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THE WORLD BANK

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Institutional Investors and Underwriters, New York
Aug. 1971. (vol 1)

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The World Bank Group
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Remarks to Institutional Investors and Underwriters - Correspondence 01

813/3/1

REMARKS TO INSTITUTIONAL INVESTORS AND UNDERWRITERS

NEW YORK -- August 4, 1971



We are a group of three institutions owned by 116 governments, financing ourselves in part in the world's capital markets and in part by appropriations from 18 of the governments, and lending to 95 of the nations to advance the economic development of their 1.8 billion people. Their development is one of the most important tasks confronting mankind in this century. The Bank is one of the institutions which have been organized to assist in that process.

But having said that, I want to emphasize we are a development investment institution, not a philanthropic organization and not a social welfare agency.

We are operating at a profit -- in FY 1971 a profit which totalled approximately \$212 million before considering a small gain from currency revaluation.

To describe to you our corporate structure I will call on Mr. Broches, our General Counsel. Mr. Broches has been with the Bank since 1946.

After Mr. Broches speaks for three or four minutes, I will ask Mr. Aldewereld, the Vice President for Finance who also supervises our project evaluation, to discuss briefly our investment policy. He, too, has been with the Bank since 1946.

Following Mr. Aldewereld's remarks, I will say a few words about the Bank's financial position and we will then turn to your questions. Mr. Broches.

* * * *

The Bank's lending position is founded on two basic principles: the project must be sound and the borrowers must be creditworthy. We will not make a loan unless both of these criteria can be met.

We insist that the investment project itself have a demonstrably high economic return and that it be directly related to the development of the country in which it is located. And we insist further that the total economy of the borrowing nation be capable of repaying their loan and meeting the interest and other charges. Mr. Aldewereld will describe to you how we select and supervise our investments. Mr. Aldewereld.

THE BANK GROUP'S OPERATIONS IN FY 1971

During the past year the Bank Group's new loans, credits and investments totalled \$2.6 billion. This compares with \$2.3 billion in 1970; \$1.9 billion in 1969; and \$1.0 billion in 1968. The total cost of the development projects financed in part by the Bank Group during the past year amounted to more than ⁶⁷\$6 billion. On some \$4 billion of this amount it was possible for the Bank to estimate the rates of return to the developing countries -- they are estimated to average ¹²18%.

To finance a rise in disbursements and to increase liquid reserves, the Bank borrowed \$1.35 billion during the year. This brought its level of liquidity to \$2.6 billion, up \$400 million from June 30, 1970 *and almost double the level of 3 yrs ago.*

As I mentioned earlier, our earnings in 1971 before considering a small gain from currency revaluation totalled \$212 million, almost exactly the same as in 1970. The earnings in both years benefitted from the unusually high rate of return on the investment of our liquid reserves and were substantially above the highest previous earnings of \$172 million in 1969.

REMARKS TO REPRESENTATIVES OF UNDERWRITERS

NEW YORK -- August 4, 1971

*statement of...
jointly & this
procedure for approval
loans: only by Fed & only on
NC of Fed.*

The IBRD, whose securities we are proposing to offer, is one of 3 institutions of the World Bank Group. The other two are the IDA, financed by appropriations from governments, and the IFC, financed by stock sold to governments and by loans from the Bank.

The IBRD is owned by 116 member governments which have purchased and paid for approximately \$2.4 billion of capital stock. It is financed by those receipts plus \$1.4 billion of retained earnings and a funded debt which approximates \$5.5 billion.

IBRD is a development investment institution, not a philanthropic organization and not a social welfare agency.

It operates at a profit -- in FY 1971 a profit which totalled approximately \$212 million before considering a small gain from currency revaluation.

To describe to you our corporate structure I will call on Mr. Broches, our General Counsel. Mr. Brockes has been with the Bank since 1946.

After Mr. Broches speaks for three or four minutes, I will ask Mr. Aldewereld, the Vice President for Finance who also supervises our project evaluation, to discuss briefly our investment policy. He, too, has been with the Bank since 1946.

Following Mr. Aldewereld's remarks, I will say a few words about the Bank's financial position and ^{later in the program} we will ~~then~~ turn to your questions. Mr. Broches.

* * * *

The Bank's lending ^{policy} ~~position~~ is founded on two basic principles: the project must be sound and the borrowers must be creditworthy. We will not make a loan unless both of these criteria can be met.

We insist that the investment project itself have a demonstrably high economic return and that it be directly related to the development of the country in which it is located. And we insist further that the total economy of the borrowing nation be capable of repaying their loan and meeting the interest and other charges. Mr. Aldewereld will describe to you how we select and supervise our investments. Mr. Aldewereld.

THE BANK GROUP'S OPERATIONS IN FY 1971

During the past year the Bank's new loans totalled \$1.9 billion. This compares with \$1.6 billion in 1970; \$1.4 billion in 1969; and \$850 million in 1968. The total cost of the development projects financed in part by the Bank Group during the past year amounted to more than \$7 billion. On some ^{702 of these} ~~\$4 billion~~ of this amount it was possible for the Bank to estimate the rates of return to the developing countries -- they are estimated to average 21%.

To finance a rise in disbursements and to increase liquid reserves, the Bank borrowed \$1.35 billion during the year. This brought its level of liquidity to \$2.6 billion, up \$400 million from June 30, 1970 and almost twice the level of three years ago.

As I mentioned earlier, our earnings in 1971 before considering a small gain from currency revaluation totalled \$212 million, almost the same as in 1970. The earnings in both years benefitted from the unusually high rate of return on the investment of our liquid reserves and were substantially above the highest previous earnings of \$172 million in 1969.

This is a brief summary of the financial position of the Bank. My associates and I will be happy ^{later in the program} to try to answer your questions.

Funded Debt and Borrowing:

1. Future borrowing; effect on financial ratios
2. Liquidity
3. U.S. Restriction on market access
4. Borrowing over the last six months
5. Cost of borrowing
6. Average life of debt and loans

Guarantee from Callable Subscriptions:

7. Borrowing beyond U.S. guarantee - Tables
8. Legislative approval for funding of callable subscriptions
9. U.S. Increase in Capital Subscription

Net Income and Financial Ratios:

10. Cost of borrowing and Net Income
11. Investments Income
12. Allocation of Net Income
13. Exchange Rate Risk

Lending and Disbursements:

14. FY69-73 lending program
15. Standards of Bank lending
16. Disbursements
17. Increase in staff
18. Sectoral composition of lending
19. Family planning
20. IBRD-IDA blend policy
21. IBRD lending policy

Loan Portfolio, Default and Rescheduling:

22. Default and debt rescheduling
23. Portfolio tables

IDA:

24. Transfer to IDA
25. U.S. Action on Third Replenishment

Expropriation:

- 26.

Country Questions:

27. China
28. Loans to Pakistan
29. Disbursements to Pakistan
30. Pakistan: debt service

Other Questions:

31. Bank's relations with Communist countries
32. Lending to repressive governments
33. General economic policies of borrowers

FUTURE BORROWING; EFFECT ON FINANCIAL RATIOS

on average, in the next 3 years about the same amount as last yr.

Question 1:

How much does the Bank have to borrow in the next 3 to 5 years; what will be the impact on the debt equity ratio and what will be its impact on the cost of all funds? What are the trends in the Bank's interest coverage and are there any fixed limits in the debentures?

*1) off profit etc
11% for US com. etc
2) now a lower debt/equity ratio than in IDB + EIB*

*Int coverage:
in '70: higher than IDB, EIB, & EIC - 2
+ sub. higher than for major com. like eg. 1.31*

Answer:

Standard Projections of May 18, 1971 (Tables 1d and 1e) revised for FY72 (Controller's - 7/16/71).

	<u>FY72</u>	<u>FY73</u>	<u>FY74</u>	<u>FY75</u>	<u>FY76</u>	<u>FY77</u>	<u>FY78</u>	<u>FY74-78</u>
Gross Borrowing	1178 ^{a/}	1343	1551	1770	1921	1824	1946	9012
Debt Retirement	607	726	765	820	1009	893	1163	4650
Net Borrowing	571	617	786	950	912	931	783	4362
<i>1.52</i> Debt-Equity Ratio ^{b/}	1.61	1.70	1.83	2.00	2.16	2.30	2.40	
Av. Cost All Funds (%)	3.91	4.01	4.13	4.31	4.53	4.72	4.86	
<i>1.70</i> Int. Coverage Ratio	1.52	1.49	1.45	1.40	1.38	1.35	1.34	

- a/ As revised in Table 111a of July 2, 1971 to reflect the July 1, 1971 Japanese Issue.
- b/ "Debt" includes delayed deliveries but not amount "Due to IDA". Equity includes usable capital, plus all reserves.

Limits in the debentures: 90% callable capital (implied in Article 111, Section 3 of the Articles).

LIQUIDITY

Question 2:

Why does the Bank need all this cash and, in particular, why does it borrow short?

Answer:

(a) In planning its borrowings and deciding the level of its liquidity the Bank looks at the different items of its cash flows such as: disbursements, debt retirement, repayments and sale of loans, retained earnings, etc. It also takes into consideration contingencies such as:

- accelerated disbursements (disbursements take place over an average of 4 to 5 years, and cannot be projected with complete certainty; loans presently undisbursed amount to about 4.7 billion)
- temporary restrictions on access to capital markets, etc.

Our cash position is designed to reflect this conservative approach.

(b) Almost all of short-term borrowings are in actuality long-term as these have been regularly rolled-over when they come to maturity and indeed have increased substantially. This is the case for all borrowings from the Central Banks (2 Yr. Issues, Bundesbank, Bank of Japan). Last year, the Bank entered for the first time, the U.S. medium-term market. It is its intention to gradually build up its medium-term debt and roll it over as necessary. The Bank is interested

in diversifying its sources of funds as its lending expands and cash requirements increase. The U.S. medium-term market constitutes from this point of view a promising new source which responded very favorably to the first Bank issue.

P & B
7/30/71

U.S. RESTRICTIONS ON MARKET ACCESS

Question 3:

In view of the U.S. Balance of Payments difficulties,
isn't the Bank vulnerable to U.S. restrictions on market access.

*To minimize the
effect and have
diversified
geographically
1970/71 752 of
IBRD work - 45
as 60% in 64-65*

Answer:

Mr. McNamara and Mr. Aldewereld to elaborate.

The attached table shows the effect of IBRD operations on
the U.S. balance of payments.

P & B
7/29/71

THE ESTIMATED EFFECT OF IBRD/IDA OPERATIONS ON THE U.S. BALANCE OF PAYMENTS 1964-74
(U.S. \$ million; fiscal years)

ANNEX I

	Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
IBRD EFFECT												
Received by IBRD from U.S.												
2 per cent subscription	64									3		
9 per cent subscription	571									22		
Net IBRD bond sales in U.S.	1092	-34	125	-28	128	90	252	48	372	349	226	313
Net IBRD loan sales in U.S. ^{a/}	344	11	-13	-34	-52	-38	-37	-37	-18	-25	-22	-18
Investment income in U.S.	300	53	52	51	58	54	71	121	151	130	118	112
Total	2371	30	164	-11	134	106	286	132	505	479	322	407
Paid by IBRD to U.S.												
Procurement of goods ^{b/}	2344	175	130	139	148	141	120	157	204	221	267	294
Interest to U.S. bondholders	333	43	45	48	53	63	76	88	110	129	127	123
Interest to U.S. loanholders ^{a/}	65	16	17	15	15	12	10	9	7	5	4	3
Administrative expenses	125	16	18	25	27	33	41	40	53	60	70	79
Total	2867	250	210	227	243	249	247	294	374	415	468	499
Net receipts to U.S.	496	220	46	238	109	143	-39	162	-131	-64	146	92
Long-term investments in U.S. ^{c/}			200	300	185	-5	404	414	82	34	-159	-79
IBRD net effect on liquidity basis ^{d/}	496	220	246	538	294	138	365	576	-49	-30	-13	13
IDA EFFECT												
Received by IDA from U.S.												
Subscriptions and contributions	68	48	66	74	106	130	36	55	38	64	100	162
Investment income in U.S.	5	3	3	2	2	3	3	5	7	8	8	8
Total	73	51	69	76	108	133	39	60	45	72	108	170
Paid by IDA to U.S.												
Procurement of goods ^{e/}	11	18	31	64	64	46	32	19	38	45	59	79
Administrative expenses ^{f/}	3	3	3	3	4	4	4	14	18	26	30	36
Total	14	21	34	67	68	50	36	33	56	71	89	115
Net receipts to U.S.	-59	-30	-35	-9	-41	-83	-4	-27	11	1	-19	-55
Long-term investments in U.S.				10				-10				
IDA net effect on liquidity basis ^{d/}	-59	-30	-35	1	-41	-83	-4	-37	11	1	-19	-55
IBRD/IDA EFFECT												
To: received from U.S.	2444	81	233	65	242	239	325	192	550	551	430	577
To: paid to U.S.	2881	271	244	294	311	299	283	327	430	486	557	614
Net receipts to U.S.	437	190	11	229	69	60	-42	135	-120	-65	127	37
Long-term investments in U.S. ^{c/}			200	310	185	-5	404	404	82	34	-159	-79
Total net effect on liquidity basis ^{d/}	437	190	211	539	254	55	362	539	-38	-31	-32	-42
MEMORANDUM ITEMS												
New issues in U.S. ^{g/}			200		425	300	250		400	450	450	500
Plus: Delayed deliveries												
Delayed			-18		-219	-138	-48		-17		-67	-83
Collected		4		18		131	154	92	28	13	4	34
Net		4	-18	18	-219	-7	106	92	11	13	-63	-49
Less: Purchase of new issues by foreigners			19		32	19	13		11	23	23	25
Sales of previous issues by U.S. to foreigners		19	18	12	4	12	2		-17	20	24	26
Redemptions						150	50			-30	75	50
Purchases for sinking funds		19	21	34	43	45	39	44	45	41	39	37
Equals: New issues in U.S. ^{net}		-34	125	-28	128	90	252	48	372	349	226	313

a/ This item is projected on the assumption that, of total projected loan sales of \$50 million per annum in FY1972-74, one-third will be bought by U.S. residents. This will not offset the repayment of principal to U.S. loanholders over this period, which is estimated at one-third of total repayments to loanholders. Interest to U.S. loanholders is projected at 6% of outstanding amounts.

b/ Past figures include procurement specifically identifiable as originating in the U.S. and the same proportion of procurement not identifiable by country of origin. Procurement is projected at 19% of IBRD disbursements (based on the average of FY1967-70).

c/ Maturities over one year. The projection assumes rather arbitrarily that the change in long-term investments in the U.S. will be equal to half the total change in IBRD holdings of cash and liquid securities, except that the figure for FY1971 is an estimate based on actual experience to date.

d/ Minus sign indicates negative impact on the U.S. balance of payments, measured on a "liquidity" basis.

e/ Past figures include procurement specifically identifiable as originating in the U.S. and the same proportion of procurement not identifiable by country of origin. Procurement is projected at 15% of IDA disbursements (based on the average of FY1967-70).

f/ The increase in IDA administrative expenses in FY1970 reflects a change in the basis of the management fee paid by the IBRD, from an arbitrary flat fee to a formula based on IDA's share in operations. For the projections, 50% of IBRD and IDA expenses are assumed to be incurred in the U.S.

g/ Projections are based on present IBRD financial planning, and assume that purchases by foreigners will be 5% of new issues and 1% of previous issues.

BORROWING OVER THE LAST SIX MONTHS

Question 4:

It is almost six months since your last issue here. In the interim where did you raise funds? How Much?

Answer:

Over the last six months (Feb. 1 - July 31, 1971) the Bank borrowed \$485 million; its debt retirement amounted to \$292 million, thus leaving a net borrowing of \$193 million.

The last U.S. market issue was the $6\frac{1}{2}\%$ 5-year notes issue of January 15, 1971. Borrowings since then were:

	<u>\$ million</u>
Feb. 1, 1971 Bundesbank roll-over	62.0
March 15, 1971 Central Banks - roll-over	192.7
- increase	7.3
March 22, 1971 Bank of Japan	100.0
June 1, 1971 German market 15 Year Bonds	54.6
June 11, 1971 Bank of Japan	19.4
July 1, 1971 Japan market 10 Year	30.6
July 1, 1971 Swiss market	18.4
	<hr/>
Total to July 31, 1971	<u>485.0</u>
(August 1, 1971 Bundesbank - roll-over	59.1)
(- increase	22.9)
	<hr/>
(Total including Bundesbank of Aug. 1, 1971	567.0)

FRG 170
Japan 150
Cent BK 200
Switz 18

485

COST OF BORROWING

Question 5:

How much did money cost you in the market over the last year? What rate did you charge borrowers on new loans in the year?

Answer:

Weighted average cost^{a/} of borrowing of market issues in FY71:
~~8.27%~~ ^{8.07%}; average life: ~~12.4~~ ^{8.0} years (not included: ~~2 years~~ issues, Bundesbank, Bank of Japan and Bank of Libya). The average lending rate was 7.23%.

a/ "Cost to IBRD" by issue weighted by amount and maturity.

QUESTIONS AND ANSWERS

1. Question: Can the Bank continue to borrow at costs in excess of 8% and loan at 7-1/4%?

Answer: It is true that Bank interest rates in recent years have been set at concessionary levels and are likely to continue at such levels in the future.

A typical 24-year Bank loan which carries an interest rate of 7-1/4% contains a grant element of approximately 20% of the face value of the loan. A combination of concessionary interest rates to our borrowers and operating profits to our stockholders is made possible by our high ratio of interest-free capital to funded debt.

Currently the average cost to the Bank for all of its funds -- that is its total funded debt, plus its paid-in capital and retained earnings -- is only 3.6%. Essentially it is the difference between this 3.6% and the Bank's lending rate, now 7-1/4%, which enables us to cover all our administrative costs, grant reasonable concessions to our borrowers, and continue to earn substantial profits.

AVERAGE LIFE OF DEBT AND LOANS

Question 6:

What is the weighted average term of Bank borrowing and how does that compare with the weighted average of Bank loans outstanding?

Answer:

The average life of loans outstanding disbursed is about 10.3 years, the average of funded debt 8.3 years. However one third of the debt outstanding is made up of short- and medium-term issues placed with Central Banks (\$725 million 2 Yr. issues, \$645 million 1½ Yr. Bundesbank, \$419 million 1½ Yr. Bank of Japan). In the past they were regularly refinanced at maturity and there is a reasonable expectation that it will remain so in the future. If these issues are excluded, the average

life of funded debt increases to 10.7 years, that is, more than the average life of loans. Besides, ^{disbursed loans of \$ (6.6) were financed} ~~loan repayment does not only contain~~ ~~repayment of borrowed funds but also repayment of "equity", thus adding~~ ^{4.1 by equity + 2.5 by debt,} flexibility in the balancing of debt retirement by loans repayment.

"Cash" * 2.6	DEBT 5.5
Loans Rec 11.7	Misc Debt .4
Less Notes 4.6	"Equity" 4.1
Loans Rec Dis 6.7	
Misc Assets .7	
Tot Assets 10.0	Total Debt + Eq 10.0

P & B
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QUESTIONS AND ANSWERS

2. Question: What security lies behind the Bank's bonds?

Answer: The combination of assets and guarantees which supports our securities and which leads to their high credit rating is wholly unique. It includes: 1. ^{a record of} ~~a century~~ ^{of successful operations} & a determination to keep them ^{successful} in the future.

2a. A portfolio of loans for projects which bring high economic returns to the borrower.

3b. A guarantee of 100% repayment of each loan by the Government of the country in which the project is located. ^{a/ c/}

4c. Cash and liquid security balances totalling \$2.6 billion, in fully convertible currencies, equal to over 45% of the outstanding Bank debt.

5d. Paid-in capital and retained earnings totalling \$4 billion and amounting to approximately 75% of our debt.

6a. The uncalled capital subscriptions backing the debt and equal to over 400% of the amount outstanding. ^{b/}

No other bond in the world offers that kind of security. It is precisely because of the strength of that security -- and our determination to maintain that strength -- that our bonds receive such high ratings, and are preferred by such institutions as the major Central Banks of the world. Sixty-^{five} ~~five~~ of these banks hold over ^{1.8} ~~1.5~~ billion of our debt, ^{1/3} ~~over 30%~~ of the total. They have substantially increased their holdings of IBRD bonds during the past three fiscal years -- from \$1.1 billion to ^{1.8} ~~1.5~~ billion -- and there is every indication they will continue to increase in the future.

a/ In the twenty-^{five} ~~first~~ year history of the Bank, there have been no losses on its loans. The Bank has not been a target for debt repudiation as have bilateral aid agencies and private credit corporations. Even in extreme situations, such as the latter years of the Nkrumah regime in Ghana, or in the period when the UAR defaulted on obligations to bilateral creditors, ~~neither of these governments~~ defaulted on World Bank loans.

have not

- b/ The guarantee represented by the uncalled subscription cannot be eroded. By the provisions of our charter, these uncalled subscriptions may not be drawn upon for loans or administrative expenses. They can be used solely as a protection for the obligations of the Bank. Moreover, the uncalled subscriptions are expressed in U.S. dollars, of the weight and fineness on July 1, 1944. Thus, they are not subject to deterioration as a result of changes in the value of currencies.
- c/ Because the loans of the Bank, made out of borrowing funds, are repayable in the same currencies, the Bank faces no devaluation risks on its borrowed funds: its obligations to its creditors are matched by the repayments due from the borrowers.

BORROWING BEYOND U.S. GUARANTEE

Question 1:

Does the Bank intend to issue its obligations beyond the U.S. uncalled capital subscription?

Answer:

(a) Yes, the Bank has no present intention to restrict the issuance of its bonds to the U.S. uncalled capital subscription.

(b) The uncalled capital subscriptions total \$21 billion of which \$13.5 billion is from Common Market countries and the U.S., Canada, U.K. and Japan. Such uncalled subscription is 2 $\frac{1}{2}$ times the Bank's present funded debt.

(c) ^{of this 5.4 of} ~~The Bank has~~ ^{debt} outstanding the equivalent of \$2.2 billion ^{is} of securities payable in currencies other than dollars, including over \$1.3 billion in marks, \$450 million in yen, and \$70 million each in guilders and in Canadian dollars.

(d) We are a financially strong institution. Profits are running over \$200 million. Cash position after this issue will be over \$2.6 billion, i.e. nearly one half of present funded debt.

(e) Incidentally, we estimate that the total amount of dollar bonds currently held in the United States is about \$2 billion, which compares with a U.S. uncalled capital subscription of \$5.7 billion.

Debt's held: by "govts" 1.8
2 private parties 3.6
Total debt 5.4

\$.8
← ann \$1.0
ret
← ann \$ 1.2

← \$ 3.7 P & B
7/30/71
ann \$ 7.1

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Data concerning Funded Debt and "Guarantee" Obligations of Members

(As of June 30, 1971)

Million of U.S. Dollar equivalents

I Dollar and Non-dollar debt

Debt payable in <u>U.S. \$</u>	3,229.6	60%	
Debt payable in <u>other currencies</u>	2,194.6	40%	\$ 1.8
Total	5,424.2	100%	5.4

Handwritten notes:
 Held by gov'ts: 818.
 Held by "indiv" in US: 2,002.
 for: 414.
 2,414.
 3,229.
 "Held by gov't" 1.0
 "indiv" 1.8

II Debt issued to governmental institutions and debt placed publicly or privately with others

Issued directly to governmental institutions	1,832.0 ^{a/}	34%
Publicly issued or placed directly with non-governmental institutions	3,592.2	66%
Total	5,424.2	100%

III U.S. Callable Portion in relation to Dollar Debt

U.S. callable portion	5,715.0 ^{b/}	100%
Total U.S. dollar debt	3,229.6	57%
U.S. dollar debt minus		
U.S. dollar debt placed directly with foreign governmental institutions	817.7	14%
U.S. dollar debt placed publicly or privately with non-governmental institutions	2,411.9	42%

a/ From the amount of Central Bank issues outstanding there has been deducted \$23.2 million held by international organizations.

b/ Will be increased to \$5,936.5 million after U.S. subscribes to pending authorized increase in subscriptions.

IV Guarantee Obligations of Selected Members other than United States and
Funded Debt outstanding in the Currencies of those Members

<u>Member</u>	<u>Guarantee Obligation</u>		<u>Funded Debt</u>		
	<u>(Present)</u>	<u>(After subscrip- tion increase)</u>	<u>(Total)</u>	<u>(Issued to governmental institutions)</u>	<u>(Otherwise issued)</u>
Australia	479.7	510.4	-	-	-
Belgium	499.1	499.1 ^{a/}	-	-	-
Canada	712.8	847.6	72.3	-	72.3
France	945.0	1,151.3	-	-	-
Germany	1,228.8	1,228.8 ^{a/}	1,296.2	566.9	729.3
Italy	599.4	767.2	24.0	-	24.0
Japan	920.7	920.7 ^{a/}	419.4	419.4	-
Kuwait	60.0	109.5	42.0	-	42.0
Netherlands	533.1	533.1 ^{a/}	71.7	-	71.7
Sweden	216.0	249.6 ^{b/}	14.5	-	14.5
U.K.	2,340.0	2,340.0	24.1	-	24.1

a/ Subscription Increase already effective

b/ Payments to be made in November 1971

V. Guarantee Obligations of Members other than United States in relation to their holdings of Central Bank bonds

(a) The Central Banks (62) of 72 members in whose currencies the Bank has no bonds outstanding hold Two-Year U.S. Dollar Obligations of the Bank in an aggregate amount of \$556 million. These holdings are substantially less than the callable portions of the present subscriptions of the respective countries concerned.^{a/}

(b) In the case of the following 6 members, whose Central Banks hold in the aggregate \$125 million of Two-Year U.S. Dollar Bonds, the sum total of these holdings and the outstanding principal amount of Bonds issued in their currencies relates to the callable portions of their subscriptions as follows:

<u>Member</u>	<u>Guarantee Obligation</u>		<u>Funded Debt in member's currency</u>	<u>Central Bank holdings</u>	<u>Total</u>
	<u>(Present)</u>	<u>(After sub- scription increase)</u>			
Canada	712.8	847.6	72.3	50.0	122.3
Germany	1,228.8	1,228.8 ^{b/}	1,296.2	4.0	1,300.2
Italy	599.4	767.2	24.0	40.0	64.0
Japan	920.7	920.7 ^{b/}	419.4	20.0	439.4
Kuwait	60.0	109.5	42.0	5.8	47.8
Netherlands	533.1	533.1 ^{b/}	71.7	5.0	76.7

^{a/} Subject to only one minor exception. In the case of Libya its holdings of \$20 million are in excess of the \$18 million callable portion of its present subscription of \$20 million. This situation will change if and when Libya takes up its authorized subscription increase which would bring its subscription to \$56.4 million, of which the callable portion would be \$50.8 million.

^{b/} Subscription Increase already effective

Addendum to II

Debt Issued to Governmental Institutions

(U.S. \$ Equivalent)

	<u>U.S.\$</u>	<u>DM</u>	<u>¥</u>	<u>£L.</u>	<u>All Countries</u>
Central Banks 2 Yr. ^{a/}	701.3				701.3
Bundesbank	81.4	566.9			648.3
Bank of Japan			419.4		419.4
Austria Central Bank	5.0				5.0
Bank of Libya				28.0	28.0
Saudi Arabia Monetary Agency	30.0				30.0
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total	817.4	566.9	419.4	28.0	1832.0

a/ Excluding \$23.2 million held by international organizations.

P & B
7/28/71

LEGISLATIVE APPROVAL FOR FUNDING OF CALLABLE SUBSCRIPTIONS

Question 2:

Does the funding of uncalled capital subscriptions have to receive further legislative approval from member countries, i.e. actual appropriations?

Answer:

By their acceptance of membership all member countries are legally bound to make any required payments on account of the callable portion of their subscriptions. As you know, in the United States with its distinctive technique which normally requires both authorization and appropriation, the Government obtained legislation which enables the Secretary of the Treasury, without further appropriation, to pay the amounts required to meet calls on the unpaid portion of the U.S. subscription and to use for this purpose the proceeds of U.S. borrowing. In some of the other major member countries the Government may consider it necessary or desirable to go through some form of parliamentary procedure. Techniques vary as among countries, but even where action akin to the U.S. type "appropriation" would have to be taken, such action would be no more than a formality, since parliaments would regard themselves as bound to take the technical steps required to implement the international obligations of the State. As regards any delays which such parliamentary procedures might cause, it is important to remember that the Bank need not postpone a call until the time when the funds are actually needed, but may make calls sufficiently in advance in order to meet its obligations as they mature.

*which only
John: UK*

work

underlying?

Legal Department

July 29, 1971

U.S. INCREASE IN CAPITAL SUBSCRIPTION

Question 3:

I note that the United States has not yet enacted legislation authorizing its increase in the capital stock of the Bank. What effect does this have on the Bank and on the United States' position in the Bank?

Answer:

U.S. authorized increase in capital subscription equals \$246.1 million, of which 1% would be paid-in in cash and presumably 9% would be released.

If and when the United States subscribes its capital increase, this will give the Bank \$25 million in cash and \$222 million in increase of callable capital, amounts which are not very significant for the Bank or, for that matter, for the United States.

The U.S. voting power will not be significantly affected by the capital increase.

P & B
7/30/71

COST OF BORROWING AND NET INCOME

Question 1:

(a) What will be the impact on the Bank's overall income if long-term rates remain at or about the present level?

(b) What is the financial justification for lending money at a lower rate than you have to pay for it and how long can and will that continue?

Answer:

The profitability of World Bank operations remains assured because of the large amount of equity capital (at present, \$4.0 billion of which \$3.6 billion is available for the Bank's operations). As of June 30, 1971, the average cost to the Bank of its total financial resources (usable equity plus borrowed funds) was 3.74% as against an average return on loans disbursed and outstanding of 5.84%.

Besides the cost of long-term borrowing, factors affecting the Bank's Net Income are:

- cost of short- and medium-term borrowings
- composition of borrowing by maturity
- yield on security investments
- lending rate
- etc.

Asset ret - "cash" 6.75⁺
Loans 5.84
Avg. Inv. 6.15⁺
Asset - Bonds
Eq. 0
all Res 3.74

INVESTMENTS INCOME

Question 2:

What is the impact on the Bank's income of changes in short-term rates of interest?

Answer:

The Bank holds about \$2.5 billion of liquid assets. In both FY70 and FY71, market conditions were exceptional and average return on our cash and securities averaged 7.93% and 8.13% respectively. Borrowing costs were also high, but on balance the Bank's Net Income showed substantial increase by comparison with preceding years. FY72 Net Income is projected assuming a rate structure closer to historical experience and this explains why although in line with results in earlier years, it will be lower than in FY71 and FY70.

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7/30/71

ALLOCATION OF NET INCOME

Question 3:

What do you do with your profits?

Answer:

FY72 Net Income available for allocation amounts to \$212 million. The Executive Directors allocated \$102 million to the Supplemental Reserve against Losses and the remaining \$110 million was transferred to IDA.

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EXCHANGE RATE RISK

Question 4:

How does the Bank cover itself against changes in exchange rates?

Answer:

The Bank does not take any exchange rate risk on funds borrowed as they are invested, lent and repaid in the same currency. Funds available from paid-in usable capital are lent in the original currency in which they were paid (or released) by subscribers. There is no risk on the usable capital as members are required to maintain its gold value. The Bank is, however, exposed to an exchange risk on its retained earnings which are kept in the currency in which they were earned, because in this case, there is no such protection from members.

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FY69-73 LENDING PROGRAM

Question 1:

Three years ago you said that the Bank in the ensuing five years would double the volume of lending, as compared to volume in the preceding five years. How close have you come to this target?

Answer:

	<u>Actual</u>			<u>Projected</u>		<u>Actual</u>	<u>Projected</u>
	<u>FY69</u>	<u>70</u>	<u>71</u>	<u>72</u>	<u>73</u>	<u>64-68</u>	<u>69-73</u>
IBRD Commitments to countries	1399	1580	1921	1800	1900	4296	8600
IDA	<u>385</u>	<u>606</u>	<u>584</u>	<u>930</u>	<u>930</u>	<u>1337</u>	<u>3435</u>
	1784	2186	2505	2730	2830	5663	12035

STANDARDS OF BANK LENDING

Question 2:

Mr. McNamara said that in doubling lending by the Bank the "high standards" of the past would be maintained. Was it found possible in view of the increased work load?

Answer:

Mr. McNamara to answer.

DISBURSEMENTS

Question 3:

The Bank has been making new loans at record levels for the last three years. What impact has this had on the volume of disbursements of loan proceeds?

Answer:

	<u>Actual</u>			<u>Projected</u>		<u>Actual</u>	<u>Projected</u>
	<u>FY69</u>	<u>70</u>	<u>71</u>	<u>72</u>	<u>73</u>	<u>64-68</u>	<u>69-73</u>
Commitments to countries	1399	1580	1921	1800	1900	4296	8600
Disbursements to countries	762	755	908	1158	1372	3395	4955

+761 +751

INCREASE IN STAFF

Question 4:

Is it a fact that your staff has doubled in three years?

How do you continue to maintain the "quality" of the Bank's work with so many new and inexperienced staff members?

Answer:

	<u>Actual</u>			<u>Projected</u>		<u>Actual</u>	<u>Projected</u>
	<u>FY69</u>	<u>70</u>	<u>71</u>	<u>72</u>	<u>73</u>	<u>64-68</u>	<u>69-73</u>
						av.	av.
Professional staff IBRD/IDA end year	961	1170	1388	1568	1679	669	1353

IBRD/IDA Commitments: FY69-73/FY64-68: 2.14

IBRD/IDA Professional: Av. FY69-73/Av. FY64-68: 2.02

SECTORAL COMPOSITION OF LENDING

Question 5:

Is the Bank widening the sectors in which it is active? Does this imply lending for promotion of social as distinct from economic objectives?

Answer:

Mr. McNamara to elaborate

FAMILY PLANNING

Question 6:

How many loans has the Bank approved for family planning and what are the amounts?

Answer:

To date, the Bank approved two loans for family planning:

- in FY70, to Jamaica (\$2.0 million)
- in FY71, to Trinidad (\$3.0 million)

The Association also approved one credit of \$4.8 million to Tunisia in FY71 for the same purpose.

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IBRD-IDA BLEND POLICY

Question 7:

How does the Bank justify Bank loans to countries who also receive IDA credits, i.e. are they partially creditworthy? In borderline cases, where the country also receives IDA credits, wouldn't it be preferable to offer only IDA credits?

Answer:

Mr. McNamara to answer.

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IBRD LENDING POLICY

Question 8:

How does Bank decide where to lend funds, i.e. according to per capita income, area of world, type of project, economic return, priority, need, etc.?

Answer:

Mr. McNamara to answer.

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DEFAULT AND DEBT RESCHEDULING

Question 1:

What is the Bank's default experience and are there any implications for debt rescheduling in Indonesia, India, Pakistan, Brazil or other countries which may have substantial debt servicing obligations? What will be the mix and concentration of debt to the Bank in 5-10 years?

Answer:

To date, the Bank has not had any defaults on its loans. Over the years, the Bank has agreed to reschedule loan repayments to assist two countries which were experiencing balance of payments difficulties. In the case of Haiti, the amortization schedule of a \$2.6 million loan was amended on three separate occasions. To help India, the amortization schedules of 12 loans were adjusted by postponing maturities totalling \$45 million for 10 years from the original maturity date. In both these cases, payments of interest continued to be made on schedule. The Bank has also rearranged maturities in a few cases for reasons related solely to the execution of the project -- delay in the start of the project in one case, a substantial change in the character of the project in another -- or to the financial condition of a non-governmental borrower.

The Bank's participation in the Indian debt renegotiation was motivated by special considerations. As a general principle, it would be highly undesirable if the "preferred creditor" position which has been accorded to the Bank were to be undermined. Because of the impact which reschedulings might have on both the volume and the cost of capital which the Bank must raise in the market, this view is generally held by developing countries.

IBRD: LOANS DISBURSED AND OUTSTANDING IN PART II COUNTRIES
AS OF JUNE 30, 1971

	<u>\$ million</u>	<u>% of Part II</u>	<u>Cumulative % of Part II</u>
Mexico	620.8	11.8	11.8
India	488.2	9.3	21.1
Colombia	372.8	7.1	28.2
Pakistan	343.2	6.5	34.7
Brazil	289.2	5.5	40.2
Yugoslavia	255.3	4.9	45.1
Venezuela	214.4	4.1	49.2
Argentina	194.6	3.7	52.9
Iran	181.8	3.5	56.4
Thailand	160.0	3.0	59.4
Spain	153.7	2.9	62.3
Malaysia	151.5	2.9	65.2
Nigeria	150.3	2.9	68.1
Philippines	127.3	2.4	70.5
Peru	125.1	2.4	72.9
Chile	118.7	2.3	75.2

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7/30/71

IBRD: LOANS DISBURSED AND OUTSTANDING IN PART II COUNTRIES
AS OF JUNE 30, 1978 a/

	<u>\$ Million</u>	<u>% of Part II</u>	<u>Cumulative % of Part II</u>
Brazil	1589.1	12.0	12.0
Mexico	874.1	6.6	18.6
Colombia	824.1	6.2	24.8
Argentina	684.7	5.2	30.0
Iran	668.4	5.0	35.0
Yugoslavia	609.2	4.6	39.6
Nigeria	471.5	3.6	43.2
China	443.7	3.3	46.5
Thailand	410.9	3.1	49.6
Pakistan	388.7	2.9	52.5
Turkey	375.7	2.8	55.3
Spain	372.3	2.8	58.1
Malaysia	359.5	2.7	60.8
Korea	335.5	2.5	63.3
Philippines	334.5	2.5	65.8
India	313.7	2.4	68.2
Venezuela	299.8	2.3	70.5
Chile	252.2	1.9	72.4
Morocco	245.9	1.9	74.3
EACSO	200.9	1.5	75.8

a/ Abstracted from Standard Table IVc dated July 16, 1971.

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7/30/71

Transfer Requirements in connection with a Call on
Unpaid Portion of the Bank's Capital

When the Bank makes a call on the unpaid portion of the capital, it must call on each member for its proportionate share (based on capital subscription) of the amount to be raised on the call. If one or more members fail to respond, the Bank will make successive calls, again on a pro rata basis, on the remaining members until the amount required is received, subject to the limitation that no member can be required to pay more in the aggregate than the unpaid portion of its subscription.

Payments may be made, at the option of the member, in gold, in United States dollars or in the currency required to meet the obligation for which the call is made. The application of this provision is simple where the call is made to meet an obligation payable in one currency, for instance a maturing DM issue or a maturing U.S. dollar issue. Its mechanical application would become less simple where all of the Bank's obligations had become due and had to be paid off since several currencies would be required in differing amounts. Presumably, unless another method were worked out by agreement, the call on each member would be for its proportionate share of each currency required by the Bank, with an option for the member to pay dollars instead of that currency.

If the Bank's outstanding obligations were denominated in the currencies of the several members in the proportions in which these members have subscribed to the Bank's capital, in the event of a call to meet these obligations each member could respond to the call in its own currency. In practice this situation is not going to materialize. The following table shows the extent to which, based on the Bank's outstanding obligations as of June 30, 1971, meeting a call would involve payment in foreign exchange for the members responding to that call:

(Thousands \$ equivalent and percentages)

Currency	Funded Debt Outstanding	Call from Members						Call from Members after Adjustment				
		Member	90% Callable	Share	Amount of Call	Paid in Members' Currency ^{a/}	Paid in Foreign Exchange	Foreign Exchange to be Purchased	Adjustment for C.B. Holdings of US\$ Issues ^{b/}	Paid in Members' Currency	Paid in Foreign Exchange	Foreign Exchange to be Purchased
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
US\$	3229594	U.S.	5715000	26.60	1442827	1442827		1786767	572635	1442827		1214132
DM	1296199	FRG	1228770	5.72	310262	310262		985937		310262		985937
¥	419444	Japan	920700	4.29	232697	232697		186747		232697		186747
Can\$	72286	Canada	712800	3.32	180082	72286	107796		(50000)	122286	57796	
f	71666	Netherlands	533070	2.48	134519	71666	62853		(5000)	76666	57853	
KD	42000	Kuwait	60030	.28	15188	15188		26812		15188		26812
EL	28000	Libya	18000	.08	4339	4339		23661		4339		23661
£	24132	U.K.	2340000	10.89	590691	24132	566559			24132	566559	
Lit	24000	Italy	599400	2.79	151334	24000	127334		(40000)	64000	87334	
SKr	14498	Sweden	216000	1.01	54784	14498	40286			14498	40286	
Other Member currencies			9140130	42.54	2307439		2307439		(477635)	477635	1829804	
Total Member Currencies	5221819		21483900	100%	5424162	2211895	3212267	3009924		2784530	2639632	2437289
SwF	202343							202343				202343
All Currencies	5424162		21483900	100%	5424162	2211895	3212267	3212267		2784530	2639632	2639632

^{a/} The amount paid by each member in its own currency is equal to the smaller of i) the debt outstanding in this currency and ii) the amount of the call on that member.

^{b/} If the Central Banks can be paid off in local currency no transfer will be required for the amounts of U.S.\$ 2 Yr. Central Bank Issues shown in this column. The total is smaller than aggregate members' holdings as, in some instances, holdings exceed the amount of the call.

TRANSFER TO IDA

Question 1:

In all how much has Bank granted to IDA?

Answer:

Transfers to IDA out of Net Income earned in

	<u>FY64</u>	<u>65</u>	<u>66</u>	<u>67</u>	<u>68</u>	<u>69</u>	<u>70</u>	<u>71</u>
	50	75	75	10	75	100	100	116
Cumulated	50	125	200	210	285	385	485	595

P & B
7/29/71

U.S. ACTION ON THIRD REPLENISHMENT

Question 2:

If the United States does not agree to its commitment under the Third Replenishment, what effect will this have on the continuation of IDA operations and on the Bank itself and its members, particularly blend countries?

Answer:

I think that the United States will agree to its commitment under the Third Replenishment, although I am not sure how long the legislative process will take; therefore, I think that the Third Replenishment will come into effect and IDA will continue its operations.

As far as current operations are concerned, several countries (Canada, Denmark, Finland and the United Kingdom)* have shown their confidence in IDA by making advance contributions to IDA which will enable it to continue operations for some months even though the Third Replenishment does not become effective.

In the event, however, that the United States does not ratify its commitment within a reasonable time, obviously the effect on IDA will be a very serious one. I would not want to speculate as to whether the other Part I members of IDA would want to continue making contributions to it without the participation of the United States.

* To this list, we may be able to add Japan and Yugoslavia.

If IDA runs out of resources, loans to blend countries will obviously be reduced since the Bank would not be able to take up the slack. In that event, the development process in those countries would be slowed down.

P & B
7/30/71

CONFIDENTIAL

SecM71-376

FROM: The Secretary

July 26, 1971

Policy on Expropriation

1. In response to the request made by several Executive Directors for information regarding the Bank's policy on expropriation, there is attached hereto (Annex A) a copy of Operational Policy Memorandum No. 1.01 entitled "Disputes over Defaults on External Debt, Expropriation and Breach of Contract".
2. The Bank's policy as stated in this Operational Policy Memorandum has evolved on a case by case basis. It was first considered by the Bank in connection with defaults on external public debt. A statement of the Bank's policy in this respect was contained in the Bank's Fifth Annual Report for the fiscal year ended June 30, 1950 (Annex B).
3. The Bank's policy in expropriation cases flowed from its policy on external debt cases. Since the policy has evolved on a case by case basis, a review has been made of the cases in which the Bank's policy has been referred to in President's reports recommending loans or credits and in discussions which have taken place at meetings of the Executive Directors. There is set forth below a list (which may not be exhaustive) of President's reports and other documents which deal with this matter and of meetings of Executive Directors for which records have been kept where there was significant discussion of the Bank's policy. Annex C contains extracts from those of the President's reports which are particularly illustrative. Transcripts of the Executive Directors' discussions are available, in accordance with Bank procedures, in the Executive Directors' Library (Room D-1356).

Distribution:

Executive Directors and Alternates
President
President's Council
Executive Vice President, IFC
Vice President, IFC
Department Heads, Bank and IFC

4. A statement of the Bank's policy in regard to defaults on foreign obligations first appeared in the first edition (1953) of the book setting out the Bank Group's policies and procedures (the so-called "Blue Book") and has appeared in all editions since then. The statement was revised in the 1968 edition to cover expropriation cases as well as external debt cases. An extract from the June 1969 edition, the latest edition outstanding, is attached hereto as Annex D. The 1953 and 1968 editions were circulated to the Executive Directors for their information and comment; our records show that no comment was received from any Executive Director on these statements.



Operational Policy Memorandum

DISPUTES OVER DEFAULTS ON EXTERNAL DEBT, EXPROPRIATION AND BREACH OF CONTRACT

Introduction

1. Except where the context requires otherwise, reference in this memorandum to the Bank applies to IDA and references to loans apply to development credits. The Bank Group has always taken an interest in disputes between a member country or a public body within it and nationals of other member countries arising out of certain international financial transactions. This interest has centered principally on three types of disputes:

(a) A dispute over the failure to service external debt in accordance with its terms. The Bank has been concerned primarily with external debt held by the general public, but on occasion with inter-governmental debt and external debt privately placed or held. It is concerned primarily with indebtedness of or guaranteed by governments and their political subdivisions and agencies.

(b) A dispute over compensation to aliens for property owned by them which has been expropriated (hereinafter referred to as a "dispute over expropriation"). Property may include direct and portfolio investment in real or personal property as well as concessions and franchises. Expropriation may be by direct transfer of ownership or by the state or other public body concerned taking effective possession or control without a transfer of ownership.

(c) A dispute over the breach of a governmental contract with aliens for goods or services.

2. Any of these disputes is a cause of concern to the Bank, but its reaction to each of them is

somewhat different. There can be no detailed rules and each case calls for an exercise of judgment. The Bank's reaction will depend on such factors as the character of the dispute, its expected consequences, and the extent to which the Bank can help resolve the dispute or mitigate its consequences. The fact that the dispute has not been formally brought to the attention of the Bank does not necessarily mean that the Bank does not take note of it.

3. The Bank's interest in disputes over defaults and expropriations is based on various considerations. First, the existence of such a dispute suggests that the debtor or expropriating country may be faced with problems, such as unfavorable economic conditions, unsound economic or fiscal policies or administration, or a lack of discipline or of a will to pay even at some sacrifice, or unwillingness to make politically difficult decisions. Any of these may well interfere with the economic progress of that country quite apart from the effects of the default or expropriation itself. As a development institution concerned with the interests of both the capital-exporting and the capital-importing countries, the Bank is interested in identifying the difficulty and seeing that it is removed.

4. Second, since the Bank is not intended to supply all the external capital requirements of its member countries, they must seek funds from public sources, the private capital market or direct private investment. A record of unsettled disputes over defaults or expropriations may deny these funds to the country and therefore interfere with its economic progress.

5. Third, the Bank (but not IDA) must also rely on the capital markets of the world to replenish its own resources. If it were to make new loans to

Issued: March 31, 1971

Page 2 of 5 Pages

Operational Policy Memorandum



countries which fail to make reasonable efforts to resolve disputes over defaults and expropriations, its market standing might suffer.]

6. Fourth, IDA depends on the governments of the capital-exporting countries for most of its resources, and their willingness to contribute funds to it may be affected by the records of the countries seeking credits from IDA in settling disputes with nationals of the donor countries over defaults and expropriations.

7. Somewhat similar considerations apply to some disputes arising out of a failure of the government or other public body to perform under a contract with non-nationals. Disputes may make it more difficult and more expensive for the country to obtain goods and services in the future and they may interfere with the effectiveness of international competitive bidding. However, they generally do not affect the credit standing of the country as directly as disputes over defaults and expropriations.

8. [Because of these considerations, the Bank seeks to promote settlements of these disputes through a variety of actions, ~~some of which are discussed in paragraphs 14 and 15.~~ When it is dissatisfied with the progress toward resolution of a dispute the Bank determines its own position with respect to lending and other activities in the country involved and, in doing so, it seeks to make a response graduated to suit the character and seriousness of the dispute and the progress toward its resolution. In some cases of dispute over defaults and expropriations, the Bank has gone the full distance of refusing to lend for projects in the country involved,] but it has not hitherto refused to do so in cases of disputes over breach of a governmental contract.

Policy on Defaults on External Debt

9. The Bank's policy can be described in the following terms:

(a) The Bank will not lend for projects in a country if it is dissatisfied with the position taken by that country with respect to external debt which is in default. Nor will it appraise projects in such a country unless it has good grounds for believing that the obstacles to lending will soon be removed. Grounds for dissatisfaction include:

(1) A refusal to negotiate in good faith with the bondholders coupled with a refusal to submit the dispute to judicial or quasi-judicial determination.

(2) A refusal to negotiate except on the basis of an offer by the debtor which, in the judgment of the Bank, is unreasonable and has been justifiably refused by the bondholders. Grounds for justifiable refusal may include an offer which appears substantially less than the country's economic situation and balance of payments position would warrant.

(3) A failure to make what the Bank deems reasonable efforts to settle. In some cases, the Bank has accepted the offer of a temporary settlement instead of a permanent one as a reasonable effort.

(4) A failure to resume debt service in accordance with the terms of an agreed settlement, a judicial decree or an arbitral award.

(b) If the defaulting debtor is a political entity or a public body for whose debts the government is not legally responsible, the Bank usually limits its refusal to lend to the defaulting body only and continues to lend to the government or other borrowers in the country. Among the factors influencing a decision of this sort are the nature of the defaulting debtor, the reason for the default, and the amount involved.



Operational Policy Memorandum

(c) If service is maintained only through payments by a guarantor, the Bank would normally refuse to lend to the original obligor who is in default. Among the factors influencing a decision of this sort are the nature of the original obligor, the reason for its failure to service the debt, its relationship to the guarantor, and the position taken by the guarantor.

(d) While lending is totally or partially suspended for these reasons, other Bank activities with respect to the member country or the defaulting body respectively will be determined in the light of the circumstances. In some cases, these activities can encourage settlement by indicating the Bank's willingness to proceed with lending as soon as it is satisfied with the country's efforts.

Policy on Expropriation

10. While the broad outlines of the policy with respect to disputes over defaults and expropriations are similar, a number of factors combine to make cases of expropriation less clear-cut than those involving defaults. These factors include more possibilities for differences over (i) the amounts involved and how payment is to be made, (ii) the respective obligations of the parties, and (iii) the responsibility for opening and carrying on negotiations. The Bank's policy with respect to disputes over expropriations can be described in the following terms:

(a) The Bank will not lend for projects in a country if it considers that the position taken by that country with respect to alien owners of expropriated property is substantially affecting its international credit standing. Nor

will it appraise projects in such a country unless it has good grounds for believing that the obstacles to lending will soon be removed.

Reasons for not proceeding with lending operations include:

(1) A denial of liability for compensation coupled with a refusal to submit the dispute to judicial or quasi-judicial determination.

(2) An admission of liability for compensation in general terms coupled with either an offer of compensation obviously inadequate in amount or terms of payment and not subject to negotiation, or else a failure to negotiate in good faith over such matters or to submit them to judicial or quasi-judicial determination.

(3) A failure, in the Bank's judgment, to make reasonable efforts to arrive at settlements.

(4) A failure to pay and, if required, to transfer abroad compensation in accordance with the terms of an agreed settlement, a judicial decree or an arbitral award.

(b) In the absence of special circumstances, the fact that the expropriated alien may have received adequate compensation through an investment guarantee or insurance scheme or in some other way does not eliminate the Bank's concern with an expropriation, and the Bank's position with respect to the expropriating country may be determined as if such compensation had not been paid. In determining its position, the Bank will take into

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account whether or not the expropriated alien's government seeks redress from the expropriating country. Normally the Bank will consider a dispute resolved if a settlement is reached between the expropriating and claimant countries.

Policy on Breach of Governmental Contracts

11. In principle the Bank wishes to see disputes over breach of governmental contracts settled expeditiously and fairly. In the Bank's experience, the typical dispute over breaches of governmental contract with aliens has involved questions of the quality of the work done or equipment provided, the prices to be paid, the time of performance, changes in the scope or nature of the project while work is in progress and the like. In such cases, many of the considerations which combine to make disputes over expropriations more difficult to resolve than those over defaults, such as uncertainty as to where the fault lies and as to the amounts involved, apply with even greater force. Furthermore, the number of these disputes is likely to be greater than in the case of default or expropriation, the amounts involved are likely to be smaller, and frequently the contracts in question provide for the settlement of disputes. In the normal case, therefore, the Bank, when faced with disputes of this sort not involving a project for which the Bank has made a loan, does not refuse to lend for projects in the country, does not lend its good offices for the settlement of these disputes, and seeks to avoid any involvement in the merits of the dispute. In cases where no steps are being taken toward resolution of this dispute, and where the existence of the dispute may impair the country's general reputation for behaving in a business-like way, however, the Bank does urge prompt action by both parties to resolve such disputes.

12. Where the dispute arises because the Government has made a significant retroactive change, by legislation or governmental decree, in the

terms under which a contractor or contractors have undertaken to work in the country, the Bank can be expected to take a more serious view of the matter.

13. Where the dispute arises in connection with a project for which the Bank has made a loan, however, additional considerations are involved. The Bank's interest in having the project completed promptly and satisfactorily calls for a prompt and equitable settlement of the dispute, and the Bank may intervene to achieve this result. Normally, such intervention occurs through the ordinary processes of project supervision, but in exceptional cases the Bank may take additional steps.

The Bank's Practice with Respect to Disputes over Defaults and Expropriations

14. In carrying out the policy set forth in paragraphs 9 and 10, the Bank seeks to promote prompt and adequate settlements, either negotiated between the parties on a mutually satisfactory basis or arrived at through conciliation, arbitration or judicial determination. Although it may eventually have to do so for the purpose of determining its own position, it initially tries to avoid passing on the merits of the dispute and to limit its role to improving communications between parties and impressing them with the desirability of a settlement. The Bank does not take the position that all the demands of the claimants must necessarily be met. At the same time it will be concerned to see that its desire to get on with its main task of lending for development does not unfairly reduce the claimant's chance of reaching a satisfactory settlement.

15. In a few cases, the Bank or its President, acting at the request of both parties, has taken a more active role in resolving a dispute. In such cases the Bank has preferred to arrange for arbitration or conciliation rather than to serve as arbitrator or conciliator itself. While the President of the Bank



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has on occasion accepted the role of conciliator where both parties have requested this, neither the Bank nor its President has ever accepted that of arbitrator. In addition, the Bank has avoided taking any public position on the rights and wrongs of such a case and has sought to find a settlement in financial, rather than juridical terms which are acceptable to the parties. With the creation of the International Centre for Settlement of Investment Disputes, it seems likely that many of these cases may be handled by the Centre rather than by the Bank.

16. Where a dispute over default or expropriation exists but the Bank decides to lend on the grounds that reasonable efforts to resolve the dispute are being made, the Bank will be concerned to see that

(a) progress toward a settlement or, if the dispute has been submitted to judicial or quasi-judicial determination, progress toward a decision continues after the loan commitment is made, and

(b) if there are different groups of claimants, progress is made with all of them, to the extent that the nature of the claims so permits, so that the Bank does not discriminate between them.

17. In most cases of default, the various bondholders' groups perform functions such as pressing for settlements, acting as a channel of communications, conducting negotiations and evaluating the adequacy of an offer of adjusted

service. The Bank takes these initiatives and evaluations into account in determining its own position with respect to the defaulting country. It does not, however, accept their evaluations as final and if it considers their refusal of an offer of settlement unreasonable, it will feel free to lend in the country in question.

18. Inevitably, disputes over defaults and expropriations involve many different factors, requiring the Bank to deal with them on a case-by-case basis. In doing so the Bank seeks to treat its member countries consistently, but from time to time the case-by-case approach may give decisions in particular cases an appearance of inconsistency. The risk of inconsistency is enhanced by the fact that the Bank's position may be affected by the position taken by the claimant's country with respect to the dispute. Since the country's reasons for its position may differ from those which arouse the Bank's concern over these disputes, the Bank will examine these reasons and take them into account in determining its position.

19. The Bank does not lend for the purpose of permitting a country to expropriate an enterprise by providing the funds needed for compensation, but if the question of compensation is satisfactorily settled, the fact of nationalization does not, of itself, prevent the Bank from lending, in appropriate cases, to enlarge or improve the properties after they have been nationalized.

3. Question: What is the Bank's position on expropriation of property by governments?

Answer: The Bank, as an international institution, does not hold or express views about government ownership of economic activities or of a government's right to acquire such ownership by exercising its power of expropriation.

The issue for us is not expropriation as such. From time to time, however, disputes arise between foreign investors and host countries concerning the compensation to be paid for nationalized or expropriated property. Unresolved disputes of this kind are a matter of concern to us.

The reason for our concern is clear: expropriation without reasonable compensation will shake investors' confidence in the host country and may reduce its creditworthiness in the eyes of foreign private and public financing institutions.

Now what is our posture in such a case? Let me start with the extreme case which fortunately occurs very infrequently. If the host country refuses to take any reasonable steps to settle the dispute, we may refuse to lend. There have been cases of this kind. We don't advertise them to the world. It is enough if the parties concerned know our decision and the reasons for it. To force a public confrontation can only serve to remove any possibility that might otherwise exist that the government will change its mind.

I mentioned the extreme cases. The decision may be painful, but intellectually it is an easy one. Much harder and much more frequent are the cases in which the issue is not as black and white. The cases in which we have to arrive at a judgment on whether the government is taking reasonable steps to work towards a solution. This calls for a pragmatic approach which the Bank has consistently followed over the last twenty years or so. When a government states its intention to compensate and shows willingness in good faith to enter into negotiations or act expeditiously in using its domestic procedures to determine compensation, we will as a rule continue normal operations in the country concerned. To the

extent that the host country's conduct is ambiguous, our response will be a graduated one in accordance with the facts as we see them. We may postpone lending until we become convinced that the country has firmly made up its mind to come to an agreement, but in other cases we may not resume lending until a settlement has actually been arrived at.

As I said, the judgments we have to make are difficult. I believe that by and large we have made the right judgments in the sense of having taken the action best calculated to promote a settlement.

NOTE:

The foregoing table shows the transfers (purchases of foreign exchange) required in order to meet calls. The extent to which a member will be able to meet a call in its own currency is directly related to the amount of Bank borrowings expressed in that currency (except for the possible adjustment on account of U.S.\$ Central Bank obligations). While the transfer requirement will be different for different members, the balance of payment effect will be the same for all. Members paying in their own currencies have already foregone the inflow which they would have received, had the Bank's obligations been paid, whereas members paying in foreign exchange experience a present outflow.

Legal/P & B
8/3/71

CHINA

Question 1:

If mainland China is admitted to the United Nations, what effect will this have on the Bank; would it be possible for Nationalist China to remain a member of the Bank; if so, under what circumstances? What would happen to their obligations to the Bank?

Answer:

There is very little I can say about this question at this time. I should point out, however, that ^{see} under the Articles of Agreement of the Bank questions of membership are to be determined by the Board of Governors of the Bank independently of what may happen in the U.N. or elsewhere; and the Board of Governors will have to deal with this question on the basis of the circumstances existing at the time.

As of June 30, 1971, the Bank has made loans to China totaling about \$295 million (of this amount \$68.9 million is not yet effective); loans outstanding (disbursed to date amount to \$94.6 million. Regardless of what may happen as far as membership is concerned, I see no reason to think that these loans will not be repaid.

P & B
7/30/71

PAKISTAN: DEBT SERVICE

Question 4:

Is Pakistan meeting debt service to the Bank?

Answer:

Yes

LOANS TO PAKISTAN

Question 2:

How much has the Bank lent to Pakistan?

Answer:

and

On June 30, 1971 loans outstanding/disbursed amounted to
\$343.2 million. Undisbursed portions of effective loans amounted to
\$119.5 million. All loans approved had become effective.

BANK'S RELATIONS WITH COMMUNIST COUNTRIES

Question 1:

Does the Bank lend to communist countries or can procurement (supplies or services) be obtained from communist non-member countries?

Answer:

The Bank can lend only to member countries. The only member country which is regarded as a communist country is Yugoslavia to which the Bank is making loans.

Under the Bank's loan agreements the Bank is obligated to make disbursements under the loan only for expenditures incurred by the borrower in the territory of any member country or Switzerland. Provisions to the same effect are incorporated in the Bank's Guidelines for Procurement.

Legal Department

July 29, 1971

GENERAL ECONOMIC POLICIES OF BORROWERS

Question 3:

Does the Bank stop disbursing on a project when a government enters office whose economic policies the Bank believes will not be consistent with the well-being of the country's citizens?

Answer:

The Bank's loan agreements contain extensive provisions requiring the borrower to carry out the project effectively and in accordance with standards designed to ensure satisfactory completion and operation of the project; and if there is a violation of any of these covenants the Bank can suspend disbursements. The Bank cannot suspend disbursements simply because it may not be satisfied with the general economic policies of a government.

Legal Department

July 29, 1971