L.B. Rist: Loan Policy, Reserves

(1)

Confidential

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

Mr Feit

Date:

Attached are two recent reports of the IMF, which are sent to us for our Depts. internal & Confidential use only. Since they have to do with distribution of IMF net income, I thought they might be of current interest to you. Please returns them to me when you have seen

Donald D. Fowler
Deputy Secretary

8/22/66

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Legal Aspects of Article XII, Section 6 - Distribution of Net Income

Exception(s)

Attorney-Client Privilege

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Chandra Kumar	31-Oct-14

1- Egypt
2 - proportion to outstanding
3. The 20's and 30's to other markets

ANNEX B

Defaults on Sterling Bonds of
Governments and Political Subdivisions
from 1825 to 1930

A tabulation of defaulted sterling bonds issued by foreign governments and political subdivisions during the hundred years ending in 1930 is attached. Although this table provides a good illustration of the defaults which occurred it does not cover all the defaults in this period. Defaults also occurred on government bonds issued in other currencies, e.g. francs, marks and dollars. The London market has been chosen both because the number of foreign issues floated in London was greater than in any other market and because more information is available about the sterling issues than about other bonds. The table is in two parts. The figures for the period from 1825 to 1870 are not entirely comparable with the figures shown for the period from 1871 to 1930. For the earlier period the amounts shown are the total principal amounts of the bonds on which defaults occurred, while the later figures represent the outstanding principal amounts actually in default.

The defaults shown were not all total losses. There were many readjustments which reduced the apparent losses to the investing countries. In this connection, it would be interesting to know the total amounts outstanding on all foreign government sterling bonds in order to determine the proportion of defaulted bonds as related to the total outstanding. The information necessary for such a study is not available but some guidance can be found in a report made in 1875 by a Select Committee of the House of Commons on Loans to Foreign States. It recorded that about 54% of all foreign government issues were in default in the early 1870's. The

percentage of defaults must have been even higher in the late 1870's with the addition of the Turkish defaults. The best estimates available are that the ratio of defaulted bonds to the total was about 15% in the 1820's, that it rose to the high point already mentioned in the 1870's, and that it went down to a low of below 5% in 1910.

The largest single default was the repudiation of Czarist Russia's debt by the Revolutionary Government after the first world war, while the second largest default occurred in Turkey in the late 1870's. Leaving aside these two conspicuous cases which arose under rather special circumstances, the movement of defaults over the hundred years under review may be divided into four periods.

The first period coincides with the second quarter of the last century. Defaults rose from £15 million in 1825 to a peak of £45 million in the late thirties and declined to £8 million by 1845. This temporary rise in defaults was due entirely to the insolvency of Spain.

The second period covers fifty years from 1846 to 1895 and includes the depression of the seventies. The total of defaults rose from £8 million to £88 million which was the highest peak attained during the hundred years' period. About £30 million of the increase occurred before the depression and was attributable mainly to the Mexican defaults which started in the late forties. During the depression of the seventies the number of defaulting countries rose from four to thirteen and new defaults amounted to £50 million of which about two-thirds was due to the default of Peru. Both Mexico and Peru resumed the service on their debts in the early nineties with the result that the total of defaults dropped to about £9 million by the end of the period.

During the third period of twenty years from 1896 to 1915, and during the last period of fifteen years from 1916 to 1930, total defaults rose to £46 and £63 million respectively. The increase in the amount of suspended payments was due to the Argentine default in the third period and to a new Mexican default in the fourth period.

Thus excluding Russia and Turkey there occurred four major defaults during the hundred years under review.

	Defaulted amount maximum £ million	Approximate duration of maximum default
Spain	33.3	1837-41
Argentine	36.3	1891-96
Peru	32.9	1876-88
Mexico	55.0	1917-21

The immediate causes for the defaults are manifold. The period of hundred years was characterized by far-reaching political changes in South America and the Balkans. Political instability, recurrent revolutions and wars, poor administration, over-borrowing and sudden interruptions in the inflow of foreign capital were primarily responsible for most of the payments difficulties. Although the largest wave of defaults coincided with the depression of the 1870's, it is difficult to establish any clear causal relationship between depressed conditions in the world markets and the defaults by individual countries. It seems that the fall in the price of a leading export commodity, which almost suggests itself as a likely cause for default, was generally only a contributing and aggravating factor after internal conditions had already deteriorated. The only significant exception where the default can directly be related to a major economic change is perhaps Peru whose default in the 1870's followed the exhaustion of its best guano deposits.

STERLING BONDS OF FOREIGN GOVERNMENTS AND POLITICAL SUBDIVISIONS IN DEFAULT

1825 to 1930

£ million

Year	Europe			Ottoman Empire	Russia	Africa	Latin America														United States	Total
	Greece	Portugal	Spain			Liberia	Argentina	Bolivia	Brazil	Chile	Colombia	Costa Rica	Dominican Republic	Ecuador	Guatemala	Honduras	Mexico	Nicaragua	Paraguay	Peru	Uruguay	Venezuela	
Figures shown from 1825 to 1870 represent total principal amounts at time of issue																						
1825-1830	2.8	-	-	-	-	-	1.0	-	-	1.0	3.4	-	-	-	0.1	-	6.4	-	-	-	-	-	-	14.7
1831-1835	2.8	-	-	-	-	-	1.0	-	-	1.0	3.4	-	-	-	0.1	-	6.4	-	-	-	-	-	-	14.7
1836-1840	2.8	-	33.3	-	-	-	1.0	-	-	1.0	-	-	-	-	0.1	-	6.4	-	-	-	-	-	-	[illegible]6
1841-1845	2.8	-	33.3	-	-	-	1.0	-	-	1.0	-	-	-	-	0.1	-	-	-	-	-	-	-	*	38.2
1846-1850	2.8	-	-	-	-	-	1.0	-	-	-	-	-	-	-	0.1	-	0.4	-	-	-	-	3.8	*	8.1
1851-1855	2.8	4.5	-	-	-	-	1.0	-	-	-	-	-	-	-	0.1	-	10.6	-	-	-	-	3.8	*	22.8
1856-1860	2.8	4.5	-	-	-	-	1.0	-	-	-	-	-	-	-	-	-	10.6	-	-	-	-	3.8	*	22.7
1861-1865	2.8	4.5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	23.0	-	-	-	-	5.4	*	35.7
1866-1870	2.8	-	-	-	-	-	-	-	-	-	-	-	-	1.8	-	-	27.9	-	-	-	-	6.9	*	39.4
Figures shown from 1871 to 1930 represent total principal amounts at time of default																						
1871-1875	2.8	-	-	-	-	0.1	-	1.7	-	-	-	3.3	0.7	-	0.5	3.5	27.9	-	1.5	-	-	6.9	*	48.9
1876-1880	2.4	-	-	197.4	-	0.1	-	1.7	-	-	-	3.3	0.7	1.8	0.5	5.4	27.9	-	1.5	32.9	3.2	6.6	*	285.4
1881-1885	-	-	-	190.9	-	0.1	-	-	-	-	-	2.4	0.7	1.8	0.5	5.4	27.9	-	1.5	32.9	-	-	*	264.1
1886-1890	-	-	-	-	-	0.1	-	-	-	-	1.9	2.7	0.7	1.8	0.5	5.4	29.4	-	1.5	31.8	-	-	*	75.8
1891-1895	-	-	-	-	-	0.1	-	-	-	-	1.9	-	-	1.8	-	5.4	-	-	-	-	-	-	*	9.2
1896-1900	-	-	-	-	-	0.1	36.3	-	-	-	1.9	2.0	-	0.7	-	5.4	-	-	-	-	-	-	*	46.4
1901-1905	-	-	-	-	-	-	17.8	-	-	-	2.7	-	3.9	-	1.5	5.4	-	-	-	-	-	-	*	31.3
1906-1910	-	-	-	-	-	-	-	-	-	-	-	2.0	-	-	1.5	5.4	-	-	-	-	-	-	*	8.9
1911-1915	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1.5	5.4	-	-	-	-	-	-	*	6.9
1916-1920	-	-	-	-	-	-	-	-	-	-	-	-	-	2.3	-	5.4	35.5	-	-	-	-	-	*	43.2
1921-1925	-	-	-	-	1,746.7	-	0.3	-	-	-	-	-	-	2.3	-	5.4	55.0	-	-	-	-	-	*	1,809.7
1926-1930	-	-	-	-	1,746.3	-	0.3	-	5.9	-	-	-	-	2.3	-	5.4	4.1	-	-	-	-	-	*	1,[illegible]

Source: Annual Reports of theCorporation of Foreign Bondholders, London.

* The Corporation of Foreign Bondholders has not been able to obtain reliable information on the defaulted bonds of certain Southern States. Some of these bonds were repudiated by individual states and others (confederate bonds) were cancelled by the Fourteenth Amendment to the Constitution of the United States.

ANNEX C

Capital structure, reserves and dividends of various medium- and long-term finance institutions.

Two world wars and the great depression of the thirties have led to the establishment of a large number of medium- and long-term finance institutions which had no parallel in the past.

However, the Bank together with its recently established affiliate - the International Finance Corporation - are the only institutions of a genuine international character. The Bank's capital stock is held by a large number of member governments, its bond issues find access to all the major capital markets and its loans are on a world-wide scale. No other institution shows in its constitution the joint presence of these three characteristics, except - in a more limited sense - the European Investment Bank which is planned to be established under the Common Market Treaty. Most of the existing medium- and long-term finance institutions draw their funds primarily from domestic sources and restrict their operations either to their national economies or, as in the case of France and the United Kingdom, to the economies of their respective commonwealth area. Only the Export-Import Bank is making loans on a world-wide basis like the Bank; it is however not dependent for the continuation of its operations on borrowing in the market.

Thus, at present there is no other lending institution which would be fully comparable with the Bank. Nevertheless all the other institutions do accumulate reserves against losses in order to protect their creditors and to maintain their capital intact.

The attached tables show the position of a selected number of institutions classified into three categories. Table I covers the category of international institutions operating on an international scale; it lists four such institutions, namely the IBRD, the IFC, the proposed European Investment Bank and the Coal and Steel Community. Table II comprises four national institutions operating on an international scale; these are the Export-Import Bank, the Commonwealth Development Finance Company, the Colonial Development Corporation and the Caisse Centrale de la France d'Outre-Mer. Table III shows the position of some of the national institutions operating on a national scale.

As for the first category, the capital of the European Investment Bank, like that of the IBRD and the IFC, would consist of government participations, whereas the Coal and Steel Community has no subscribed capital. Both of these institutions have power to raise additional funds in the market or to borrow from other sources.

At the end of the last financial year 1955/56, the IBRD maintained reserves representing about 15% of loans outstanding and 28% of bonds outstanding. The Coal and Steel Community has so far restricted its borrowing and lending operations to the approximate level of the guarantee fund established by its member governments. The European Investment Bank would be under the obligation to accumulate reserves equal to 10% of its subscribed capital; this formula, if applied to IBRD, would call for reserves of $926 million as compared to $266 million as of March 31st.

In the second category the Export-Import Bank is by far the largest institution. Its reserves amount to 16% of loans outstanding and 36% of

funds borrowed from the Treasury. In 1951 when reserves reached a level equal to 10% of loans outstanding, the Export-Import Bank began to pay a dividend of 2% which was raised to 2¼% in 1953 and has been maintained at this level since.

As for the Caisse Centrale de la France d'Outre-Mer, its lending operations consist, for three-quarters, of advances to overseas territories and for one-quarter, of advances controlled by a French government investment fund (FIDES). Although it has statutory power to borrow in the market, it has so far obtained all its funds from the French Government. After covering administrative expenses and providing for interest payments to the government, there seems to be no net earnings left for accumulating reserves. In fact the Caisse Centrale carries only a very small reserve which has remained unchanged during the last five years.

The capital stock of the Commonwealth Development Finance Company is held partly by the Bank of England and partly by private corporations; additional funds are borrowed from private sources. The Company seems to have reached the stage where it will be possible to begin the accumulation of reserves.

The Colonial Development Corporation has no share capital, it obtains all its funds from the government. The Corporation has suffered substantial losses which are being gradually written off out of current earnings.

The third category consists of a large number of medium- and long-term finance institutions, including the various development institutions established after the second world war. The institutions listed in Table III have been so selected as to illustrate the major characteristics of this

category.

Capital structure, reserves and dividends in this category vary a great deal from institution to institution.

The capital stock is usually divided between the government, the central bank and other shareholders, including private or nationalized banking institutions. Additional funds are raised by issuing bonds or by borrowing, in various forms, from the government or other domestic sources, and in some cases also from external sources such as the IBRD.

Except for the Herstelbank, and the Reconstruction Finance Corporation which is a special case, reserves are rather low if related either to the amount of commitments or to the amount of borrowed funds. This is due in part to the fact that included in the amount of commitments is, in some cases, a large volume of operations either guaranteed by the government or carried out on behalf of the government. Moreover the need for reserves is reduced by the fact that the borrowers are generally required to provide adequate commercial security such as bank guarantees, mortgages or collateral deposits. Another factor tending to reduce the level of reserves is the distribution of dividends which in some cases are comparatively high.

The above analysis leads to the conclusion that the accumulation of reserves is a common characteristic of all the institutions listed in the three tables. The extent however to which such reserves have actually been set aside depends in each case on the particular nature and structure of operations carried on by the individual institution.

TABLE 1

INTERNATIONAL INSTITUTIONS OPERATING ON AN INTERNATIONAL SCALE

Institution	Million U.S. dollars						Percentages Reserves to	
	Subscribed capital	Capital paid in	Reserves	Borrowed funds	Loans and guarantees outstanding	Dividend	Loans and guarantees outstanding	Borrowed funds
I.B.R.D. (March 1957)	9,265	1,111	266	948	1,741	-	15.3	28.1
I.F.C. (April 29, 1957)	92	92	-	-	-	-	-	-
Proposed European Investment Bank	1,000	250	100	-	-	-	-	-
European Coal and Steel Community (April 30, 1956)	none	-	100	113	101	-	99.-	88.5

General notes

Reserves include unallocated profits and special reserves.

Loans - The term is used to mean loans disbursed and outstanding.

Specific notes

I.B.R.D.

Paid-in capital excludes the amount shown on the balance sheet as "receivable on account of subscribed capital".

Loans include $23 million of loans sold with the Bank's guarantee.

European Investment Bank

Reserves are to attain a minimum of 10% of the subscribed capital.

European Coal and Steel Community

Reserves represent the guarantee fund which recently reached the statutory minimum of $100 million.

Borrowed funds include $100 million from Ex-im bank.

TABLE 2

NATIONAL INSTITUTIONS OPERATING ON AN INTERNATIONAL SCALE

Institution	In national currencies as indicated										Percentages		
	Subscribed capital	Capital paid in: Government 1/	Capital paid in: Private	Capital paid in: Total	Reserves	Borrowed funds: Government 1/	Borrowed funds: Private	Borrowed funds: Total	Loans 2/	Dividend	Reserves to Loans 2/	Reserves to Borrowed funds	Dividend to Capital paid in
Export-Import Bank - U.S.A. ($000.000-Dec. 1956)	1,000	1,000	-	1,000	435	1,197	-	1,197	2,636	22.5	16.5	36.3	2.25
Commonwealth Development Finance Co. Ltd. - U.K. (£000-March, 1956)	15,000	2,025	825	2,850	17	-	5,985	5,985	8,728	-	0.2	0.3	-
Colonial Development Corporation-U.K. (£000-Dec.1955)	none	-	-	-	-	47,494	1,483	48,977	37,845	-	-	-	-
Caisse Centrale de la France d' Outre-Mer-France (Ffr.000.000-Dec. 1955)	2,500	2,500	-	2,500	500	186,306	-	186,306	178,689	-	0.3	0.3	-

1/ Including government institutions.

2/ Including participations and guarantees - amounts outstanding.

Notes to Table 2

General notes

Reserves include unallocated profits and special reserves.
Loans - The term is used to mean loans disbursed and outstanding.

Specific notes

Export-Import Bank

"Loans, participations and guarantees" exceed the total of capital, reserves and borrowed funds because the latter are exclusive of "liabilities on loans disbursed by commercial banks".

Commonwealth Development Finance Co.Ltd.

Reserves - The low level of reserves is due to the fact that profits earned since the beginning of operations in 1953 have been used to write off initial expenses.

Colonial Development Corp.Ltd.

Capital - The corporation has no share capital, it obtains all its funds from the government.

Losses - The corporation has sustained substantial losses; the amount still to be written off amounted to £10 million at the end of 1955.

Caisse Centrale de la France d'Outre-Mer

Capital - The "Caisse" has no share capital; the amount shown as capital has been appropriated from the budget.

Loans include operations on behalf of the government or guaranteed by the government.(Operations of the issue department are small and have been disregarded).

TABLE 3

NATIONAL INSTITUTIONS OPERATING ON A NATIONAL SCALE

In national currencies as indicated

Institution	Subscribed capital	Capital paid in			Reserves	Borrowed funds				Loans[2]	Dividend	Percentages		
		Government[1]	Private	Total		Government[1]	Private	Foreign	Total			Reserves to Loans[2]	Reserves to Borrowed funds	Dividend to Capital paid in
Reconstruction Finance Corp. U.S.A. ($000.000-June 1953)	100	100	-	100	317	287	-	-	287	662	-	47.9	110.5	-
Finance Corp. for Industry Ltd. - U.K. (£000-March 1956)	25,000	166	334	500	921	-	41,152	-	41,152	41,239	17	2.2	2.2	3.4
Industrial and Commercial Finance Corp.Ltd. U.K.(£000 - March 1956)	15,000	-	7,500	7,500	2,650	-	22,000	-	22,000	32,193	216	8.2	12.0	2.9
Crédit National - France (Ffr.000.000- Dec.1955)	2,100	-	-	2,100	6,655	279,502	59,842	-	339,344	356,581	173	1.9	2.0	8.2
Herstelbank- Netherlands (fl.000.000 - Dec. 1955)	300	151	149	300	49	67	81	16	164	433	8	11.3	29.9	2.7

1/ Including government institutions.

2/ Including participations and guarantees - amounts outstanding.

TABLE 3 CONTINUED.

Institution	In national currencies as indicated										Percentages		
	Subscribed capital	Capital paid in: Government 1/	Capital paid in: Private	Capital paid in: Total	Reserves	Borrowed funds: Government 1/	Borrowed funds: Private	Borrowed funds: Foreign	Borrowed funds: Total	Loans 2/	Dividend	Reserves to Loans 2/	Reserves to Borrowed funds	Dividend to Capital paid in
Société Nationale de Crédit à l'Industrie - Belgique (Bfr.000.000- Dec. 1956)	410	41	175	216	220	2,546	20,019	-	22,565	19,697	25	1.1	1.0	11.6
Kreditanstallt für Wiederaufbau - Germany (DM000.000 - Dec. 1955)	1	1	-	1	210	3,956	889	-	4,845	5,291	-	4.0	4.3	-
Instituto Mobiliare Italiano-Italy (lire 000.000- March 1955)	5,511	-	-	1,653	16,134	-	218,892	21,236	240,128	266,588	133	6.1	6.7	8.0
Mediobanca - Italy(lire 000.000-June 1955)	3,000	-	3,000	3,000	706	-	52,172	-	52,172	38,018	210	1.9	1.4	7.0
Nacional Financiera, S.A.- Mexico (Pesos 000.000- Dec. 1955)	200	-	-	200	78	-	-	-	2,186	2,449	12	3.2	3.6	6.-

1/ Including government institutions.

2/ Including participations and guarantees - amounts outstanding.

TABLE 3 CONTINUED

Institution	In national currencies as indicated											Percentages		
	Subscribed capital	Capital paid in: Government[1]	Capital paid in: Private	Capital paid in: Total	Reserves	Borrowed funds: Government[1]	Borrowed funds: Private	Borrowed funds: Foreign	Borrowed funds: Total	Loans[2]	Dividend	Reserves to Loans[2]	Reserves to Borrowed funds	Dividend to Capital paid in
Banco de Desenvolvimento Economico-Brazil (Cruzeiros 000,000-Dec. 1954)	20	20	-	20	72	2,333	-	540	2,873	2,032	-	3.5	2.5	-
Corporacion de Fomento de la Produccion - Chile (Pesos 000.000-Dec. 1954)	none	14,854	-	14,854	1,255	1,735	-	6,216	7,951	18,565	-	6.8	15.8	-

1/ Including government institutions.

2/ Including participations and guarantees - amounts outstanding.

Notes to Table 3

General notes

Reserves include unallocated profits and special reserves; the existence of hidden reserves, in some cases, is possible and even probable.

Loans, participations and guarantees - Owing to the inclusion of guararantees, the amount shown under this heading is, in some cases, larger than the combined total of capital, reserves and borrowed funds. In the case of three institutions, namely the Credit National, the Société Nationale de Crédit a' l'Industrie and the Herstelbank, the balance sheets include operations guaranteed by the government or carried out on behalf of the government; they also include advances made in order to prefinance payments due by the government on account of war damages.

Specific notes

Reconstruction Finance Corporation

Status - The corporation entered into liquidation in 1954.

Reserves - The high level of reserves as compared to the other magnitudes is due mainly to the fact that no dividends have been paid until reserves reached $250 million.

Finance Corp. for Industry

Capital - The amount shown under "Government or government institutions" has been subscribed by the Bank of England.

Dividend - Net of income tax.

Industrial and Commercial Finance Corp.

Capital - A smallproportion has been subscribed by the Bank of England.

Crédit National

Capital is held mainly by nationalized banks.

Loans, participations and guarantees - Short-term acceptance credits to finance government expenditures have been excluded. (This branch of operations will not continue).

Société Nationale de Crédit à l'Industrie

Borrowed funds - amount shown under "Government or government institutions" consists of E.R.P. counterpart funds and advances from the Treasury. Bond issues are guaranteed by the government.

Kreditanstallt für Wiederaufbau

Reserves - include DM 129 million from E.R.P. counterpart funds.

Borrowed funds - amount shown under "Government or government institutions" consist mainly of E.R.P. counterpart funds.

Instituto Mobiliäre Italiano

Capital - many semi-public institutions are among the shareholders.

Mediobanca

Capital - held by the three big commercial banks.

Reserves - a large amount of hidden reserves appears probable.

Borrowed funds consist exclusively of time deposits. Therefore, a high degree of liquidity is maintained and this explains the large excess of "Borrowed funds" over "Loans, participations and guarantees".

Notes to Table 3 Continued

Nacional Financiera

Capital - The government holds a small majority; the rest being held by financial and investment institutions.

Borrowed funds include an unspecified amount of foreign loans.

Banco de Desenvolvimento Economico

Capital - Consists of U.S. counterpart funds and the proceeds of specific taxes assigned to the corporation.

Borrowed funds - The large excess over "loans, participations and guarantees" is due mainly to the fact that funds still to be received by the corporation from the Treasury are included in "Funds borrowed".

Corporacion de Fomento

Capital - is currently accumulating from government appropriations.

Victor Wouters

May 6. 1957

Statutory Provisions with respect to Reserves and Dividends

1) I.B.R.D.

The charter of the Bank states that the amount of commissions received on account of its guarantees and loans shall be set aside as a special reserve.

As to other reserves or dividend payments, no specific provision is made for maximum or minimum levels.

2) I.F.C.

The statutes provide that: the Board of Governors may determine from time to time what part of the Corporation's net income and surplus, after making appropriate provision for reserves, shall be distributed as dividends.

3) Proposed European Investment Bank

The statutes provide for the constitution of a reserve fund which should amount to at least 10% of the subscribed capital. If the Bank's obligations justify such action, the Board of Directors may decide to constitute additional reserves.

There is no specific provision with respect to maximum or minimum dividendspayments.

4) European Coal and Steel Community

The Treaty constituting the European Coal and Steel Community provides for the establishment of a reserve fund. This fund has never been established. Instead the High Authority has decided to establish a guarantee fund in the amount of 100 million dollars. This fund serves the same purpose as a reserve fund but it has been accumulated out of the levies.

As there exists no fixed capital the Treaty does not mention the question of dividends.

5) Export-Import Bank - U.S.A.

The statutes do not contain any maximum or minimum provisions with respect to reserves and dividends. They merely state that: "Net earnings of the Bank after reasonable provision for possible losses shall be used for payment of dividends on capital stock".

6) Commonwealth Development Finance Co. - U.K.

The statutes do not contain any provisions as to maximum or minimum reserves and dividends. It is stated that: "No dividends shall

be payable except out of the profits of the Company, or in excess of the amount recommended by the Board".

7) Colonial Development Corp. - U.K.

The charter explicitly states that: "The Corporation shall establish a reserve fund". On the other hand there is no provision at all with respect to dividend payments, probably, because the Corporation has no share capital.

8) Caisse Centrale de la France d'Outre-Mer - France.

The statutes do not contain any provision with respect to maximum or minimum reserves. However, they explicitly state that the "Caisse Centrale" shall not distribute any profits. All profits, after making allowance for depreciation, are to be put into reserve.

9) Reconstruction Finance Corporation - U.S.A.

With regard to reserves, the statutes provide that: "The accumulated net income shall be determined after provision for reasonable reserves for uncollectibility of loans and investments outstanding."

Dividends: "within six months after the end of each fiscal year ..... the Corporation shall pay over to the Secretary of the Treasury as miscellaneous receipts, a dividend on its capital stock owned by the United States of America, in the amount by which its accumulated net income exceeds $250 million."

10) Finance Corporation for Industry Ltd. - U.K.

The Statutes state that the Board may, before recommending any dividend, set aside out of the profits of the Corporation such sums as it thinks proper to reserve to meet depreciation, losses, liabilities or claims upon the Corporation or contingencies, etc. The Board may also carry over such profits as it deems expedient in the interest of the Corporation.

The statutes provide that a dividend shall be paid subject to the above provisions with respect to a reserve.

The statutes do not contain any provision with respect to maximum or minimum reserves and dividends.

11) Industrial and Commercial Finance Corporation Ltd. - U.K.

The statutes do not contain any specific provision as to maximum and minimum reserves and dividends. They merely say that the Corporation may pay regular and interim dividends when justified by the profits of the Corporation. The Board may also, from time to time, set aside out of profits and carry to reserves such sums as it thinks proper. The Board may also,without placing the profits into reserve, carry them over to the following year.

12) Credit National - France.

According to the statutes, the distribution of net profits will proceed as follows:

(i) 5% shall be put into reserve. This stipulation ceases to be obligatory after the reserves have reached 10% of the authorized capital.

(ii) 6% shall be paid as dividend on the paid in capital.

(iii) The Board may decide to put the remaining profits into supplementary reserves or to carry forward to the next year.

(iv) The remaining profits will be divided into two parts in proportion, on the one hand to the obligations guaranteed by a budgetary annuity and whose proceeds financed the loans extended by the institution and, on the other hand, to the capital of the Corporation, to its reserves (except those reserves against defaults on "contrats en cours") and to the obligations not guaranteed as before. Of the first portion, 50% goes to the government and 50% goes to the shareholders. The second portion goes entirely to the shareholders.

The profits remaining, with reference to the stipulation in this last paragraph, are computed after all the deductions mentioned before have been made and also after reimbursement is made to the government of its advances in connection with medium-term credits.

13) Herstelbank - Netherlands

According to the statutes, the distribution of profits shall proceed as follows:

(i) Profits of a particular year shall first of all be devoted to cover losses of previous years.

(ii) 20% of the remaining profits shall be put into reserve until this reserve attains one-quarter of the subscribed capital.

(iii) Out of the rest, and as much as possible, a primary dividend of maximum 3½% of the nominal amount of the shares shall be distributed to the shareholders, starting first with the holders of 'B' shares (private).

(iv) The remaining profits are paid out to the government to the extent necessary for reimbursement of sums paid on account of its guarantees on loans for the benefit of the Bank and payment of the primary dividends on 'B' shares.

(v) The General Meeting of the shareholders shall decide upon the distribution of the remaining profits, except that they cannot be used for payment of another dividend on 'B' shares.

14) Societe Nationale de Credit a l'Industrie - Belgium.

The statutes provide that net profits, which is profit after deduction of amortization charges, shall be distributed as follows:

(i) 5% will be put into reserve.

(ii) An amount sufficient to pay a net dividend of 5% on the paid in capital will be deducted.

(iii) An amount to be decided upon by the Board of Directors, shall be set aside for the benefit of the officers and employees.

(iv) Of the remaining profit, 50% shall be devoted to the constitution of extraordinary reserves; this proportion may be reduced to 25% when these reserves are equal to the authorized capital. The remaining 50% or 75% shall be used as decided by the Board of Directors. If the Directors decide to distribute a second dividend, the government shall receive a sum equal to half the amount set aside for the distribution of a second dividend.

The constitution of extraordinary reserves ceases to be obligatory as soon as these reserves attain twice the amount of the authorized capital.

15) Kreditanstalt Für Wiederaufbau - Germany.

According to Article 10 of the Law, the legal reserves of the institution have to amount to 10% of the sum total of (a) the capital, (b) the loans outstanding, (c) the guarantees. Any net income afterwards shall be paid out as a dividend on the subscribed capital.

In addition to this legal reserve the Kreditanstalt has accumulated a "Reserve formed from resources of the ERP Special Fund". This reserve fund is not mentioned in the statutes. It consists of funds received from the German Marshall Plan Administration. These funds are becoming free as Germany pays back dollar grants received from the U.S.

16) Istituto Mobiliare Italiano - Italy.

According to the statutes, the profits of the Istituto Mobiliare Italiano shall be distributed as follows:

(i) 20% shall be credited to the reserve fund.

(ii) A dividend of 5% on the paid in capital shall be distributed to the member institutions.

(iii) The remaining balance (after refund to the government of payments made under guarantee obligations) shall be divided as follows: 75% shall be credited to the reserve fund and 25% shall be distributed pro-rata among the members.

The government guarantees sums due to member institutions under (ii) above.

Profits from resale of securities and profits due to increased value of securities owned by the Istituto Mobiliare Italiano, shall constitute a special "securities fund" to be drawn upon in cover of any losses resulting from the resale of securities and decrease in value of securities owned by the Istituto Mobiliare Italiano.

17) Nacional Financiera - Mexico.

The annual net profits of the Company shall be distributed as follows:

(i) 10% of the profits shall be put into reserve until this reserve attains an amount equal to the subscribed capital.

(ii) The shareholders which represent a qualified majority of shares at the general meeting, can decide to set aside funds for special social benefits or any other such purposes.

(iii) Up to 10% of the surplus shall be paid to the functionaries and employees of the Company; these bonuses shall not exceed 30% of their annual salaries.

(iv) If the assembly so decides, of the remaining profits a bonus may be distributed to the Directors of the Company, with this restriction, that the bonus shall not exceed their annual earnings.

(v) Of the rest, an amount shall be put aside to distribute a dividend of 7% on the paid in capital of shares 'A-I' and 'A-II'(Federal Government).

(vi) Of the remaining profits, a dividend of 7% shall be paid on the paid in capital of 'B' shares.

(vii) Of the rest, a dividend of 2% shall be paid on the nominal value of 'A-I' and 'A-II' shares.

(viii) Of the remaining profits, a dividend of 2% shall be paid on the nominal value of 'B' shares.

(ix) The remaining profits shall be distributed proportionally to the number and the value of the shares of both series.

(x) No dividend shall be paid out when no funds are available for their payment after the amounts have been deducted in connection with (i), (ii) and (iii) above.

18) Mediobanca - Italy.

According to the statutes, 10% of net profit shall be put into reserve. After allowance has been made for compensation to be paid to the Board of Directors, the distribution of the remaining profit shall be decided by the General Meeting, upon proposal by the Board.

19) Banco Nacional de Desenvolvimento Economico - Brazil

The statutes provide for the establishment of a special reserve in order to assure the regular payment of amortization and interest charges on Economic Re-equipment bonds, issued by the Bank. This reserve is constituted with means obtained from taxes, surcharges, income and contributions instituted by law or derived from the operations of the Bank.

The net profits of the Bank shall be put into reserve; at the time they reach an amount equal to the capital of the Bank, they shall be incorporated.

20) Corporacion de Fomento de la Produccion - Chile.

The basic law by which the corporation was created and organized, does not contain any specific provisions with regard to the distribution of profits, formation of reserves or payment of dividend.

DRAFT
April 29, 1957

MEMORANDUM

Principal considerations to be taken into account by the Bank in reaching conclusions about the appropriate levels of Bank reserves.

I. Scope of memorandum

This memorandum is prepared in response to suggestions made by several Executive Directors at the January 15th meeting of the Financial Policy Committee. It makes no attempt to suggest a formula for determining the level of reserves. Indeed, it is the view of the staff that that determination cannot be made on the basis of a formula; it calls for a continuing re-examination of all relevant factors by the Executive Directors and the Board of Governors. That such a re-examination should take place at least annually is contemplated by the Articles of Agreement (Article V, Section 14(a)). The factors which the staff considers relevant are set out in this memorandum.

Unless otherwise stated, the word "reserves", as used in this memorandum, refers to statutory loan commissions and to accumulated earnings, whether allocated to the special reserve or the supplemental reserve or held as surplus.

II. Preliminary points

Three preliminary points must be made:

(a) Ordinary business and banking rules and standards cannot be applied automatically to the reserve policy of the

Bank. The Bank differs from other banking institutions in many important ways, including the following:

(i) It follows from the general objectives of the Bank and the nature of its operations that the Bank's loans are inherently more risky than those which the private market is willing to undertake. Indeed, the Articles of Agreement authorize loans to be made only if private lenders are unwilling to risk their capital on reasonable terms.

(ii) The Bank's Articles of Agreement impose certain limitations not customarily found in the capital structure of other financial institutions. Unloaned 18% capital and principal repayments on loans out of capital are not immediately available to meet the Bank's obligations arising out of its own borrowings or guarantees (Article II, Section 5 and Article IV, Section 7). Funds held in the special reserve, on the other hand, may be used for no other purpose except to meet the Bank's liabilities and probably, though this question of interpretation has never been decided, only "in cases of default on loans" (Article IV, Sections 6 and 7). And there is at least a question whether dividends can be paid out of previously accumulated surplus or reserves as well as out of current year's earnings (Article V, Section 14).

(b) For the purposes of this memorandum, the 80% liability of

members should not be regarded as a source of protection to the Bank as a going institution, even though that liability is perhaps the most important single element of the Bank's credit. The 80% should rather be looked upon as a last resource to be availed of for the ultimate protection of the Bank's bondholders, almost as in the case of a bankruptcy or liquidation. The only prudent assumption for the Bank to make is that a call on the 80% might make it very difficult for the Bank's operations to continue. Accordingly, the 80% liability should be disregarded in arriving at a policy with respect to reserves.

(c) A determination of the desired level of Bank reserves does not automatically determine the appropriate level of loan charges. It is certainly an element of the latter decision but it is not the only consideration or even the decisive one. Even if reserves should reach what is considered to be a satisfactory level, the Executive Directors might decide not to reduce loan charges either (i) because to do so might result in a rate considerably lower than must be paid by those Bank members who can borrow in the private market; (ii) to facilitate participations and portfolio sales; or (iii) to assure a margin of earnings for distribution as dividends.

III. The problem of liquidity

The problem of fixing the level of Bank reserves should not be confused with the problem of maintaining a satisfactory degree of liquidity in the Bank's assets. The Bank needs liquid assets, if only to meet its immediate operating requirements to service its own obligations and to disburse under approved loan commitments. The distinction between level

of reserves and degree of liquidity is admittedly somewhat blurred in the Bank's capital structure by the requirement of Article IV, Section 6, that the special reserve is to be held in liquid form. Since there is no such statutory requirement with respect to the supplemental reserve, the latter contributes directly to the Bank's liquidity position only to the extent that amounts appropriated to this reserve are in fact at any given time held in liquid form.

Thus the level of reserves does not determine the extent of the Bank's ability to meet its obligations without refunding. For this purpose regard must rather be had to the level of the Bank's liquid assets[1/] (and in considering assets from the liquidity standpoint, account must be taken of the question mentioned above, whether funds in the special reserve can be used for debt service in the absence of a default on loans). If, however, liquidity is taken to mean the Bank's ability to obtain new financing in the long run, rather than a definite degree of liquidity maintained at any given time, then there certainly is a connection between liquidity and reserves. Since the Bank's assets are not wholly in liquid form, over the long run the Bank's ability to service its obligations, to disburse fully under existing commitments, and last but not least to expand its commitments, depends largely upon its ability to borrow in the market. The Bank's own credit is by now so well established that it has no difficulty in floating new issues. This is attributable, in part at least, to the excellent loan service record of its borrowers.

1/ Appendix A contains information on the Bank's liquidity position projected over the next 10 years.

If some of these should in the future be faced with payments difficulties, the market, in appraising the Bank's credit, would necessarily give increased attention to the Bank's reserve position. To the extent that a high level of reserves provides reassurance to the market, and thus facilitates borrowing by the Bank, the reserve level does affect the Bank's liquidity as well as its ability to expand. In this connection the psychological importance of maintaining an appropriate level of reserves can hardly be overstated.

IV. Functions of reserves

In addition to contributing to the Bank's ability to obtain new financing, the Bank's reserves serve other purposes:

(1) They protect the Bank against an impairment of capital in the event of losses on loans and guarantees by providing a fund against which such losses can be written off. They serve this purpose whether held as "reserve" or "surplus".

(2) The reserves add to the resources available to the Bank for its lending operations. Their use is not limited by any statutory provision, except insofar as the special reserve is concerned. At the same time they reduce the over-all cost to the Bank of money used in lending operations. Thus they enable the Bank to keep loan charges low and, by providing more extensive earnings coverage for service of the Bank's bonds, they assist the Bank's marketing operations.

(3) The supplemental reserve against losses makes it unnecessary to reflect specific default situations in the Bank's financial statements, at least as long as the total of defaults remains below the total of the

supplemental reserve.

(4) The supplemental reserve insures that to the extent that the Board of Governors foregoes distribution of earnings and allows them to accumulate, the earnings will not be diluted as a result of withdrawal or expulsion of members.[1/]

V. Nature of risks inherent in the Bank's lending operations

A default will not necessarily, and probably rarely would, result in complete loss of a loan. In all likelihood the cases in which a loan can be considered entirely uncollectible will be exceptional. Instances would be outright repudiation by the debtor country or disappearance of the borrowing or guaranteeing state as a political entity. Even when such extreme situations arose in the past, the expectation of receiving some payment has never completely disappeared, but in practice such claims had obviously to be written off.

The widespread defaults which resulted from the world depression of the thirties and from the war have to a large extent been the subject of settlements. In retrospect it appears that it would not have been

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1/ Poland withdrew from the Bank before the supplemental reserve had been set up, and upon withdrawal received a share of the undistributed profits (since they were reflected in the book value of Poland's shares). Poland had participated in the earlier decision not to distribute earnings as dividends. The share of profits it received was far greater than the amount it would have received by way of dividend had dividends been paid. In contrast, when Czechoslovakia's membership terminated, the supplemental reserve being by then in existence, Czechoslovakia accordingly received no payment in excess of the par value of its shares. In the absence of the supplemental reserve it might well be that the Bank would have no way of protecting continuing members against dilution of this kind; even charging new members a subscription price higher than par would not adequately protect against the withdrawal of other members.

necessary to write off completely most of the claims which met with difficulties. But the period during which the defaults persisted and the terms of the final settlements varied considerably from country to country. Substantial losses were incurred by the creditors. Whatever the judgment as to the likelihood of a world depression or a world war, the possibility of widespread defaults and substantial loss to the Bank arising as a result of either cannot be completely ruled out.

The more likely risks, however, are of an essentially different order: defaults which are the consequence of balance of payments difficulties or political developments - internal or external - affecting individual countries. Such troubles beset many countries from time to time, although their duration is generally temporary. They may result in a suspension of payments or perhaps a renegotiation of the terms of the loan or an adjustment of the amount due.

The duration and extent of the default situation would depend upon a number of factors, some of which it may not be within the power of the borrower to influence. These factors would include a marked decline in the price of, or in the demand for, an important export commodity; attitudes of other governments, including their foreign assistance policies; and the willingness of creditors to refinance or accept delays, or even to extend new credits or make new investments in the country.

A fall in the export price of a particular commodity may well give rise to balance of payments difficulties for not merely an individual country but rather for a group of countries all dependent on that commodity. Here the risk of default, while being less than world-wide, would not be

limited to a single debtor.

It must be concluded, therefore, that in the normal course of Bank operations, even short of a world depression or a world war, there may be periods during which the Bank would be faced with service suspensions, without any assurance as to the terms on which, or the time after which, debt service may be resumed.

History affords little guidance to an appraisal of these risks. Even by limiting the analysis to the defaults which occurred prior to the depression of the thirties, it is difficult to make a useful comparison with present circumstances. A brief review of the historical record is set forth in Annex B.

VI. Reserve policies of other institutions

As already stated, the Bank cannot be compared with ordinary banking institutions. There are, however, other medium- and long-term financing institutions which are similarly confronted with the problem of determining the proper level of reserves to cover either international or domestic long-term risks or both. Annex C attempts to draw some comparisons between the capital structures, reserves and dividends of a selected number of these institutions and the Bank. It is interesting to note that in most of the cases reviewed it has been considered proper policy to accumulate reserves for the protection of both creditors and capital. Although in one of the cases mentioned, losses have been too heavy to permit the setting aside of a reserve fund, it was the explicit intention of the founders of all the institutions reviewed that reserves should be set up.

VII. Conclusions as to magnitude of reserves

The foregoing discussion of the nature of the risks confronting the Bank indicates that they cannot be expressed in terms of figures. Therefore no formula can possibly be devised to determine the "proper" level of reserves.

It must be conceded that to cover the risk of defaults by reason of a world depression or a world war would require an amount of reserves far in excess of the amount which the Bank could hope to accumulate under its present rate policies and with continued expansion of its operations. But it is clearly the Bank's duty to aim at at least reducing to a minimum the need for drawing on the 80% in case of emergency.

What have been referred to as the more likely risks - defaults of a temporary character by individual debtors or groups of debtors - should, however, be fully covered by reserves, in time. In several countries Bank commitments already exceed $200 million. The Bank cannot ignore the possibility that one or another of its large borrowers may run into payments difficulties, or that several smaller borrowers may simultaneously find themselves in such difficulties.

The decade of the Bank's existence has been a period of prosperity and expansion, and debt service charges incumbent upon the borrowers have been on the whole moderate. The Bank must, however, take account of the possibility that recessions, even though geographically restricted, may set in, or that some of its members may assume too heavy a debt burden, from sources other than the Bank.

The Bank's goal should be the accumulation of sufficient reserves

to give full assurance to the bond market that defaults by one or even several of the Bank's borrowers will not materially affect the Bank's credit or its future activity.

Perhaps in time the continuation of reserve accumulations will have less importance. But as long as it is not possible to predict the reaction of the market to bond issues over and above the limit of the United States 80% liability, it would be unwise for the Bank to depart from its present reserve policy. More important than the level of reserves is the rate at which they actually accumulate, and at this time in its history the Bank is in the best position to accumulate reserves quickly in proportion to its liabilities, since its capital is still a large proportion of its lendable funds. The opportunity should be fully exploited.

Annex D is an attempt to show the development of reserves under certain assumptions regarding dividends, loan charges, level of borrowing and lending, 18% releases and portfolio sales.

UNDISBURSED BALANCE OF IBRD LOANS AND FUNDS AVAILABLE FOR LENDING

BASED ON SITUATION AS OF JANUARY 24, 1957

(In thousands of U.S. dollar equivalents)

Undisbursed balance of loans			
a)	Effective loans as of December 31, 1956	608,588	
b)	Loans not yet effective as of December 31, 1956	205,577	
	Subtotal	814,165	
c)	Loan to Iran in January 1957	75,000	
			889,165
Funds available for lending			
a)	Excess of available funds over loan disbursements as of December 31, 1956	516,876	
b)	Dollar bond issue in January 1957	100,000	
c)	Swiss Government loan in January 1957	46,539	
			663,415
Undisbursed balance of loans less available funds			225,750

IBRD - Economic Staff
January 24, 1957

PAYMENTS RECEIVABLE /1 ON IBRD LOANS BASED ON SITUATION AS OF JANUARY 24, 1957

(In thousands of U.S. dollar equivalents)

Year	Amortization	Interest	Total
1957	33,038	89,655	122,693
1958	43,827	108,111	151,938
1959	80,232	111,493	191,725
1960	134,545	107,432	241,977
1961	152,428	101,067	253,495
1962	175,803	93,650	269,453
1963	165,278	85,705	250,983
1964	162,929	78,230	241,159
1965	168,542	70,749	239,291
1966	164,308	62,967	227,275
1967	153,806	55,589	209,395
1968	151,129	48,528	199,657
1969	150,272	41,526	191,798
1970	131,992	34,760	166,752
1971	115,832	28,858	144,690
1972	107,315	23,641	130,956
1973	99,225	18,813	118,038
1974	92,155	14,265	106,420
1975	80,436	10,152	90,588
1976	62,570	6,667	69,237
1977	33,296	3,979	37,275
1978	19,061	2,689	21,750
1979	17,299	1,805	19,104
1980	13,812	987	14,799
1981	9,789	368	10,157

/1 Excludes payments by borrowers (including interest charges owed to IBRD) on sales to third parties.

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EXCESS OF AMORTIZATION RECEIVABLE /1 ON IBRD LOANS OVER AMORTIZATION PAYABLE ON IBRD FUNDED DEBT BASED ON SITUATION AS OF JANUARY 24, 1957

(In thousands of U.S. dollar equivalents)

Year	Net inflow of amortization	
	Non-cumulative	Cumulative
1957	18,252	18,252
1958	- 52,095	- 33,843
1959	8,084	- 25,759
1960	103,120	77,361
1961	120,308	197,669
1962	132,048	329,717
1963	129,024	458,741
1964	137,309	596,050
1965	133,373	729,423
1966	144,808	874,231
1967	127,806	1,002,037
1968	97,859	1,099,896
1969	60,912	1,160,808
1970	108,863	1,269,671
1971	58,208	1,327,879
1972	518	1,328,397
1973	86,563	1,414,960
1974	71,498	1,486,458
1975	43,640	1,530,098
1976	16,935	1,547,033
1977	- 20,704	1,526,329
1978	15,061	1,541,390
1979	13,299	1,554,689
1980	9,812	1,564,501
1981	- 40,211	1,524,290

/1 Excludes payments by borrowers on sales to third parties.

IBRD - Economic Staff
January 24, 1957

EXCESS OF INTEREST RECEIVABLE /1 ON IBRD LOANS OVER INTEREST PAYABLE ON IBRD FUNDED DEBT BASED ON SITUATION AS OF JANUARY 24, 1957

(In thousands of U.S. dollar equivalents)

Year	Net inflow of interest	
	Non-cumulative	Cumulative
1957	58,225	58,225
1958	75,476	133,701
1959	82,062	215,763
1960	79,859	295,622
1961	74,414	370,036
1962	67,947	437,983
1963	61,385	499,368
1964	55,107	554,475
1965	48,634	603,109
1966	41,853	644,962
1967	35,118	680,080
1968	28,978	709,058
1969	24,083	733,141
1970	20,173	753,314
1971	15,074	768,388
1972	11,866	780,254
1973	10,394	790,648
1974	6,321	796,969
1975	2,958	799,927
1976	760	800,687
1977	- 416	800,271
1978	674	800,945
1979	- 80	800,865
1980	- 768	800,097
1981	- 1,257	798,840

/1 Excludes payments by borrowers (including charges owed to IBRD), on sales to third parties.

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FUNDS AVAILABLE FOR LENDING AS OF DECEMBER 31, 1956 PLUS AMORTIZATION RECEIVABLE /1 FROM IBRD LOANS, SWISS GOVERNMENT LOAN AND PROCEEDS OF $100,000,000 BOND ISSUE OF JANUARY 1957 BASED ON SITUATION AS OF JANUARY 24, 1957

(In thousands of U.S. dollar equivalents)

Year	Principal receivable
1957	630,453
1958	55,827
1959	92,232
1960	134,545
1961	152,428
1962	175,803

AMORTIZATION PAYABLE ON IBRD FUNDED DEBT PLUS DISBURSEMENTS ON IBRD LOANS /2 BASED ON SITUATION AS OF JANUARY 24, 1957

Year	Principal payable /1
1957	519,857
1958	315,391
1959	150,348
1960	81,878
1961	52,843
1962	59,088

NET INFLOW TO IBRD

Year	Non-cumulative	Cumulative
1957	110,596	110,596
1958	- 259,564	- 148,968
1959	- 58,116	- 207,084
1960	52,667	- 154,417
1961	99,585	- 54,832
1962	116,715	61,883

/1 Excludes payments by borrowers on sales to third parties.
/2 Includes disbursements by participants.

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January 25, 1957

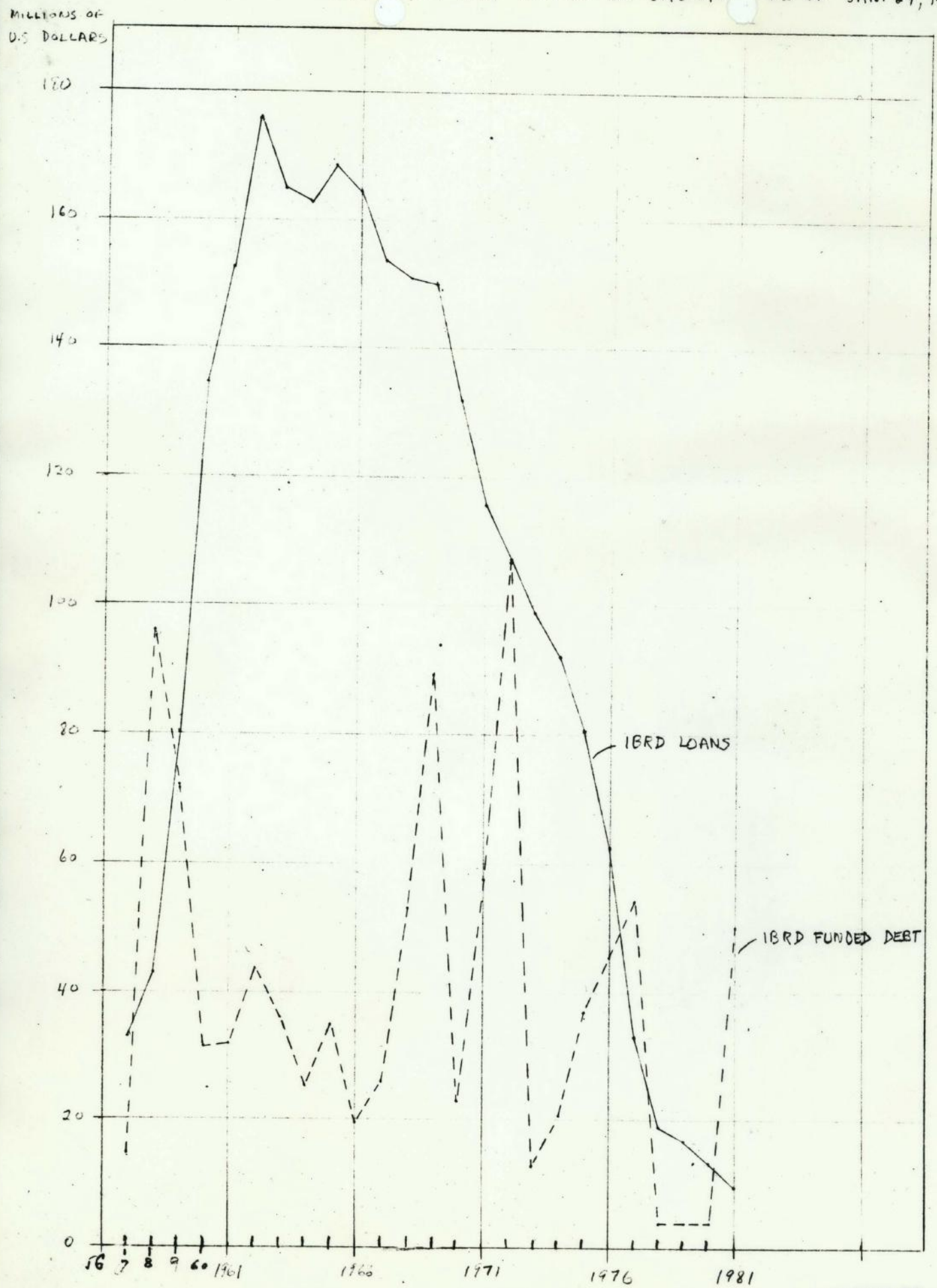
PAYMENTS DUE ON IBRD FUNDED DEBT BASED ON SITUATION AS OF JANUARY 24, 1957

(In thousands of U.S. dollar equivalents)

Year	Amortization	Interest	Total
1957	14,786	31,430	46,216
1958	95,922	32,635	128,557
1959	72,148	29,431	101,579
1960	31,425	27,573	58,998
1961	32,120	26,653	58,773
1962	43,755	25,703	69,458
1963	36,254	24,320	60,574
1964	25,620	23,123	48,743
1965	35,169	22,115	57,284
1966	19,500	21,114	40,614
1967	26,000	20,471	46,471
1968	53,270	19,550	72,820
1969	89,360	17,443	106,803
1970	23,129	14,587	37,716
1971	57,624	13,784	71,408
1972	106,797	11,775	118,572
1973	12,662	8,419	21,081
1974	20,657	7,944	28,601
1975	36,796	7,194	43,990
1976	45,635	5,907	51,542
1977	54,000	4,395	58,395
1978	4,000	2,015	6,015
1979	4,000	1,885	5,885
1980	4,000	1,755	5,755
1981	50,000	1,625	51,625

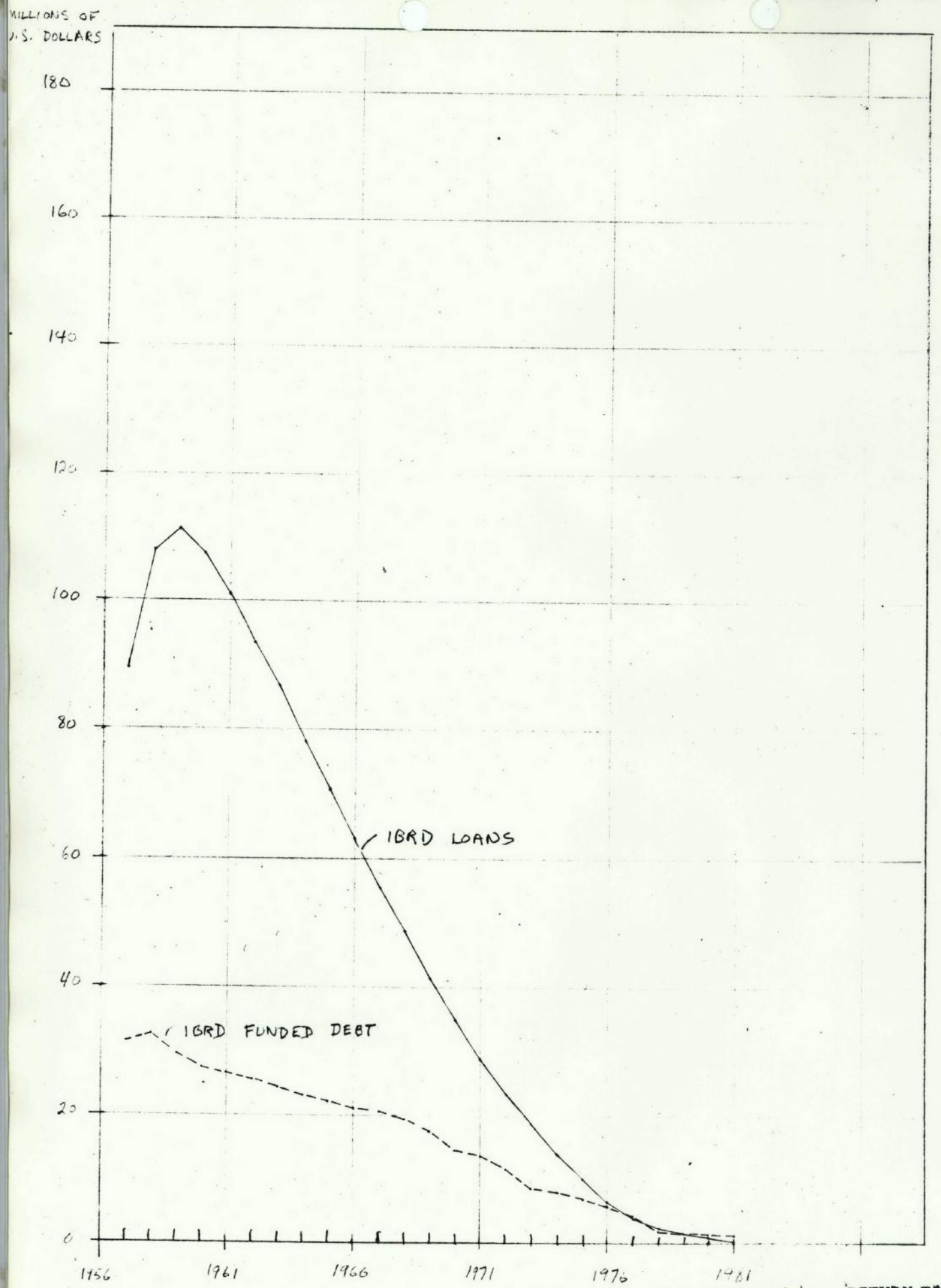
IBRD - Economic Staff
January 24, 1957

AMORTIZATION RECEIVABLE [1] FROM IBRD LOANS AND AMORTIZATION PAYABLE ON IBRD FUNDED DEBT 1957-1981 BASED ON SITUATION AS OF JAN. 24, 1957



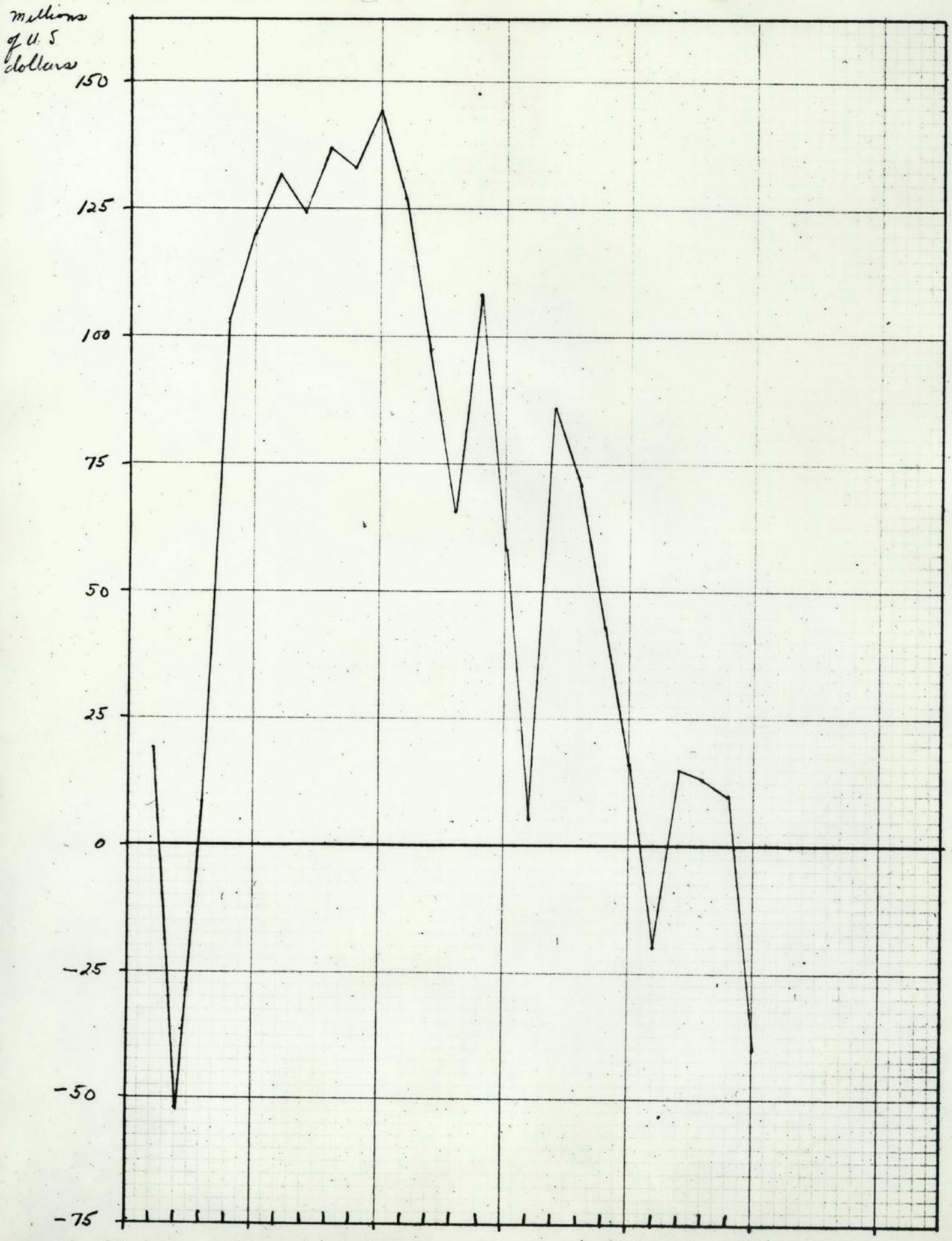
[1] Excludes payments by borrowers on sales to third parties.

INTEREST RECEIVABLE [1] FROM IBRD LOANS AND INTEREST PAYABLE ON IBRD FUNDED DEBT 1957-1981 BASED ON SITUATION AS OF JAN. 24, 1957



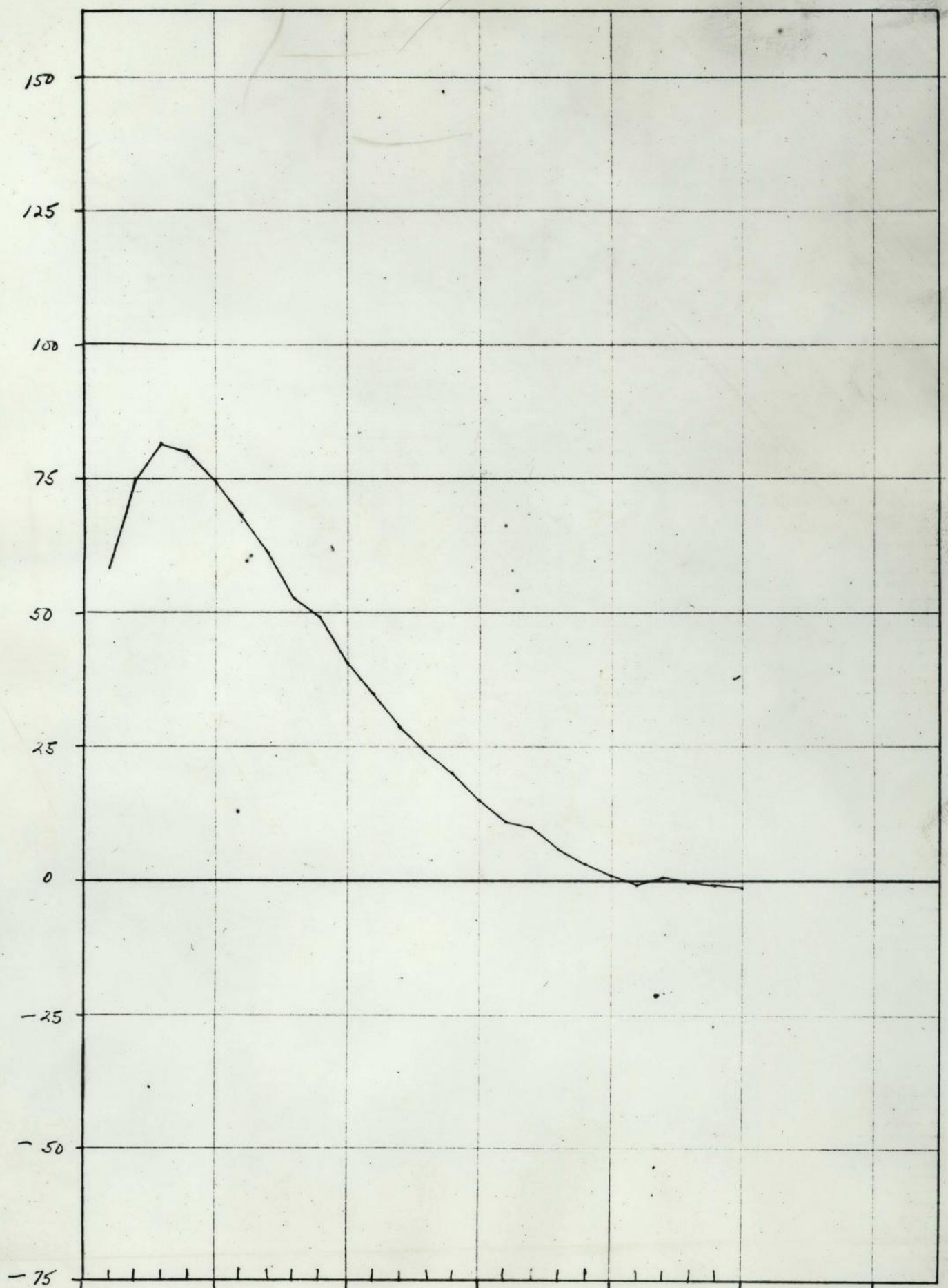
[1] Excludes payments by borrowers on sales to third parties (including charges owed to IBRD)

EXCESS OF AMORTIZATION RECEIVABLE[1] FROM IBRD LOANS OVER AMORTIZATION PAYABLE ON IBRD FUNDED DEBT 1957-1981 BASED ON SITUATION AS OF JAN. 24, 1957



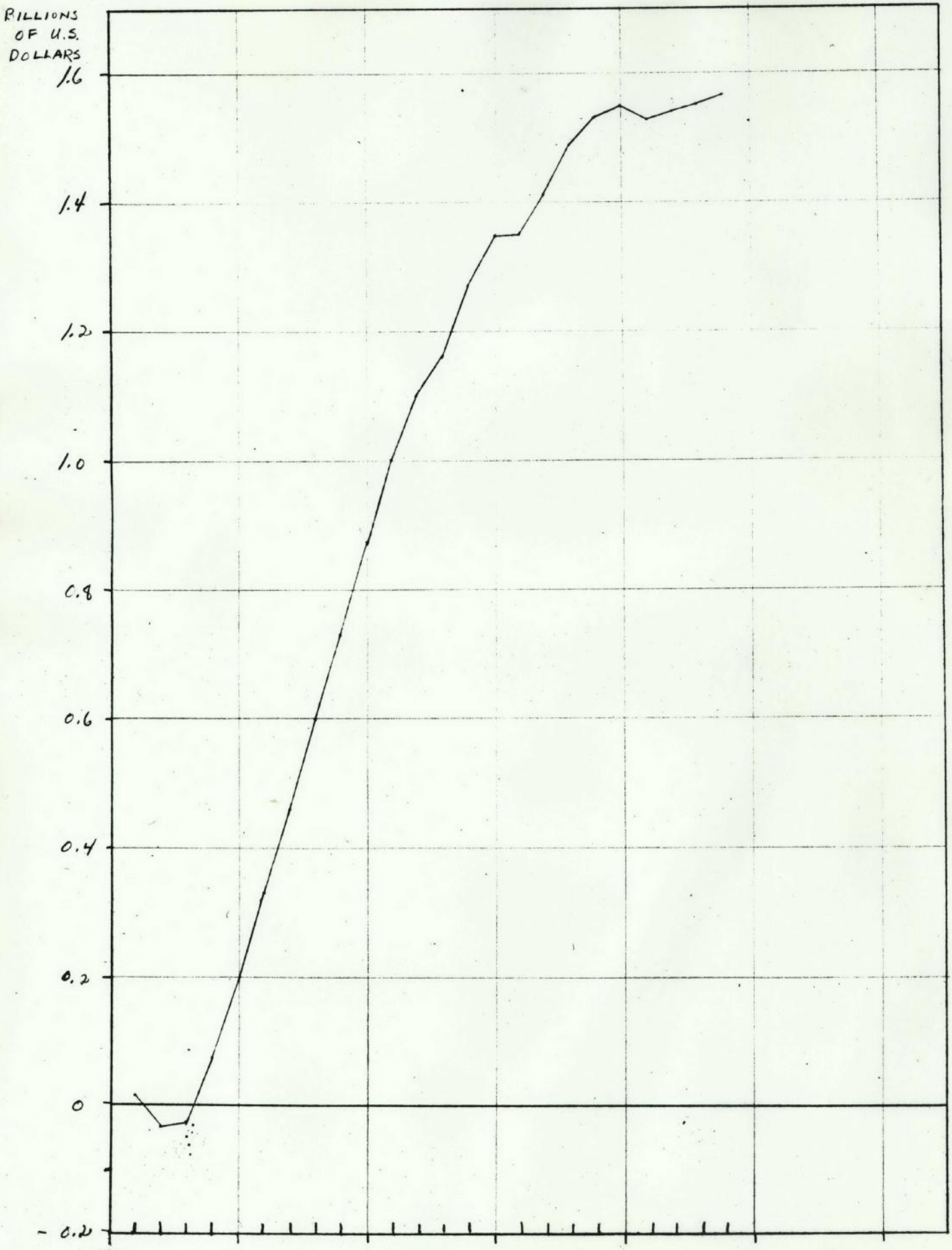
[1] Includes payments by borrowers on sales to third parties.

EXCESS OF INTEREST RECEIVABLE [1] FROM IBRD LOANS OVER INTEREST PAYABLE ON IBRD FUNDED DEBT 1957-1981 BASED ON SITUATION AS OF JAN 24, 1957



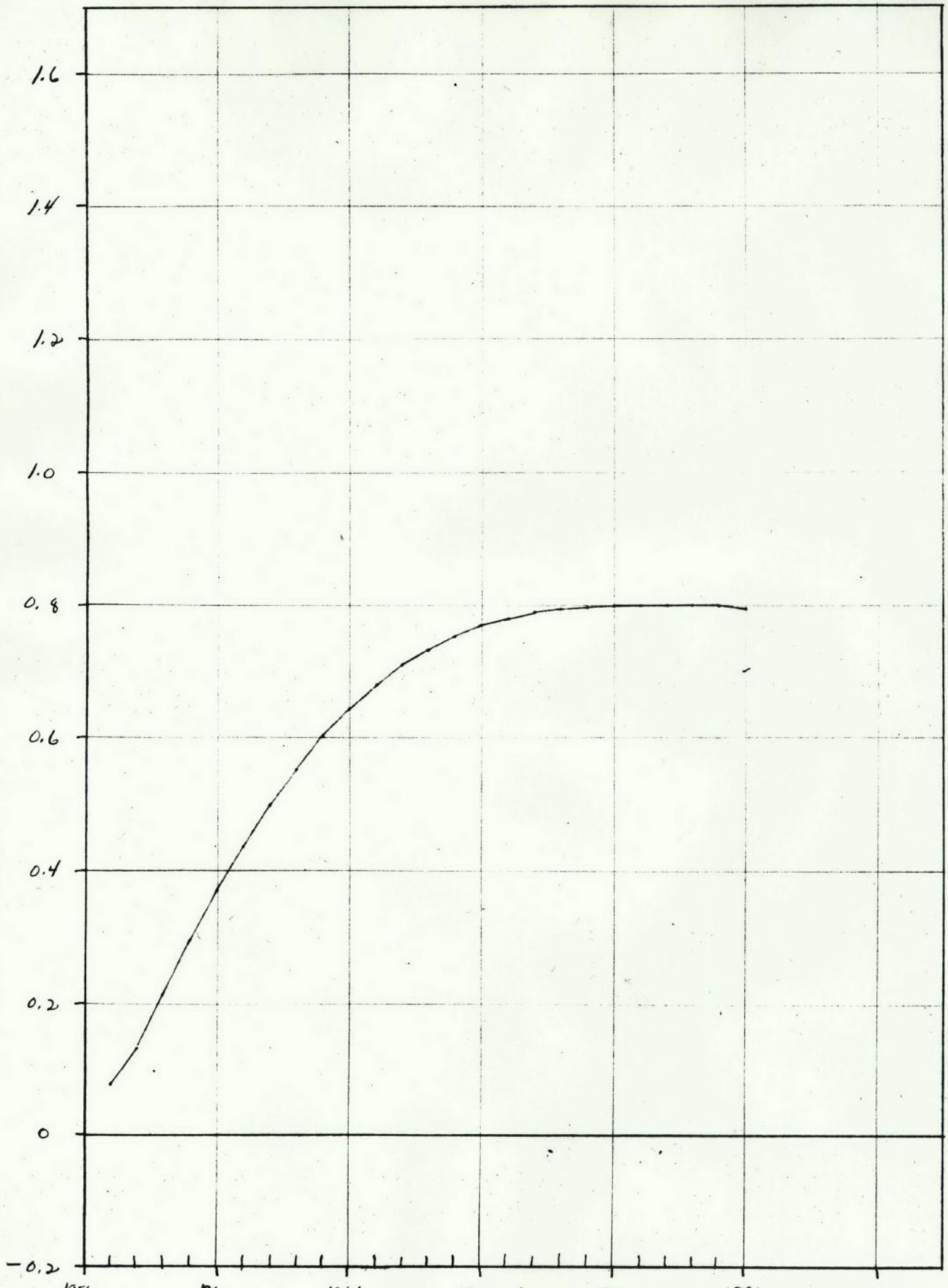
[1] Excludes charges payable by borrowers on sales to third parties (including charges owed to IBRD)

CUMULATIVE EXCESS OF AMORTIZATION RECEIVABLE FROM IBRD LOANS OVER AMORTIZATION PAYABLE ON IBRD FUNDED DEBT FROM JAN. 1, 1957 BASED ON SITUATION AS OF JAN 24, 1957



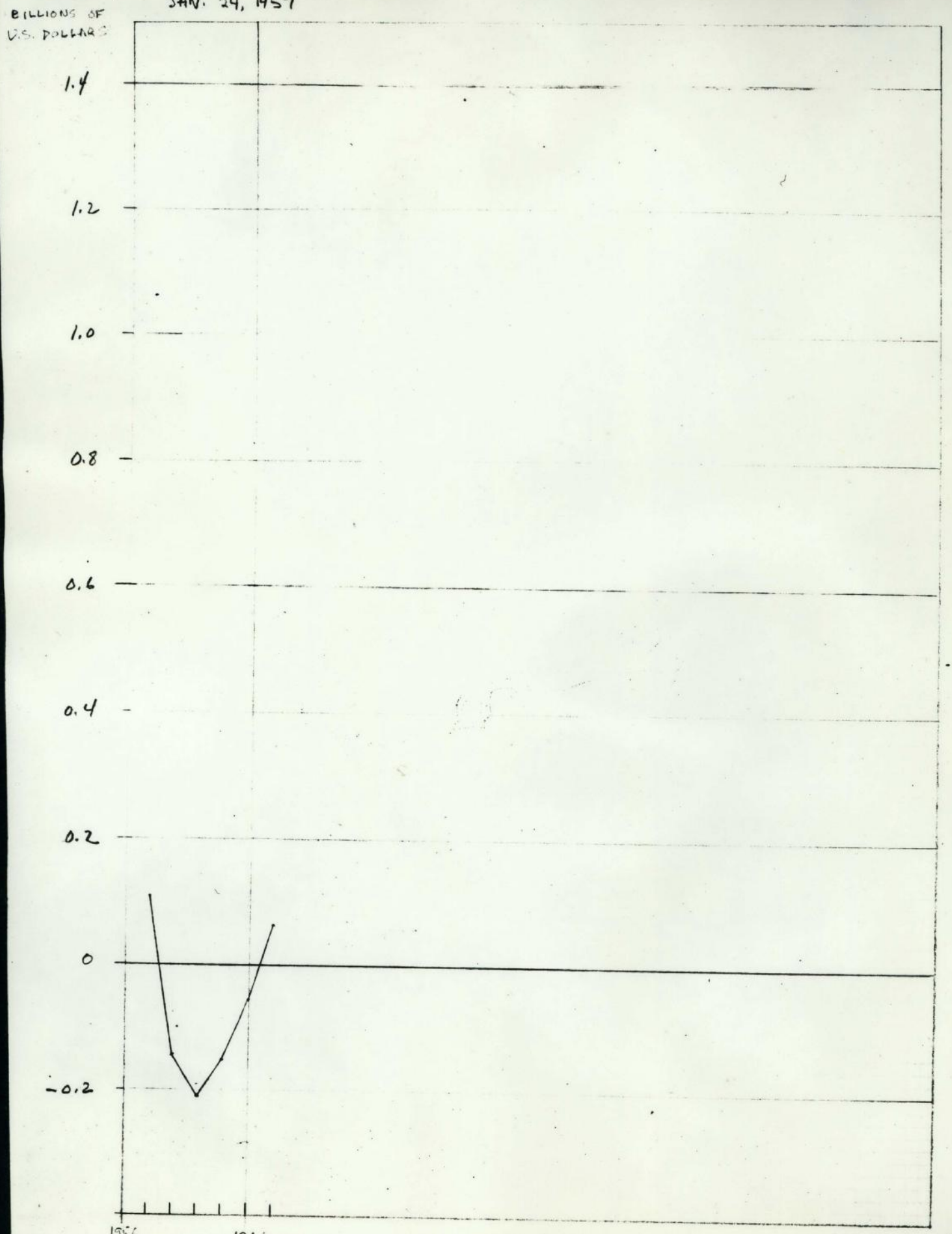
1/ Excludes payments by borrowers on sales to third parties.

CUMULATIVE EXCESS OF INTEREST RECEIVABLE[1] FROM IBRD LOANS OVER INTEREST PAYABLE ON IBRD FUNDED DEBT FROM JAN. 1, 1957 BASED ON SITUATION AS OF JAN. 24, 1957



[1] Excludes charges payable to IBRD on guaranteed sales

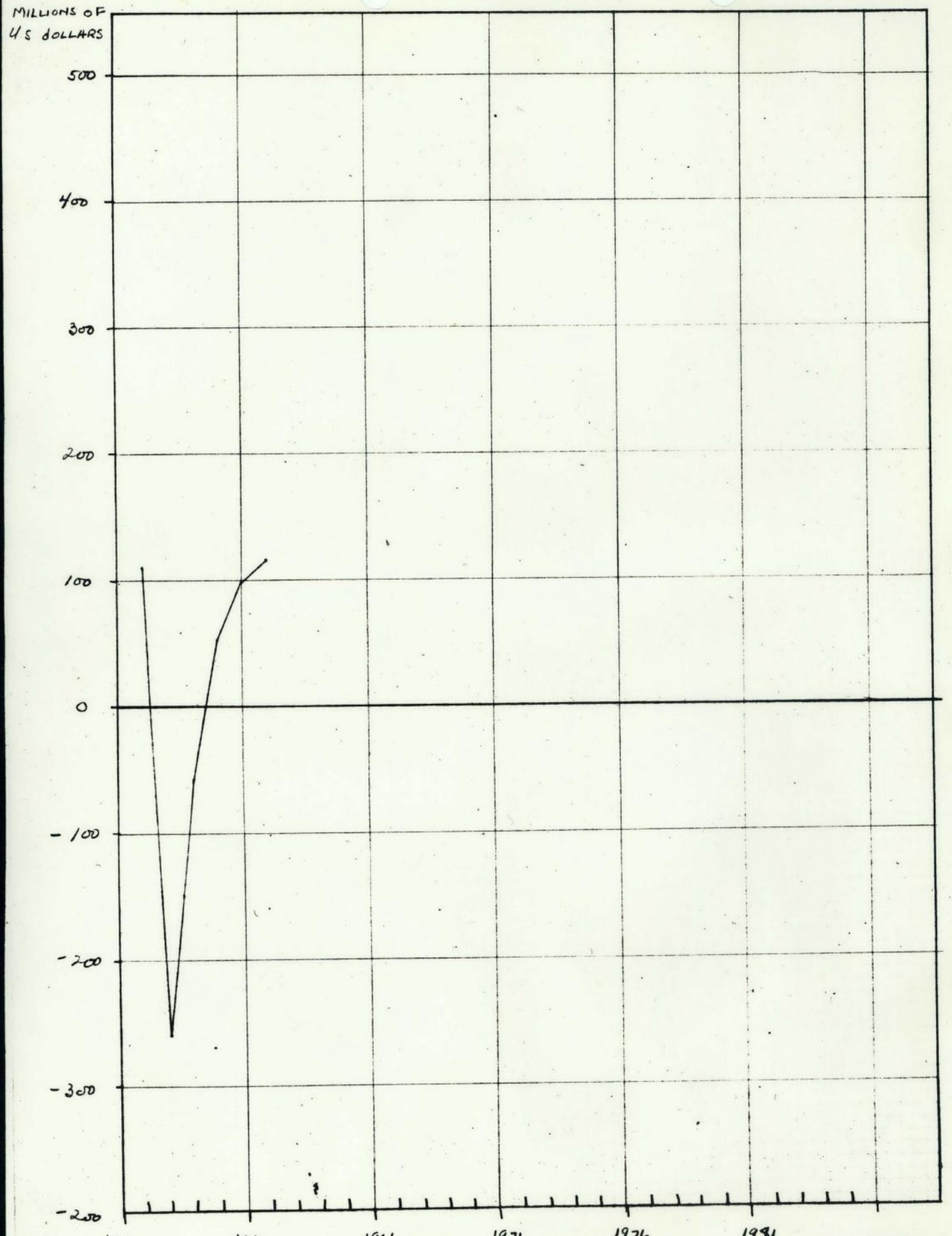
CUMULATIVE EXCESS OF FUNDS AVAILABLE FOR LENDING AS OF DEC. 31, 1956 PLUS ① AMORTIZATION RECEIVABLE FROM IBRD LOANS, ② SWISS GOVERNMENT LOAN, ③ PROCEEDS OF $100,000,000 BOND ISSUE OF JAN. 1957 LESS AMORTIZATION PAYABLE ON IBRD FUNDED DEBT PLUS DISBURSEMENTS ON IBRD LOANS [1] [2] FROM JAN. 1, 1957 BASED ON SITUATION AS OF JAN. 24, 1957



[1] Excludes payments by borrowers on sales to third parties
[2] Includes disbursements by participants

RETURN TO
IBRD - STATISTICS DIVISION

EXCESS OF FUNDS AVAILABLE FOR LENDING AS of DEC. 31, 1956 PLUS ① AMORTIZATION RECEIVABLE [1] FROM IBRD LOANS, ② SWISS GOVERNMENT LOAN, ③ PROCEEDS OF $100,000,000 BOND ISSUE OF JAN. 1957 OVER AMORTIZATION PAYABLE ON IBRD FUNDED DEBT PLUS DISBURSEMENTS ON IBRD LOANS [2] FROM JAN 1, 1957 BASED ON SITUATION AS OF JAN. 24, 1957



[1] Excludes payments by borrowers on sales to third parties
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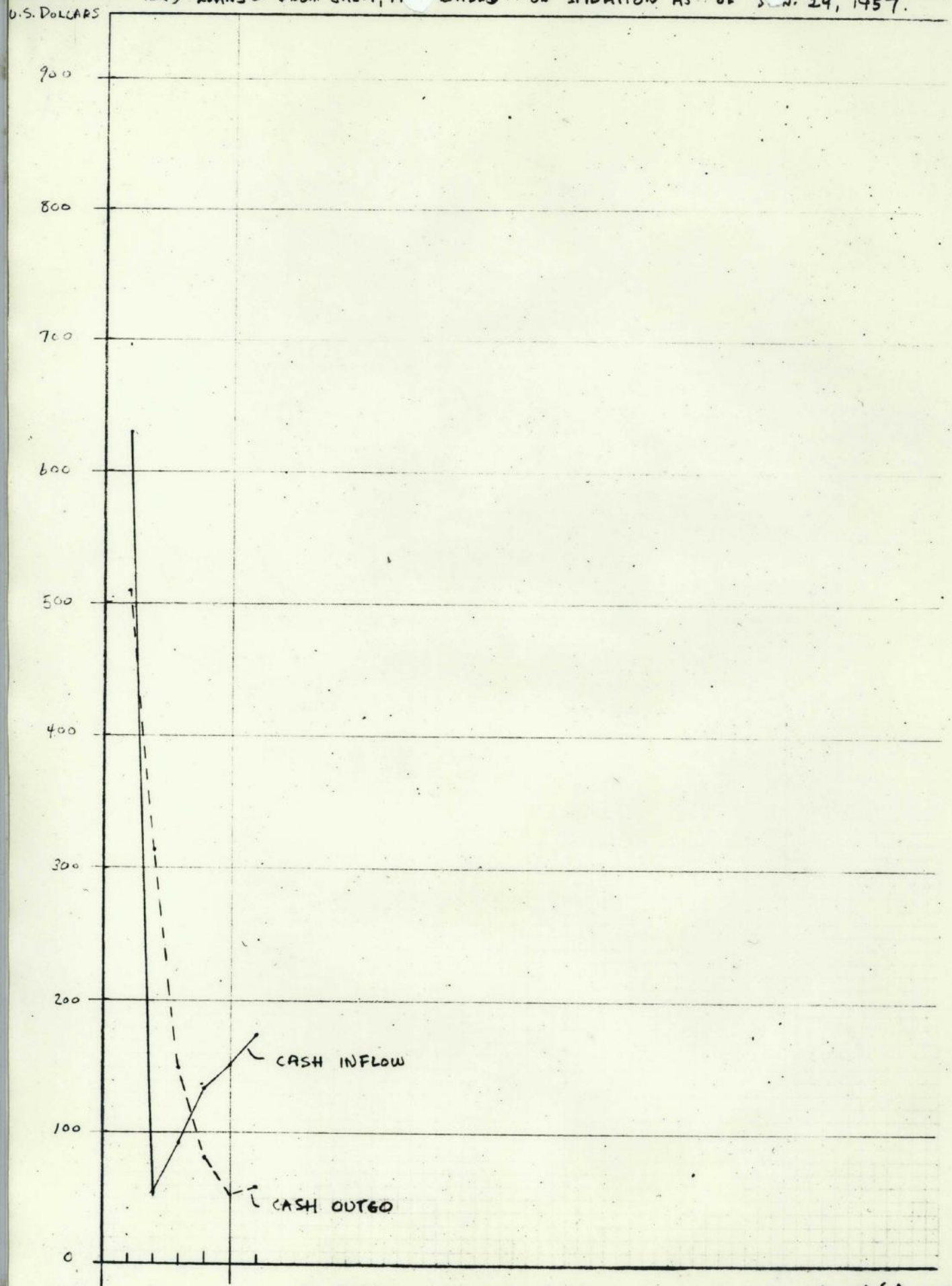
FUNDS AVAILABLE FOR LENDING AS OF DEC. 31, 1956 PLUS ① AMORTIZATION RECEIVABLE [1] FROM IBRD LOANS, ② SWISS GOVERNMENT LOAN, ③ PROCEEDS OF $100,000,000 BOND ISSUE OF JAN. 1957 AND AMORTIZATION PAYABLE ON IBRD FUNDED DEBT [2] LESS DISBURSEMENTS ON IBRD LOANS [2] FROM JAN. 1, 19[illegible] BASED ON SITUATION AS OF J[illegible]N. 24, 1957.



[1] Excludes payments by borrowers on sales to third parties

[2] Includes disbursements by participants

Mr. D. Sommers

February 25, 1957

Leonard B. Rist

IBRD Reserves.-

After our meeting on the above subject a few weeks ago, I asked Dr. Baranyai to analyze the adequacy of our present reserves in facing the two risks which to me loom larger than any other at present:

a) a serious decline of coffee and copper prices,

b) a political crisis in the Middle East.

The attached paper by Dr. Baranyai is the result of this discussion. As you will see, it is an attempt to distinguish capital from income losses and to evaluate the effect of defaults on our liquidity position. The conclusion is that if these risks should materialize and if the Bank ceased to expand both its lending and its borrowing operations our present reserves would be just about adequate but certainly not excessive.

I am passing it to you for your information, with the thought that it should be useful as a basis for further work on the subject.

Your suggestions would be welcome.

1 att.

Baranyai

February 25, 1957

RESERVE REQUIREMENTS OF THE BANK

I. The Problem.

Suggestions have been put forward by some of our members to slow down the accumulation of reserves by reducing the loan commission to 3/4% and by distributing a 2% dividend. These proposals, if accepted, would considerably reduce the Bank's capacity to strengthen its reserve position. In fact during the next five years up to 1960-61, the ratio of reserves to disbursed loans would remain unchanged at the level of 15% attained at the end of the last fiscal year, whereas the ratio to bonds would decline from 27% to 22% (see memorandum submitted to the Financial Policy Committee on January 11, 1957).

There seems to be general agreement in the management as well as on the board of directors that reserves must be raised to a level which would permit the Bank to meet any risk inherent in its operations without falling back on the 80% guarantee. It is feared that any recourse to the guarantee would close the market to further bond issues with the result that the volume of lending would have to be gradually reduced to an amount corresponding to the paid-in capital. On the other hand, it is assumed that if reserves are high enough to absorb losses resulting from possible defaults, the Bank's position on the bond market would not suffer any lasting damage.

As a matter of principle, the accumulation of reserves should continue until reserves reach a level equal to the risk the Bank is currently assuming by expanding its operations. The factors which determine the Bank's capacity to raise its reserves are fairly well known and can be projected more or less accurately into the future. The difficulty lies on the side of the risk which can only be measured by some sort of good guessing. The problem consists therefore in finding a suitable method which would enable the Bank to make the best possible guess at the nature as well as the amount of

the risk.

II. Historical Background.

One way of tackling the problem would consist in studying the history of past defaults.

Closest to our days are the defaults stemming from the two world wars and the great depression of the thirties. However, the history of these defaults is not likely to provide a typical pattern applicable to the future. Experience gained during the two wars and the interwar period may be helpful in doing some general speculation about the consequences of another world war or another great depression, but the specific impact on the solvency of our borrowers, and perhaps also on the availability of the 80% guarantee, is clearly unpredictable. What can be learnt from this period is the way in which defaults have been handled in those days in order to arrive at suitable readjustments.

There is however the period of about one hundred years up to the first world war which might offer an interesting field for investigation. This period coincided with a protracted process of political readjustment especially in the Spanish American colonies and in the Balkans. An almost uninterrupted series of defaults occurred mainly in Latin America and also in some other countries such as Portugal, Greece, Turkey and Egypt. Most of the defaults were brought about by external wars or internal revolutions, by excessive military and administrative expenditures, or by excessive investment mainly in roads, railways, and other public utilities. Thus, the circumstances leading to insolvencies were predominantly of a political or financial character or both. It might be possible, however, to discover some cases in which the default was exclusively due to difficulties of a purely economic nature such as the depletion of important physical resources,

the discovery of substitutes for important export products or the fall in prices of leading export commodities. Illustrations are: the exhaustion of the best guano deposits in Peru, the nitrate crisis in Chile and perhaps the repercussions of declining wheat prices on the economy of the Argentine.

A study of this one hundred-year period will be undertaken and the findings will be presented in a separate memorandum. An analysis of the past may yield interesting results pointing in the direction in which the Bank's thinking would have to proceed in order to form an opinion of the risk involved in its operations.

III. Dr. Machado's Method.

An attempt to simplify the issue was made by Dr. Machado in a memorandum dated January 24, 1957. As a result of purely logical reasoning, Dr. Machado suggested to relate the level of reserves to the amount lent either to the largest borrower which is Australia, or to the largest geographical group of borrowers which is Europe. His formula with which to determine the level of reserves is based on two assumptions: first, that the annual service payments due to the bondholders amount to about 10% of the outstanding bonds; second, that any possible default would last from three to five years. The application of this formula would call for a reserve of between $100 and 150 million as related to the largest individual borrower, and between $300 and 500 million as related to the largest group of borrowers.

The formula implies the conclusion that present reserves of about $255 million while more than sufficient to cover the risk inherent in the default of any individual borrower, are by far too small to cover the maximum risk inherent in the collective default of the largest geographical group of borrowers.

IV. A Hypothetical Illustration.

This would consist in placing the problem into the short-range perspective of say five years.

Although not all the risks inherent in the next five years can be foreseen, the presence of two specific risks is fairly obvious. A specific economic risk arises from the generally assumed fall in coffee and copper prices, while a specific political risk might be seen in the tension prevailing in the Middle East and also in the delicate position in which the Yugoslav Government finds itself in the wake of the Hungarian uprising. These are the two most obvious risks which would emerge from a short-range approach to the problem.

An attempt will be made to show what the position of the Bank would be if the two risks inherent in the present situation should actually materialize and lead to formal defaults. Before doing this, it will be emphasized however that nothing in this analysis is intended to suggest that the assumed defaults will really occur. The political risk may be greatly reduced or even entirely eliminated by the efforts of the United States to maintain peace and order in the Middle East area. As for the economic risk, the expected decline in coffee and copper prices may create serious difficulties, but it should not be impossible for the producing countries to adjust their foreign accounts to a lower level of prices without resorting to the expedient of defaulting on their debts. In fact, all the coffee and copper producing countries are in need of continued foreign assistance and they are certainly aware that a default on the part of anyone of them would do great damage to the creditworthiness of the group as a whole. Moreover, in order to avoid defaults, temporary difficulties of adjustment can be reduced with the assistance of the Monetary Fund and perhaps also with the help of further loans. Nevertheless, both the political

and the economic risk is potentially inherent in the present situation. The risk is there and the only way to meet it is to accumulate adequate reserves.

However this might be, the following analysis will be undertaken with a view to illustrating the potential magnitude of the risk as compared to the Bank's capacity to absorb losses. The purpose of the analysis is to show the maximum of possible losses, though real losses might be expected to remain well below the maximum. Thus, it would be quite reasonable to assume that most of the defaulting debtors should be able to arrive at some sort of a funding agreement under which arrears would be gradually released and transferred.

In discussing the consequences of possible defaults, a distinction will be made between immediate and deferred consequences. The immediate consequence arises from the fact that the defaulting borrowers need a breathing space, during which untransferred arrears accumulate, whereas the Bank has to continue service payments on its bonds by drawing on its liquid funds. The deferred consequence might be a real loss due to the total or partial inability of the borrowers to release and transfer the arrears accumulating up to the end of the breathing space.

In order to appraise the hypothetical impact of these consequences on the position of the Bank over the next three or five years, it is necessary to make a number of assumptions, some of which are of an entirely arbitary character.

(i) As regards the economic risk, it will be assumed that all the coffee and copper producing countries will default on their debts, except those whose coffee and copper exports represent less than 20% of total exports; that all the defaults have occurred simultaneously at the end of 1956; that the breathing space will range from three to five years; that untransferred arrears

accumulating during the breathing space will have to be abandoned.

(ii) As for the political risk, it will be assumed that the defaults may take a form equivalent to a final repudiation of all foreign debts with the result that our loans to Yugoslavia, Lebanon and Iran will have to be written off as a total loss.

(iii) Finally, it will be assumed that the defaulted loans have been entirely disbursed and that no bond issues will be made during the period of defaults.

Table I attached gives a list of the loans affected by the assumed economic and political risks. The two categories together amount to $682.2 million which is about 27% of the total of our loan portfolio, including undisbursed balances and loans not yet effective.

A. Losses and Reserves.

In computing the losses arising from the assumed defaults, a distinction will be made between loss of capital and loss of income. The first column of the following table shows the losses arising during a three-year period, whereas the second column covers a period of five years.

	Assumed period of default	
	Three years	Five years
	millions of $	
I. Capital loss		
Yugoslavia, Lebanon, Iran total of repudiated loans	158.0	158.0
Coffee and copper producers defaulted amortisation	65.2	128.5
Subtotal	223.2	286.5
II. Loss of income		
Yugoslavia, Lebanon, Iran interest on repudiated loans	17.7	29.9
Coffee and copper producers defaulted interest payments	65.0	105.8
Subtotal	82.7	135.7
III. Total loss	305.9	422.2

The loss of capital is heavy as compared to the total of present reserves amounting to about $254 million. This is due to the fact that the loans to Yugoslavia, Lebanon and Iran are assumed to be written off entirely. Reserves, while enough to offset the assumed losses of a three-year period, would fall short of the losses arising during a five-year period.

On the other hand, the corresponding loss of income would remain well below the level of current surpluses. As shown in Table II attached, the Bank would continue to earn a net income high enough to absorb a substantial proportion of the loss on capital account.

The position of the accounts during the assumed period of default would develop as shown in the following table:

	Assumed period of default	
	Three years	Five years
	millions of $	
Income account		
Net income if no defaults occur	193.6	333.0
Deduct interest on defaulted loans	82.7	135.7
Surplus	110.9	197.3
Capital account		
Existing reserves - end of 1956	253.7	253.7
Surplus brought down from income account	110.9	197.3
Total	364.6	451.0
Capital loss as shown in previous table	223.2	286.5
Balance of reserves	141.4	164.5

As seen from these figures, current surpluses would absorb about 50% of the assumed loss of capital if the default lasted three years, and 68% if the default lasted five years. Therefore, reserves would decrease by only about $112 million in three years and by $89 million in five years.

The remaining balance of reserves as related to bonds outstanding would amount to 17.5% at the end of the third year and 22% at the end of the fifth year. This would compare with a ratio of about 30% as of the end of 1956.

However, the position would quickly deteriorate if after the end of the period of default, the Bank decided to float a new issue of say $500 million in order to resume the expansion of its lending. The above ratios would decline to 11% and 13% respectively.

B. Liquidity Position.

An analysis showing existing liquid assets and the flow of funds over

the assumed period of default is given in Table III attached. The following is a condensed summary of the position:

	Assumed period of default	
	Three years	Five years
	millions of $	
Existing liquid assets - end of 1956	554.8	554.8
Excess of payments over receipts during assumed period of default	-693.5	-564.8
Balance	-138.7	-10.0

The shortage of liquid funds during the first three years is considerable. It is due to the fact that payments on account of undisbursed loans would bulk heavily in these three years.

The obvious remedy would consist in building up a larger amount of liquid assets. This however would curtail profits and reduce the Bank's capacity to increase its reserves.

C. Loan Commission and Dividend.

The proposed reduction in the loan commission by 1/4% together with the distribution of a 2% dividend would slow down the accumulation of reserves considerably as shown in the following table:

	Assumed period of default	
	Three years	Five years
	millions of $	
Balance of reserves as calculated above for the end of the period	141.4	164.5
Deduct:		
1/4% reduction in commission on non-defaulted loans	12.4	20.6
2% dividend on about $1,000 million	60.0	100.0
Reduced reserves at the end of the period	69.0	43.9

Reserves at this reduced level would represent only 8.5% of bonds outstanding at the end of the third year and less than 6% at the end of the fifth year as compared with the present ratio of 30% as of the end of 1956.

However, a situation where the ratio of reserves to bonds would drop to such low levels as shown in the above table is not expected to arise in practice, because it is quite unthinkable that during a period of defaults the Bank should agree either to a reduced loan commission or to the distribution of a dividend.

D. Groups of creditors involved in assumed defaults.

It might be interesting to see what the relative position of the various creditors or groups of creditors would be in the case of a default involving the coffee and copper producing countries. This appears from the attached table IV which may be summarized as follows:

	Amount of loans	
	millions of $	in % of total
IBRD	524.2	21.6
Eximbank	709.2	30.5
Suppliers	274.0*	11.8
Public bond issues	483.0	20.8
Other claims	356.0	15.3
Total	2,329.8	100.0

Thus, five groups of creditors would be rivalling for the funds the defaulting countries would eventually be able to put up during the breathing space and thereafter, when the situation is ripe for proceeding to a readjustment of the defaulted debts. The category of "other claims" consists mainly of various government debts to private creditors. Details of this category are given in Table V attached.

It will be noted that the above table does not include the indebtedness

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* Based on information obtained from debtor countries.

of the private sector which will have to be added to make the picture complete.

This is perhaps not the place to discuss the possibility of securing the Bank a privileged position among the various creditors. It will be noted however, that there are precedents indicating that specific loans can be treated with special consideration. An instance drawn from the Hungarian precedent is described in a separate note attached to this memorandum.

E. Concluding remarks.

The above analysis leads to the conclusion that although the Bank's financial position is strong enough to offset the assumed losses, the balance of reserves remaining at the end of a possible series of defaults would be too small to permit a further expansion of operations. It follows that the demand for a reduced loan commission and also for the distribution of a dividend is premature and should be postponed for another five years.

A reduction of the loan commission by 1/4% combined with a 2% dividend would reduce the accumulation of reserves by about $120 to 130 million over the next five years. This is a large amount in the hands of the Bank, whereas it is almost negligible if split up among the borrowers and the stockholders. Assuming that an agreement could be reached to postpone the problem for another five years, the largest stockholder which is the United States would forego an annual dividend of about $12.5 million, which is an infinitesimal fraction of the United States' budget, whereas the largest borrower, Australia, would sacrifice an annual $0.8 million by paying the full amount of the loan commission.

It will be noted that all the above calculations are based on the material readily available in Mr. Rist's files, such as balance sheets, loan statements and various tables prepared by the Statistics Division. There are some slight discrepancies resulting mainly from the fact that the material does not always

refer to the same date or period. If the way of reasoning described in this memorandum should be approved, the calculation will have to be revised.

Finally it will be observed that the above calculations disregard the possibility of further releases of 18% subscriptions. Such releases, if large enough, would improve the position.

TABLE I.

List of loans involving specific risks

	Amount of loans end of 1956	Undisbursed or not yet effective	Sales	Coffee and/or copper exports in % of total exports
	millions of $			
I. Economic risk				
Coffee producers				
Brazil	181.7	31.4	5.1	59
Colombia	94.3	38.3	7.1	84
Costa Rica	3.0	3.0	-	47
El Salvador	22.3	6.9	1.2	86
Guatemala	17.6	11.2	0.6	67
Haiti	2.6	2.2	0.4	79
Nicaragua	17.7	11.6	1.7	41
Copper producers				
Chile	46.0	9.3	2.5	66
Coffee and copper				
Mexico	122.8	17.3	13.1	20
Subtotal	524.2	131.6	31.7	
II. Political risk				
Yugoslavia	56.0	2.1	-	
Lebanon	27.0	26.8	-	
Iran	75.0	75.0	-	
Subtotal	158.0	103.9	-	
III. Grand total	682.2	235.5	31.7	

Source: Statement of loans - end of 1956.

Note: The amount of loans given in the first column includes undisbursed balances as well as loans not yet effective. It excludes portions of loans sold or agreed to be sold. The loan to Iran, although granted after the end of the year, has been included.

TABLE II.

Account of income and expenses.

	If no defaults occur		If defaults occur as assumed	
	Three years	Five years	Three years	Five years
	millions of $			
Income				
Interest receivable	309.3	517.7	309.3	517.7
Interest in default approximate estimate	-	-	82.7	135.7
Total Income	309.3	517.7	226.6	382.0
Expenses				
Interest on bonds	93.5	147.7	93.5	147.7
Administrative expenses at $7.4 million p.a.	22.2	37.0	22.2	37.0
Total expenses	115.7	184.7	115.7	184.7
Net income	193.6	333.0	110.9	197.3

Notes: (i) Income includes the statutory loan commission.

(ii) It has been assumed that no new loans will be granted and no new bond issues will be made during the assumed period of default.

(iii) No account has been taken of income from investment, commitment charges and service charges. This income will be transformed gradually into interest income from loans as disbursements proceed.

TABLE III.

Liquid assets and flow of funds.

	If no defaults occur		If defaults occur as assumed	
	Three years	Five years	Three years	Five years
	millions of $			
I. Flow of funds				
(i) amortisation receivable and funds raised in January 1957.	261.4	548.4	261.5	548.4
amortisation in default			80.3	190.2
			181.2	358.2
(ii) Interest receivable - net *	215.8	370.0	215.8	370.0
Interest in default approximate estimate			82.7	135.7
			133.1	234.3
Total inflow	477.3	918.4	314.3	592.5
(i) Amortisation payable and disbursements	985.6	1,120.3	985.6	1,120.3
(ii) administrative expenses at $7.4 million p.a.	22.2	37.0	22.2	37.3
Total outflow	1,007.8	1,157.3	1,007.8	1,157.3
Net outflow	-530.5	-238.9	-693.5	-564.8
II. Liquid assets - end of 1956	554.8	554.8	554.8	554.8
III. Balance	+24.3	+315.9	-138.7	-10.0

Notes: (1) It has been assumed that no new loans will be granted and no new bond issues will be made during the assumed period of default.

(2) No account has been taken of income from investment, commitment charges and service charges. This income will be transformed gradually into interest income from loans as disbursements proceed.

* After deducting interest payable.

TABLE IV.

External public debt of coffee and copper producing countries.

	IBRD	Eximbank	Suppliers' credits	Bond issues	Other claims	Total
	millions of $					
Brazil	181.7	433.0	49.7	163.7	279.6	1,107.7
Colombia	94.3	24.8	78.7	68.6	-	266.4
Costa Rica	3.0	16.8	6.6	14.9	-	41.3
El Salvador	22.3	-	-	4.3	-	26.6
Guatemala	17.6	0.6	-	-	3.0	21.2
Haiti	2.2	30.2	6.7	0.1	0.1	39.3
Nicaragua	17.7	0.7	5.4	-	-	23.8
Mexico	122.8	133.4	89.9	67.4	68.2	481.7
Chile	46.0	69.7	37.0	164.0	5.1	321.8
Total	507.6	709.2	274.0	483.0	356.0	2,329.8

TABLE V.

Details of "other claims" shown in Table IV.

	$ millions
Brazil - Maritime Adm. (US)	3.1
Private US banks	200.0
UK settlement	76.5
	279.6
Guatemala - privately placed bonds	3.0
Haiti - G.S.A. (US)	0.1
Mexico - privately placed bonds	60.7
lend-lease (US)	7.5
	68.2
Chile - private banks (US and UK)	4.0
Italian Government	1.1
	5.1

PREFERENTIAL TREATMENT OF SPECIFIC INTERNATIONAL LOANS

- The Hungarian Precedent -

The Hungarian default during the great depression of the thirties is a case in point to illustrate the way in which priority can be secured to loans of a specific character.

After introducing foreign exchange controls in the late summer of 1931, the Government announced a general transfer moratorium as of the end of the same year. At the same time a communique was issued to assure that payments to the bondholders of the Reconstruction Loan and to a syndicate of Central Banks, headed by the Bank for International Settlements, would continue unchanged in spite of the moratorium.

The exemption granted to the syndicate was easy to justify because the claim of the syndicate originated from a stand-by credit extended to the Central Bank of Hungary mainly after the imposition of foreign exchange controls. The syndicate was clearly entitled to rank before all the other creditors.

The case of the Reconstruction Loan was less obvious. This loan was issued after the first world war, it helped the country to balance its budget, to stabilize its currency and to rebuild its economy. It was floated under the auspices of the League of Nations and was strongly supported by the Bank of England. Various specified categories of government revenue had been pledged as security for the loan and the Financial Committee of the League of Nations was entitled to control the flow of the pledged revenues.

Such was the background which enabled the loan to be considered as a specific international transaction. The nature of the Hungarian Reconstruction Loan is in many ways similar to that of our loans. However, the specific

character of our loans is perhaps more pronounced because the Bank is an institution specifically organized for making international loans, whereas the Hungarian loan was floated by private bankers.

It is interesting to note that the preferential treatment granted to the Hungarian Reconstruction Loan was the result of a unilateral action taken by the Government. No attempt was ever made to obtain the formal consent of any other group of creditors. The unilateral action of the Government was acknowledged but not formally approved by the Financial Committee of the League of Nations, and it was supported behind the scene by the Bank of England. As a result, the matter was passed over in complete silence without any opposition either in Hungary or abroad.

The Hungarian precedent clearly shows that justified exemptions can be made without arousing either national or international criticisms. However, the defaulting government must be able to take action and it must be willing to assume the responsibility for such action.