Europe, has never been considered ME by the Bank in view of its low income per head and of its important investment requirements.

3. The words "economically stronger countries" would probably be a broader and more suitable description for members which the Bank feels should be charged a higher interest rate. On the other hand, if this new definition

1/ Economic Committee M.66-10
2/ Economic Committee M.65-42

were adopted it should then be made clear that one of the factors contributing to economic strength may well be the ability to have recourse to private markets. In short, there seems to be no urgent need to change the name and for the purpose of the present paper the words "market eligible" will be used.

B. List of Countries

4. The second question relates to the listing of the countries which could be included in the ME list. It is interesting to note in the attached table that this list does not exactly coincide with the list of IDA Part I countries. Among those which are considered obviously ME are Libya and Saudi Arabia which rank as Part II countries in IDA. Similarly, Iceland and Ireland are now ME although they are Part II in IDA, and Israel will become ME after its next borrowing although it is also Part II.

5. Similar discrepancies are noticeable between the ME list and the list of countries made subject to the Interest Equalization Tax (IET) by the U.S. Government 1/ as is apparent from the attached table. Thus the IET applies today to Iran, Iraq, Portugal and Spain but the Bank does not consider these countries as ME. On the other hand, Finland and Iceland are ME today and Israel will be classified as such after one more loan, although their bonds issued in the U.S. are not subject to the IET. The Bank classification is based largely on level of income, foreign indebtedness, urgency and size of development needs. The U.S. Government test, although not spelled out, seems to relate mostly to financial strength and the prospective dollar income and reserves of the country.

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1/ Executive order of the President 11071 dated December 27 1962, subsequently amended by Executive order 11224 of May 13 1965 and by Executive order 11285 of June 10 1966.

6. There is no particular reason why the ME classification should be limited to Part I IDA countries. The division of members in the two categories of subscribers in IDA is largely a matter for the countries themselves. A number of Part II countries have in fact no hope of receiving IDA credits in the foreseeable future. This is true for all the Part II countries which the Bank has or will classify as ME. On the other hand, a contradiction between ME classification and the U.S. IET listing may at one time or another create some embarrassment if the Bank were to lend dollars to these countries, inasmuch as the purpose of IET is to slow down dollar capital exports. It is therefore recommended that particular care be taken not to lend dollars in the immediate future to countries such as Iran, Iraq, Portugal and Spain which are not ME now but are all subject to IET under U.S. legislation.

C. New Problems

7. A new set of issues has come to light more recently. The borrowing capacity of the Bank is now somewhat limited by the situation prevailing in the main financial markets. Its lending ability is therefore not as flexible as it used to be. In addition, the New York market remains the main single source of funds for Bank borrowing. Finally, the balance of payments position of the U.S.A. has made both the Treasury and public opinion even more reluctant than before to facilitate foreign lending, as shown in the recent increase of IET applicable as of January 26th 1967; it was announced on that day that the 1% rate would be doubled, but recent discussions in the Ways and Means Committee of the House 1/ indicate that it may only be increased by one half of a point.

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1/ Washington Post - February 24, 1967

8. (a) Should the spread be increased?

In order not to run counter to the policy applied by the U.S. to capital exports from New York to the countries subject to IET, the Bank in turn should charge not 1% but 1-1/2% or 2% above the standard rate for dollar lending to countries which can finance themselves mainly in the private market. Since practically all our loans are denominated in dollars and since when other currencies are required we usually have to purchase them with dollars, it is hardly conceivable that we could maintain a margin of 1% only for any of our ME lending. One could recommend that the 1% margin remain in principle in force for other than dollar lending, while a 1-1/2% or 2% margin be charged for dollar lending; however the lower rate would apply to only a very few cases, if at all. This would be a simple solution for those countries which are both classified by the Bank as ME and are subject to the IET. The high income per head of Finland and Iceland would explain why they are ME without being subject to IET while the low income per head of Iran, Iraq, Portugal and Spain would explain why the Bank does not treat them as ME although the U.S. applied IET. It should be added that as long as the standard lending rate is not modified it may be preferable to postpone discussion, and action, on the interest spread for ME loans.

(b) Could the Bank guarantee public issue of its members?

9. The situation described in paragraph 7 actually suggests that an entirely new approach may be in order today. Why don't the ME countries call more on the European markets rather than the U.S.? It is true that London is beset by balance of payments problems, and Switzerland is limited by what in effect amounts to rationing. But this leaves Germany, Holland, Italy,

Belgium, possibly France, and more important perhaps, and more flexible, the so-called "international market" which includes essentially Luxembourg, Zurich, Frankfurt, and in the past, London. The rates for the local currencies, for dollars and for the European unit of account which is the same as the dollar, are higher than for dollars in New York.* But it is likely that with IET at 1-1/2% or 2% the rates would often be lower in Europe than in New York and that the policy objections to lending abroad would be less today in continental Europe than in the U.S. or the U.K.

10. The potential volume of these markets is of course a matter of uncertainty; moreover the names of many of the countries which are now, or may become, ME or subject to IET are not as well known in Europe as they are here (e.g. Iran, Iraq, Mexico, Venezuela). Could we not facilitate the marketing of foreign bonds in Europe (and in the U.S. for countries not subject to IET) by offering to guarantee the public issues of a number of highly creditworthy countries when and if their amount is too big to be readily marketed under normal circumstances? We would not refuse to assist these countries we would just decline from serving as a channel for the cash to be borrowed by them. In other words, we would still be able to help the most creditworthy countries without going to the trouble of issuing our own bonds.

11. The Articles of Agreement give the Bank the power to attach its guarantee to bonds issued by its member countries. The reason this has been avoided in the past is that the credit of the various potential debtor

* except the Swiss francs which however are rationed.

countries is not always exactly comparable, and that bonds guaranteed by us may command slightly different yields depending on which country is the principal obligor. It was felt that such differentials may harm our own credit when we issued our own bonds. Since however the whole purpose of the ME policy is to make distinctions among borrowers, since our credit is now well established in the markets of the world, this objection may lose weight if we really wish to assist our most creditworthy members. It may be recalled in this connection that the Swiss bankers have in the past frequently suggested that the Bank give its guarantee to foreign bonds issued in Zurich. It may also be pointed out that in markets such as Zurich, the introduction of new names on the "waiting list" may well hasten the approval of new issues by the fiscal authorities.

12. As to the conditions under which this suggestion could be put into practice, they would require serious study. A 1% guarantee commission might be suggested; alternatively, 1% for full guarantee and 3/4% for guarantee on principal only if this is attractive to the market. The Bank may wish to consider the extent to which its normal procedures should apply for the analysis of the loan purposes, or whether some simpler methods could be acceptable in the case of certain countries, if not all. The same issue could also arise in connection with end-use supervision. A number of other questions would inevitably arise,such as whether the borrower should be encouraged to issue two kinds of bonds, some guaranteed and some not; what currencies we could guarantee (European monetary unit etc.); whether we could, or should, take part in underwriting syndicates; what Stock Exchange listings we would prefer; whether we would accept that bankers' commissions be the regular ones or whether we should insist our privileged rates be applied etc.

Ultimately and when the United States' balance of payments is no longer a matter of concern, the same guarantee procedure might be considered for dollar bonds to be issued in New York.

13. The point here is not to make a detailed proposal, but only to raise the problem, and to suggest that it be carefully considered. If found acceptable, the expression "market eligible" may perhaps be changed to "market and guarantee eligible". This may imply slight revisions in the present list of ME countries, limiting it only to those whose names are already acceptable on the markets but not for sufficient amounts, and to those who should become acceptable to the market within the foreseeable future but do not yet have an international credit standing.

14. It is therefore recommended that the possibility of guaranteeing direct bond issues of some of our member countries be seriously investigated. At first the inquiry should concern itself mainly with European markets. Discussion with the security underwriters in Europe should give some indication as to the acceptability of I.B.R.D. guaranteed bonds and the influence this may have on our own credit for direct I.B.R.D. borrowing. Meanwhile the conditions under which the Bank could grant its guarantee to bonds issued by member countries should be examined by the staff.

LRist/mh
27 February 1967.

## IBRD MEMBER COUNTRIES

| | IDA Status | Subject to I.E.T (US) | Last World Bank loans since February 1965 | | | Bond Issues (Govt or Govt Guaranteed) in external markets since 1960 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | Date | Amount in mil.$ | Interest | Number | Amount in mil.$ | Current Yield on last issue | |
| | | | | | | | | U.S.* | Europe |
| I. M.E. Status obvious - No borrowing from IBRD expected | | | | | | | | | |
| Australia | Part I | Yes | | - | | 22 | 595 | 5.97 | 6.92 $ London |
| Austria | " | Yes | | - | | 8 | 95 | - | 6.05 $ Luxembourg |
| Belgium | " | Yes 1/ | | - | | 7 | 120 | 6.04 | 6.08 fl.Amsterdam |
| Canada | " | Yes 1/ | | - | | - | - | - | - |
| Denmark | " | Yes | | - | | 16 | 213 | 6.92 | 6.90 $ London |
| France | " | Yes | | - | | 2 | 16 | - | 4.90 SF Zurich |
| Germany | " | Yes | | - | | - | - | - | - |
| Kuwait | " | Yes | | - | | - | - | - | - |
| Libya | Part II | Yes | | - | | - | - | - | - |
| Luxembourg | Part I | Yes | | - | | - | - | - | - |
| Netherlands | " | Yes | | - | | - | - | - | - |
| Saudi Arabia | Part II | Yes | | - | | - | - | - | - |
| Sweden | Part I | Yes | | - | | 5 | 29 | - | 6.54 $ Luxembourg |
| U.K. | " | Yes | | - | | 2 | 39 | - | 6.44 $ Luxembourg |

1/ Exempt of I.E.T. on new bond issues.

* Bonds not subject to I.E.T.

| | IDA Status | (Subject to IET (US) | Last World Bank loans since February 1965 | | | Bond Issues (Govt or Govt Guaranteed) in external markets since 1960 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | Date | (Amount in mil. $ | Interest | (Number | Amount in mil.$ | Current Yield on last issue U.S.* | Europe |
| II. M.E. Status decided after discussion in Bank: | | | | | | | | | |
| A. Ireland | (Part II | Yes | | - | | 3 | 90 | - | 7.18 £ London |
| Italy | (Part I | Yes | 28 Jun '65 | 100 | M.E. | 13 | 211 | - | 6.66 $ Luxembourg |
| Japan | (Part I | Yes 1/ | 29 Jul '66 | 100 | M.E. | 21 | 427 | 6.78 | 7.10 DM Frankfurt |
| N.Zealand | 2/ | Yes | 17 Dec '65 | 62.5 | M.E. | 10 | 278 | 6.45 | 7.22 £ London |
| Norway | (Part I | Yes | | - | | 18 | 245 | 6.50 | 6.87 $ Luxembourg |
| S. Africa | " | Yes | 8 Sep '66 | 20 | M.E. | 1 | 13 | - | 7.36 DM Frankfurt |
| B. Finland 3/ | " | No | 27 Apr '66 | 20 | standard | 12 | 141 | 6.95 | 7.35 £ Luxembourg |
| Iceland 3/ | (Part II | No | 14 Sep '66 | 18 | standard | 1 | 6 | - | 7.38 £ London |
| Israel 4/ | " | No | 16 Sep '65 | 20 | standard | 8 | 437 | 5.29 5/ | - |
| III. M.E. Status TO be applied after several loans | | | | | | | | | |
| A. Spain | (Part II | Yes | 29 Sep '65 | 40 | standard | - | - | - | - |
| B. Venezuela | 2/ | No | 26 Jan '67 | 15 | standard | 1 | 15 | 6.36 | - |

1/ Exempt of I.E.T. up to $100 million bond a year.
2/ Not member of IDA.
3/ M.E. after this loan.
4/ Will be M.E. after one more loan.
5/ This issue includes both coupon bonds and capital appreciation bonds. Yield shown is a weighted average return.

* Bonds not subject to I.E.T.

| | IDA Status | Subject to I.E.T. (US) | Last World Bank loans since February 1965 | | | Bond Issues (Govt or Govt Guaranteed) in external markets since 1960 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | Date | Amount in mil. $ | Interest | Number | Amount in mil. $ | Current Yield on last issue U.S.* | Europe |
| IV. May become M.E. at some stage in the future: | | | | | | | | | |
| Jamaica | 1/ | No | 23 Jan '67 | 11.2 | standard | 5 | 38 | 8.05 | 8.32 $ London |
| Mexico | Part II | No | 25 May '66 | 19 | standard | 9 | 193 | 7.56 | 7.10 u.a.Luxb |
| Peru | " | No | 7 Sep '66 | 10 | standard | - | - | - | - |
| Trinidad/ Tobago | 1/ | No | | - | | - | - | - | - |
| V. Discussed and found NOT M.E.: | | | | | | | | | |
| A. Iran | Part II | Yes | 26 Jul '66 | 25 | standard | - | - | - | - |
| Iraq | " | Yes | 22 Jul '66 | 23 | standard | - | - | - | - |
| Portugal | 1/ | Yes | 14 Jun '66 | 30 | standard | 4 | 63 | 6.41 | 6.96 $ Luxembourg |
| B. Argentina | Part II | No | | - | | 1 | 25 | - | 7.65 $ Frankfurt |
| Chile | " | No | 23 Dec '66 | 60 | standard | - | - | - | - |
| Cyprus | " | No | | - | | - | - | - | - |
| Greece | " | No | | - | | - | - | - | - |

1/ Not member of IDA.

* Bonds not subject to I.E.T.

Leonard Rist
February 28, 1967

Mr. S. R. Cope 28th February 1967.

Leonard Rist

Bonds.

Herewith two tables showing the most recent available yields of publicly issued bonds of our member countries in European and U.S. markets. They are based on material provided by the statistical office of the Economics Department.

LRist/mh

L. Rist

27th February 1967.

## Yields of Selected Government or Government-guaranteed Bonds Issued in the United States

| Issue | Current Price | Yield to Maturity |
|---|---|---|
| Argentina | - | - |
| Australia | | |
| Government of Australia, 5%, $30,000,000, April 10,1963-1983 | 90.00 | 5.97 |
| Austria | - | - |
| Belgium | | |
| Kingdom of Belgium, 5-1/4%, $30,000,000, March 24,1962-1977 | 94.00 | 6.04 |
| Canada (only provincial bonds) | - | - |
| Denmark | | |
| Copenhagen Tel. Co,5-3/8%, $15,000,000, April 9, 1963-1978 | 88.00 | 6.92 |
| Finland | | |
| Government of Finland, 6½%, $15,000,000, October 19, 1965-1980 | 96.00 | 6.95 |
| France | - | - |
| Iceland | - | - |
| Ireland | - | - |
| Israel | | |
| State of Israel Third Development Issue, 4%, $400,000,000, February 14,1964-March 1,1975/1979 | 90.00 | 5.29 1/ |
| Italy | - | - |
| Jamaica | | |
| Government of Jamaica, 6-3/4%, $7,500,000, January 12,1966-1981 | 89.25 | 8.05 |
| Japan | | |
| Japan Development Bank, 6½%, $20,000,000, November 22, 1965-1980 | 97.50 | 6.78 |

| Issue | Current Price | Yield to Maturity |
|---|---|---|
| **Mexico** | | |
| Government of Mexico, 6%, $27,500,000, October 27, 1965-1980 | 91.00 | 7.56 |
| **New Zealand** | | |
| Government of New Zealand, 5-1/4%, $25,000,000, May 7, 1962-1977 | 91.00 | 6.45 |
| **Norway** | | |
| Kingdom of Norway, 5-1/4%, $25,000,000, April 24, 1963-1978 | 90.00 | 6.50 |
| **Portugal** | | |
| Republic of Portugal, 5-3/4%, $20,000,000, January 26, 1965-1985 | 93.00 | 6.41 |
| **South Africa** | - | - |
| **Sweden** | - | - |
| **United Kingdom** | - | - |
| **Venezuela** | | |
| Republic of Venezuela, 6-1/4%, $15,000,000, April 21, 1965-1980 | 99.00 | 6.36 |

1/ This issue includes two types of bonds, coupon bonds and capital appreciation bonds; the yield shown is a weighted average return.

L. Rist. 27th February 1967.

## Yields of Selected Government or Government-guaranteed Bonds Issued in Europe.

| Issue | Market | Current Price 1/ | Yield to Maturity |
|---|---|---|---|
| **Argentina** | | | |
| Argentine Republic, 6½%, $25,000,000, July 21, 1961-1973 | Frankfurt | 94.25 | 7.65 |
| **Australia** | | | |
| Government of Australia, 6½%, $25,000,000, December 15, 1966-1977 | London | 97.00 | 6.92 |
| **Austria** | | | |
| Brenner Autobahn, 7%, $15,000,000, September 21, 1966-1971 | Luxembourg | 103.75 | 6.05 |
| **Belgium** | | | |
| SABENA, SA., 4-3/4%, f.22,000,000, October 16, 1961-1981 | Amsterdam | 87.25 | 6.08 |
| **Canada** (only provincial bonds) | - | - | - |
| **Denmark** | | | |
| Jutland Telephone Co., 5-3/4%, $5,000,000, May 23, 1966-1984 | London | 88.50 | 6.90 |
| **Finland** | | | |
| Enso-Gutzeit Oy, 6½%, £4,000,000, January 20, 1965-1980 | Luxembourg | 93.00 | 7.35 |
| **France** | | | |
| Societe Concessionaire Française pour la Construction et l'Exploitation du Tunnel Routier sous le Mont Blanc, 4-3/4%, Sw.F.50,000,000, June 3, 1965-1980 | Zurich | 98.50 | 4.90 |
| **Iceland** | | | |
| Republic of Iceland, 6½%, £2,000,000, December 6, 1962-1988 | London | 91.00 | 7.38 |
| **Ireland** | | | |
| Government of Ireland, 7½%, £5,000,000, August 1, 1966-1983 | London | 103.25 | 7.18 |
| **Israel** | - | - | - |

| Issue | Market | Current Price 1/ | Yield to Maturity |
|---|---|---|---|
| **Italy** | | | |
| Ente Nazionale Idrocarburi, 6½%, $20,000,000, September 16, 1966-1981 | Luxembourg | 98.50 | 6.66 |
| **Jamaica** | | | |
| Government of Jamaica, 7-3/4%, £3,000,000, October 25, 1966-1979 | London | 95.75 | 8.32 |
| **Japan** | | | |
| City of Osaka, 6-1/4%, DM 100,000,000, February 1965-1980 | Frankfurt | 92.88 | 7.10 |
| **Mexico** | | | |
| Comision Federal de Electricidad, 6½%, u/a 20,000,000, April 1, 1966-1986 | Luxembourg | 93.75 | 7.10 |
| **New Zealand** | | | |
| Government of New Zealand, 7½%, £12,000,000, October 6, 1966-1986 | London | 103.81 | 7.22 |
| **Norway** | | | |
| Roldal-Suldal Power Co., 6-1/4%, $15,000,000, October 20, 1965-1985 | Luxembourg | 93.50 | 6.87 |
| **Portugal** | | | |
| Government of Portugal, 7%, $18,000,000, November 2, 1966-1976. 2/ | Luxembourg | 100.25 | 6.96 |
| **South Africa** | | | |
| ESCOM, Johannesburg, 6½%, DM 50,000,000, October 25, 1965-1980 | Frankfurt | 92.63 | 7.36 |
| **Sweden** | | | |
| Kockums Verkstads, 6-3/4%, $5,000,000, October 13, 1966-1976 | Luxembourg | 101.50 | 6.54 |
| **United Kingdom** | | | |
| British Petroleum Co., 6-3/4%, $25,000,000, December 14, 1966-1978 | Luxembourg | 102.50 | 6.44 |
| **Venezuela** | - | - | - |

1/ Prices of sterling issues quoted on the London Stock Exchange include accrued interest.
2/ $5,000,000 nominal amount of this issue was privately placed.

Extract from: April 29 1966

US AID PROPOSED ECONOMIC ASSISTANCE PROGRAMS for FY 1967

IRAN

Iran's improved economic position has permitted a substantial reduction in U.S. assistance over the course of the past five years.

With AID help, the government has established an agricultural extension service in addition to rural and urban health services. Schools of medicine, nursing, veterinary medicine, industrial and agricultural vocational training, and teacher training have been developed. In the case of teachers alone, graduates of AID-assisted schools now account for 44 percent of the national total.

Iran has undertaken a land redistribution program which is breaking down the old feudal structure. It is using army conscripts to teach villagers to read and write and to improve their standards of hygiene.

Rising oil revenues, exceeding $500 million this year (compared with $350 million four years ago), are now financing the development program. Government expenditures for development average $250 million annually.

Economic improvements will permit AID to terminate concessional lending to Iran after fiscal year 1966, but the technical cooperation program will continue through fiscal year 1968 to complete existing programs and finance analyses of specific development sectors preparatory to the formulation of the Fourth Plan. The $1.4 million program proposed for fiscal year 1967 includes assistance to a vocational training school, training of extension workers, and support of the government's drive to increase yields of citrus fruits, sugar beets, oil seeds, and forage crops. The University of Pennsylvania will continue to assist the medical school of Pahlavi University under an AID-financed contract.

IET - Iran is subject to it since June 10 1966
like Iraq Qatar
Libya Saudi Arabia
Bahrain
Abu Dhabi
Neutral Zone

J. Lepreux
Jean Frère (Lambert) m'a demandé ceci hier soir pour examiner et me le rendre ? JR

Main bond issues for which Banque Lambert has acted as leader of the underwriting syndicate

| | | | | | |
|---|---|---|---|---|---|
| PETROFINA (x) | 1957 | $ 25 million | 20 years | 5 1/2 to 7 1/2 % | Exchange option in BF, DM, SwF Dutch guilders |
| REGIE des TELEGRAPHES et des TELEPHONES (xx) (guarantor : Kingdom of Belgium) | 1958 | $ 22 million | | | |
| | | ( $ 12m. serial notes | 3 to 5 years | 5 % | |
| | | ( $ 10m. | 15 years | 5 1/2 % | |
| SABENA AIRLINES (guarantor : Kingdom of Belgium) | 1959 | $ 10 million | 15 years | 5 3/4 % | Exchange option in DM |
| RESETTLEMENT FUND OF THE COUNCIL OF EUROPE | 1959 | $ 10 million of equiv. in DM | | | |
| | | ( $ 2.8 m. serial notes | 2-3-4-5 yrs | 5 % ) | |
| | | ( $ 7.2 m. | 15 years | 5 1/2 % ) | No exchange option |
| FONDS DES ROUTES (guarantor : Kingdom of Belgium) | 1959 | $ 30 million | 15 years | 5 3/4 % | Exchange option in DM |
| RESETTLEMENT FUND OF THE COUNCIL OF EUROPE | 1961 | $ 10 million or equiv. in DM : | | | |
| | | ( $ 2.4 m. serial notes | 2-3-4 yrs | 5 % ) | |
| | | ( $ 7.6 million | 15 years | 5 1/2 % ) | No exchange option |
| BELGIAN RAILWAYS (guarantor : Kingdom of Belgium) | 1961 | $ 23 million or equiv. in DM | | | |
| | | ( $ 3 m. serial notes | 2-3-4 yrs | 5 % | |
| | | ( $ 20 million | 15 years | 5 1/4 % | Exchange option in DM |

(x) : co-leader with Banque de la Société Générale de Belgique
(xx): co-leader with Blyth and Co

| | | | | | |
|---|---|---|---|---|---|
| OFFICE NATIONAL DE PENSIONS DES TRAVAILLEURS INDEPENDANTS (guarantor: Kingdom of Belgium) | 1962 | $ 6million | 15 years | 5 1/2 % | |
| INTERESSENTSKABET VESTKRAFT ELEKTRICITETSSELSKAB (guar. Kingdom of Denmark) | 1963 | $ 7 million<br>($ 1 m.serial notes<br>($ 6 million | <br>4-5 years<br>15 years | <br>5 1/4 %<br>5 1/2 % | |
| SANYO SPECIAL STEEL (guarantor: Mitsubishi Bank) | 1963 | $ 5 million | 7 years | 6 1/2% | Minus 10% Japanese withholding tax. |
| IMATRAN VOIMA (guarantor: Republic of Finland) | 1963 | EPU units of account 5 million | 15 years | 6 % | |
| RESETTLEMENT FUND OF COUNCIL OF EUROPE | 1963 | $ 5.5 million<br>($ 1 m. serial notes<br>($ 4.5 million | <br>4-5 years<br>15 years | <br>5 %<br>5 1/2 % | |
| CASSA per il MEZZOGIORNO (guarantor: Republic of Italy) | 1963 | EPU units of account<br>$ 18 million<br>( $ 2 m. serial notes<br>( $ 16 million | <br><br>2-3-4-5 yrs<br>15 years | <br><br>5 1/4 %<br>5 1/2 % | |
| BANCO DE FOMENTO NACIONAL (guarantor: Republic of Portugal)(*) | 1963 | EPU units of account<br>$ 13 million<br>( $ 3 m. serial notes<br>( $ 10 million | <br><br>3-4-5 yrs<br>15 years | <br><br>5 1/4 %<br>5 1/2 % | |
| TEIJIN LIMITED (**) | 1964 | $ 10 million<br>Convertible debentures | 20 years | 6 1/4 % | Minus 10% Japanese withholding tax. |

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* : Co-leader with Kredietbank and Société Belge de Banque
** : Co-leader with Blyth and C° and the Nomura Securities Ltd.

| | | | | |
|---|---|---|---|---|
| RESETTLEMENT FUND OF COUNCIL OF EUROPE | 1964 | $ 5.5 million | 15 years | 5 3/4 % |
| I.R.I. (x) ISTITUTO per la RICOSTRUZIONE INDUSTRIALE | 1964 | $ 25 million with warrants attached | 15 years | 5 3/4 % |

Brussels, July 1st, 1964
SMH/SLP

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(x) co-leader with Carl M. Loeb, Rhoades and Co, M. Samuel and Co.Limited and Berliner Handels-Gesellschaft

# Some External Bonds of Australia, Italy, Japan and Norway in different markets.

45-112 EYE-EASE 45-412 20/20 BUFF

| Country | Market | Interest | Date of Bond | Original Issue | Amount Date | Outstanding Amount | Date | Price | Yield |
|---|---|---|---|---|---|---|---|---|---|
| Australia | London | 5 1/2 | 1960-1980 | £12,000,000 | 6/30/63 | £11,910,000 | 6-30-64 | 95 1/2 | 5.95 |
| | | 6 | 1958-1976 | £16,000,000 | 6/30/63 | £15,850,000 | 6-30-64 | 102 1/4 | 5.74 |
| | New York | 5 | 1958-1978 | $25,000,000 | 6/30/63 | $20,445,000 | 6-30-64 | 103 | 4.71 |
| | | 5 1/2 | 1959-1979 | $25,000,000 | 6/30/63 | $22,975,000 | 6-30-64 | 103 7/8 | 5.13 |
| | Switzerland | 4 1/2 | 1960-1975 | Sw.f 60,000,000 | 12/30/63 | Sw.f 60,000,000 | 6-30-64 | 101 1/4 | 4.35 |
| | | 3 3/4 | 1955-1970 | Sw.f 60,000,000 | 12/30/63 | Sw.f 60,000,000 | 6-30-64 | 95 | 4.77 |
| | Canada | 4 | 1955-1970 | Can $16,000,000 | 12/30/63 | Can $11,544,000 | | | |
| Italy | London - City of Rome | 3 3/4 | 1904/1905-1964 | £152,582,000 | 4/1/63 | £6,276,000 | | not quoted | |
| | New York So. Italy Dev. Fund | 5 1/2 | 1959-1974 | $30,000,000 | 12/30/63 | $25,000,000 | 6-30-64 | 93 | 6.47 |
| | Italian (Rep.) | 3 | 1947-1977 | $37,236,000 | 12/30/63 | $24,141,257 | 6-30-64 | 74 1/2 | 5.91 |
| | Switzerland So. Italy Dev. Fund Cassa per il Mezzogiorno | 4 1/2 | 1961-1974 | Sw.f 50,000,000 | 12/30/63 | Sw.f 47,186,825 | 6-30-64 | 94 1/2 | 5.22 |
| | Sot. de Credito | 3 | 1947-1977 | Sw.f 22,682,200 | 12/30/63 | Sw.f 16,357,694 | 6-30-64 | 84 1/2 | 4.65 |
| Japan | London | 6 | 1924/52-1969 | £25,000,000 | 12/30/63 | £4,140,915 | 6-30-64 | 99 3/4 | 6.74 |
| | | 6 | 1963-1988 | £5,000,000 | 12/30/63 | £5,000,000 | 6-30-64 | 95 1/4 | 6.49 |
| | New York | 5 1/2 | 1959-1974 | $30,000,000 | 6/30/63 | $27,000,000 | 6-30-64 | 100 1/4 | 5.46 |
| | | 5 1/2 | 1963-1980 | $27,500,000 | 6/30/63 | $27,500,000 | 6-30-64 | 100 5/8 | 5.44 |
| | Switzerland | 4 | 1910/1952-1985 | £11,000,000 | 12/30/63 | £6,709,660 | 6-30-64 | 73 | 7.70 |
| | Frankfurt City of Osaka | 6 1/2 | 1962-1977 | DM 100,000,000 | 12/30/63 | DM 100,000,000 | 6-30-64 | 101 1/4 | 5.97 |
| | City of Osaka | 6 1/2 | 1963-1978 | DM 100,000,000 | 12/30/63 | DM 100,000,000 | 6-30-64 | 101 | 6.39 |
| Norway | London | 4 1/4 | 1951-1966 | £5,000,000 | 6/15/63 | £1,726,900 | 6-30-64 | 98 | 5.19 |
| | | 3 1/2 | 1904/1905-1964 | £5,962,180 | 12/30/63 | £288,880 | 6-30-64 | 97 | 9.80 |
| | New York | 5 1/4 | 1958-1973 | $17,500,000 | 12/30/63 | $15,475,000 | 6-30-64 | 101 3/4 | 5.01 |
| | | 5 1/2 | 1962-1977 | $20,000,000 | 12/30/63 | $20,000,000 | 6-30-64 | 101 1/4 | 5.36 |
| | Zurich | 3 | 1938-1971 | Sw.f 46,500,000 | 12/30/63 | Sw.f 15,149,500 | 6-30-64 | 95 1/2 | 3.74 |
| | | 4 1/2 | 1960-1975 | Sw.f 50,000,000 | 12/30/63 | Sw.f 50,000,000 | 6-30-64 | 100 3/4 | 4.41 |
| | Amsterdam | 4 1/4 | 1955-1975 | f 35,000,000 | 12/30/63 | f 28,100,000 | 6-30-64 | 92 7/8 | 5.11 |
| | City of Oslo | 5 | 1961-1981 | £30,000,000 | 12/30/63 | £30,000,000 | not quoted | | |
| | Frankfurt City of Oslo | 5 1/2 | 1959-1975 | DM 30,000,000 | 12/30/63 | DM 30,000,000 | 6-30-64 | 101 1/2 | 5.31 |

IBRD
Statistics Division
7/31/64

EXTRACTS from E.D.s MEETINGS

February 9, 1965

Market eligible - Docts. 65/9 of January 25
Review first quarter of 1967

Mr. WOODS says also: "5½% is a low rate compared with what most borrowers from the Bank would have to pay in private markets, at home and abroad. At the same time it yields the Bank substantial earnings and it has been accepted as a sound and conservative rate by the financial markets to which we look for our funds."

February 10, 1966

Mr. WOODS feels that standard rate of interest should be increased to 6%:

1. It was 5½% since September 1962;
2. In the countries where we borrow, rates have increased since then by 1% and 3%;
3. Many governments in Europe pay 6½% or more to borrow their own currencies in their own markets, some pay close to 8%;
4. Interamerican Bank charges 6% to 7½% on its loans;
5. European Investment Bank charges 6¼ to 6 3/4%;
6. Our Canadian issue will cost us about 6%;
7. Increasing our loan interest should enable us to increase our sales of portions of loans.

"The best way to get a maximum IDA pool, in my judgment, is to continue to run the affairs of the Bank itself in a fashion that will be widely regarded as intelligent and businesslike."

Yardstick:

"At all times, the rate of interest charged by the Bank should have the relationship of 1 to 1¼% higher than the best judgment of the cost of borrowed money by the Bank".

"Interest rate in an institution of this sort is something that is not susceptible to discussion , rumors, speculation and guesses. It is among the responsibilities of the President and I have decided it."

Mr. WOODS to Rajan (page 71)

"You said there was a question of whether 1-1¼% was the right spread. In fixing this rate (6%) I did reduce the spread from 1¼ to 1%. Whether it should be reduced more than that is an interesting question..... I will keep this point in mind and some time when, as early as I can figure, we are

approximately mid-way between changes in rates, I will introduce the subject."

February 15, 1966

On hand: $ 1.2 billion
Undisbursed: $ 1.4 billion
Annual disbursements: $700 million

RAJAN: "Should we not distinguish between gross and net disbursements?"

Mr. WOODS: "I would rather take gross but the difference would be about 200."

P. 79: "I am going to take the suggestion made by Mr. Rajan and referred to by Mr. Thor, some time in between interest changes

Files April 13, 1966

S. R. Cope

Market Eligible Countries

1. A meeting was held in Mr. Woods' office on Friday, April 8, 1966, to consider which countries should be made market eligible. Messrs. Woods, Knapp, Friedman, Kamarck, and Cope were present.

2. Mr. Woods noted that loans at market eligible rates had been made to Italy, Japan and New Zealand, and that Norway and South Africa had been told that they were market eligible. The Irish had been told that they would probably be market eligible, and this should be confirmed to them. At or around the time of concluding the next loans to Finland (roads), Iceland (Burfell), and Israel (finance company), these countries should be told that thereafter they would be market eligible.

3. Further active study should be given to the cases of Spain and Venezuela. Subject to further consideration of the possibilities of these countries finding support in the private capital markets, it was tentatively decided that these countries should be informed at the next Annual Meeting that they would thereafter be regarded as market eligible.

4. Other cases would be considered as they arose.

JBKnapp/SRCope:mmr
IBRD

Cleared with Mr. George D. Woods and
Mr. J. Burke Knapp

cc: Messrs. J. Burke Knapp
Irving S. Friedman
Andrew M. Kamarck

Can they afford = credit worthy

What is p.c income =

Can they actually sell bonds

FORM No. 60-EC
(7.65)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

# ECONOMIC COMMITTEE



EC/M/66 - 12

April 6, 1966

## Meeting on the Economic Aspects of "Market Eligibility"

### I. Introduction

1. A sub-committee of the Economic Committee met on March 29, 1966[1] to discuss whether certain countries, in terms of economic factors, should be considered suitable for re-classification as "market eligible" countries. The Committee had before it a memorandum from the Director of the Economics Department, and the country data tables which had been prepared by the Economics Department.[2] In the light of the considerations which are set forth in the following Statement of Issues, the conclusions and recommendations of the sub-committee are given in Section III below.

### II. Statement of Issues

2. At this time, the following countries were not recommended for re-classification for the reasons stated.

| | |
|---|---|
| Argentina<br>Chile<br>Mexico | Facing high debt service payments |

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1/ Members of the sub-committee present: Messrs. Kamarck (Chairman), Brakel, Edelman, Gilmartin, Lipkowitz, McDiarmid
Also present: Miss Zafiriou, Mr. Ross

2/ "Data Tables on Economically Stronger Countries", (EC/A/66-11/1, dated March 28, 1966)

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| | |
|---|---|
| Spain | Eligible on most counts, but income level still marginal |
| Greece<br>Trinidad & Tobago<br>Jamaica | Income level marginal, and development problems still not completely in hand |
| Portugal<br>Iraq<br>Iran | Income level too low |

3. The discussion then concentrated on the remaining countries:

a) Ireland -- With a per capita GDP of $900, very low debt, and apparently favorable economic prospects, Ireland qualified for consideration as a "market eligible" country. The Bank's first economic mission to Ireland was in the field.

b) Israel -- Per capita GDP was $1,050, and economic prospects were good. The country had a relatively high short-term debt, but this should decline during the next few years.

c) Venezuela -- Per capita GDP was $900, but there were considerable disparities in the distribution of income. Growth prospects were good. The debt service ratio was low, although the country would need substantial inflows of capital for development and this could create a debt problem in the future. In 1965, as a result of Venezuela's relatively strong economic position, the maturities on the Bank's loans were shortened.

d) Iceland -- Per capita GDP was $1,700, and economic prospects were favorable. The debt service ratio was low.

e) Cyprus -- In view of the economic uncertainties created by the political situation and uncertain growth prospects, consideration of classifying the country as "market eligible" was premature.

4. In the general discussion the Committee agreed on the following main points:

a) A country which was recommended for consideration as "market eligible" could have its status changed back, if its economic prospects became less favorable. To describe a country as being "on the margin" would particularly allow for possible revision of its status.

b) While a country may be recommended by the Committee for consideration as "market eligible", consideration should also be given to particular terms within the general category of "market eligible" which would reflect the country's economic circumstances and prospects. It was pointed out that while Israel had the economic strength to pay a higher interest rate, its short-term debt structure would probably justify loan terms with longer maturities and/or grace periods.

## III. Conclusions and Recommendations

5. The sub-committee concludes that Iceland, Ireland, Israel and Venezuela are "economically stronger countries", and recommends that these countries should be considered for re-classification as "market eligible" countries. This recommendation is subject to the following qualifications:

a) Ireland -- the country's favorable economic position and prospects will be confirmed by the economic mission now visiting Ireland;

b) Venezuela -- the country's position, in terms of economic strength, is marginal, but is just within the margin.

C. F. Owen
Secretary

NOTE: The Economic Committee had recommended, in previously issued Conclusions and Recommendations, that the following countries be considered for re-classification as "market eligible" countries:

1. Japan (EC/M/65-30, dated September 10, 1965)
2. New Zealand (EC/M/65 -36, dated November 9, 1965)
3. Finland (EC/M/66-9, dated March 7, 1966)

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

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# ECONOMIC COMMITTEE



EC/M/66 - 10

March 7, 1966

Economy of Finland: Meeting on Draft Conclusions and Recommendations

1. In the meeting of the Economic Committee, which was held on March 1, 1966[1] to discuss the draft Conclusions and Recommendations on the Economy of Finland[2], the main points raised were as follows:

2. Most of the Committee members thought that Finland could well be considered by the Bank as being in the category of "market eligible" countries. This conclusion was based on the strength of the economy, as reflected in the per capita income, economic performance and rate of growth, economic prospects, and ability to undertake a higher debt service burden.

3. During the discussion reference was made to the definition of "market eligible" countries, given in Operational Memorandum Number 2.02, as "those economically stronger countries which cover their external need mainly in the private markets". One Committee member contended that, as Finland was not meeting its external capital need mainly in the private markets, it could not be defined as a "market eligible" country. Another Committee member commented that he was struck by the fact that the only argument for not considering Finland in this category was the narrow "statistical" test, i.e. the proportion of the country's external capital need obtained from private markets within a very short time horizon; he supported an earlier comment by the Chairman that the Committee's recommendation should be based on economic analysis, reflecting the broader aspects of economic strength and performance, and a longer time horizon. Other Committee members made the following observations: while the

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1/ Members of the Committee present: Messrs. Friedman (Chairman), Kamarck, Brakel, Larsen, Lipkowitz, Thompson, Weiner, Wright. Also present: Miss Zafiriou, Messrs. Kochav, Tolbert.

2/ Distributed on February 25, 1966, under covering memorandum EC/O/66-26.

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definition in the Operational Memorandum was imprecise, it did refer to "economically stronger countries" and this term applied to Finland; proximity to the U.S.S.R. might affect Finland's capability to raise capital in private markets, and thus the Bank should be a source of capital, but Finland should be treated as a "market eligible" country; proximity to the U.S.S.R. was not a reason for giving Finland exemption from classification as a "market eligible" country--a category in which other countries with similar economic situations would certainly be found.

4. Comparisons were drawn to other countries. South Africa had been declared a "market eligible" country, because it was an economically strong country, although it was not raising any of its long-term external capital needs in private markets. On the narrow "statistical" test, South Africa would have not been regarded as a "market eligible" country. One member observed that if the "statistical" test were applied as the only criterion, Jamaica would be considered as a "market eligible" country, because of the proportion of its external capital needs which was met from private markets. Yet, when the draft economic report on Jamaica had been reviewed by the Economic Committee in December, and the proposal for a power loan had been made to the Loan Committee in January, the issue of "market eligibility" had not been considered, because Jamaica was not a sufficiently economically strong country.

5. The question of the Bank possibly having to "ration" its resources arose. Drawing a comparison between Finland and Japan, a Committee member said that as the Bank had decided to refrain from further lending to Japan, there could be an argument for similarly terminating Bank lending to Finland. Another Committee member questioned the validity of the comparison between the two countries, especially their comparative industrial strength. New Zealand was cited as an example of a country which had been discouraged from coming to the Bank for funds. A Committee member stated that placing Finland in the category of "market eligible" countries would be an aspect of the "rationing" of Bank resources, if this became necessary, because the Bank could hope to sell more participations.

6. In response to the Chairman's question, the staff member responsible for the draft economic report on Finland expressed the opinion that, if the Bank were to treat Finland as a "market eligible" country, this would <u>not</u> affect the country's exemption from the U.S. interest equalization tax.

7. Various Committee members commented that Operational Memorandum Number 2.02 was ambiguous, it did not present the issues effectively, and queried whether the term "market eligible" should be dropped and replaced by the term "economically stronger countries". One member proposed that the minutes of the meeting be written in a form that would summarize the issues involved, and thus facilitate any reconsideration of the Operational Memorandum. There was a consensus that this be done.

8. In summarizing the conclusions of the meeting, the Chairman made the following observations:

a) The Committee faced a dilemma posed by the wording of the Operational Memorandum and its own analysis of the Finnish economy;

b) The Committee was sensitive to the general world capital shortage, and knew realistically that Finland could not be pushed into the market for all of its needs;

c) Foreign borrowing was needed to support a reasonable growth rate in Finland, and thus Bank lending would be economically justified;

d) Nonetheless, the sentiment in the Committee was that, in terms of Finland's basic economic position--a country which had reached a high stage of economic development--it would be economically difficult to justify Bank lending at the standard rate;

e) If only the standard rate of interest were charged, other countries might cite Finland as an example to obtain comparable treatment;

f) The fact that a country was classified as "market eligible" now, would not preclude the possibility of the Bank changing this status in the future, if the country's economic conditions then justified it.

C. F. Owen
Secretary

FORM No. 60-EC
(7.65)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

# ECONOMIC COMMITTEE



EC/M/65 - 42

December 28, 1965

Page 3

Conclusions and Recommendations on the Economy of Jamaica

## I. Introduction

1. The Economic Committee has considered the report[1] reviewing Jamaica's general economic performance and the country's creditworthiness for further Bank lending.

2. Economic Performance: During the decade 1954-1964 Jamaica achieved a remarkably high rate of economic growth. Real GDP advanced by an annual average of 6.8 percent, raising per capita GNP from $250 to $445 in 1964, despite the fact that the rate of economic growth tapered off between 1961 and 1963. This slow-down was largely due to uncertainties incident to Jamaica's transition to independence in 1962. However, by the end of 1963 these uncertainties had been removed and the growth rate accelerated to a healthy 7.8 percent in 1964. With the rising standard of living and the maintenance of monetary and price stability, domestic savings rose rapidly and have financed the greater part of the country's gross capital formation. The resource gap, which amounted to over 40 percent of gross domestic capital formation in 1956, had dropped to 21 percent by 1964.

3. The Jamaican Government has shown a sound and imaginative approach towards economic development. This approach consists primarily of creating a stimulating environment for the development of private sector activity, developing the rural economy to raise agricultural production and farmers' incomes and thus also reducing emigration to overcrowded towns, providing adequate infrastructure and furthering social progress largely through the expansion of the education system.

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1/ Draft report "Current Economic Position and Prospects of Jamaica" (Report WH-154) dated November 15, 1965

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4. The Government's investment program, covering the period April 1966 to March 1968, reflects the priority needs of the economy. However, the program's financing is only partly assured. Public savings are expected to cover about 20 percent of investment expenditures (which are now expected to rise rapidly), non-inflationary internal borrowing about 35 percent, and drawings on existing external loan commitments another 10 percent. A financing gap of about J$ 6-7 million per annum remains to be filled.

5. In earlier years, the Government would have been able to cover the main part of its external financing requirements in the private capital markets of London, and by placing smaller issues in New York and Toronto. At the present time, however, the Jamaican Government may encounter difficulties in placing bond issues in the London market because of balance of payments problems in the United Kingdom.

6. As for domestic financing, the Jamaican Government has consistently covered a substantial portion of its investment expenditures by public savings. In 1965, public savings covered 38 percent of fiscal 1965 public investment expenditure and were equivalent to 2.3 percent of the GDP (a slight increase over previous years). However, public savings are expected to fall to only 1 percent of GDP by 1968, declining in absolute amount below the average level for 1959-65, since, under the present tax laws, current revenue in fiscal 1966 and 1967 is projected to increase less rapidly than current expenditure. The Jamaican Government is consequently reconsidering its financing plans, recognizing that it may have to increase taxation further in order to raise the level of budgetary savings. It may also have to defer some expenditures now being planned for fiscal 1967-1968.

## II. Policy Recommendations

7. In order to fill the expected financing gap for the fiscal years 1967 and 1968, the Jamaican Government should now:

a) Define and implement the revenue and expenditure measures required to complete the 1967-1968 public investment financing plan;

b) Further re-orient its project identification and preparation efforts, including the development of larger composite "packages" of small, but related projects, in order to increase access to official external lending agencies.

## III. Conclusions and Recommendations

8. Jamaica's favorable growth prospects, the Government's prudent financial management, sound and imaginative development policies, solid internal financing effort and low burden of external indebtedness lead to the conclusion that Jamaica has a very substantial margin for incurring additional foreign debt at conventional terms.

9. Because of its special relationship with the United Kingdom, Jamaica has been able to cover the main part of its external financing requirements in private markets abroad. However, the Economic Committee does not consider Jamaica among the economically stronger "market eligible" countries to which higher market rates should be charged by the Bank. The probability is that Jamaica is unlikely to remain in the category of countries which cover their external needs mainly in the private markets.

L. E. Christoffersen
Acting Secretary

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL
SSM/M/65-6
February 16, 1965

DECLASSIFIED
Date: 11/15/2010 STB

SENIOR STAFF MEETING

Board Room, February 10, 1965, 9:30 a.m.

Present: Messrs. Woods (Chairman), Adler, Aldewereld, Alter, Cargill, Chadenet, Consolo, Cope, Demuth, El Emary, Friedman, Graves, Johnson, Kamarck, Lejeune, Mendels, Reid, Rist, Schmidt, Stevenson, Avramovic, Clark, Poore, Wishart, Shivnan (Secretary)

BOND ISSUES

1. The Chairman said there was a good prospect of floating a $25 million to 30 million, Canadian dollar 5-1/4% bond issue in Canada on February 17. The market was good and Messrs. Cavanaugh and Nurick were discussing terms in Toronto.

2. The Deutsche Bank had cabled suggesting a DM 200 million ($50 million) 5-1/2% issue at or close to par, the same size as the Bank's only other public offering in Germany; action should be taken in the next few weeks, as the withholding tax would shortly become law, and improve the receptivity of the market. He felt the Bank should try for more.

PROJECTS

3. Mr. Aldewereld announced that the first report of the Study of the water and power resources of West Pakistan (the "Indus Report") had now been completed and that its conclusion favored the Tarbela Dam project. The investment cost would be high and construction would take about eight years.

4. The Chairman said the report would be transmitted to President Ayub Khan in the first instance. He stressed that the next step would be to arrange the financing for Tarbela, a task that would probably extend into 1966 and which he thought should be handled by the Consortium.

TRADE PREFERENCES

5. The Chairman said he was hoping to circulate, in the fairly near future, a paper providing a basis for a discussion within the Bank of the question of preferences for domestic suppliers. The paper would be discussed at a future meeting.

Distribution:

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INDUSTRIAL FINANCE

6. The Chairman referred to paragraph 18 of his Memorandum of July 18, 1963, on Bank Financial Policy, which discussed expanding the Bank's technical assistance for industry. A related question, which would be discussed in the next few months, was the extent to which the Bank should finance government-owned manufacturing and extractive industrial enterprises in countries where the lack of private savings precluded the development of shareholder-owned companies. A similar problem was posed by the needs of development finance companies in Africa that were government-controlled for the same reason. These questions were likely to come up after the Governors had acted to permit the Bank to lend to IFC without government guarantee, and IFC to borrow from the Bank.

AREA OPERATIONS

Europe and Middle East

7. Mr. Cope said that exploratory discussions had taken place with Pechiney, about an aluminum smelter and power plant in Yugoslavia, and that Pechiney now seemed to be interested. A number of difficult questions would have to be resolved before a satisfactory proposition could be evolved but he was preparing a paper for the Loan Committee and would suggest that the Bank go into the matter seriously.

8. Tentative, exploratory discussions had taken place about the financing of the Keban project in Turkey in order to find ways in which the use of tied finance could be reconciled with international competitive bidding. The German Government and the European Investment Bank did not appear to be ready to discuss the matter but a further attempt to arrange informal discussions would be made next month.

Far East

9. Mr. Cargill said that the New Zealand Government was actively canvassing the idea that Western Samoa should join the IMF, the Bank and IDA. In his opinion this would hardly be worth while as, given the small size of the country and its population, the amount of IDA aid was likely to be little more than the cost of joining the three institutions.

Western Hemisphere

10. Mr. Schmidt said the Inter-American Economic and Social Council was meeting in Washington on February 10 and 11 to vote on a resolution, introduced by the U.S. and Costa Rica, amending the Charter of Punta del Este to give the President of CIAP a voice in the nomination of members of the "Panel of Nine", to permit up to four of the nine to be on a part-time basis, and to formally provide for the election of a "Coordinator" to organize the work of the Panel. The Council would also elect new members of the Panel as well as three members of CIAP to replace the three whose terms have just expired.

"MARKET ELIGIBLE" COUNTRIES

11. Mr. Graves reported that there had not been any press enquiries since the Executive Directors' meeting on loans to "market eligible" countries. The Office of Information would take the line that the new policy would help to make sure that countries which could use the market were encouraged to do so.

U.S. BANKS

12. Mr. Johnson reported that, following recent discussions with the three big Detroit banks, he was hopeful of selling them parts of the Bank's portfolio or of arranging for them participation in new loans.

ADJOURNMENT

13. The meeting adjourned at 10:20 a.m.

M. P. Shivnan
Secretary

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

FOR EARLY ATTENTION

DECLASSIFIED

Date: 11/15/2010 SrB

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R65-23

FROM: The Secretary

February 15, 1965

MARKET ELIGIBLE LOANS

1. Pursuant to the discussion on Market Eligible Loans at the Meeting of Executive Directors on February 9, 1965, it is proposed that the following be included in the minutes of that meeting:

"The Executive Directors, having considered the memorandum from the President on Market Eligible Loans (FPC 64-17 dated October 28, 1964), agreed that:

(a) The Bank should charge rates of interest on loans to market eligible countries higher than those charged to other borrowers.

(b) Market eligible countries would be those which cover their external capital needs mainly in private markets. The countries to be included in this category would be determined from time to time as loan requests came forward.

(c) Uniform rates for market eligible countries would be determined from time to time with reference to the rates which such countries would have to pay in the market, but would not be more than 1% higher than the Bank's standard rate.

(d) Where a loan coincided with a substantial market issue by the borrower, the rate applied would be fixed by taking into account the cost of the money being raised by the borrower in the market, such rate being not more than those established under (c) above and not less than the Bank's standard lending rate.

(e) In selling parts of loans made to market eligible countries, the Bank would have regard to the necessity of safeguarding the market credit of the country concerned; rates would be determined from time to time in consultation with the borrower and guarantor, if any, in the light of current market conditions.

(f) Any difference between the rate of interest carried by the loan and the rate of interest at which part of the loan was sold would be passed on to the borrower.

Distribution:

Executive Directors and Alternates
President
Vice Presidents
Department Heads

Mr. van Vuuren voted against this decision and Messrs. Handfield-Jones, Lieftinck and Thor abstained. Mr. Lieftinck stated that the Netherlands wished to be recorded as against the decision, and Yugoslavia in favor, while Cyprus and Israel had expressed no view. Mr. Thor stated that Sweden wished to be recorded as in favor of the decision and Denmark, Finland and Norway against, while Iceland had expressed no view.

The Chairman made the following statements:

(a) Pursuant to paragraph (c) of this decision, the following rates of interest would apply initially for market eligible countries:

| Final Maturity Date | Rate |
|---|---|
| Up to and including 10 years | 6% |
| More than 10 years to and including 15 years | 6-1/4% |
| More than 15 years | 6-1/2% |

(b) It was intended to review with the Executive Directors in the first quarter of 1967 the question of the interest charge for loans to market eligible countries, in the light of the experience gained and the developments in financial markets."

2. In the absence of objection by the close of business on Wednesday, February 17, 1965, the foregoing will be deemed approved, to be so recorded in the minutes of the meeting of February 9.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

**FOR EXECUTIVE DIRECTORS' MEETING**



CONFIDENTIAL

R65-9

(for consideration on February 9, 1965)

FROM: The President

January 25, 1965

MARKET ELIGIBLE LOANS

The discussions of the Financial Policy Committee on December 15 and 18, 1964 and on January 5, 1965 on my memorandum dated October 28, 1964 (FPC 64-17) have indicated that there is a very substantial agreement, not unanimous but a large majority, that the Bank could properly apply higher rates of interest in lending to "market eligible" countries, i.e., those member countries which, while not normally regular borrowers, need to borrow from the Bank from time to time.

I do not propose to draw up a definitive list of countries which fall into this category. The Bank has never formally listed the countries which were so strong that the Bank was not justified in lending to them at all, although there are several countries which fall into this category. Membership of the market eligible category will be similarly informal. It will change with changing conditions, and will be determined as and when countries apply for loans.

Although there may be borderline cases, the general criterion for the selection of market eligible countries is clear. I have in mind that market eligible countries would be those which cover their external capital needs mainly in private markets.

I would not apply this test in the form of a rigid formula relating to a fixed period. The record of a single year would sometimes be misleading. On the other hand, too long a base period might fail to reflect changes in the basic economic position of the country concerned. In interpreting the term "mainly" there has to be some latitude. Short-term supplier credits have to be distinguished from long-term transactions. Direct investments and portfolio purchases of shares would have to be taken into account as well as bond issues.

The decision has to be a matter of judgment, and I would advise with you from time to time as loan requests come up from countries which appear to be in the market eligible category.

Distribution:

Executive Directors and Alternates
President
Vice Presidents
Department Heads

A number of operations are pending with countries which might come in the market eligible category. Executive Directors are already aware of three — Italy, Japan and Norway. In addition, certain other countries which might fall within this category have approached the Bank for loans, and the staff is at present studying their position in order to decide whether or not they come within it.

So far as interest rates are concerned, I would propose to start with those set out in my memorandum of October 28, 1964. For loans with a life of up to and including 10 years, the rate would be 6%. For loans of more than 10 years, and not more than 15 years, the rate would be 6-1/4%. For loans of more than 15 years, the rate would be 6-1/2%, i.e., 1% more than the standard rate of 5-1/2%. These rates would be reviewed from time to time and changed as necessary.

I have considered the idea, alluded to by several Directors, of basing interest rates on the actual market credit of the borrowing country. I think that this idea is worth adopting. I would therefore propose that in the case of a loan which coincided with a sizeable market issue (one at least as large as the Bank loan), the rate on the Bank loan would be determined by reference to the cost to the borrower of the money being raised in the market. But in the absence of a simultaneous market issue, the rates in the schedule mentioned above would be applicable.

As in the case of loans at standard rates, parts of loans made to market eligible countries would be sold as opportunity offers. Selling rates would be determined from time to time and the higher rates carried by market loans should afford more room to fix selling rates which correspond to market conditions. As loans were made to market eligible countries, the Bank would explore selling possibilities in close consultation with the countries whose paper is involved. For the present the Bank would not sell in the United States. Its aim would be to get a fair deal, taking into account on the one hand the importance of preserving the market credit of the country concerned and the desirability of selling on a yield basis which gives the borrower a reasonable interest saving, and on the other hand the desire of the Bank to sell as much as possible in the form of longer maturities or "strips".

I think that it would be appropriate to record in the minutes the following as the decision of the Executive Directors:

> The Executive Directors, having considered the memorandum from the President on "Market Eligible Loans" (FPC 64-17 dated October 28, 1964), agreed that:
>
> (a) The Bank should charge rates of interest on loans to "market eligible" countries higher than those charged to other borrowers.

(b) "Market eligible" countries would be those which covered their external capital needs mainly in private markets. The countries to be included in this category would be determined from time to time as loan requests came forward. ?

(c) Rates for "market eligible" countries would be determined from time to time with reference to the rates which such countries would have to pay in the market, but would not be more than 1% higher than the Bank's standard rate.

(d) The following rates are established initially:

| Final Maturity Date | Rate |
|---|---|
| Up to and including 10 years | 6% |
| More than 10 years to and including 15 years | 6-1/4% |
| More than 15 years | 6-1/2% |

(e) Where a loan coincided with a substantial market issue, the rate applied would be fixed by taking into account the cost of the money being raised in the market, such rate being not more than those set out in (d) above, and not less than the Bank's standard lending rate.

(f) In selling parts of loans made to market eligible countries, the Bank would have regard to the necessity of safeguarding the market credit of the country concerned; rates would be determined from time to time in consultation with the borrower and guarantor, if any, in the light of current market conditions.

(g) Any difference between the rate of interest carried by the loan and the rate of interest at which part of the loan was sold would be passed on to the borrower.

George D. Woods
President

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

DECLASSIFIED
Date: 11/15/2010
SOB

CONFIDENTIAL

Bank/FPC64-20/1

FROM: The Secretary

December 30, 1964

Memorandum of Meeting of Bank Financial Policy Committee on "Market Eligible" Loans, December 18, 1964 - (Bank/FPC64-20) - Corrigenda

Please amend the above memorandum as follows:

Paragraph 52 - 10th line. For "wherever" read "whenever".
Last line. Add "in the United States".

Paragraph 54 - Third sentence: after "assume that" insert "the existing internal", and at end of sentence add, "in the sense that they could be considered as the level toward which European interest rates would tend to move".
Fourth sentence: at end add "but there was still a significant difference between such rates".

Paragraph 55:- Second sentence: for "most" read "all", and for "needed on the terms available on" substitute "it might wish to raise in".

Distribution:

Members of the Financial Policy Committee
President
Vice Presidents
Department Heads

see Lightner page 7+9
10
underwriting by BK

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT



CONFIDENTIAL

Bank/FPC64-20

December 24, 1964

*Memorandum of Meeting of Bank Financial Policy Committee on "Market Eligible" Loans (FPC64-17, October 28, 1964); Friday, December 18, 1964, at 11:00 a.m. (continued from December 15, 1964)

1. There were present:

Chairman

George D. Woods, President

Executive Directors and Alternates acting as Executive Directors

Reignson C. Chen
John M. Garba
Joaquin Gutierrez Cano
O. Haushofer (Alternate)
R. Hirschtritt (Temporary Alternate)
Rene Larre
Luis Machado
Jorge Mejia-Palacio
K.S.S. Rajan
Abderrahman Tazi
Otto Donner
John M. Garland
S.J. Handfield-Jones (Alternate)
J. Haus-Solis (Alternate)
M. N. Kochman
Pieter Lieftinck
Mumtaz Mirza
E. Ozaki (Alternate)
N.M.P. Reilly (Alternate)
Vilhjalmur Thor

Alternates not acting as Executive Directors

H. Abramowski
Said Mohamed Ali
A. Bogoev
S. O. Coleman
Rufino Gil
S. Guhan
Odd Høkedal
Ali Akbar Khosropur
Sergio Siglienti
A.J.J. van Vuuren

Officers and Staff Participating

J. Burke Knapp
G. M. Wilson
M. M. Mendels
A. Broches
C. H. Davies
C. R. Willoughby

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

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Members of the Financial Policy Committee
President
Vice Presidents
Department Heads

2. Mr. Tazi said he was inclined to support the President's proposal that the interest rate be increased on loans to market eligible countries. However, the criteria for identifying market eligible countries had not yet been defined. Since the proposed change would not initially greatly alter the Bank's financial activities, it might be desirable to undertake a deeper study of the issue and to provide a more precise criterion of market eligibility.

3. If the market eligible countries were, as the memorandum said, economically strong countries,then it would seem logical to expect that their projects would be soundly prepared and conceived. They would thus not need much technical assistance from the Bank, and the size of appraisal missions to such countries could therefore be kept to a minimum, thus setting free Bank technical staff to assist countries in greater need of their services.

4. Mr. Tazi said that the developing countries wished the Bank to reduce its interest rate. He asked whether it would be possible for a study to be made of the effect that such a reduction might have upon the Bank's activities.

5. Mr. Rajan said that the proposal before the Committee raised difficult issues on which opinionswere bound to differ. There was considerable force to the arguments advanced in the paper for higher interest rates on loans to market eligible countries. At the same time the arguments advanced by Mr. Garland and Mr. Thor against such higher rates could not be overlooked. Everyone was interested in keeping the interest charges on loans, whether to developed or to developing countries, as low as possible. One way of doing that would be, as Mr. Garland had suggested, by reduction or elimination of the 1% commission.

6. Mr. Rajan said he wanted to associate himself with Mr. Garba's statement that the developing countries were very conscious of what was being done for them by the industrialized countries both by way of direct bilateral aid and through the Bank and IDA. The basic question was how the Bank could determine whether a country was making sufficiently diligent efforts to raise funds elsewhere. As the President's paper pointed out, to the extent that Bank funds were available at a lower rate of interest than market funds, countries had an incentive to resort to the Bank rather than to the market. There were three or four highly developed countries which were unable to raise all the capital they needed on the private capital markets. Some members of the Bank, including certain industrialized countries, were very anxious that increased Bank lending to these developed countries should not cut into the resources available for developing countries.

7. The President's proposed solution to this problem was apparently acceptable to at least two of the countries principally concerned - Italy and Japan. They apparently preferred to borrow more from the Bank at a higher rate of interest than less at the rate of 5-1/2%.

8. The President's proposal, Mr. Rajan continued, would increase the Bank's capacity to borrow and should be welcomed on that account. It would help make Bank bonds and participations in loans to the developed countries more attractive.

9. The exact rate which a market eligible country should be charged could ideally be determined by having a market issue coincide with the Bank loan, but that was not generally practicable. He therefore supported the proposal that there should be only one rate or one schedule of rates - with lower rates on shorter loans and higher rates or longer loans - applicable to all market eligible countries. The President was in the best position to determine the exact rate that should be charged at any one time; it would no doubt change with changing market conditions. Mr. Rajan stressed that the views of the borrowing countries, which would have actually to pay the higher rates, should be given due consideration.

10. Mr. Rajan, noting that borrowing countries received the benefit of any reduction in interest rate obtainable as a result of participations and sales from the Bank's portfolio, said that this practice should be left undisturbed. The average rate of interest on a loan to a market eligible country might, as a consequence, turn out to be 5-1/2% or less.

11. Mr. Rajan asked whether increased sales out of the Bank's portfolio of loans to market eligible countries and of participations in such loans would increase the Bank's total resources rather than merely siphon off funds which would otherwise have gone to participations in, and purchases out of the Bank's portfolio of, loans to developing countries. It would clearly be desirable if the present proposal, together with the recent increase in interest rates on sales out of portfolio, led to an increase in the total volume of private funds available to the Bank. He asked for clarification on this point.

12. Mr. Woods said that since the introduction of the new interest rate on portfolio sales there had been a substantial increase in such sales, particularly of loans to the less developed countries. $19 million worth of loans had been sold during December.

13. Mr. Ozaki said that he supported a higher interest rate on loans to market eligible countries. The Japanese Government understood and accepted the need to pay a higher rate, but they would not be prepared to pay a rate for Bank loans which was higher than the market rate. On this point they shared the views expressed by Mr. Garland and Mr. Thor.

14. The Chairman had distinguished four categories of countries: IDA countries, soft blend countries, hard blend countries and Bank countries. Market eligible countries constituted a fifth category of "Bank and market blend countries". At Tokyo, Mr. Sangster, the Governor for Jamaica, had emphasized the need for a flexible interest rate policy, particularly with respect to the so-called "middle" countries. Soft and hard blends were an approach to flexibility. Leaving aside the question of how the rate for market eligible loans should be fixed, it was quite understandable that countries in the fifth category should pay a somewhat higher rate of interest.

15. The distinction between IDA as a welfare organization and the Bank as a banking institution was not very persuasive. The idea that the exercise of direct control over Bank loans was preferable to the introduction of differential interest rates was also not very helpful. All Bank loans were already subject to direct control.

16. Mr. Ozaki expressed the hope that it might be possible to remove the ceiling of 1% on the extent to which reductions in interest rates resulting from portfolio sales could be passed on to borrowing countries.

17. Mr. Ozaki distinguished a sixth category of countries: "market only countries", consisting of the most highly developed countries. It was noteworthy that the most advanced countries did not borrow on the international capital market. Long-term capital moved from the industrial to the underdeveloped countries, rather than among the industrial countries themselves. For the sake of the economy of the free world as a whole it was desirable that long-term capital should move freely in large amounts. The Bank had an important part to play in encouraging such an exchange of capital throughout the free world as a whole.

18. With reference to Mr. Ozaki's suggestion that Japan and possibly one of the Scandinavian countries might borrow in normal commercial channels at less than the Bank's proposed 6-1/2%, Mr. Woods said no country was ever obliged to borrow from the Bank. He did not personally feel that 6% for a ten-year loan, 6-1/4% for a 15-year loan and 6-1/2% for a longer maturity were unreasonable rates. But he would certainly expect any country which could raise all the capital it needed in normal commercial channels below these rates to do so.

19. Dr. Lieftinck said that while his remarks would generally reflect the views of the Netherlands Government, he thought that the views of the other governments he represented would not differ greatly. The Netherlands did not contemplate borrowing from the Bank in the foreseeable future, so that its interests were not involved in the matter under discussion. He would try to examine the proposal from the point of view of the Bank and all its members.

20. Dr. Lieftinck said he had always considered the Bank as a cooperative institution which gave capital surplus countries the opportunity to invest at a reasonable return and capital importing countries the opportunity to borrow on reasonable conditions. Even apart from reconstruction, the Bank's objectives, as set out in the Articles of Agreement, were not restricted to assisting the less developed countries. Its purposes included promoting private foreign investment, furthering the long-range balanced growth of international trade and helping maintain equilibrium in balances of payments. It fulfilled these purposes by encouraging international investment for the development of the productive resources of all members, thereby helping to raise productivity and standards of living in member countries. The Bank was intended to provide all its members with a source of capital that could be drawn upon when their internal savings fell short of legitimate requirements.

21. The only restriction to the Bank's lending was set forth in Article III, Section 4 (ii), which said that the Bank should be "satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower". He wished to stress this point because it had been suggested earlier in the discussion that the Bank should restrict itself exclusively to lending to the less developed countries. Such a policy would be inconsistent with the purposes for which the Bank had been established.

22. Continuing, Dr. Lieftinck said that Article III, Section 1(b) of the Articles of Agreement ran: "For the purpose of facilitating the restoration and reconstruction of the economy of members whose metropolitan territories have suffered great devastation from enemy occupation or hostilities, the Bank, in determining the conditions and terms of loans made to such members, shall pay special regard to lightening the financial burden and expediting the completion of such restoration and reconstruction". This was a clear indication that the Bank's Founding Fathers expected it to set more lenient terms and conditions for reconstruction loans to the more heavily devastated countries. There was no parallel provision with respect to the development activities of the Bank. In fact, after careful consideration, the Bank's Executive Directors had concluded in 1946 that there should be no differentiation among countries in the interest rate charged. The Founding Fathers appeared rather to favor the adjustment of terms and conditions to the project (Article III, Section 4 (iv). In practice, the Bank had applied this adjustment to maturities and grace periods rather than to interest rates.

23. Dr. Lieftinck recalled that, in the financial policy paper which the President had submitted 18 months before, he had indicated that he saw no reasons for changing the Bank's interest rate. Dr. Lieftinck said he agreed that there was no decisive reason for the Bank to change the current rate, which was on the whole favorable to borrowers.

24. Because of its cooperative character the Bank was concerned with more than assisting the less developed countries only. There was a prima facie case for giving all members eligible for Bank loans the full benefit of the Bank's high standing as a borrower. Discrimination among members with respect to the interest rate would require a very strong and convincing justification.

25. Dr. Lieftinck said that it had been suggested from time to time that the Bank should differentiate among countries by reducing the rate at which it lent to weaker members. Yugoslavia, one of the countries which he represented, had suported such differentiation at the last Annual Meeting. Dr. Lieftinck, noting that the Bank had always resisted differentiation, said that since the creation of IDA there was less reason to adjust interest rates downward to suit particular members. It was unfortunate that the funds available to IDA did not permit as much lending on IDA terms as would be desirable, but the mixing of IDA credits and Bank loans gave a certain flexibility in this respect.

26. The present proposal would differentiate among members by raising the interest rate charged to the stronger countries. The main supporting argument in the paper before the Committee was that to deny market eligible countries the benefits of the Bank's ability to charge a relatively low lending rate would discourage them from seeking Bank loans.

27. In previous discussions it had repeatedly been stated that the Bank was not short of loanable funds. This subject had been fully discussed in connection with the transfer of Bank income to IDA. He (Dr. Lieftinck) had then suggested that the Bank would be well advised to keep in its own reserves the full amount of its income in order to guard against the day when difficulties arose in raising money in world capital markets. It had then been stated, however, that the Bank had no shortage of loanable funds, and he had joined in the decision to transfer income to IDA.

28. The proposal before the Committee would not benefit the Bank's weaker members. It would only penalize the stronger members for being market eligible - i.e., for having a higher credit standing than other members. Discriminatory rates of interest could be justified if they were necessary in order to induce market eligible members to take full advantage of the exisiting capital market facilities. But paragraph 4 of the President's paper made it clear that this was not the case. It stated that "the Bank has frequently urged its members to borrow in the market at rates higher than its own lending rate, and has always exercised its judgment as to whether or not the applicant was making diligent efforts to raise funds elsewhere." If the Bank had in the past been able, on the basis of its own judgment, and without the assistance of a penalty rate, to decide whether and to what extent to accommodate market eligible countries, he did not see why it should not continue to be able to do so. The purpose of the present proposal was apparently not to open the Bank's doors wider for market eligible countries but to keep the Bank as only a supplementary source of finance and to make it a more expensive one. The proposed higher interest rate was not needed to discourage members from coming to the Bank.

29. It was argued in paragraph 7 of the President's paper that the higher interest rate might facilitate sales out of the Bank's portfolio and thereby enable it to turn over its funds more rapidly. However, the result of selling portfolio items bearing higher interest rates might well be the deterioration of the overall quality of the Bank's portfolio as it came to consist increasingly of assets invested in the weaker countries.

30. Mr. Rajan, said Dr. Lieftinck, had suggested that a policy of interest rate discrimination would strengthen the borrowing capacity of the Bank. He (Dr. Lieftinck) felt that it would weaken this capacity to the extent that investors looked at the composition of the Bank's portfolio.

31. Dr. Lieftinck summarized his objections to the proposal before the Committee as follows:

(a) The proposal represented a shift away from the cooperative principle underlying the Bank.

(b) The proposal would deprive some members of the benefit of the Bank's capacity to charge relatively low interest rates.

(c) The proposed policy was contrary to normal banking practice, because it involved charging the better debtors higher interest, and would thus not be easily understood in the private capital markets.

(d) The proposal created uncertainty, first as to the countries to which it would be applicable, and secondly as to its affect on the market standing of such countries. Japan, Norway and Italy had been mentioned. Finland, with per capita income of $1,300, was not one of the poorer countries. It was market eligible and had raised $30 million in the private market in 1963. Yugoslavia was trying to become market eligible and making a courageous effort to attract foreign capital. Its per capita income was lower than Finland's, but it did not belong to the underdeveloped countries in the stricter sense of the word.

(e) The proposal would suggest that the Bank was following U.S. policy.

32. The Bank, Dr. Lieftinck continued, should display a positive and cooperative attitude towards all its members. It should seriously consider whether it could not better achieve this by entering the field of underwriting of public issues. The Bank would thus cooperate with private lenders and find out what could be raised in the capital market. It might itself take up part of the issues. It would at least carry part of the risk of placing the countries' paper in the private market. The Bank might sometimes keep such paper in its portfolio until conditions on the capital market improved sufficiently to make it saleable.

33. One great advantage to be derived from participation in underwriting was that in each case the Bank, in close cooperation with the market eligible member and with the potential investors, would sound out the market to discover the proper rate of interest. The proposal before the Committee suggested general rates which, though no doubt based on an intimate knowledge of the market, could not be adjusted to the particular circumstances of the borrowing member. The rates, though not fixed indefinitely, would still be relatively inflexible. There would be much more flexibility if rates could be negotiated from time to time with borrowing countries in the framework of underwriting operations. It was suggested in the paper that a market eligible country might need capital at a moment when the market could not absorb a loan, so that the underwriter would have to take up the whole issue. He doubted whether in fact capital importing countries were so inflexible that they could not wait until there was an opening in the market. Furthermore, if interest rates were properly set, it was usually possible to accommodate creditworthy countries in the capital markets of the world. The Bank should therefore consider whether the positive course of entering the field of underwriting was not preferable to the negative and discouraging attitude towards the market eligible countries advocated in the paper before the Committee.

34. Mr. Woods said that the idea that the Bank might underwrite an issue and at the same time take a commitment had already been discussed among senior members of the staff, who were in favor of it. Operations of this kind would in fact involve higher interest rates for market eligible countries and thus embody the basic concept in the paper before them. The Bank, as co-underwriter or sub-underwriter with a group of security dealers or bankers would take up its commitment on the basis of the rate of interest fixed by that group for the public offering. In fact, the Bank would take a slightly more attractive price because it would also get the benefit of the underwriting and service commission. In this kind of an operation the Bank would be underwriting the excess over and above what could be placed in normal commercial channels at a reasonable rate.

35. Continuing, Mr. Woods said that he wanted to make two comments on the subject of "good banking practice", which had been referred to by several of the Directors. First, the Bank was not really a bank. It was neither a bank for deposit nor a fiduciary for trust funds. It was rather a bond investment trust; it purchased entire issues of securities for its own account and sold them out of portfolio whenever people wanted.

36. Though it might seem ridiculous to suggest that better borrowers be charged higher interest, yet the fact was that all loans from the Bank were at subsidized rates of interest. The Bank's bonds were rated triple A by the U.S. rating agencies; they also had the highest rating in other private capital markets. They were given the highest rating because of the approximately $18 billion or $19 billion which the Bank could call from its shareholders if it was unable to pay its debts, not because of the kind of business the Bank did or the quality of its portfolio or because of its earnings record. This top rating enabled the Bank to raise money at relatively low rates of interest. Since the Bank was able to subsidize its borrowers it was reasonable that those who had already achieved some credit standing should be subsidized to a lesser extent than others. The completely unsophisticated new country with some creditworthiness should enjoy the maximum benefit from the Bank's ability to raise funds at a low rate.

37. Dr. Lieftinck interjected that this was the very reason why he had emphasized the cooperative principle of the Bank. In a credit cooperative all members enjoyed the lower interest rate which the cooperative could offer. Mr. Woods agreed that all members should enjoy a lower interest rate. The question was whether they should all enjoy the same lower interest rate. He referred to the fact that there had never been any suggestion that the Bank's expenditure on technical assistance should be allocated pro rata among countries. Some members benefited much more than others from the Bank's services. Nevertheless, he agreed that all members of the Bank should draw some benefit from the Bank's ability to raise funds at a particularly low rate of interest.

38. Consequently some judgment had to be reached about the rate of interest which the Bank considered it reasonable for its members to pay on the private capital market. Mr. Woods said he had reached the figure of 6-1/2% for long-term money. The four countries which might be considered market eligible and which had indicated a desire for accommodation from the Bank in 1965 were Italy, Japan, Norway and South Africa. If these countries were forced to raise all the money they needed through the normal commercial channels, they would either have to cut back their investment programs, which would be good neither for them nor for the lesser developed countries with which they traded, or they would have to pay very much more for their money. The Bank should try to accommodate them; he agreed with Dr. Lieftinck in rejecting the idea that the Bank should confine its lending to the less developed countries.

39. The Bank was confronted with the need to pay higher rates of interest. During the '50's the Bank had been able to draw without limit on the great reservoir of low cost money in the United States. In the 1960's the United States remained the great reservoir of low cost money, but the U.S. Government had stressed that a maximum effort must be made to tap the other available sources of capital. In these other capital markets the Bank would have to pay about 5-1/2%, as compared with 4-1/2% in the United States. As the Bank had to pay more for its money so, as a matter of good business practice, it would inevitably sooner or later have to raise its own rate above 5-1/2%. This would not of course be unprecedented; the Bank's interest rate had been as high as 6-1/4%.

40. An alternative to raising the Bank's general interest rate was to charge a higher rate to those countries that, for varying reasons, had obtained access to the market. The higher rates proposed had been chosen with a view to encouraging countries that were able to use the market to do so to the maximum possible extent. He agreed with the suggestion made by some Directors that these higher rates should be reviewed and changed from time to time in the light of circumstances. The fact that the Bank was prepared to take care of part of the needs of the market eligible countries would benefit them because the market rates for their bonds would be less than they otherwise would have been.

41. Mr. Woods thanked Dr. Lieftinck for his suggestion about underwriting and said he hoped that there would be occasions when the Bank could join with others in an underwriting operation. But it would be a miracle if the interest rate on bonds taken up by the Bank on such an operation turned out to be the same as the rate which the Bank was currently charging other countries.

42. Dr. Lieftinck said that he had envisaged the Bank as taking part in underwriting only in cases when it was at the same time itself making an adequate loan to the member concerned.

43. Mr. Woods said that he looked at the matter the other way round: his concern was to ensure that market-eligible countries obtained as much as possible of the capital they needed from the market, rather than from the Bank. This approach would not, of course, have been realistic in 1946, when there were no established markets which could meet the capital requirements of such countries. Countries like France, Luxembourg, Belgium and Holland which had since been able to raise much money in the market could then raise nothing. In the changed circumstances of 1964 the need was to ensure that countries which had earned a standing in the market made use of it.

44. Mr. Handfield-Jones said that the proposal before the Committee was an important one which would significantly alter the Bank's policy and manner of operation. He, like others, felt uneasy about it. He agreed with much of what had been said by Mr. Garland and Dr. Lieftinck.

45. The proposal was more than a straightforward extension of the principle of adapting the terms of loans to the needs of different countries by means of varying IDA/Bank blends. The Bank and IDA had separate sources of funds, whereas Bank loans to market eligible countries would be from the same source as loans to other members. This was also the reason why the analogy of the Inter-American Development Bank was not fully relevant, for IDB had various sources of funds as well as various interest rates on its loans.

46. The founders of the Bank and IDA had shown great wisdom in keeping the two separate. As Mr. Garland had pointed out, the character of the Bank and its stature in the private capital markets of the world had been preserved by channelling public funds for aid on soft terms through IDA. IDA's funds were of course limited and any increase would be of unmistakable benefit to developing countries. However, any attempt to achieve this indirectly by making the Bank more like IDA would be disadvantageous to everyone.

47. Mr. Handfield-Jones said that he would strongly oppose the idea of raising interest rates against market eligible countries if the purpose were to cover the Bank's higher costs of borrowing or to build up larger profits for transfer to IDA. However, he was aware that these were not the purposes of the proposal before the Committee. He was confident of the President's determination to resist the inevitable pressures for extension of the principle of differential interest rates which Mr. Garland had vividly described.

48. Mr. Handfield-Jones went on to define the real and important problem with which he felt the proposal was designed to deal. An institution like the Bank could usefully act as an intermediary through which funds could move from rich countries to poor countries. At the same time, and without prejudice to this first purpose, it could also help to channel funds from surplus countries to deficit countries. Very often the two functions coincided. However, it made less sense for the Bank to borrow in rich deficit countries in order to lend to countries which were also relatively rich and which were no more in deficit than the country where the Bank had raised the money.

49. The present difficulty arose from two sources: the perfectly proper determination of the U.S. authorities to reduce their balance of payments deficit, which was due in part to the existence of vast borrowing facilities in the United States, and the difficulty of borrowing large amounts of money at reasonable rates in surplus countries in Europe and elsewhere.

50. Mr. Handfield-Jones said that there were three ways of mitigating these problems. One was for market eligible countries to minimize their need for borrowing. A second was for market eligible countries to borrow as much as possible in the markets of the surplus countries. A third was for the Bank also to borrow as much as possible in the surplus countries. He appreciated the efforts which the President was making to increase Bank borrowing in the surplus countries. He felt that the Bank could do even more than it had been doing to persuade market eligible countries to borrow as little as possible abroad and to concentrate necessary borrowings in the markets of surplus countries. As compared with these three courses of action the proposed increase in interest rates on loans to market eligible countries would have much more uncertain effects. It might reduce these countries' total borrowings, but probably not very substantially. It might divert borrowings from the Bank to other sources; but the diversion would most likely be to the United States market, despite the interest equalization tax, and this was surely the reverse of what was needed. Moreover, if market eligible countries accepted the proposed change reluctantly, then the influence of the Bank upon them might be diminished.

51. Mr. Handfield-Jones said that he doubted whether the proposal before the Committee was the best way of dealing with the problem. There might be other solutions which would have less undesirable side effects. He requested that the Committee be provided a fuller justification for the proposed policy than the brief paper which had been circulated.

52. Dr. Donner said that much of the earlier discussion of the proposed interest rate change had been based on the assumption that the Bank had a much greater degree of freedom in conducting its policies than it in fact had. Mr. Black had been accustomed to point out that the Bank was not constrained by lack of financial resources, but rather by lack of worthwhile projects. At that time there had, for all practical purposes, been no limit to the amount the Bank could borrow in the United States. The Bank had therefore been in a unique position for an agency concerned with economic assistance: it could raise money wherever it wished in the cheapest capital market in the world. The Bank had of course borrowed outside the United States, but more to emphasize the truly international character of the Bank than to meet any financial need. In setting its own lending rates the Bank had come to focus exclusive attention on the terms at which it could issue its own bonds.

53. The situation was now completely different. The Chairman had pointed out that the Bank's access to the U.S. Bond market was limited. He had not set a figure and probably no figure could be given, but it was clear that the Bank could no longer operate on the assumption that it could raise in the U.S. market as much as it could use. This was chiefly the result of the U.S.

authorities' quite justifiable efforts to correct their balance of payments disequilibrium. In the meantime, capital markets in Europe had grown much larger and stronger, but their terms were much stiffer than those in the United States.

54. In former discussions of the gap between the terms available on the U.S. capital market and those available on the European capital market it had usually been suggested that European rates were abnormally high. European governments had been advised to ease the terms available on their markets as well as to enlarge the markets. However, it was no longer justified to assume that U.S. interest rates were normal. In fact, it seemed that there was a continuing process underway: U.S. interest rates moving upward, despite the efforts of the U.S. authorities to stem the trend, and rates outside the United States tending to fall over the years.

55. The past practice of the Bank was therefore only slightly relevant to the present problem, because the basic conditions out of which the Bank's practices and principles had grown were no longer the same. The Bank could no longer operate on the assumption that it would be able to raise most of the capital needed on the terms available on the U.S. market. It was in fact confronted with the need to raise capital in several separate markets: a limited amount at very favorable rates in U.S. markets, and limited amounts at higher interest rates in other markets.

56. One way of meeting this situation was to pool all the money that the Bank could raise, to average out the terms on which it was raised, and to make the funds available to the Bank's borrowers at a uniform rate. While some speakers appeared to favor such a course, Dr. Donner felt that it would be contrary to the Bank's purposes. The Bank had been established to pursue policies which private institutions would not pursue. A policy of averaging, since in this case it would mean increasing interest rates, would at the same time increase the legitimate need for IDA resources. Such serious consequences of changes in Bank policies could not be neglected in the formation of those policies. Thus this course of action seemed both impractical and contrary to the spirit, if not the letter, of the Bank's Articles.

57. The other possible course of action was for the Bank to reserve the available low cost money for those members of the cooperative who needed it most urgently. This had been called discrimination. The Bank had of course always given different countries different treatment. For instance, there were a number of countries which were ineligible for Bank loans either because their financial practices excluded them or because they did not need the money.

58. Dr. Donner was glad that there seemed to be little support for the position that countries in a better economic and balance of payments situation should be made ineligible for Bank loans. There were a number of ways in which the Bank could continue to help countries which were quite far advanced but which obviously still needed capital. Dr. Donner said he welcomed the support which the Chairman had given to Dr. Lieftinck's

suggestion that the Bank underwrite market loans to its members. But there was no reason why the Bank should not at the same time continue lending to its more advanced members. It could do so, for instance, if it conducted its affairs in a compartmentalized way like the Inter-American Development Bank. It could reserve money borrowed at low rates for a particular group of the Bank's members, and it could use money borrowed at higher rates for relending to countries which could pay higher rates. It would not be necessary to establish separate accounts for these different compartments. However, in each case the cost of Bank loans would be related to what the Bank would have had to pay had it been raising money for relending to the country in question, and the Bank would avoid giving the impression that rates on loans to market eligible countries were artificially high.

59. It had been argued that such a policy of charging market eligible countries higher rates was contrary to "normal banking practice", the Bank's adherence to which was said to give it its favored position in international capital markets. Dr. Donner said that he thought that the issue of "normal banking practice" was a false one. One accepted business practice was to charge the customer what the traffic would bear. Bankers had often owed their success to a certain disregard for "normal banking practice", and had undertaken operations which run-of-the-mill bankers had considered unorthodox. In fact, it was not clear what was meant by "normal banking practice". It was hard to see anything in the proposed policy change which was contrary to sound practice for the Bank as a financial institution.

60. Dr. Donner said that he did not agree that differential interest rates would be unfavorably received in the market. The German Central Bank did not expect an unfavorable reaction in the German market, and felt rather that adjustment of the Bank's lending rates, where possible, to market terms would make it easier to mobilize funds. The increase in portfolio sales which had followed the increase in interest rates for loan sales suggested that the market reaction to the new proposal would be favorable. Furthermore, the Inter-American Development Bank had already developed the practice of lending as well as borrowing at different rates, without affecting its credit standing; IDB Bonds had the same triple A rating in the U.S. market as Bank bonds.

61. Dr. Donner said that his remarks were based on the assumption that pressures, such as Mr. Garland had feared, for progressive reductions in the interest rates charged to weaker countries, would be successfully withstood. It was important that the Bank should remain a self-supporting institution and that it should not enter the field which had been reserved for IDA. There was nothing in the President's paper to suggest he had in mind a future softening of the Bank's lending.

62. He concluded by saying that the proposed interest rate increases seemed to reflect realistically the situation faced by the Bank. They would not harm the Bank's traditional borrowers. Rather than harming the market eligible countries, they would probably result in their obtaining more international capital than would otherwise have been available to them, although at somewhat higher interest rates.

63. Mr. Woods commented that every Bank loan had to be approved by the Executive Directors. Therefore the pressure which Mr. Garland said he feared and to which Dr. Donner referred would have to influence a majority of the Directors in order to become effective.

64. The meeting adjourned at 12:45 p.m.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT



CONFIDENTIAL

Bank/FPC64-19

December 17, 1964

*Memorandum of Meeting of Bank Financial Policy Committee on "Market Eligible" Loans (FPC64-17, October 28, 1964); Tuesday, December 15, 1964, at 11:35 a.m.

1. There were present:

Chairman

George D. Woods, President

Executive Directors and Alternates acting as Executive Directors

Helmut Abramowski (Alternate)
John M. Garba
Joaquin Gutierrez Cano
R. Hirschtritt (Temporary Alternate)
Rene Larre
Luis Machado
Mumtaz Mirza
K.S.S. Rajan
M. San Miguel
Vilhjalmur Thor
Reignson C. Chen
John M. Garland
S.J. Handfield-Jones (Alternate)
M. N. Kochman
Pieter Lieftinck
Jorge Mejia-Palacio
Eiji Ozaki (Alternate)
N.M.P. Reilly (Alternate)
Abderrahman Tazi
Andre van Campenhout

Alternates not acting as Executive Directors

Said Mohamed Ali
C. Ayari
A. Bogoev
Jose Camacho
S. O. Coleman
Rufino Gil
S. Guhan
O. Haushofer
J. Haus-Solis
Odd Høkedal
Ali Akbar Khosropur
Jean Malaplate
A.J.J. van Vuuren

Officers and Staff Participating

J. Burke Knapp
M. M. Mendels
A. Broches
C. 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. Woods said that the members of the Financial Policy Committee had received Bank Document FPC64-17 at the end of October, concerning interest rates on loans to "market eligible" countries. He added that Mr. Larre had raised the question whether the subject was one for decision by the Board. There was a precedent for regarding interest rates on Bank loans as a matter appropriate for consideration by the Board. The Financial Policy Committee had met on November 7, 1946 on the general subject of interest rates and the minutes of a subsequent meeting of the Executive Directors on November 15, 1946 stated that, with reference to the report of the Financial Policy Committee: "The Executive Directors considered and approved the Report of the Committee on Financial Policy regarding interest rates and commissions to be charged". Thus the matter appeared to be in the jurisdiction of the Board.

3. The paper before the Committee contained a series of observations without any specific recommendation. Mr. Woods said that he felt however that there was merit in the idea of relating the charges on Bank loans to the cost of Bank borrowing only for loans to countries that were truly underdeveloped. Countries which had access to the market should pay an interest rate related more closely to the rate they paid in the open market. Those which did not have access to the open market might reasonably be expected to pay a rate based on the rate the Bank itself had to pay to raise money.

4. Mr. Woods said that he did not feel that this step represented a great change in the policies of the Bank group. Since the creation of IDA, countries had borrowed from the Bank group at varying rates of interest. Some were too creditworthy to be eligible for IDA. Others were not sufficiently creditworthy to be eligible for Bank loans. Yet others fell in between these two categories, as "hard blend" or "soft blend" countries. The former were countries which could borrow mostly on Bank terms while the latter were countries which had to borrow mostly from IDA.

5. It was also noteworthy that other agencies almost invariably had more than one rate of interest. Had IDA not been created the Bank would almost certainly have had to introduce variable interest rates. The Inter-American Development Bank had a remarkable number of interest rates.

6. Mr. Woods said that after nearly two years of study and activity in the Bank group he did not favor any further major changes in general philosophies; and he did not consider the proposed interest rate change radical. The basic program of the Bank was good and the chief need was to put it into operation and to improve it in detail.

7. Mr. Woods added that he was particularly concerned with raising money during the coming six months. He was engaged in discussions about possible bond issues in Switzerland, the United States, Germany and Canada. With such market operations in prospect, he did not wish to raise further deep and complicated questions similar to those involved in the changes he had proposed regarding agricultural projects, education projects, financing of domestic currency expenditures, and transfer of Bank earnings to IDA. He did not regard the proposed change in interest rate policy as a matter of that sort.

8. Mr. Garland stated that the proposal before the Board raised issues which went a long way back into the history of the Bank and had implications for both its basic philosophy and its future development. The proposal introduced the principle of discrimination among countries in respect of Bank interest rates. This principle had been rejected in earlier Board discussions and was inconsistent with the basic cooperative principle on which the Bank, as an international institution, operated. Discrimination was a more appropriate word than differentiation because differentiation implied variation in interest rates according to market principles whereas discrimination was just the opposite. It was true that the Bank already discriminated among member countries. But the growth of discrimination, in whatever form, was not to be encouraged by the Bank.

9. The important point was that there had previously been no discrimination in Bank lending rates. The more creditworthy borrowers amongst Bank members might normally have expected to borrow at lower rates than others, but they had not questioned the existing Bank policy of charging all borrowers the same rate. To charge borrowers with higher credit standing a higher rate of interest would reverse both past practice and normal banking principles. Borrowers who were being discriminated against would likely have reservations about what the Bank was doing. Outside observers would find it difficult to follow the Bank's line of reasoning. The Bank had hitherto been known as an institution which followed accepted market principles and sound common sense policy. The introduction of discriminatory rates was likely to arouse a good deal of uneasiness and questioning among governments and in other places where the image of the Bank was formed.

10. The issue was important, because the principle of discrimination, once accepted, was liable to develop. A natural line of development would be in the direction of lowering interest rates for less creditworthy countries. If countries with good credit ratings should pay a higher rate of interest a natural corollary was that countries with lower credit ratings should pay a lower rate of interest. Pressure would clearly develop in this direction, and the pressure would probably be hard to resist.

11. Introduction of a discriminatory principle in interest rate formulation would not only break down the basis of sound interest rate determination hitherto maintained by the Bank but it would tend to destroy the crucial distinction between the Bank and IDA. The Bank had so far been maintained as a preserve of sound banking principles and it had passed over to IDA the problem of dealing with countries with inadequate credit ratings and of coping with the problems of international welfare. Some of the original Part I countries had participated in establishing IDA as a separate institution partly because they recognized the need to maintain the Bank on a sound banking basis. It would be extremely unwise to mix the two concepts, the banking one and the welfare one.

12. It was hard to predict exactly how world opinion would react to the proposed change if it were introduced. There would be an awareness that the Bank was changing its philosophy somewhat by departing from purely banking principles in the direction of welfare ideas. The main element in the past success of the Bank had been its ability to raise large sums of money in world capital markets. This ability resulted primarily from its high standing in financial circles. It was important that this borrowing ability should not be impaired for there was clearly a need for an international

institution which could mobilize capital on market terms and channel it to those members that could pay a remunerative rate for it. If the Bank's lending activities were allowed to be unduly influenced by welfare considerations, then the Bank's standing with investors and its capacity to carry out its intended role could suffer. Once its creditworthiness was impaired the Bank would be forced to pay more for the funds it raised on the market; and it would have to increase its "normal" interest rate on loans, to the detriment of all concerned. There was a serious risk that the market might react adversely; and the main question was whether the Board should expose the Bank to that risk.

13. The memorandum before the Committee did not provide adequate justification for the proposal. The purpose of the proposed policy change should be considered more fully. If the main purpose of discriminatory interest rates was to ensure that borrowing countries would make maximum use of private capital markets, then the proposal was unnecessary because the Bank achieved this purpose under its existing policy. The Bank always exercised its judgment whether or not loan applicants were making sufficiently diligent efforts to raise funds elsewhere.

14. Because the demand for international loans was much larger than could be met by all the capital markets and financial institutions in the world, borrowers could not choose between one source and the other. They had to take what they could get from all sources and were still usually unable to fill their requirements. In these circumstances borrowers were not attracted to the Bank just because Bank interest rates were slightly lower than market rates. The Bank was a special lender, lending under fairly rigid conditions and disposing of a limited amount of funds. Any country which borrowed from the Bank would also be interested in obtaining funds from the market. Many countries in fact borrowed from both sources. Therefore, all that was necessary was to ensure that countries approaching the Bank had exhausted all reasonable alternative channels of borrowing. The President had stated that he had recently emphasized to the Japanese authorities the need to exhaust alternative channels of borrowing before approaching the Bank.

15. If the main purpose of the proposal was to have the economically stronger borrowers subsidize the interest rate paid by other borrowers then its implementation would turn the Bank into more of an aid institution. That would have dangers for the Bank's standing in world markets and the result might then be contrary to the interests of the very countries it was designed to help. Aid and welfare were matters for IDA and any subsidizing of interest rates should be strictly confined to IDA.

16. Perhaps the proposed interest rate discrimination was related to the U.S. interest equalization tax. Clearly the Bank, in deference to its principal stockholder, should be careful to insure that its operations did not unnecessarily burden the U.S. balance of payments. There would be some embarrassment if a potential borrower who was subject to the interest equalization tax in the U.S. market could, without strict scrutiny, obtain dollar loans on better terms from an international window. Consideration

of the U.S. balance of payments was especially important because the Bank might soon wish to raise funds in New York and it would have first to secure the approval of the U.S. Government. The Bank would want then to show that its borrowers were exhausting every avenue in other markets. But the Bank could ensure this by more direct means. In this connection it was interesting to note that according to the recent report of the Eximbank, credits of $235 million which were made available to Italy during the early part of 1964, when the interest equalization tax proposal was in Congress, were extended at rates of 4-3/4% and 4-7/8%; these rates appeared to be, if anything, below the general run of rates charged by the Eximbank.

17. The Bank should certainly cooperate closely with the U.S. and it should be careful not to aggravate U.S. problems, but, as an international organization, it should not simply adopt parallel policies. In particular it should not change a long-standing lending rate policy simply to accommodate itself to a temporary tax that was designed to cope with a steadily diminishing problem.

18. Two other general aspects of discrimination against "market eligible" countries could also be considered. Discrimination against countries with high growth potential and the need for capital imports could have an adverse effect on international development as a whole. To insure a maximum international rate of economic development capital should be permitted to flow freely and without discriminatory interference to countries with a high growth potential. The more rapid the economic growth of borrowing countries the more rapidly secondary benefits from trade multiplied throughout the international community. It might well be that the amounts which the Bank was making available to the countries with a high growth potential were, as the President had recently suggested in the case of Japan, critically important contributions to meeting their requirements.

19. Mr. Garland added that he was not convinced by the statement in paragraph 5 of the Committee paper that there had been, in recent years, an improvement in the ability of the economically stronger countries to raise money in world capital markets. This could be true for some countries. For others, the scope for raising external capital on reasonable terms by independent approaches to the capital markets had tended, if anything, to diminish; nor did the future look very hopeful. For some countries the Bank was the only source available to supplement their own independent approaches to the capital markets. Some countries had sought membership of the Bank for this very reason and they would find the present proposals most disconcerting.

20. Countries which were contributing to IDA and which found themselves called upon to pay increased loan charges were carrying a double burden of assistance - a discriminatory interest charge, presumably for the ultimate benefit of Part II countries, plus an obligation to contribute to IDA replenishment. Such countries would also be conscious of the fact that when they assumed the responsibilities of Part I membership of IDA they did not expect to be denied access to Bank loans on the same terms as other borrowers. They would also remember that they had waived their right to a dividend from the Bank in order to assist developing countries through IDA. Therefore, the proposal might ultimately affect IDA.

21. Turning to the proposed schedule of rates Mr. Garland said that it seemed quite reasonable for a cooperative institution like the Bank to maintain a structure of charges which was both uniform and somewhat under the market. To charge a rate slightly above prevailing market rates, as had been suggested, would seem not only unreasonable but contrary to the basic purpose for which the Bank had been established.

22. The proposed schedule of rates should be examined, especially from the point of view of two groups of countries. First, countries which were still only approaching the stage of market eligibility would be discouraged from trying to improve their credit standing in world capital markets to the point where they could borrow on reasonable terms. Secondly, countries for which market rates were lower than the proposed new Bank rates might find that their credit standing, which they had so carefully built up in world capital markets, was seriously damaged. The market might interpret a long-term 6-1/2% rate on Bank loans to these countries as an unfavorable judgment by the Bank on the prospects of these countries.

23. Introduction of a double lending rate structure along the lines proposed would also present considerable difficulties in the determination of interest rates at which participations and portfolio sales were made. If the Bank lending rate were 6-1/2% then buyers of participations would clearly press for 6-1/2% for themselves. A double rate for participations might be the sequel to double lending rates, but, even if this could be avoided, the general level of interest rates on participations and portfolio sales might increase unnecessarily.

24. Mr. Garland concluded by saying that he saw nothing to recommend the proposal. If asked to suggest an alternative he would say that it did not seem necessary to alter the Bank's present lending rate policy. The rate at which the Bank could borrow had risen and might rise further. However, Bank profits were rising and the margin between Bank borrowing and lending rates was still high. The margin could be reduced substantially by eliminating the commission charge and in other ways. The Bank had other resources besides borrowed funds. Even if the average cost of new borrowings increased appreciably, the 5-1/2% lending rate could be maintained. If any increase in lending rates was necessary, then it should be uniform in incidence among borrowing countries. If it were decided that discrimination between borrowers was necessary then it might be desirable first to raise the interest rates on any loans to IFC.

25. Mr. Garland said that the proposal was important enough for the Governors to be asked, not necessarily to adopt a resolution, but perhaps to give considered views in the light of fuller and more comprehensive statements by the Management. This would give the Governors a useful opportunity to contribute to the general development of Bank policy and to the improvement of the Bank's relationship with its members.

26. Mr. Woods said it was unthinkable that countries of the market eligible type would, as Mr. Garland had suggested, take reprisals by changing their policies with respect to IDA contributions. Of the seven principal contributors to the first replenishment of IDA resources, only two were in the category of market eligible countries: Japan and Italy. He (Mr. Woods) had laid before the Finance Ministers of both countries the reasons for the impending increase in interest rates, and they had both agreed that there was no alternative to raising the interest rate. Mr. Garland said he had had in mind only that such considerations would be weighed by the policy makers; not that they would necessarily be expressed in policy.

27. Mr. Garba said that he found the arguments in favor of a higher interest rate on Bank loans to market eligible countries convincing and logical. It might seem ungracious for a representative of developing countries to advocate discrimination against the Part I countries which were the principal contributors to IDA. However, market eligible countries were economically stronger than the developing countries and were therefore able to amortize their loans more rapidly. It was therefore desirable for the Bank to charge market eligible countries rather higher interest rates so that it could turn over its funds more profitably and discourage them from resorting to it for funds.

28. Mr. Garba said that although he supported the arguments and conclusions of the memorandum before the Committee, he had reservations about the definition of market eligible countries. Though it was not necessary to say exactly which countries fell into this category, it would be desirable to formulate some criteria of market eligibility. Only countries that were generally considered fully developed should be included in the category.

29. Mr. Mirza said that while all members of the Bank must be regarded as equally eligible for Bank loans, countries which were able to raise funds on the world market should be encouraged to do so to the fullest extent. The Bank's ability to borrow funds from the market in any one year was limited. Therefore, in the interest of the world economy, the Bank should stop lending to the advanced countries with high credit standing or should at least devote most of its attention to financing the less fortunate countries that were not in a position to obtain capital from sources other than the Bank. Otherwise the Bank would have to borrow more and more for the benefit of the advanced countries and thus it would have less and less for the poorer countries. Such a course would be inconsistent with the keen and sympathetic interest that the Bank had taken in the development of the less developed countries.

30. The Bank should therefore discourage members with high credit standing from seeking its financial assistance. One way of doing this was, as suggested in the paper before the Committee, to make loans to such countries only at rates of interest higher than the Bank's normal rate. Another way, as suggested by one of the countries Mr. Mirza represented, would be to stop financing the more developed countries altogether, since Bank funds might in future barely suffice to meet the growing needs of the developing countries, more of whom had recently joined the Bank family. That would undoubtedly be the ideal solution. If it was not considered feasible then, as suggested by the same country, the possibility of augmenting IDA resources by amounts equivalent to the loans to developed countries should be considered. That would ensure that the needs of developing countries were adequately met.

31. Continuing, Mr. Mirza said that he would support the suggestion in the paper before the Committee if he could be sure that it would effectively discourage developed countries from coming to the Bank. He was afraid that this objective might not be achieved, for loans to Part I countries could be sold out of the Bank's portfolio at lower interest rates than loans to Part II countries. Since the Bank's normal practice was to pass on to the borrower the benefit of lower rates obtained on portfolio sales, the Part I countries would, under the plan proposed in the paper, only pay more for their loans in the early years before the Bank had sold them, and no appreciable change would have been brought about.

32. Some further steps might therefore be needed in order to achieve the desired objective. The Bank might discontinue passing on to the borrower the difference between its own interest rate and that at which sales were made from portfolio. The money so earned could be placed in a special fund for use by IDA. This suggestion was intended primarily to provoke further thinking on the subject, not to rule out other solutions.

33. Mr. Mirza concluded by saying that he supported the suggestion made in the paper - that the rate of interest on loans to Part I countries should be increased. As the Chairman had pointed out, the practice of charging different rates of interest on different categories of loans already existed and the present proposal should not therefore adversely affect the ability of the Bank to borrow funds on the world market.

34. Mr. Thor said that the question before the Committee was whether the Bank should break away from its rule of charging all borrowers the same interest rate and charge countries with stronger economies up to 1% a year higher interest. The Bank would no doubt continue to raise money in those financial markets which offered the best rate of interest. Rates of interest had been increasing generally in the world for some time. The question therefore arose whether the Bank would not have to follow the general trend. Apparently the Bank was, for certain reasons, also handicapped in issuing bonds in the cheapest markets, so that it would have to make more use of the more expensive markets; this was another reason why the average rate of interest on its bonds would probably rise. To meet these higher costs it was now suggested that the Bank should adopt the new course of charging some countries higher interest rates than others.

35. Mr. Thor said that, of the governments which he represented, Sweden was definitely in favor of the proposal in the memorandum before the Committee. Iceland did not wish to participate in the discussion. Denmark, Finland and Norway were strongly opposed to the proposal. Mr. Thor went on to outline the views of these three countries.

36. The Bank's earnings position had in the past been satisfactory, so that from a business point of view there did not appear to be any reason for changing its lending rates. With its current interest rate structure the Bank had been able to sell considerable portions of its loans to private investors in industrialized countries, and the proceeds of these sales had been added to the Bank's resources.

37. The proposed graduation of interest rates on Bank loans would discriminate, not only between industrialized and other borrowers, but also among the industrialized countries themselves. The interest rates proposed for loans to certain countries, including Denmark and Norway, were higher than the interest rate that these countries had been paying on the international capital markets, while the new rates proposed for some other industrialized countries corresponded to the terms which they would be able to obtain on the market. Conditions on the international capital markets were constantly changing, and these changes could have considerable effect on the industrialized countries' prospects for borrowing. Consequently, a scale of interest rates on Bank loans, as now proposed, was unlikely to ensure that the Bank's terms for any individual industrialized member country were the same as those of the open capital market.

38. Denmark felt that it would prefer the Bank to limit its lending to industrialized member countries by means of a direct quantitative limitation rather than by differential interest rates. Such a limitation would make clear the criteria regarding a country's economic and foreign exchange position which the Bank would use in its lending.

39. In order to finance a large bridge project, Denmark might soon wish to raise a large amount of money. It might combine a loan on the foreign capital market with a loan from the Bank. If it had exhausted open market sources of capital, there seemed to be no reason why Denmark should only be permitted to borrow from the Bank on more restrictive terms than other countries.

40. A Norwegian view was that there seemed to be no real grounds for discrimination among those of the Bank's borrowers that were not eligible for IDA credits. Countries which did qualify for IDA credits could already borrow at lower rates and on more favorable terms than other countries.

41. Mr. Thor thought that if the proposal were adopted the Bank would face special difficulties when the time came to decide which countries should pay higher interest rates. Governments could often be treated like individual human beings: some were industrious and hard-working, others less so. The hard-working man should not be punished nor should the lazy man be given a bonus. To charge the prime borrower the higher lending rate

and the least creditworthy borrower the premium rate was contrary to usual banking practice. The Bank was not of course bound by the rules of regular commercial banking. Nevertheless, it had in the past always operated with a single rate and had treated projects on an equal basis. When the Bank came to the conclusion that it was necessary to introduce differential interest rates IDA was created, partly to keep the Bank itself on a clear banking basis. Would it not be sounder and better to continue to keep the Bank itself on this clear banking basis?

42. Mr. Gutierrez Cano thought the President's memorandum on market eligible loans was extremely important. The Bank had up to now charged all borrowers a single rate of interest based on the cost of the Bank's borrowing. The Bank had at the same time differentiated among countries by discontinuing financial assistance to some because of their economic prosperity.

43. The memorandum before the Committee suggested that the Bank should base its interest rate, not on its own rating in the capital market, but on the rating of the individual borrowing country in that market.

44. Diversification of interest rates had been proposed during the Bank's Annual Meetings. Some had argued that the introduction of differential interest rates was justified by the special financial situation of the developing countries. The memorandum before the Committee did have the merit of considering the peculiarities of individual countries more precisely than in the past.

45. The memorandum justified the adoption of differential interest rates on the grounds that the Bank might have to go to capital markets in which it would have to pay more on its bonds. A higher rate of interest on some Bank loans might however also affect conditions in the capital market. Higher interest rates on Bank bonds would then force a gradual extension of higher interest rates to a greater number of countries. If the proposed dual interest rate were introduced, then the 5-1/2% rate, the lower of the two, might gradually come to be considered as a subsidized or privileged rate. The Bank might have to use its net earnings to maintain it at the 5-1/2% level.

46. There was a need to define very clearly the criteria for deciding whether or not a country was eligible for the international financial market. The memorandum gave only a brief discription of market eligible countries. Nevertheless, it seemed to suggest that such countries had the following characteristics:

(a) A high level of economic prosperity and personal income.

(b) An efficient domestic capital market adequate to the country's needs and regular recourse to the international capital market for additional borrowing on reasonable terms.

(c) A need to come to the Bank only to complement the capital raised elsewhere.

The Bank should determine market eligibility in such a way that countries were added to the category only when they reached a financial, economic and social position in which the higher interest rate on Bank loans would not come as a limitation on their efforts toward economic progress. The Bank would have to be careful that, by the way it defined market eligibility, it did not discourage countries from going to the international capital market to meet their requirements. It was evidently not the intention of the memorandum to interfere or discourage these countries in their efforts to secure better access to international capital markets.

47. The memorandum before the Committee also discussed the period of loans for market eligible countries. The period of Bank loans had to be decided on the basis of a country's financial and economic situation, the nature and repayment period of the project and the financial needs of the Bank. The Bank's loans had generally had reasonable maturity dates and grace periods. Borrowing countries would not benefit from an undue extension of either.

48. Mr. Gutierrez Cano concluded by saying he felt that the establishment of differential interest rates should not have any adverse effects on the developing countries which required Bank assistance. The Bank had to keep an interest rate appropriate to the needs of these countries and therefore lower than that on loans to market eligible countries. To maintain that lower interest rate the Bank might have to use its net income.

49. Mr. Reilly said that, despite his sympathy with much of Mr. Garland's interesting contribution to the discussion, he wanted to support the proposals in the President's memorandum. It was quite true, as Mr. Garland had said, that the Bank's main task was to encourage development and therefore it should help those countries which were progressing rapidly. The proposal before the Committee seemed to encourage that effort; the Bank had resumed lending to Japan about two years ago and would consider a new loan to Japan in the near future. The Bank could supplement the efforts of countries like Japan and Italy to raise loans on the market. Nevertheless, there was a need for the Bank to exercise some judgment as to what proportion of its available funds should be lent in that way. It was also necessary to recognize that the Bank's 5-1/2% lending rate could not be sustained if the Bank continued to lend on a large scale to such countries for they could absorb very large amounts of capital. It therefore seemed right for the Bank to charge such countries an interest rate more in line with the market than its 'normal' rate. The latter was subsidized because the Bank did not have to pay interest on its subscribed capital.

50. Mr. Reilly said that he was uncertain whether a single schedule of rates, as proposed, was best. Probably it was the best way to launch differential interest rates. But he felt that more consideration should be given to the possibility of adapting the interest rate for each individual country more closely to the market rate for that country.

51. Mr. Reilly said that he did not agree with Mr. Mirza's suggestion that the Bank should not pass on to the borrower the benefit of any difference between the rate it charged on a loan and the rate at which it sold portions of the loan from its portfolio. That would be an extreme departure from the Bank's past practice. Once loans had been sold out of portfolio the Bank no longer had anything to do with them. A country was surely entitled to get the benefit of lower interest rates, where possible, on the market. The Bank could play a useful role by providing the ready money required to go forward with a big development project and then feeding the loan out on to the open market as and when it could be absorbed.

52. Mr. Woods said he agreed with Mr. Reilly's comments on Mr. Mirza's proposal that the Bank should not pass on the benefit of a lower interest rate obtained when a portion of a loan was sold from portfolio. If market eligible countries were to be charged interest rates related to the market rate, then they should also be given the benefit of savings that could be realized when their paper was sold in the market. The opposition that some countries such as Norway were said to feel to the introduction of what they considered an unduly high rate might be tempered by the knowledge that, if portfolio sales of their paper could be made at a lower rate, they would receive the benefit of it.

53. At 12:40 p.m., the meeting was adjourned.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT



CONFIDENTIAL

FPC64-17

FROM: The Secretary

October 28, 1964

"MARKET ELIGIBLE" LOANS

The attached memorandum from the President will be considered at a meeting of the Financial Policy Committee to be held on a date to be announced.

Distribution:

Members of the Financial Policy Committee
President
Vice Presidents
Department Heads

## "Market Eligible" Loans

1. The Bank was intended to supplement, not to supplant borrowing by its members in capital markets. Article III, Section 4(ii) of the Articles of Agreement provides that the Bank should lend only after it satisfies itself that "in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which, in the opinion of the Bank, are reasonable for the borrower."

2. The Bank, at an early stage in its history, decided not to base its lending rates on the rates which its borrowers paid in the market, but to have a single rate for all borrowers and to relate it to the cost of Bank borrowing.

3. Because of its ability to call on its members if necessary to enable it to meet its liabilities, the Bank can borrow at low rates. Thanks to this fact, the Bank's borrowers have obtained funds at rates which have generally been below those they would have had to pay in the market--if they could borrow at all.

4. In considering loan requests from the stronger of its members, the Bank has never considered that, ipso facto, a market rate higher than its lending rate was unreasonable. The Bank has frequently urged its members to borrow in the market at rates higher than its own lending rate, and has always exercised its judgement as to whether or not the applicant was making diligent efforts to raise funds elsewhere.

5. In recent years, there has been an improvement in the ability of the economically stronger countries to raise money in the capital markets of the world. From time to time, however, the amounts they can raise on reasonable terms still fall short of their requirements, and the Bank is therefore justified in lending to them, even though this increases the amount the Bank has to raise in the market. These countries generally have a substantially higher income level than the developing countries who by and large have little or no market credit, and it is questionable whether they should receive funds at the low rates at which the Bank lends to developing countries. Moreover, to the extent that funds are available to them from the Bank at a rate lower than the rate they would pay in the market, they have an incentive to come to the Bank.

6. These considerations seem to lead to the conclusion that on loans to countries which normally cover a substantial part of their external capital needs by borrowing on the capital markets of the world, the Bank should charge a rate of interest higher than that charged to its borrowers generally. It is not necessary at this stage to decide upon the countries coming into this category. Such countries, which might be termed "market eligible countries," would be determined as loan applications come up for consideration in the light of circumstances existing at the time.

7. If this conclusion is accepted, the question arises as to how this higher rate or rates should be determined. Determination of lending rates, case by case, on the basis of the market rating of the borrower would be difficult in the absence of a market issue which coincided with a Bank loan, and would complicate loan negotiations. A rate or schedule of rates, common to all market eligible countries, would be the simplest solution. The question arises as to whether there should be a single rate or a scale of rates, depending on the maturity of the loan. Almost by definition, market eligible countries are in a relatively strong position, and able to amortize their loans faster than other countries can. It is to the advantage of the Bank to encourage them to do so since the Bank would be repaid sooner and be able to sell maturities more readily, thereby turning over its funds more rapidly. Thus, the conclusion would seem to be that a scale of rates is preferable to a single rate, the rates being lowest for the shortest loans and highest for the longest.

8. This scale should be determined by reference to the rates which market eligible countries concerned would have to pay in the market for various maturities and would vary with the general level of interest rates. Since it should induce market eligible borrowers to maximize the use of the market place and minimize the use of Bank funds, the scale of rates should err on the side of being above market rates rather than below. Under current conditions, a maximum of 6-1/2% and a minimum of 6% seem appropriate, as shown below:

| Final Maturity Date | Rate |
|---|---|
| Up to and including 10 years | 6% |
| More than 10 years to and including 15 years | 6-1/4% |
| More than 15 years | 6-1/2% |

9. Although these rates might be somewhat higher than market rates in the case of some market eligible countries, the market rates themselves might be higher if these countries were forced to obtain all their capital requirements in the market. Furthermore , to the extent that the Bank is able to pass on to the market, through participations or portfolio sales, portions of its loans to market eligible countries at interest rates lower than those established by the Bank, the borrower would obtain a benefit from the lower market rates.

George D. Woods
President

October 28, 1964

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION



CONFIDENTIAL
SSM/M/64-40
October 30, 1964

SENIOR STAFF MEETING

Board Room, October 28, 1964, 9:30 a.m.

Present: Messrs. Woods (Chairman), Knapp, Wilson, Adler, Aldewereld, Alter, Broches, Cargill, Cavanaugh, Chadenet, Cope, Demuth, Friedman, Johnson, Lejeune, Mendels, Miller, Reid, Rist, Avramovic, Consolo, Williams, Wishart, Davies (Secretary)

"MARKET ELIGIBLE" LOANS

1. The meeting considered the revised version (SSM/A/64-55) of Mr. Cope's paper on the above subject.

2. It was agreed that the policy change recommended in the paper did not entail any consequential changes of loan policy not stated therein. In particular, the determination of maturities and periods of grace and of procurement policies in the case of loans to "market eligible" countries should be based on the same principles as in the case of loans to other countries, and any decision to relax normal standards of project appraisal and supervision in the case of a particular loan should depend on confidence in the borrower's ability to prepare and execute a project satisfactorily, rather than on the ground that the country in question happened to be "market eligible".

3. It was noted that the question was under consideration whether the Bank, when a participation or portfolio sale was effected at a rate less than that charged by the Bank on the loan in question, should pass on to the borrower the whole of the benefit of the difference of rates, instead of not more than 1%, as was the current practice. To pass on the whole benefit would deprive "market eligible" countries of grounds for complaining that the Bank charged them unduly high rates.

4. The paper was approved, subject to a number of drafting changes. It was agreed that the paper, with these changes, would be sent to the Financial Policy Committee of the Executive Directors for discussion as soon as the latter had had sufficient time to prepare their views; it was desirable that a decision be reached on the matter before loan negotiations with Italy began.

Distribution:
President
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Economic Adviser to the President
Special Advisers to the President
Department Heads (Bank and IFC)
Assistant Department Heads
Special Representative for UN Organizations
Mr. de Wilde
Personal Assistant to the President

Secretary's Office

AREA OPERATIONS

Africa

5. Mr. Williams said that, until the situation in the Sudan had been clarified, consideration of the second railways loan by the Executive Directors and the departure of the mission to review the Gezira Scheme would be deferred.

SETTLEMENT OF INVESTMENT DISPUTES

6. Mr. Broches reported that:

(a) Draft Rules of Conduct for the meeting of the Legal Committee (beginning on November 23) to draft the proposed Convention for the Settlement of Investment Disputes might be ready for consideration at the November 10 Executive Directors' meeting.

(b) Mr. Gabriel Valdes, a Chilean lawyer who had been General Counsel of the Compania Acero del Pacifico, and who had written to him in sympathetic terms about the SID proposals just before the Santiago meeting, would be Foreign Minister in the new Chilean Government.

"LOST WEEK END"

7. It was noted that, at the "Lost Week End" meeting of Senior Staff held at The Homestead, Va. on October 23 and 24, it had been agreed that:

(a) Sections of the report on "Training and Career Development" (SSM/A/64-43) would be discussed week by week at Senior Staff Meetings.

(b) TOD and the Economic Department would make recommendations on the identification of the authorship of reports, which had been considered desirable in principle as a means of delegating responsibility.

(c) Messrs. Knapp and Cope would consider ways of reducing the flow of paper in the Bank and of reducing the size of documents circulated to the Executive Directors.

(d) Messrs. Graves and Miller would consider ways of supplementing the routine press releases on individual loans and credits in order to improve publicity for the activities of the Bank and, in particular, IDA.

(e) A small joint Bank/IFC group would be set up to consider the implications of financing industry, with a view to further discussion, possibly at a future "Lost Week End".

(f) TOD would draft an Operational Memorandum on "Project Preparation".

(g) Further consideration should be given to the manner of budgeting for project and sector study costs.

(h) Policy with regard to the nationalization of foreign property would be discussed case by case at SSM meetings.

ADJOURNMENT

8. The meeting adjourned at 10:30 a.m.

C. H. Davies
Secretary

CORRIGENDUM

Mr. Miller should have been recorded as present at the October 21 meeting (SSM/M/64-39).

CONFIDENTIAL

SENIOR STAFF MEETING

SSM/A/64-55

October 27, 1964

"MARKET ELIGIBLE" LOANS

Attached is a revised paper by Mr. Cope on the above subject for consideration at tomorrow's meeting, which will be held in the Board Room at 9:30 a.m.

C. H. Davies
Secretary

Distribution:

President
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Economic Adviser to the President
Special Advisers to the President
Department Heads
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Mr. de Wilde
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## "Market Eligible" Loans

1. The Bank was intended to supplement, not to supplant borrowing by its members in capital markets. Article III, Section 4(ii) of the Articles of Agreement provides that the Bank should lend only after it satisfies itself that "in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which, in the opinion of the Bank, are reasonable for the borrower."

2. The Bank, at an early stage in its history, decided not to base its lending rates on the rates which its borrowers paid in the market. Few of them habitually borrowed in the capital markets of the world, and had any established credit abroad. For any of them, the determination of rates, country by country, would be very difficult, particularly in the unsettled conditions of the late 'forties. In these circumstances, it was decided to have a single rate, or a schedule of rates, for all borrowers and to relate it to the cost of Bank borrowing.

3. Because of its ability to call on its members if necessary to enable it to meet its liabilities, the Bank can borrow at low rates. Thanks to this fact, the Bank's borrowers have obtained funds at rates which have generally been well below those they would have had to pay in the market--if they could borrow at all.

4. In considering loan requests from the stronger of its members, the Bank has never considered that, ipso facto, a rate higher than its lending rate was unreasonable. The Bank has frequently urged its members to borrow in the market at rates markedly higher than its own lending rate, and has always exercised its judgement as to whether or not the applicant was making due efforts to raise funds elsewhere.

5. In the last fifteen years, there has been an improvement in the ability of the economically stronger countries to raise money abroad. From time to time, however, the amounts they can raise still fall short of their requirements, and the Bank is therefore justified in lending to them, even though this increases the amount the Bank has to raise in the market. These countries generally have a substantially higher income level than the developing countries who by and large have little or no market credit, and it is questionable whether they should receive funds at the low rates at which the Bank lends to developing countries. Moreover, as long as funds are available to them from the Bank at a rate lower than the rate they would pay in the market, they have little incentive to try to borrow elsewhere before approaching the Bank.

6. These considerations seem to lead to the conclusion that on loans to countries which normally cover a substantial part of their external capital needs by borrowing on the capital markets of the world, the Bank should charge a rate of interest higher than that charged to its borrowers generally. It is not necessary at this stage to decide upon the countries coming into this category. Such countries, which might be termed "market eligible countries," would be determined as loan applications come up for consideration in the light of circumstances existing at the time.

7. If this conclusion is accepted, the question arises as to how this higher rate or rates should be determined. Determination of lending rates, case by case, on the basis of the market rating of the borrower would be difficult in the absence of a market issue which coincided with a Bank loan, and would greatly complicate loan negotiations. A rate or schedule of rates, common to all market eligible countries, would be the simplest solution. The question arises as to whether there should be a single rate or a scale of rates, depending on the maturity of the loan. Almost by definition, market eligible countries are in a relatively strong position, and able to amortize their loans faster than poorer countries can. It is to the advantage of the Bank to encourage them to do so since the Bank would be repaid sooner and be able to sell maturities more readily, thereby turning over its funds more rapidly. Thus, the conclusion would seem to be that a scale of rates is preferable to a single rate, the rates being lowest for the shortest loans and highest for the longest.

8. This scale should be determined by reference to the rates which market eligible countries concerned would have to pay in the market for various maturities and would vary with the general level of interest rates. Since it should induce market eligible borrowers to maximize the use of the market place and minimize the use of Bank funds, the scale of rates should err on the side of being above market rates rather than below. Under current conditions, a maximum of 6-1/2% and a minimum of 6% seem appropriate, as shown below:

| Final Maturity Date | Rate |
|---|---|
| Up to and including 10 years | 6% |
| More than 10 years to and including 15 years | 6-1/4% |
| More than 15 years | 6-1/2% |

9. Although these rates might be somewhat higher than market rates in the case of some market eligible countries, the market rates themselves might be higher if these countries were forced to obtain all their capital requirements in the market. Furthermore, to the extent that the Bank is able to pass on to the market, through participations or portfolio sales, portions of its loans to market eligible countries at interest rates lower than those established by the Bank, the borrower would ~~obtain~~ the benefit from ~~of~~ the lower market rates.

S. R. Cope
October 26, 1964

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

# OFFICE MEMORANDUM

TO: Mr. Leonard Rist

DATE: October 21, 1964

FROM: John H. Adler

SUBJECT: Lending rate on Market Loans

Thank you for showing me the note. As you gathered I find myself much in agreement with your reasoning. I still think it would have been much simpler (and more honest) to propose an increase of the interest charges to market eligible countries simply by saying that our charges should maintain the same relation to the market rates as before the imposition of the interest utilization tax and that therefore we are raising our interest rates charged to them to the same extent as the new tax does.

JHA/mwm

(Mr Rist's note of August 7, 1964 to Messrs. Woods, Knapp & Wilson.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION



CONFIDENTIAL

SENIOR STAFF MEETING

SSM/A/64-54

October 20, 1964

"MARKET ELIGIBLE" LOANS

The attached paper by Mr. Cope on the above subject replaces the paper on "Market Loans" circulated on October 15 (SSM/A/64-53).

The new paper will be considered at tomorrow's meeting, which will be held in the Board Room at 9:30 a.m.

C. H. Davies
Secretary

Distribution:

President
Vice Presidents (Bank and IFC)
Economic Adviser to the President
Special Advisers to the President
Department Heads
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Mr. de Wilde
Personal Assistant to the President

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Assistant Department Heads

## "Market Eligible" Loans

1. The Bank has currently under consideration applications in substantial amounts from countries (such as Italy, Japan and Norway) which normally should depend largely on private capital markets for their external capital needs.

2. The Bank was intended to supplement, not to supplant borrowing by its members in capital markets. Article III, Section 4(ii) of the Articles of Agreement provides that the Bank should lend only after it satisfies itself that "in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which, in the opinion of the Bank, are reasonable for the borrower."

3. While over the past few years countries with established market credit have been able to raise substantial amounts in the capital markets of the world, the amounts they can raise on reasonable terms may still fall short of their requirements. Where this is the case, Bank lending can be justified. However, the question arises as to whether a rate of interest different from that normally charged to borrowers should be applicable in such cases.

4. The rate of interest normally and currently charged by the World Bank (5-1/2%) is related to the cost of Bank borrowing. So long as the credit of member countries is not established in the private capital markets of the world, there seems to be no other way to determine logically the Bank's lending rate. Because of its ability to call on governments if necessary to enable it to meet its liabilities, the Bank can borrow at low rates, thus making possible a low rate of interest for these countries, which constitute the great majority of the Bank's membership.

5. The rates of interest at which funds are at present available to foreign borrowers which have access to the principal capital markets of the world are generally higher than the rate of 5-1/2% which is currently charged by the Bank. These rates, however, can still be considered "reasonable" for the borrowers within the terms of Article III, Section 4(ii), and the Bank can still press applicants for loans to resort to the market wherever possible. As long as funds are available at lower cost from the Bank, however, it is difficult to make sure that borrowing from the Bank is not a substitute for borrowing from market sources, instead of being a supplement to it. If borrowing from the Bank were more expensive (or at least no cheaper) than borrowing in the market, there would be greater assurance that Bank funds were meeting a need that could not be met in the market.

6. These considerations seem to lead to the conclusion that on loans to countries which normally cover a substantial part of their external capital needs by borrowing on the capital markets of the world, the Bank should charge a rate of interest which would be related to the price generally paid by borrowing governments in those markets. It is not necessary at this stage to decide upon a list of countries coming into this

category. Such countries, which might be termed "market eligible countries," would be determined from time to time as loan applications come up for consideration in the light of circumstances existing at the time.

7. Since the objective is to make the Bank's interest rate for market eligible countries reflect market conditions, it would be logical for the Bank in fixing its interest rate on any loan to reply on the market's assessment of the individual country's credit. This raises the question as to which market is to provide the measure, for the rates paid by borrowers in various markets vary widely. If, however, the Bank's loan were to be made in conjunction with a public offering of a significant size, the cost of the public issue could determine the rate charged by the Bank.

8. This might not always be practicable. The probabilities are that in many instances a Bank loan could not be arranged to coincide with a public offering. The choice in such cases would lie between (a) making a judgement of what the cost of borrowing would be if a public offering were made or (b) applying a fixed rate, or a fixed scale of rates, which would be applicable to all market borrowers.

9. As to alternative (a), it must be said that in the absence of a public offering the determination of the rate in any individual case would be extremely difficult, since rates vary from one market to another, and since even in a single market the right rate to apply, although based on market prices, must in the last resort be a matter of judgement.

10. As to alternative (b), it is clear that a rate or schedule of rates, common to all market countries, would be simple and could not be regarded as discriminatory. On the other hand, it would mean that most countries would pay more (some might conceivably pay less) than would be indicated by the quotations of their bonds. In the end, however, the difference between the two methods might be less than appears to be the case at first sight. If, having made a loan at the fixed rate, the Bank sold part of it at an interest saving to the borrower, the result to the borrower (to the extent of these sales) might not be so very different from what it would have been had the interest rate been fixed in the first instance on the basis of a market quotation.

11. If the idea of having a common rate is accepted, the question arises as to whether there should be a single rate or a scale of rates, depending on the maturity of the loan. The answer depends on whether there are special arguments applying to the countries under consideration which do not apply generally. Almost by definition these countries are in a relatively strong political and economic position, and they are usually able to amortize their loans faster than poorer countries can. Since they are able to repay more quickly, it is to the advantage of the Bank to encourage them to accept a shorter amortization period, since the Bank will be repaid sooner and be able to sell maturities more readily, thereby turning over its funds more rapidly. Thus the conclusion would seem to be that if treatment common to all market countries is applied, a scale

of rates is preferable to a single rate, the rates being lowest for the shortest loans and highest for the longest.

12. The range of this scale should be determined by reference to the rates which the countries concerned would have to pay in the market at the time. It would change upwards or downwards with changes in the general level of interest rates and while in no sense being a scientifically weighted average would represent a rough measure of the cost of borrowing in major capital markets. It must necessarily be somewhat arbitrary. Since the purpose is to induce market eligible borrowers to maximize the use of the market plan and minimize the use of Bank funds, the scale of rates should err on the side of being above market rates rather than below. Under current conditions a maximum of 6-1/2% and a minimum of 6% seems appropriate, as shown below:

| Final Maturity Date | Rate |
|---|---|
| Up to and including 10 years | 6% |
| More than 10 years to and including 15 years | 6-1/4% |
| More than 15 years | 6-1/2% |

Annexed is a statement showing present yields on a representative list of foreign bonds.

13. Any one method of determining the rate of interest on market loans has advantages and disadvantages. The best course, therefore, might be to combine them by giving the borrower the option of selecting either

(a) a rate on the scale of rates depending on the final maturity, or

(b) a rate representing the cost to the borrower of a public offering made simultaneously with the Bank loan, assuming approximately comparable average maturities.

14. Loans to market eligible countries would not necessarily be linked to projects in the narrow sense of the term. The time and labor necessary for a detailed project appraisal and follow-up are less justified in developed countries whose projects are usually competently set up and operated and need the Bank's influence and supervision less. In accordance with established policy, the Bank would relate its lending to increasing the productivity and exports of the country concerned, examining its economic situation and prospects, reviewing its major investment needs and the reasons why domestic resources needed to be supplemented by foreign borrowing. For the purposes of Article III of the Articles of Agreement, the Bank would in some circumstances regard as the "project" a development

program or planned development in a particular sector or part of the country, and the loan would be disbursed for this purpose. The extent to which the Bank would study the program or examine specific projects in it would have to be decided on a case-to-case basis in the light of circumstances.

S. R. Cope
October 20, 1964

ANNEX

## Yields on Selected Issues in Amsterdam, London, New York, and Zurich

Yields are expressed as percentages and are calculated to final redemption date or to call date whichever gives the lower yield. They take into account currency options, where applicable, and are based on end-August prices.

| | Amsterdam | London | New York | Zürich |
|---|---|---|---|---|
| **Australia** | | | | |
| 5% bonds 1958-78 | | | 4.61 | |
| 5½% stock 1960-80 | | 6.11 | | |
| 4½% bonds 1960-75 | | | | 3.80 |
| **Austria** | | | | |
| 5½% bonds 1958-73 | | | 6.11 | |
| 4½% bonds 1954-80 | | 5.11 | | |
| 4½% bonds 1954-80 | | | | 3.60 |
| 4½% bonds 1954-80 | 5.28 | | | |
| **Denmark** | | | | |
| 4% bonds 1938-68 | 4.46 | | | |
| 3½% bonds 1946-72 | | 6.09 | | |
| 5½% bonds 1959-74 | | | 4.57 | |
| 4½% bonds 1959-74 | | | | 3.55 |
| **Finland** | | | | |
| 5% bonds 1961-76 | | | | 4.75 |
| **Italy** (Cassa per il Mezzo.) | | | | |
| 5½% bonds 1959-74 | | | 6.05 | |
| 4½% bonds 1961-74 | | | | 5.16 |
| **Japan** | | | | |
| 6% bonds 1952-69 | | 5.96 | | |
| 5½% bonds 1959-74 | | | 5.25 | |
| **New Zealand** | | | | |
| 3½% stock 1954-84 | | 6.00 | | |
| 5½% bonds 1958-70 | | | 4.65 | |
| **Norway** | | | | |
| 4¼% bonds 1955-75 | 5.07 | | | |
| 4¼% bonds 1951-66 | | 5.12 | | |
| 5¼% bonds 1958-73 | | | 5.11 | |
| 3% bonds 1938-71 | | | | 3.80 |

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION



CONFIDENTIAL

SENIOR STAFF MEETING

SSM/A/64-53

October 15, 1964

MARKET LOANS

The attached paper by Mr. Cope on the above subject is circulated for consideration at the next meeting (October 21).

C. H. Davies
Secretary

Distribution:

President
Vice Presidents (Bank and IFC)
Economic Adviser to the President
Special Advisers to the President
Department Heads
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## Market Loans

1. The Bank has currently under consideration applications in substantial amounts from countries (such as Italy, Japan and Norway) which normally would depend largely on private capital markets for their external capital needs.

2. The Bank was intended to supplement, not to supplant borrowing by its members in capital markets. Article III, Section 4(ii) of the Articles of Agreement provides that the Bank should lend only after it satisfies itself that "in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which, in the opinion of the Bank, are reasonable for the borrower."

3. In the past, the Bank has acted in accordance with this provision by lending, not only to the underdeveloped countries of the world, but also to countries which had established market credit, but which were unable to satisfy fully their requirements for external funds.

4. While over the past few years countries with established market credit have been able to raise substantial amounts in the capital markets of the world, the amounts they can raise on reasonable terms may still fall short of their requirements. Where this is the case, further Bank lending can be justified.

5. The rates of interest at which funds are at present available to foreign borrowers in the principal capital markets of the world are generally higher than the rate of 5-1/2% which is currently charged by the Bank, except in Switzerland. These rates, however, can still be considered "reasonable" for the borrowers within the terms of Article III, Section 4(ii), and the Bank can still press applicants for loans to resort to the market wherever possible. As long as funds are available at lower cost from the Bank, however, it is difficult to make sure that borrowing from the Bank is not a substitute for borrowing from market sources, instead of being a supplement to it. If borrowing from the Bank were more expensive (or at least no cheaper) than borrowing in the market, there would be greater assurance that Bank funds were meeting a need that could not be met in the market.

6. These considerations lead to the conclusion that on loans to countries which normally cover a substantial part of their external capital needs by borrowing on the capital markets of the world, the Bank should charge a rate of interest which in some way or other would reflect the price generally paid by borrowing governments in those markets. It is not necessary at this stage to decide upon a list of countries coming into this category. In the past the Bank has never listed all the countries to which it would not lend because they were able to rely on their own resources. The decision whether to lend or not has been made from time to time in the light of circumstances. Similarly the countries which might be termed "market countries" would be determined as cases come up for consideration.

7. Since the objective is to make the Bank's interest rate for market countries reflect market conditions, it would be logical for the Bank in fixing its interest rate on any loan to rely on the market's assessment of the individual country's credit. This raises the question as to which market is to provide the measure, for the rates paid by borrowers in various markets vary widely. If, however, the Bank's loan were to be made in conjunction with a public offering of a significant size, the cost of the public issue could determine the rate charged by the Bank.

8. This might not always be practicable. In many instances a Bank loan could not be arranged to coincide with a public offering. The choice in such cases would lie between (a) making a judgement of what the cost of borrowing would be if a public offering were made or (b) applying a fixed rate, or a fixed scale of rates, which would be applicable to all market borrowers.

9. As to the first alternative, it must be said that in the absence of a public offering the determination of the rate in any individual case would be extremely difficult, since rates vary from one market to another, and since even in a single market the right rate to apply, although based on market prices, must in the last resort be a matter of judgement.

10. As to the second, it is clear that a rate or schedule of rates, common to all market countries, would be simple and would not be regarded as discriminatory. On the other hand, it would mean that most countries would pay more (some might conceivably pay less) than would be indicated by the quotations of their bonds. In the end, however, the difference between the two methods might be less than appears to be the case at first sight. If, having made a loan at the fixed rate, the Bank sold part of it at an interest saving to the borrower, the result to the borrower (to the extent of these sales) might not be so very different from what it would have been had the interest rate been fixed in the first instance on the basis of a market quotation.

You assume IBRD will sell -

11. If the idea of having a common rate is accepted, the question arises as to whether there should be a single rate or a scale of rates, depending on the maturity of the loan. The answer depends on whether there are special arguments applying to the countries under consideration which do not apply generally. Almost by definition these countries are in a relatively strong economic position, and they are usually able to amortize their loans faster than poorer countries can. Since they are able to repay more quickly, it is to the advantage of the Bank to encourage them to accept a shorter amortization period, since the Bank will be repaid sooner and be able to sell maturities more readily, thereby turning over its funds more rapidly. The conclusion is that if treatment common to all market countries is applied, a scale of rates is preferable to a single rate, the rates being lowest for the shortest loans and highest for the longest.

12. The range of this scale should be determined by reference to the rates which the countries concerned would have to pay in the market at the time. It would change upwards or downwards with changes in the general level of interest rates and while in no sense being a scientifically weighted average would represent a rough measure of the cost of borrowing in major capital markets. Since the purpose is to induce borrowers to go to the market before they approach the Bank, the scale of rates should, if anything, be above market rates rather than below. Since rates vary from one borrower to another and are different in different markets, the scale determined by the Bank must necessarily be somewhat arbitrary. Under current conditions a maximum of 6-1/2% and a minimum of 6% seems appropriate, as shown below:

| Final Maturity Date | Rate |
|---|---|
| Up to 10 years | 6% |
| Between 10 and 15 years | 6-1/4% |
| More than 15 years | 6-1/2% |

Annexed is a statement showing present yields on a representative list of foreign bonds.

13. Any one method of determining the rate of interest on market loans has advantages and disadvantages. The best course, therefore, might be to combine them by giving the borrower the option of selecting either

(a) a rate on the scale of rates depending on the final maturity, or

(b) a rate representing the cost to the borrower of a public offering made simultaneously with the Bank loan.

Australia

The borrower would further have the option of selecting the final maturity date.

14. Loans to countries with established market credit would not necessarily be linked to projects in the narrow sense of the term. The time and labor necessary for a detailed project appraisal and follow-up are less justified in developed countries whose projects are usually competently set up and operated and need the Bank's influence and supervision less. As always, the Bank would relate its lending to the general development of the country concerned, examining its economic situation and prospects, reviewing its major investment needs and the reasons why domestic resources needed to be supplemented by foreign borrowing. For the purposes of Article III of the Articles of Agreement, the Bank might regard as the "project" either a development program or planned development in a particular sector or part of the country, and the loan would be disbursed for this purpose. The extent to which the Bank would study the program or examine specific projects in it would have to be decided on a case-to-case basis in the light of circumstances.

S. R. Cope
October 15, 1964

ANNEX

## Yields on Selected Issues in Amsterdam, London, New York, and Zurich

Yields are expressed as percentages and are calculated to final redemption date or to call date whichever gives the lower yield. They take into account currency options, where applicable, and are based on end-August prices.

| | Amsterdam | London | New York | Zürich |
|---|---|---|---|---|
| **Australia** | | | | |
| 5% bonds 1958-78 | | | 4.61 | |
| 5½% stock 1960-80 | | 6.11 | | |
| 4½% bonds 1960-75 | | | | 3.80 |
| **Austria** | | | | |
| 5½% bonds 1958-73 | | | 6.11 | |
| 4½% bonds 1954-80 | | 5.11 | | |
| 4½% bonds 1954-80 | | | | 3.60 |
| 4½% bonds 1954-80 | 5.28 | | | |
| **Denmark** | | | | |
| 4% bonds 1938-68 | 4.46 | | | |
| 3½% bonds 1946-72 | | 6.09 | | |
| 5½% bonds 1959-74 | | | 4.57 | |
| 4½% bonds 1959-74 | | | | 3.55 |
| **Finland** | | | | |
| 5% bonds 1961-76 | | | | 4.75 |
| **Italy** (Cassa per il Mezzo.) | | | | |
| 5½% bonds 1959-74 | | | 6.05 | |
| 4½% bonds 1961-74 | | | | 5.16 |
| **Japan** | | | | |
| 6% bonds 1952-69 | | 5.96 | | |
| 5½% bonds 1959-74 | | | 5.25 | |
| **New Zealand** | | | | |
| 3½% stock 1954-84 | | 6.00 | | |
| 5½% bonds 1958-70 | | | 4.65 | |
| **Norway** | | | | |
| 4½% bonds 1955-75 | 5.07 | | | |
| 4¾% bonds 1951-66 | | 5.12 | | |
| 5¼% bonds 1958-73 | | | 5.11 | |
| 3% bonds 1938-71 | | | | 3.80 |

Messrs. G. Woods, B. Knapp, G. Wilson August 7, 1964

Leonard Rist

Lending rate on Market Loans.-

The attached note was prepared at the request of the President, after consultation with Messrs. Cavanaugh and Cope.

att.

Cc: Mr. Cope
Mr. Cavanaugh

Leonard RIST

August 7, 1964

## LENDING RATE on MARKET LOANS

1. The rate of interest normally charged by the World Bank is related to the cost of Bank borrowing. So long as the credit of the debtor countries is not established in the market, there is no other way to determine the Bank's lending rate. The Bank is now considering whether it could charge a different rate for the countries which have an established credit in the financial markets. The question then arises what rate could be applied to these countries.

2. Logically the Bank's lending rate could be directly related to the market rate, but this raises a number of difficult issues. The market rate varies (a) from one financial market to another, (b) from one debtor country to another, and (c) according to time.

3. Variations according to markets: The differences between the yields obtaining for bonds of the same country are substantial from one market to another - and from one currency of issue to another. Swiss franc bonds of Australia yield between 4.34% and 4.75% in Zurich. Sterling bonds of the same country yield between 5.75% and 6% in London. The same is true of all other debtor countries. The biggest spread probably concerns Italy which has one bond issue in Switzerland yielding 4.65% and another one in New York yielding almost 6.50% 1/. Generally speaking, Swiss franc issues give the lowest yield, Marks and Pound sterling issues the highest, and dollar issues somewhat less than the average between these two extremes.

4. Arithmetic averages could, of course, be computed approximately, but they would not take account of the fact that the sizes of each of the markets are not comparable. Amsterdam, London (and Paris) have a system of capital issues control which gives preference to certain borrowers, e.g. members of the Commonwealth

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1/ All figures as of end June 1964.

on the London market. In Switzerland the types of borrowers are less important than timing, but the amount of each issue in Zurich is relatively small, the equivalent of $15 million being considered a sizeable bond issue. In New York the amounts are larger than in most other markets. If one country attempted to float bonds in all principal financial markets at about the same time, it would probably be able to collect in New York over one-half of the total, and it could also return to the New York market more often than to the others. The World Bank itself would not expect to issue in Europe in any given year more than about one-fifth of a total of say $500 million. It would seem therefore that both the arithmetic averages and the weighted averages of possible interest rates would point to the New York rate as providing the best test.

5. Variations from country to country: But this does not provide a full answer to the question. The obligations of various borrowing countries command various rates. Taking the New York market alone, Australian bonds yield between 4-3/4% and 5.10%; Norwegian bonds between 5% and 5-3/8%; Japanese bonds around 5.45% and Italian bonds around 5.90%. Roughly speaking, the range among these four countries is between 5% and 6%. The recent Mexico issue was a 6-1/2% at 15 years, to yield 6-3/4%, i.e. distinctly higher than the preceding instances.

6. Assuming that the New York rate were taken as a rough basis of computation, one should, of course, correct it by adding around 3/8 or 1/2% to the current yield since, in order to compute the real cost to the borrower, one must take account of (a) the issuing charges which at 2-1/2% of the principal would represent about 1/4 of 1% a year on a 15 or 20 year-bond, and (b) the premium enjoyed by already seasoned issues which may be estimated very roughly at 1/8 to 1/4% in terms of yield. This would result in a borrowing rate for Australia of around 5-1/4% to 5-1/2%; for Norway around 5-1/2% to 5-3/4%; for Japan around 5-3/4% to 6%; for Italy around 6-1/4% to 6-1/2% and for Mexico well over 7%. It is interesting to note that in the case of Australia and Norway, these rates are roughly the same as the standard lending rate of the World Bank, but that Japan and Italy would rate 1/2% to 1% higher than our standard rate, Mexico still more. These computations take no account of the exchange equalization tax, which adds roughly 1% to the annual cost of borrowing in New York.

7. Timing: In addition, yields may vary quite substantially from time to time on the same market for the same bonds. Over the last year variations in yield of as much as a quarter or a half per cent could be observed in New York and in London. This suggests that if the market rate were taken as a basis for the lending rate, the same countries would enjoy different rates according to the timing of the loan contract. At the very moment when an effort is being made to stabilize the standard lending rate of the Bank, a complicated and unpredictable pattern of rates would emerge for the most desirable debtors. Even if one market only - New York - were taken as a basis, rates would vary over time and they would vary from one borrowing country to another. In addition, countries with the best credit would be treated better than those less favored in the market, while the countries with no established credit rating would be offered the standard rate and therefore be treated best of all. Loan negotiations would become most delicate.

8. Under the circumstances, one cannot but wonder whether a single rate would not be better for the so called "market eligible" countries. Adding a fixed amount to the standard Bank rate for all market-eligible borrowers would eliminate the inequality of treatment referred to in the preceding paragraphs. It would be less logical but more practical than a series of different rates as discussed above.

9. A margin of 1%, i.e. equal to the exchange equalization tax, would have the advantage of placing the Bank above the suspicion of unduly facilitating exports of capital agains the policy of the U.S. Treasury. It would mean a 6-1/2% rate of interest for the market-eligible borrowers; this corresponds roughly, as indicated in paragraph 6, to what Australia, Norway and Japan might have to pay if they floated an issue in New York, account being taken of the equalization tax. It would, however, be lower than what Italy, and of course Mexico, would have to pay. In short, instead of basing the Bank's lending rate on the market rate for the bonds of the market-eligible countries, the World Bank would still base its own lending rate on the cost of the money to it, but at an interest premium corresponding to the interest equalization tax.

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION



CONFIDENTIAL
SSM/M/64-28
July 29, 1964

SENIOR STAFF MEETING

Room 946, July 22, 1964, 9:30 a.m.

Present: Messrs. Woods (Chairman), Wilson, Aldewereld, Alter, Broches, Cargill, Cavanaugh, Chadenet, Cope, Mendels, Moussa, Reid, Rist, Goodman, Gordon, Larsen, Wishart, Davies (Secretary)

AREA OPERATIONS

Western Hemisphere

1. Mr. Alter reported that he had discussed Mexico's borrowing program with the Minister of Finance, who had agreed to increase public investment by Mex$ 1.2 billion over the next year. The Minister had said, however, that he could not see his way to increase the power tax as previously agreed, even though, as Mr. Alter indicated, this would place an obstacle in the way of the contemplated $125-150 million power loan. The Minister had expressed the hope that the next Government might be able to take this step. The Bank would proceed to appraise the power projects on the assumption that the tax would in due course be increased. Appraisal missions were also being arranged for projects in other sectors.

South Asia and Middle East

2. Mr. Reid reported that at the July 16 "pledging" meeting of the Pakistan Consortium, commitments totalling $431 million of aid had been made for 1964-65, the last year of the five-year plan: $425 million had been pledged at the corresponding 1963 meeting for the year 1963-64, but additional contributions of $17.5 million had been made during that year. The Bank had pledged $30 million and IDA $50 million, subject to the usual provisos. The meeting had been more or less of a formality, largely because of the absence of the bargaining which had prevailed in previous years. The aid offered by Canada, France, Germany and Japan had been on better terms than in the previous year.

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Secretary's Office

Europe

3. Mr. Cope reported that:

(a) Yugoslavia would release the rest of its 9% subscription over a seven-year period.

(b) Spain had agreed not to exclude Yugoslavia from bidding for the supply of equipment under the proposed railway loan (SSM/M/64-27), if Yugoslavia did not discriminate against Spain in connection with procurement under Bank loans.

INDUS BASIN

4. Mr. Aldewereld reported that meetings of the Agricultural and Dam Sites Sub-Committees of the Indus Basin power and water resources study group had taken place in London and Boston respectively.

GENERAL TRAINING PROGRAM

5. The Committee considered the section (paragraphs 85-92) of the Report of the Committee on Training and Career Development (SSM/A/64-43) dealing with the General Training Program. There was no dissent from the recommendation made in the report that the program be discontinued.

6. It was agreed that the report would be considered as a whole at a later meeting.

MARKET LOANS

7. The meeting considered the paper on "Market Loans" (SSM/A/64-44).

8. The proposal in the paper was criticized on the grounds that for the Bank to charge certain countries a rate (or rates) of interest higher than others was inappropriate for a cooperative institution, which should charge the same rate to all its members. Moreover, it was contrary to sound banking practice to penalize the borrowers with the highest credit, and to do so would lead potential investors in the Bank's bonds to believe that the Bank was correspondingly planning to charge uneconomically low rates to its poorer borrowers. They had accepted the affiliation to the Bank of IDA, which relied on funds provided by governments, but if they thought that the Bank also was going to charge "give-away" rates, its reputation as a sound lending institution would be seriously impaired.

9. Against this view, it was urged that the Bank was not a cooperative institution in a sense which precluded it from treating different members according to their circumstances, and that a sound lender did not charge the same rate to every borrower. It was quite possible that a year later the customary formula (market rate plus 1-1/4%) for determining the Bank's interest rate might dictate a rise from 5-1/2% to 5-3/4% or 6%; it would be preferable in such circumstances to raise the rate to "market credit" countries only, keeping it at 5-1/2% for the mass of borrowers.

10. Opinions differed on whether, as the paper proposed, the Bank should charge each "market credit" country a rate based on its individual market rating, or whether it should, at a given time, apply a single "market rate" to all countries in this category. It was agreed that "market rate" was an unequivocal concept only when a Bank loan was made "in tandem" with a market issue by the borrowing country and, when there was no simultaneous market issue, the concept became hypothetical and arbitrary. In the latter case, to try to keep as close as possible to the idea of a market rate would involve the Bank in difficult and invidious estimates and an undesirable multiplicity of rates, since there was considerable difference in the market standing of the "market credit" credit countries; some could borrow at little more than 5-1/2%, while others would have to pay 6-1/2%; moreover, different rates prevailed on the New York and European markets. An arbitrary single market rate would avoid these complications; on the other hand, it would penalize the countries with higher ratings as against those with lower.

11. The Chairman said that it did not seem unreasonable to divide the Bank's borrowers into two categories, those with no market standing and those with market standing, and to charge two rates; the former a rate based upon the cost of money to the Bank, and the latter a rate <u>related</u> to what they would pay in the market.

12. In reply to the suggestion that dollar loans to market credit countries might be criticized in the U.S. as frustrating the intention of the proposed interest equalization tax, it was pointed out that, by raising its rate to such borrowers, the Bank would be making access to it more difficult for them. Its rate for such dollar loans would have to take account of the interest equalization tax.

13. It was noted that the resale in the U.S. by the Bank of "market loans" would involve S.E.C. registration of the obligations; in the case of "in tandem" issues, this would be taken care of by the bankers concerned. As regards the possibility that such resale would be regarded with disfavor by the borrowers as spoiling the market for further issues on their part, the Chairman said that he thought that there was a trend in the U.S. towards the holding of more foreign bonds which, in the long run, would make such fears groundless.

14. It was pointed out that while for some "market loans" the "specific project" link might be completely severed, it would often be desirable to retain it, though in a form more or less attenuated, according to the circumstances.

ADJOURNMENT

15. The meeting adjourned at 11:10 a.m.

C. H. Davies
Secretary

INTERNATIONAL BA FOR RECONSTRUCTION AND DEVEL MENT Rist

INTERNATIONAL DEVELOPMENT ASSOCIATION

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Date: 11/15/2010 SFB

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SENIOR STAFF MEETING

SSM/A/64-44

July 21, 1964

MARKET LOANS

The attached Aide Memoire by Mr. Cope on the above subject is circulated for discussion at tomorrow's meeting.

REPORT OF THE COMMITTEE
ON TRAINING AND CAREER DEVELOPMENT

At tomorrow's meeting paragraphs 85-92 only of the above Report (SSM/A/64-43) will be considered.

C. H. Davies
Secretary

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# MARKET LOANS

## Aide Memoire

1. For some time now I have been thinking about our policy in relation to lending to the more developed countries, and I have reached the stage at which I should like to explore some ideas with you. The prospect of further lending to Japan, Norway and possibly Italy make consideration of the matter timely.

2. When the Bank was created, the intention was to supplement, not to supplant, lending by private capital markets. While it was expected at Bretton Woods that during the immediate postwar period access by many countries to such markets would be limited, it was explicitly provided in Article III, Section 4 (ii) that the Bank should lend to a country only after it had satisfied itself that "in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which, in the opinion of the Bank, are reasonable for the borrower."

3. In the past, the Bank has acted in accordance with this provision by lending not only to the underdeveloped countries of the world, but also to those countries in Europe and elsewhere which have established market credit, but which, because of the limited absorbtive capacity for foreign issues in the major capital markets or of special factors operating in individual cases, were unable to fully satisfy their requirements for funds.

4. In recent years, however, several of these countries have succeeded in obtaining substantial amounts in foreign capital markets. The rates of interest at which funds are at present available in capital markets are generally higher than the rate charged by the Bank, but they can still be considered to be "reasonable" for the borrowers within the terms of Article III, Section 4 (ii).

5. Therefore, the question arises whether lending to these countries at rates appreciably below the rates at which the open market values their credit can continue to be justified. The amounts that can be raised in normal commercial channels by most of these countries will fall short of their requirements, and this may continue to be so for some more years. Whenever this is the case, and where the countries concerned are creditworthy and are following proper policies, further Bank lending would be justified. With funds available at lower cost from the Bank, it is virtually impossible to determine the extent to which borrowing from the Bank supplements rather than supplants borrowing from commercial sources. If borrowing from the Bank were on about the same terms as the market, there would be greater assurance that Bank funds were meeting a need that could not be met in the market. ?

6. What I have in mind is that, in the case of these countries, the Bank should make loans at rates reflecting the market rating of their bonds, or at its standard rate, whichever is higher. These loans would be disposed of at future times as opportunity offered, marketing techniques being adapted to conditions ruling at the time and place of sale.

7. It is inherent in this approach that the Bank should rely on the market's assessment of the appropriate rate of interest to be applied. I would hope and expect that a loan of this kind would be made at the same time as a public issue in the market. This, however, will not always be possible, and in such cases the rate would have to be determined after discussion with the borrower and his bankers.

8. Such loans would not necessarily be linked to projects in the narrow sense of the term. We are all aware of the strain which the increase in the Bank's membership has imposed on our technical appraisal staff. The time and labor necessary to appraise a project and follow it up are less justified in the case of projects in developed countries which are usually competently set up and operated and where, therefore, the Bank's influence and supervision are less needed. Where in these cases there appears to be no useful purpose to be served by following the Bank's usual project approach, the Bank would relate its loan to the general development of the country, and restrict itself to an overall examination of its economic situation and prospects. Such an examination would include a review of major investment needs and of the reasons why domestic resources need to be supplemented with foreign borrowing. Another variation from the usual project approach could be to identify the Bank lending with a specific project, but rely on covenants and agreements to assure the investment in the manner and for the purpose planned.

9. Such a procedure might apply to Australia, Austria, Denmark, Italy, Japan, Norway, and New Zealand. Others might be considered upon further review. The decision on which countries should come under the new procedure will not be easy to make, but would present a less difficult problem than some others we have to face. It would certainly be less difficult than deciding on eligibility for IDA credits, since in the case of a market loan we have at least market judgements and criteria as a basis for our decision.

10. I think it is important that the Bank's role of facilitating the movement of private capital into international investment should be played to the full. In recent years the Bank, in my view rightly, has concentrated on those of its members who were least developed and in consequence were least in touch with private investors. It should not be forgotten, however, that the Bank has a complementary role in relation to more developed countries, namely, to do more to create market interest in their obligations and to tide them over periods in which for one reason or another the market cannot give them what they need. These loans, because they would be at higher rates, would be easier to sell than loans at the Bank's conventional rate. I believe that these

objectives would be achieved more effectively if we were prepared in appropriate cases to make our lending procedures more flexible along the lines I have described.

11. The ideas I have outlined have many facets. I have already explored with the staff some of the implications of this proposal. Further study is needed, but so far we have not come up against any insuperable difficulties. Before, however, we go much further, I wanted to obtain your reaction on the general approach. If we agree that the matter should be pursued, I shall have a detailed study made of the proposals and have a paper prepared for your consideration.

1. Discrimination.
2. Practical difficulty of choosing basis, which makes of N.Y. tax.
3. Doubtful short sale.

S. R. Cope
July 21, 1964

INTERNATIONAL BA[illegible] FOR RECONSTRUCTION AND DEVEL[illegible]MENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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Date: 11/15/2010 STB

**FOR EARLY ATTENTION**

CONFIDENTIAL

SENIOR STAFF MEETING

SSM/A/64-41

June 30, 1964

MARKET LOANS

The attached draft of an oral statement on the above subject to be made by the President to the Executive Directors is circulated for consideration at tomorrow's meeting.

C. H. Davies
Secretary

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## Market Loans

### Draft of oral statement to be made by the President to the Executive Directors

1. For some time now I have been thinking about our policy in relation to lending to the more developed countries, and I have reached the stage at which I should like to explore some ideas with you. Two recent applications for loans from Italy and Norway and the prospect of further lending to Japan make consideration of the matter all the more timely.

2. As you know, when the Bank was set up, the intention was to supplement, not to supplant, lending by private capital markets. While it was expected at Bretton Woods that, during the immediate postwar period, access by many countries to such markets would be limited, it was explicitly provided in Article III, Section 4 (ii) that the Bank should lend to a country only after it had satisfied itself that "in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which, in the opinion of the Bank, are reasonable for the borrower."

3. In the past, the Bank has acted in accordance with this provision by lending not only to the underdeveloped countries of the world, but also to more developed countries in Europe and elsewhere which, because of the limited reception given to foreign issues in the major capital markets or of special factors operating in individual cases, would otherwise have been unable to raise the money they needed abroad.

4. In recent years, however, several of the developed countries have succeeded in obtaining substantial amounts in foreign capital markets. The rates of interest at which funds are at present available in capital markets are generally higher than the rate charged by the Bank, but they can still be considered to be "reasonable" within the terms of Article III, Section 4 (ii).

5. The question, therefore, arises whether lending to these countries at all and especially lending to them at rates below market rates continues to be justified. In my opinion, the amounts that can be raised in private markets by most of these countries will fall short of their requirements and this may continue to be so for some more years. Whenever this is the case, and where the countries concerned are creditworthy and are following proper policies, further Bank lending would be justified. With funds available at lower cost from the Bank, it is difficult, if not impossible, to determine the extent to which borrowing from the Bank supplements rather than supplants market borrowing. If borrowing from the Bank were on the same terms as the market, there would be greater assurance that Bank funds were meeting a need that could not be met in the market.

6. During the past years the Bank has been able to sell a growing proportion of its loans to the more developed countries to private investors, and it seems reasonable to expect that, apart from measures such as the proposed interest equalization tax in the U.S.A., the opportunities for such sales will continue. Thus, the role of the Bank in assisting countries which are normally able to meet in the market a substantial part of their needs for external capital should increasingly be one of tiding them over relatively short periods, until their needs can be met from the market, rather than in playing an active part over a long period in their economic development. This would not necessarily mean lending at short term. A country normally importing long-term capital from the market might find this process temporarily interrupted and would therefore need long-term capital from the Bank until the market could again satisfy its needs. What I have in mind is that, in the case of these countries, the Bank should make loans at rates reflecting the market rating of their bonds, or at its standard rate, whichever is higher, and would expect to receive bonds of a marketable type and market them through the countries' own investment bankers as suitable opportunities arose.

7. It is inherent in this approach that the Bank should rely on the market's assessment of the appropriate rate of interest to be applied. I would hope and expect that a loan of this kind would be made at the same time as a public issue in the market. This, however, will not always be possible, and in such cases the rate would have to be determined after discussion with the borrower and his bankers. The judgment should be that of the market, the decision that of the Bank.

8. These loans would not necessarily be linked to projects in the narrow sense of the term. After all, loans issued in the market are customarily for general purposes. Moreover, we are all aware of the strain which the increase in the Bank's membership has imposed on our technical appraisal staff. The time and labor necessary to appraise a project and follow it up are less justified in the case of projects in developed countries which are usually competently set up and operated and where, therefore, the Bank's influence and supervision are less needed. It may therefore be wise in the case of loans to these countries to omit detailed project appraisals, restricting ourselves to an overall examination of their economic situation and prospects. Such an examination would include a review of their major investment needs and of the reasons why they need to supplement domestic resources with foreign borrowing.

9. Conceived in this way the proposal might apply to the following countries: Australia, Austria, Denmark, Italy, Japan, Norway, and New Zealand. Some of these countries may be borderline cases. Others which I have not mentioned might be considered upon further review. The decision on which countries should come under the new procedure will not always be easy to make, but this would be a less difficult problem than some of the others we have to face daily. It would certainly be less difficult than deciding on eligibility for IDA credits, since in the case of a market loan we have at least market judgments and criteria as a basis for our decision.

10. I think it is important that the Bank's role of facilitating the movement of private capital into international investment should be played to the full. In recent years the Bank, in my view rightly, has concentrated on those of its members who were least developed and in consequence were least in touch with private investors. We must not forget, however, that there is a complementary role in relation to more developed countries, namely to do more to create market interest in their obligations and to tide them over periods in which for one reason or another the market does not give them what they need, while at the same time not locking up too much capital in loans that we cannot sell out of portfolio. I believe that these objectives would be achieved more effectively if we were prepared in appropriate cases to make our lending procedures more flexible along the lines I have described.

11. The ideas I have outlined have many facets. I have already explored with the staff some of the implications of this proposal. Further study is needed but, so far, we have not come up against any insuperable difficulties. Before, however, we go much further I wanted to obtain your reaction on the general approach. If we agree that the matter should be pursued, I shall have a detailed study made of the proposals and have a paper prepared for your consideration.

S. R. Cope
June 30, 1964