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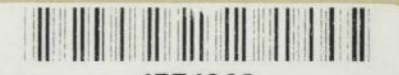
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A.3.03

Paper prepared for the Finance Committee on variable rate
borrowing in the U.S. market

OFFICE MEMORANDUM

TO: Members of the Finance Committee
(Through Mr. Moeen A. Qureshi)
FROM: Eugene H. Rotberg
SUBJECT: US Market - Variable Rate Borrowing Program

DATE: March 24, 1981

This memorandum (A) describes the US domestic market for short-term discount notes, (B) reviews the suitability of this type of financing for the Bank, and (C) outlines a phased approach to entering the market. Actions are recommended to prepare for Board approval a variable rate borrowing program by the Bank.

(A) The US Market for Short-Term Paper

The US short-term market represents a large reservoir of funds which is being tapped by the Federal government, US agencies, domestic and foreign corporate issuers of commercial paper and banks issuing Certificates of Deposit and bankers' acceptances. The total funds outstanding in this market are estimated at \$521 billion. The market provides a high degree of liquidity due to the short-term nature of the instruments involved and the broad spectrum of buyers - - corporations, bank trust departments, money market funds, insurance companies, pension funds, municipalities, central banks, etc. Generally, during periods when investor interest for intermediate and long-term bonds practically disappears, the short-term market continues to function as an operational necessity, particularly as a basis for government financing.

About two-thirds of the outstanding short-term instruments in the US market are issued in the form of discount paper - - the most typical is the 3, 6 and 12 month US Treasury Bill. Such instruments do not

bear interest but are issued at a discount from their face value; on maturity, the investor receives the full face value. The discount from par, therefore, corresponds to the return on the investment.

There are differences in yields offered by different borrowers. The yield is directly related to the credit standing of the issuer, the extent to which the short-term paper is eligible for various reserve requirements, and its appeal as an investment vehicle for institutional investors. The Federal agency discount notes command the highest market rating and are normally offered at the lowest yield spread over direct US Treasury obligations.

The Bank's investment bankers have suggested that it embark on a program of issuing short-term obligations in the form of discount notes which would be offered and refinanced continuously at 30-365 day intervals. Our bankers argue that, in view of the size of the Bank's overall borrowing program, it must tap new markets in the United States and have a visible and continuous presence in the financial markets. They contend there are investors who are not presently holding World Bank intermediate and long-term securities who would purchase, as a first step, our short-term obligations, and thereafter, would purchase future offerings of intermediate and long-term obligations. These resources would essentially be permanent in character - - they would tap the huge pool of the short-term money market in the United States - - though with a variable interest rate set at the time of refinancing a maturing obligation.

In addition, considering the large increases in funding requirements even over the near term, it is not probable that the Bank can finance its lending exclusively through medium and long-term fixed rate debt either

because of the unavailability of the Bank's normal resources and/or because of the cost burden which would have to be assumed by the Bank's borrowers.

B. The Suitability of this Type of Financing for the Bank

There are two separate risks to borrowing in the short-term markets:

(1) an interest rate risk and (2) a refinancing risk. The extent of the risk exposure depends upon the uses of the borrowed funds; if the uses change over time, the risks associated with using the funds will also change.

1. Interest Rate Risk. If the Bank had no liquidity at all and simply borrowed the funds in the short-term market - - or for, say, 10 years but with the interest rate reset every 3 or 6 months - - the variability would have to be passed on to our borrowers in order to avoid risk to the Bank. The Bank, however, does have substantial liquidity - - estimated at about \$10 billion at the end of FY81, derived from various sources - - equity, loan repayments and fixed interest borrowings. Thus, if the Bank were to borrow, say, \$2 billion in the short-term markets, those funds could be invested profitably in matching maturities in other segments of the short-term market, e.g., the Eurodollar market - - by taking advantage of the positive spreads between US domestic and Europaper. The tables below set forth recent historic spreads between the cost of issuing discount notes in the United States and reinvesting simultaneously at the same maturity either in US bank domestic Certificates of Deposit or in the Eurodollar market. While there can be no certainty that the Bank will achieve these profits, these spreads offer reasonable prospects for a similarly structured Bank program.

Table 1 below shows that for the past three years a positive spread existed between discount notes issued by U. S. Federal agencies and US domestic Certificates of Deposit (CD's).

TABLE I

MONTHLY SPREAD BETWEEN, DOMESTIC U.S. CD's
AND US FEDERAL AGENCY DISCOUNT NOTES

(in basis points)

	<u>1978</u>		<u>1979</u>		<u>1980</u>	
	<u>3-month</u>	<u>6-month</u>	<u>3-month</u>	<u>6-month</u>	<u>3-month</u>	<u>6-month</u>
Jan.	35	15	90	80	60	35
Feb.	20	20	55	30	60	55
Mar.	17	15	20	30	130	105
Apr.	10	15	5	20	205	175
May	25	30	15	30	130	85
June	13	30	10	5	50	50
July	10	50	45	32	75	65
Aug.	35	35	55	45	10	35
Sep.	30	55	45	80	35	40
Oct.	25	45	75	92	60	55
Nov.	145	120	100	95	75	55
Dec.	<u>70</u>	<u>120</u>	<u>80</u>	<u>90</u>	<u>165</u>	<u>90</u>
Average:	37	46	49	53	89	71

Table 2 below compares US federal agency discount notes with 3- and 6-month LIBOR. The positive spreads are even more convincing. Investment of short-term borrowing proceeds in Euro-deposits would have consistently provided considerably higher positive spreads during the past three years than the US domestic CD's and would, therefore, have been a more attractive investment (see also recommendation, page 8, paragraph 2).

TABLE 2

MONTHLY SPREAD BETWEEN LIBOR AND U.S. FEDERAL AGENCY DISCOUNT NOTES
(in basis points)

	<u>1978</u>		<u>1979</u>		<u>1980</u>	
	<u>Maturity</u>		<u>Maturity</u>		<u>Maturity</u>	
	<u>3-Month</u>	<u>6-Month</u>	<u>3-Month</u>	<u>6-Month</u>	<u>3-Month</u>	<u>6-Month</u>
Jan.	86	78	181	174	181	179
Feb.	80	83	84	61	169	144
Mar.	85	70	69	79	244	184
Apr.	81	73	74	65	400	319
May	75	71	94	105	244	206
June	60	80	68	59	153	169
July	75	120	135	114	159	165
Aug.	80	96	168	119	81	85
Sep.	100	111	145	160	175	162
Oct.	91	101	168	170	165	151
Nov.	245	214	210	188	156	120
Dec.	<u>190</u>	<u>218</u>	<u>190</u>	<u>178</u>	<u>244</u>	<u>165</u>
Average:	104	109	132	123	197	179

A profit center, therefore, would be established which (on the basis of assets and liabilities with matched maturities) would contribute to the overall profitability of the system. Assuming, therefore, the Bank's liquid holdings were to rise to, say, \$12 billion, there would be no need to pass on the cost of, say, a \$2 billion short-term borrowing program to our borrowers. Indeed, conceptually, until our liquidity reached a level equal to the amount of short-term obligations outstanding, there would be no intermediation cost risk which had to be passed on to borrowers. But at that point, because of the large pool of undisbursed loans at fixed rates and our lending rate policy, it would be far too late to implement decisions to pass on the costs to our borrowers. It is therefore important to fix a point at which the interest rate risk might appropriately be passed on to World Bank borrowers. While there may be several appropriate points at which to trigger lending at variable rates to LDC's or incorporating the costs of variable rate borrowings into a fixed lending rate, this paper recommends that, pending any change in our liquidity formula and/or a change in the method by which the lending rates are set, it would seem prudent and less controversial if we simply passed on the cost only at that point at which short-term borrowings were needed to maintain our liquidity at the 40% level (see discussion of Phase 2 below).

2. Refinancing Risk. There is also the risk that, assuming the Bank wants to refinance, the funds will not be available at maturity for refinancing. This risk, in turn, can occur from two causes. First, there is the risk that the Bank's credit would deteriorate to the point that its credit standing did not permit it to refinance short-term maturing obligations even for

30 to 60 days; the second risk is that all short-term money markets might "disappear" and not be available to any borrowers. The first risk, while hopefully not a realistic one, is one which must be considered if the Bank is dependent on the short-term funds - - either to maintain its "40%" liquidity, or for disbursements. In order to avoid that risk, the Bank can arrange for a 10-year line of credit (from commercial banks) which would guarantee to the subscribers of short-term paper a facility to repay them and to the Bank a longer term source of funds. In effect, the standby would permit the Bank to draw down, say, \$2 billion for a period of 10 years at variable rates linked to the marginal costs of commercial bank financing (Certificates of Deposit, plus reserve requirements) prevailing in the market as a substitute for the short-term market borrowing.

The second risk, namely that the short-term funds would disappear, is simply not possible. These resources represent about 30% of M2 - - a broad based measure of the US money supply.

TABLE 3: SHORT-TERM PAPER
(Under 1 Year Maturity)

	<u>Growth of Outstanding</u>			<u>12/31/80 Amount Outstanding (\$ billions)</u>
	<u>1978</u>	<u>1979</u>	<u>1980</u>	
<u>ISSUERS</u> ^{1/}				
Treasury Bills	0%	17.3%	23.3%	212.9
Federal Agencies	19%	17.7%	18.0%	18.6
Certificates of Deposits	29%	-13.2%	27.0%	109.9
Bankers' Acceptances	32%	34.0%	21.0%	54.7
Commercial Paper	28%	35.0%	12.3%	<u>124.8</u>
			TOTAL	520.9

<u>Held By:</u>	<u>(%)</u>
Nonbank Finance Institutions ^{2/}	35.2
Commercial Banks	6.3
Business Corporations	31.2
State & Local Governments	4.1
Central Banks & Monetary Agencies	22.9
Residual Households Direct	<u>0.3</u>
	100%

^{1/}In addition, there are about \$3.5 billion of short-term discount notes issued and guaranteed by foreign governments in the US market (EDF, GDF, CNT, SNCF, British Postal Service, British Gas, EDC, and Svenskavar).

^{2/}These include: money market funds, mutual savings banks, savings and loan associations, credit unions, life insurance companies, property liability companies, private noninsured pension funds, state and local retirement funds, foundations and endowments, taxable investment funds, and security brokers and dealers.

It is the short-term market which, during periods of price volatility, inflation, economic and political instability, has been consistently viable. Ninety percent of all commercial bank resources are derived from the short-term money markets through the issuance of CD's, time deposits and bankers' acceptances. It is the primary source for financing government deficits. It is the primary investment vehicle for the international reserves of the world's central banks and an important outlet for funds for insurance companies, pension funds, thrift institutions, and other managers of funds as seen in the Table above. The Bank would need U.S. consent for a program of short-term borrowing. We could request, say, 10 year authority for a program with a limitation on maximum outstanding dollar amounts. Given this consent, the only circumstance in which short-term resources would be unavailable is in an environment in which inflationary expectations were such that savers preferred to make investments in long-term fixed instruments with a fixed, certain and substantial real return. Under that environment, or indeed during circumstances leading up to that environment, the Bank could readily repay its short-term funds and refinance in medium- and long-term markets.

C. Phasing the Entrance to Market

It is proposed that a two phased approach be taken with respect to short-term borrowing.

Phase 1

In the first phase the Bank would enter the US discount note market with a 30 to 365 day maturity paper on a modest scale with an overall ceiling for the program - - to be extended over 18 months - - of say, \$2 billion. Our investment bankers suggest \$2 billion as a reasonable order of magnitude to assure investors of the seriousness of the program and market receptivity.

These funds would be invested in broadly matching maturities thereby locking in the positive spread existing between the various short-term markets. The operations and investing would be self-contained and profitable.

In the first phase the short-term funds would not be counted as part of the borrowing program or used in setting the lending rate. The program would offer us considerable future flexibility in planning and executing our regular, medium and long-term fixed rate borrowing program in that we could forego entering intermediate and long-term markets at excessively high rates for a longer period by such additions to our liquidity within budget periods. To some extent, therefore, it could permit us to avoid making intermediate and long-term borrowings at nominally high fixed rates which become a permanent part of the Bank's liability structure at costs now directly borne by our borrowers. In a sense, during the year, we could be adding to our liquidity by means of a program which would carry no cost. Because, however, we do not think it prudent to substitute short-term borrowings for our basic program of intermediate and long-term fixed rate obligations (which are designed to fund a lending program with similar characteristics), it is proposed to treat such short-term debt as "additional" to our calculated borrowing program.

The proposal to initiate a short-term borrowing program for the Bank with a matching investment program would give the Bank an opportunity to familiarize itself with this new type of borrowing. It would provide a source of net income for the ultimate benefit of the Bank's operations. Finally, it would tap new markets in the United States and provide a visible and continuous presence in the financial markets which could lead to additional long-term funds. Our bankers are convinced there are investors who are not

presently holding World Bank intermediate and long-term securities who would purchase, as a first step, our short-term obligations, and thereafter, following familiarization with the institution, would purchase future offerings of intermediate and long-term obligations. There is some urgency to laying the foundation for these future borrowings considering the substantial requirements for our borrowing program.

In this connection we should ask the U.S. Treasury to authorize investment of 100% of our borrowed short-term funds in the Euromarket (present arrangements with Treasury permit only 50% of funds raised outside US in Euromarkets) in order to maximize the benefits of the program.

There does not seem to be any necessity for providing a standby credit facility for these operations during the first phase. Such a facility, however, is available in the market. We have received indications from a major bank in New York that a \$2 billion standby with a term of 10 years would cost the Bank about \$4 million annually - - well below the normal commitment fee for long-term commercial bank lines of credit. Indeed, our investment bankers have considered this "standby" facility as unnecessary; given our liquidity and callable capital, it might be considered "gilding the lily" to the point where it could be counterproductive and might increase the cost of the short-term borrowing program because of a perceived sign of weakness.

In short, the first phase of entry into the short-term markets would have the following characteristics:

1. The Bank could raise up to \$2 billion in 30-365 day paper in the US domestic market;
2. The borrowings would not form part of the Bank's borrowing program;

3. The cost of these borrowings would not be included in the lending rate calculation;
4. The Bank would be permitted to fully invest these funds both in the Eurodollar market and in bank deposits.
5. The Bank would not arrange for a standby facility with commercial banks.

Phase 2

The second phase in a variable rate borrowing program would be triggered when borrowings by the Bank in medium and long-term markets were insufficient to maintain the Bank's 40% liquidity formula on a year-to-year basis. At that point, the Bank would implement steps to protect itself against both the interest rate risk and the refinancing risk of short-term funding.

With respect to the refinancing risk, we believe that, although the potential risk may be small, the Bank might wish to avail itself of standby lines of credit to effectively transform short-term funds into long-term liabilities, at such time as such funds are required to maintain the 40% liquidity margin on an annual basis, i.e., when such borrowings represent a funding of undisbursed commitments under current financial policies. At that point, the Bank management should also be in a position to recommend to the Board measures for passing on the variable costs of such borrowings in our lending operations.

The Bank's lending and commitment program is only partially funded by long-term borrowings. Even if full long-term debt funding were assumed, the present lending rate formula does not cover all the risks to which the Bank would be exposed through its borrowing activities, given the volatility in the long-term markets, the lag between commitments and disbursements, and the maturity mismatching among our long-term assets and liabilities. Given the substantial holdings of undisbursed loans (\$28 billion at 6/30/81) at an interest

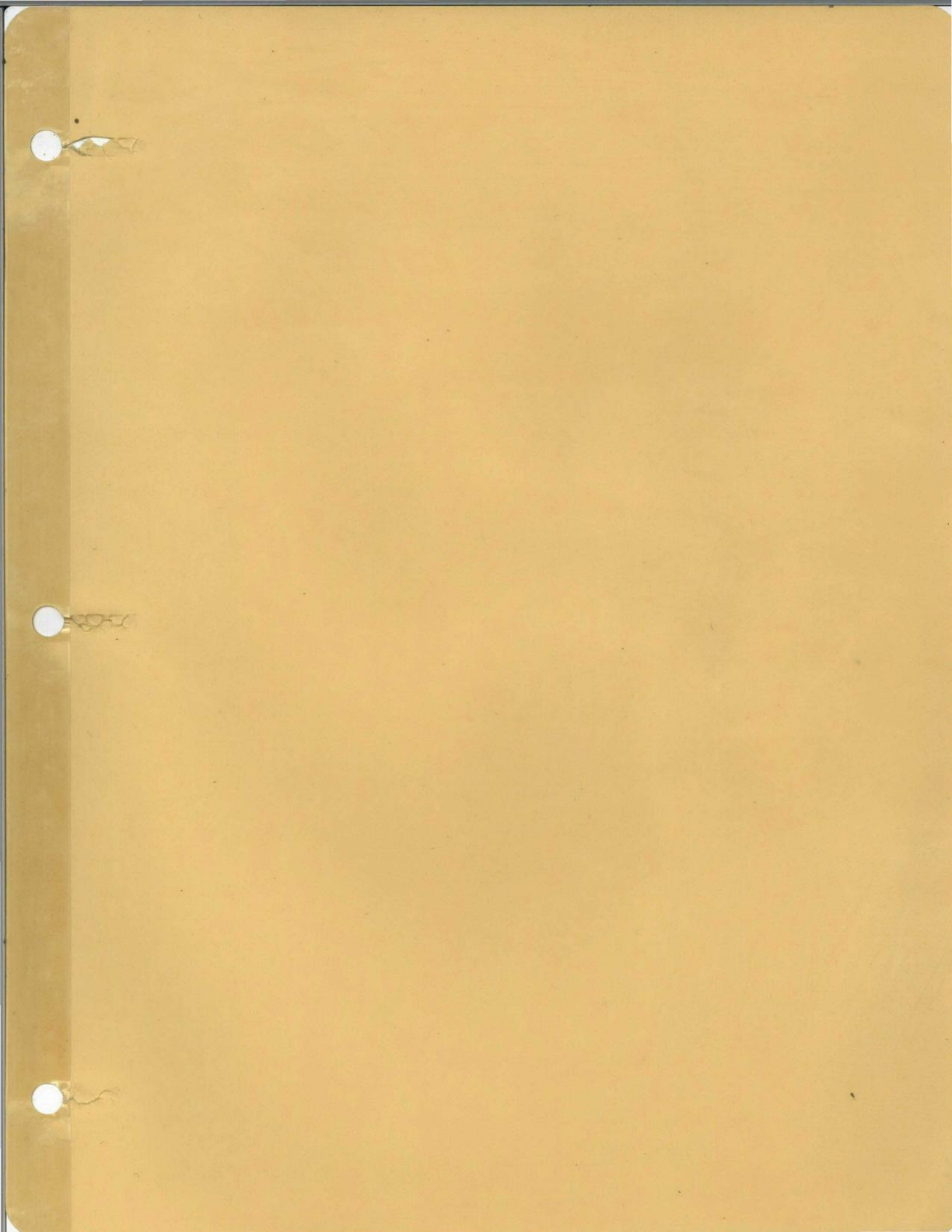
rate of 8.2%, an examination of lending rate policy should be undertaken in the context of recent structural changes in the capital markets, rather than as a response to the initiation of a variable rate borrowing program.

Several options for offsetting the variable rate costs are available. At one extreme, the Bank could change the rate for loan commitments from fixed to variable, and set it at the time of loan disbursement rather than at commitment in order to assure a certain recovery of cost. At the other extreme, the Bank could change the present fixed rate spread over borrowing costs to a rate believed sufficient to assure cost recovery for variable rate borrowings. Or, the Bank might specifically incorporate the cost of variable rate resources - - on a single-weighted basis - - in setting a fixed lending rate. Between these positions, several options and blends are possible: for example, certain loans, e.g., structural adjustment loans, might be offered at floating rates - - perhaps at the option of the borrower; or, loans might carry a blend of fixed rates under the currency pooling system and floating rates in US dollars in a manner similar to the practice of the European Investment Bank.

Action To Be Taken:

- (1) A paper should be prepared for the Board recommending that we go forward with Phase 1 of the variable rate borrowing program, the cost of which would not be calculated in setting the lending rate. The borrowings would not be counted against the borrowing "requirement" under the 40% formula on a year-to-year basis.

- (2) The paper would take the position that if the Bank were required to borrow at variable rates in order to maintain the 40% formula, it would first address the issue and recommend to the Board how the variable cost might be passed on to its borrowers.
- (3) In anticipation of (2) above, Bank management should initiate a review of alternative means of setting the lending rate - - even assuming continuation of only fixed rate funding - - and incorporate in that paper how it would propose to pass on the cost of a variable rate borrowing program.



717/4/3

A.3.01

Descriptive material on the Bank's borrowing operations

(Extract from "The World Bank: A Financial Appraisal",
by Eugene H. Rotberg, Vice President and Treasurer;
January 1981)

THE WORLD BANK
A FINANCIAL APPRAISAL

BY

Eugene H. Rotberg
Vice President and Treasurer
World Bank

January, 1981

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1818 H Street, N.W.
Washington, D.C. 20433

2. BORROWING OPERATIONS

The World Bank's borrowing operations constitute the major source for financing its lending program. The Bank borrows about 70% of what it lends. The aggregate of the Bank's borrowings in the six fiscal years 1975-80 was about \$30 billion compared with \$8.6 billion in the preceding six years. Its outstanding debt rose from \$12.3 billion in 1975 to \$29.7 billion at September 30, 1980. The higher rate of borrowing in the capital markets supported the World Bank's financial requirements that resulted from the expansion in its lending operations during the period.

Borrowing Policies

The Bank's basic borrowing policy is to diversify the markets for its obligations in order to avoid undue dependence on one particular market. The Bank's obligations are held by investors in more than 100 countries in Africa, Asia, Australia, Europe, the Middle East, and North and South America. The Bank is the largest non-resident borrower in virtually all countries where its issues are held.

When the Bank first borrowed in 1947, the only major market open to it was the United States. It was there that most borrowed funds were raised through the 1950's. Beginning in 1950, the Bank started to develop markets for its securities in other countries, and in that decade it raised funds in Belgium, Canada, the Federal Republic of Germany, the Netherlands, Switzerland, and the United Kingdom. As world trade and finance recovered from the effects of World War II, the Bank pressed in the late 1960's and the 1970's to establish a substantial and widespread market for its securities outside the United States - both with the traditional private institutional markets and with governments and their agencies having funds to invest.

Thus, the shifting pattern of savings and foreign exchange since the mid-1960's was reflected in corresponding shifts in the major sources of funds for the Bank. The Federal Republic of Germany was the principal source in the late 1960's, Japan in the early 1970's, certain members of the Organization of Petroleum Exporting Countries (OPEC) in 1974, and the United States in 1977. In fiscal years 1976 and 1977, the Bank raised the majority of its funds in the United States, Germany, and Switzerland. In fiscal years 1978 and 1979 and 1980, substantial borrowings have been executed in Swiss francs, Deutsche mark, and Japanese yen, reflecting the demand of non-resident investors. The Bank has developed the flexibility to select the markets and currencies that will allow optimum borrowing conditions and has lessened its dependence on any particular specific market. Currently, the Bank's securities are denominated in 17 different currencies. As shown in the table below, while the U.S. dollar historically has been the currency of choice for World Bank borrowings, in recent years the Deutsche mark, Swiss franc and Japanese yen have financed most of the Bank's increasing requirements. The cost of the Bank's outstanding debt essentially has remained unchanged since 1975 - the implications of which are described below.

**OUTSTANDING BORROWINGS
BY CURRENCY OF BORROWING**
(in Millions of US\$ Equivalents)

CURRENCY	As of June 30						As of September 30
	1975	1976	1977	1978	1979	1980	1980
United States dollars	\$ 5,692.5	7,151.1	9,172.9	9,847.8	9,733.0	9,819.4	9,396.1
Austrian schillings	-	-	-	-	-	80.0	78.0
Belgian francs	80.8	70.9	75.4	80.0	85.3	80.7	78.2
Canadian dollars	145.3	153.8	129.4	110.2	93.9	59.9	58.7
Deutsche mark	2,858.7	3,198.8	4,493.5	5,687.8	7,061.1	8,809.7	9,118.8
French francs	37.1	30.6	28.8	28.5	29.5	29.3	26.5
Italian lire	95.2	71.4	50.9	52.6	51.6	47.4	41.8
Japanese yen	1,500.9	1,495.0	1,652.9	2,919.1	3,515.7	4,133.7	4,268.8
Kuwaitidinars	422.7	390.6	373.2	352.6	310.5	278.9	271.8
Lebanese pounds	33.7	30.5	24.4	-	-	-	-
Libyan dinars	135.1	101.3	101.3	101.3	101.3	101.3	101.3
Netherlands guilders	195.9	313.3	335.2	403.1	426.0	426.7	417.7
Pounds sterling	34.9	27.6	8.9	9.0	9.8	9.9	10.0
Saudi Arabian riyals	143.3	141.6	141.6	145.1	148.2	150.2	150.6
Swedish kronor	38.1	33.7	33.5	31.7	31.5	30.1	30.0
Swiss francs	673.1	1,237.0	1,635.1	2,635.2	4,485.3	5,427.9	5,501.1
United Arab Emirates dirhams	76.0	76.0	77.0	77.4	79.0	72.9	73.2
Venezuelan bolivares	123.7	123.5	123.5	121.1	118.8	109.5	101.3
TOTALS	\$12,287.0	\$14,646.7	\$18,477.5	\$22,602.5	\$26,280.5	\$29,667.5	\$29,779.1
Weighted Average Effective Interest Rates*	7.14%	7.41%	7.40%	7.24%	7.06%	7.23%	7.27%

*These rates reflect the cost of borrowings established at the date of issues.

The diversity of the Bank's borrowings is unique. Since 1970, the Bank has borrowed, through public issues or private placements, in Austria, Belgium, Canada, France, the Federal Republic of Germany, Italy, Japan, Lebanon, the Netherlands, Sweden, Switzerland, the United Kingdom, the United States, Yugoslavia, and in the Eurobond market, as well as from OPEC countries. In many, if not most of these countries, the Bank has access to markets beyond that accorded other non-resident borrowers.

Borrowing Program

Given the diverse mix of the Bank's borrowings by country and currency, it may be useful to examine what the Bank looks at in deciding where, when, what and how much to borrow. The Bank does not borrow at random. Given the life of its outstanding loans, it aims to have an average life at fixed interest rates of 8 to 10 years for its debt. It seeks to achieve such a goal after taking into account direct placements (which use no financial intermediaries) of two to six and one half year bonds or notes with central banks. These direct placements are continually refinanced, but because of their rather short-term nominal maturity, the Bank offsets these borrowings with 10 to 15 or even 20-year resources.

The Bank is prepared to give long-term call protection with respect to public issues. It will adjust sinking funds and amortization to meet fully the requirements of the buyers of its securities. It is also prepared to accept delayed delivery for funds for as long as one or possibly two years.

The Bank does not favor public issues over private placements. For example, of approximately 30 to 50 different issues a year, less than 10 are listed or traded in public markets. The remainder are done with governments or central banks or through private placements with the investment banking community.

The Bank does not take a currency risk on its borrowings: Pending disbursement, the Bank holds as part of its liquidity the currencies it has borrowed. As noted in the previous section, when it disburses these funds, the Bank disburses to its borrowers the currencies borrowed and borrowers repay their loans, and pay interest thereon, in the same currencies as those originally disbursed by the Bank. Borrowers are lent a variety of different currencies over the six or seven year disbursement period.

The Bank, however, acts as if it took the currency risk. That is, it calculates the implicit revaluation potential of a currency borrowed against the interest rate differential of other major currencies. Thus, if the cost of a Swiss franc borrowing is 5% for 10 years and the cost of a U.S. dollar issue 12% for a similar maturity, a rather simple formula tells us that the implicit revaluation of the Swiss franc over 10 years, which would offset the favorable nominal interest rate differential, is 91%. Thus, if we think that the dollar will not devalue more than 91% over the succeeding 10 years, we borrow Swiss francs. If on the contrary, we believe that the dollar is likely to devalue more than 91%, we will borrow U.S. dollars. It is not a random choice.

One of the principal reasons why the Bank borrowed almost exclusively in Deutsche mark, yen and Swiss francs in recent years is that it was our belief that the dollar, given the interest rate differentials vis-a-vis these currencies, was undervalued. This does not mean that we believed that the dollar would not devalue at all. Rather, we did not believe the dollar would devalue by as much as the interest rate differential implied. For the Bank's borrowers, the gain from this policy has been considerable - in the hundreds of millions of dollars in recent years - since the Bank's borrowers have had the advantage of both a low nominal interest rate and a revaluation gain in terms of dollars. Clearly, however, we do not know whether future movements of the U.S. dollar vis-a-vis these other currencies will be in a manner which will offset the lower nominal interest rate advantage afforded by such other currencies.

Markets of borrowings

The World Bank sells its securities in two main categories of markets: First, it places its bonds and notes directly with its member governments, their agencies or central banks. Second, it offers its issues to investors in the private investment markets through the medium of investment banking firms, merchant banks, or commercial banks. During the five fiscal years 1976 to 1980, the World Bank borrowed from governmental sources in some 95 of its member countries and has sold its securities through underwriters in markets of five countries. A breakdown of the Bank debtholders among governments (or central banks) and private holders - mainly institutional holders - during fiscal years 1977 to 1980 is shown in the table below:

CLASSIFICATION OF BANK DEBT BY CATEGORY OF HOLDERS
(As of June 30 in \$ millions)

	<u>U.S. Dollar</u>	<u>%</u>	<u>Other Currencies</u>	<u>%</u>	<u>Total</u>	<u>%</u>
1980						
Central Banks or Government Accounts	\$ 3,371.5	34.3%	\$ 4,525.8	22.8%	\$ 7,897.3	26.6%
Other Holders	<u>6,447.9</u>	<u>65.7</u>	<u>15,322.3</u>	<u>77.2</u>	<u>21,770.2</u>	<u>73.4</u>
Total Outstanding Debt	\$ 9,819.4	100.0%	\$19,848.1	100.0%	\$29,667.5	100.0%
1979						
Central Banks or Government Accounts	\$ 3,678.0	37.8%	\$ 4,077.6	24.6%	\$ 7,755.6	29.5%
Other Holders	<u>6,055.1</u>	<u>62.2</u>	<u>12,469.9</u>	<u>75.4</u>	<u>18,525.0</u>	<u>70.5</u>
Total Outstanding Debt	\$ 9,733.1	100.0%	\$16,547.5	100.0%	\$26,280.6	100.0%
1978						
Central Banks or Government Accounts	\$ 3,676.1	37.3%	\$ 3,678.2	28.8%	\$ 7,354.3	32.5%
Other Holders	<u>6,171.7</u>	<u>62.7</u>	<u>9,076.5</u>	<u>71.2</u>	<u>15,248.2</u>	<u>67.5</u>
Total Outstanding Debt	\$ 9,847.8	100.0%	\$12,754.7	100.0%	\$22,602.5	100.0%
1977						
Central Banks or Government Accounts	\$ 3,659.0	39.9%	\$ 2,784.5	29.9%	\$ 6,443.5	34.9%
Other Holders	<u>5,513.9</u>	<u>60.1</u>	<u>6,520.2</u>	<u>70.1</u>	<u>12,034.1</u>	<u>65.1</u>
Total Outstanding Debt	\$ 9,172.9	100.0%	\$ 9,304.7	100.0%	\$18,477.6	100.0%

The widespread holdings of the Bank's obligations by member countries and their central banks, which represent about 27% of its total outstanding debt at the end of fiscal year 1980, reflects their support for the Bank's development activities and

their assessment of its credit. The diversification through direct placement with governments or central banks has given the Bank increased flexibility in its borrowing program by providing a stable and permanent source of resources at market based terms.

A breakdown of outstanding Bank obligations held by investors (as distinguished from currencies) indicates that a large amount of the Bank's debt is concentrated in five sources:- the United States, the Federal Republic of Germany, Japan, Switzerland and OPEC (see table below).

CLASSIFICATION OF OUTSTANDING DEBT

BY SOURCE OF BORROWING

(As of June 30 in \$ billions)

	<u>% of Total</u>				<u>Total</u>			
	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>
United States	18.01%	21.68%	25.72%	27.92%	\$ 5.4	\$ 5.7	\$ 5.8	\$ 5.2
Germany	27.72	25.41	24.33	23.51	8.2	6.7	5.5	4.3
Switzerland *	15.94	15.53	10.60	7.99	4.7	4.1	2.4	1.5
Japan	14.07	13.49	13.03	9.06	4.2	3.6	2.9	1.7
OPEC **	14.17	15.38	16.65	19.74	4.2	4.0	3.8	3.6
Other	<u>10.09</u>	<u>8.51</u>	<u>9.67</u>	<u>11.78</u>	<u>3.0</u>	<u>2.2</u>	<u>2.2</u>	<u>2.2</u>
	100.00%	100.00%	100.00%	100.00%	\$29.7	\$26.6	\$22.6	\$18.5

Notes:

*Switzerland is not a member country.

**Includes OPEC Countries, Bahrain, Oman, and Trinidad and Tobago of which:

Saudi Arabia	5.58%	5.81%	6.39%	7.56%	\$ 1.7	\$ 1.5	\$ 1.4	\$ 1.4
Kuwait	1.88	2.04	2.50	3.11	0.6	0.5	0.6	0.6
Libya	1.70	2.06	1.30	1.15	0.5	0.5	0.3	0.2
Venezuela	1.67	2.05	2.41	2.98	0.5	0.5	0.5	0.5

Borrowing Costs and Debt Structure

The Bank's obligations carry a Triple A rating at the principal bond rating services in the United States. Outside the United States, governments typically prefer that sales of World Bank issues be set at yield levels that are comparable to those obtainable on government-backed issues of similar maturity.

As noted above, the Bank's borrowing costs have remained relatively stable despite the continued increase of the volume of its borrowings, reflecting the Bank's ability to attract funds in a variety of international markets and currencies - and because the flexibility provided by its liquidity permits the Bank to avoid capital markets during periods of instability or excessively high rates. The average cost of all the Bank's outstanding borrowings totalling \$29.7 billion as of September 30, 1980, is 7.35%. It should be noted, however, that because of its large equity base, the cost of its total resources - borrowings plus paid-in capital and reserves - was only 6.05%. The table below sets forth the Bank's borrowing costs and its costs of total funds.

HISTORICAL BORROWING COSTS

	<u>Fiscal years ended June 30</u>						<u>As of</u>
	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>Sept. 30,</u> <u>1980</u>
Average Cost of:							
Borrowings executed in period	8.16%	8.17%	7.46%	6.73%	6.22%	8.24%	8.20%
All borrowings outstanding during period *	7.06%	7.32%	7.53%	7.45%	7.21%	7.28%	7.35%
Total borrowings and other funds (equity) available during period	4.96%	5.43%	5.96%	6.09%	5.98%	6.00%	6.05%

*Cost of borrowings as a percentage of average borrowings outstanding during fiscal period.

As noted in the previous section, the cost of the Bank's new borrowings is directly reflected in the charges the Bank levies on the new loans it makes. The interest rate to be charged on loans submitted to the Bank's Executive Directors after January 6, 1981 has been set at 9.60%. At least once a year, and more often if necessary, the Bank's lending rate is adjusted so as to achieve a spread of approximately 1/2 of 1% per annum above its marginal cost of borrowing for the most recent and prospective six-month period.

The maturity structure of the World Bank's outstanding borrowings is summarized below:

MATURITY STRUCTURE OF BORROWINGS OUTSTANDING
(in \$ billions)

	As of June 30												As of September 30 1980	
	1975	% Total	1976	% Total	1977	% Total	1978	% Total	1979	% Total	1980	% Total		
1 year	\$ 1.3	10.6%	\$ 1.4	9.5%	\$ 1.4	7.6%	\$ 1.7	7.5%	\$ 2.5	9.5%	\$ 2.7	9.1%	\$ 2.4	8.1%
5 years	4.0	32.5	5.2	35.4	6.8	36.7	9.3	41.2	10.2	38.8	12.4	41.8	12.7	42.8
6-10 years	4.2	34.1	5.5	37.4	7.3	39.5	7.8	34.5	9.3	35.4	9.1	30.6	8.8	29.6
11 or more years	2.8	22.8	2.6	17.7	3.0	16.2	3.8	16.8	4.3	16.3	5.5	18.5	5.8	19.5
Total	<u>\$12.3</u>	<u>100.0%</u>	<u>\$14.7</u>	<u>100.0%</u>	<u>\$18.5</u>	<u>100.0%</u>	<u>\$22.6</u>	<u>100.0%</u>	<u>\$26.3</u>	<u>100.0%</u>	<u>\$29.7</u>	<u>100.0%</u>	<u>\$29.7</u>	<u>100.0%</u>

Note: Most of debt maturing in less than 6 years held by central banks has virtually always been refinanced.

The average life of the Bank's outstanding debt as of September 30, 1980 is 6.24 years. The average life of its outstanding public debt, however is 7.23 years. The non-public borrowings from governments and central banks are carried at an average maturity of 3.49 years. These are not, however, "short-term" borrowings. If experience over the last twenty-three years is a fair guide, it is reasonable to expect that these placements with central banks, including particularly the two to six and one half year issues (the Deutsche Bundesbank, The Bank of Japan, the Bank's U.S. dollar Central Bank Issues and its Swiss franc Central Bank Issues) will

be refinanced at maturity. These issues have been consistently refinanced at interest rates prevailing for government obligations. It is expected that the Bank's placements with "official" institutions amount to permanent debt with the interest rate for particular issues fixed periodically.

The maturity structure of the Bank's debt may be compared with the average life of its outstanding loans receivable - 9.12 years at September 30, 1980. Thus, the Bank is a relatively long-term lender and borrower at fixed interest rates. That lending is also financed by paid-in capital and retained earnings aggregating \$7.7 billion which provides "infinite maturity" resources. If intermediate or longer maturities were not available for an extended period at rates compatible with our lending rate, the Bank would draw-down its liquidity until the market stabilized. And if the markets for fixed rate obligations remained unstable for a prolonged period of time - say, several years - the Bank would use the further option of reducing its lending program, and thereby its future cash requirements. Alternatively, the Bank would raise the interest rates on new loans to the point where it could prudently borrow intermediate and longer-term resources at higher costs - or alternatively it would borrow at floating or variable rates and, to the extent necessary, pass on those costs to its borrowers.

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A.3.02

Staff summary of Board discussion on borrowing prospects
(Means of Financing memorandum, December 1980)

International Bank for Reconstruction and Development
International Development Association
International Finance Corporation

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SD81-3

FROM: The Vice President and Secretary

March 20, 1981

Summary of Discussions at the Meetings of the Executive
Directors of the Bank and IDA, January 27 and 28, 1981*

<u>Contents</u>	<u>Page</u>
Possible Expansion of IBRD/IDA Lending Program and Means of Financing Such Expansion	1
Credit for Agricultural Development in Upper Volta	23

D. Borrowing Prospects; New Instruments

86. Divergent views were expressed with respect to the prospects for borrowing the significantly larger amounts implied by an expanded IBRD lending program. The paper's assessment of those prospects was (a) endorsed by four speakers, one of whom drew attention to the need to contain the inflation-related erosion of the long term bond market; (b) considered too optimistic by three other speakers, one of whom cautioned against overestimating the German market's capacity to absorb Bank paper and another of whom expressed skepticism about its projections for borrowings in hard currencies generally; and (c) seen by one as prompting the need for a study of the impact of such vast borrowing requirements on the capital markets. This speaker also said his constituency shared the Bank's concern that the member governments would continue to assure the Bank access to their capital markets; he urged those members whose markets were now closed to reconsider their position.

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87. The need to tap new markets was recognized by several speakers. One saw diversification in the direction of OPEC markets as the only way to fill the gap between borrowing needs and prospects.

88. A few speakers found the idea of arranging credit lines with governments or private financial institutions to cover a part of the Bank's liquidity needs interesting in principle. One cautioned, however, that use of this practice would have to remain speculative until its modalities had been investigated further, particularly since conservative investors might not see such credit lines as complete substitutes for liquidity which, in turn, might necessitate larger amounts in the form of credit lines than might be required in more conventional forms of liquidity. Moreover, although such lines might have some attraction for private financial institutions and for nonconventional investors, the additional contingent liability they represented might not be welcomed by governments.

89. A speaker wanted more detail about the credit lines' technical characteristics and their lasting impact on the Bank's financial and organizational structure. He also wanted to know what alternatives existed to implement this part of the borrowing program, in the event credit lines were not feasible.

90. Another speaker said that it might be useful to establish lines of credit with commercial sources, regardless of the final action on an expanded IBRD lending program. However, with respect to the possibility of seeking to have governments bolster IBRD liquidity through credit lines, loan purchase facilities, or other arrangements resulting in member governments being designated as lenders of last resort, he suggested that consultations would be needed to determine whether such arrangements would be palatable to national legislatures.

91. The paper's description of the implications of inflation-related changes on the prospects for IBRD borrowing in the US capital market was mentioned by several speakers, who concurred with its positive assessment of the Bank's prospects for borrowing through instruments which exposed long-term investors to less capital risk than traditional fixed rate bonds. One speaker felt that the objective of providing a more predictable return and less capital risk to investors could best be achieved by some degree of adjustability in the bonds' interest rate. He did not support the index linking of capital because this technique was not widespread in the markets in which the Bank currently borrowed.

92. Doubt was expressed by a speaker about the opportunity for large-scale borrowing at variable interest rates. He foresaw a danger of competition between the Bank and commercial banks and of loss of customers to commercial banks as borrowers sought to obtain loans with fewer conditions attached. In such a situation, the Bank might be forced to lend mainly to high-risk countries, with deleterious consequences for its portfolio. Thus, any switch to variable interest rates would have to be preceded by a detailed study of its implications.

93. With respect to liquidity, one speaker said that the prospect of a considerable increase in the Bank's liquid holdings warranted a review of the Bank's present 40 percent formula, while another said that the attitude of major central banks about a reduction in the Bank's liquidity to lower its borrowing needs would have to be identified before such a step was taken.

94. A speaker expressed concern about the financial projections' revelations regarding the financial ratios and policies that might be accepted as adequate by the IBRD in the future, particularly with respect to net income and reserve adequacy. He said that any changes in criteria used to determine appropriate net income levels should be made only after a full study of the implications of such change on the Bank's borrowing.

E. Callable Capital

95. The paper's assessment of IBRD borrowing prospects assumed that the security offered creditors would continue to be sufficient to maintain the Bank's prime credit standing in financial markets. It also examined the implications of this assumption for the volume of callable capital that might be needed in future years to support the borrowing program. Callable capital was one component of the security offered creditors. Other forms of security included liquid assets and outstanding loans.

96. In discussing this topic, two speakers urged that the Bank exercise caution in attempting to make the idea palatable to creditors that even a small portion of the loan portfolio should be considered additional security. One thought that, while it was reasonable to expect markets to come to accept a progressively greater proportion of liquid holdings as adequate security, the loan portfolio was in a different category. At a time when the Bank might be introducing various new ideas to the market, a further approach that would materially alter the quality of its security would require careful and lengthy preparation. In the meantime, even Case II, which postulated 70 percent of callable capital, plus liquid holdings, plus 25 percent of disbursed loans, should not be relied upon as a practicable proposition. The other speaker considered Case II to be the utmost acceptable limit on sources of security.

97. Other speakers said that, if the loan portfolio was to be used as a source of security for creditors, a careful evaluation was needed of how shifts in the portfolio's composition, especially out of high-return energy investments and into high-risk soft sector investments, would affect underwriters' views of the Bank and its standing in the capital markets.

98. A speaker expressed his authorities' preference for continuing to adhere to the lending authority limits corresponding to the "non-disruptive adjustment" scenario, given the difficulties being encountered by member governments now in agreeing on the present general capital increase, and on the maintenance of value principle. In this context, another speaker sought clarification as to why the "steady-state" lending limit had increased by \$3 billion.

Section A.3. IBRD Borrowed Funds

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Section A.3: IBRD Borrowed Funds

Historical Background

1. Borrowed funds are by far the largest source of finance for IBRD operations: net borrowing accounts for about two-thirds of cash receipts in a typical year. The remainder comes from repayments of past loans (now running at about \$1.3 billion per annum), net income (about \$0.5 billion per annum) and the paid-in portion of capital subscriptions (about \$0.2 billion per annum in recent years).

2. Gross borrowings have risen dramatically over the past decade--from an average of roughly \$1 billion per annum ten years ago to about \$6 billion in the current fiscal year. This growth has been achieved through a diversified program that has tapped both public and private sources in a variety of markets. A little over one-quarter of outstanding IBRD debt--which now totals \$30 billion--is currently held by central banks or other government accounts. The Bundesbank, Bank of Japan and SAMA are the largest such holders. Non-government issues have been mainly concentrated in four currencies: the US dollar, the Deutschmark, Swiss francs and Japanese yen. The IBRD is now the largest non-resident issuer in the capital markets of Germany, Switzerland and Japan--operating in each case through syndicates made up of the premier underwriting institutions. Non-resident demand for US dollars, German marks, Japanese yen and French francs has also been tapped through Eurobond issues. The following table summarizes the distribution of IBRD borrowing by markets for the fiscal years 1977 to

1981. More information on the past structure of borrowing is presented in the first reference document at the end of this section.

IBRD BORROWINGS BY SOURCE: FY77-81
(in US\$ millions equivalent)

	FY77		FY78		FY79		FY80		FY81*		Total FY77-81	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
<u>Major Private Markets</u>												
United States	1,250	30	1,350	32	-	-	-	-	400	6	3,000	12
Germany	1,191	29	894	21	758	18	1,678	32	1,091	16	5,612	23
Switzerland	502	12	363	9	1,167	27	724	13	639	10	3,395	14
Japan	-	-	317	7	876	20	1,014	19	650	10	2,857	12
	<u>2,943</u>	<u>71</u>	<u>2,924</u>	<u>69</u>	<u>2,801</u>	<u>65</u>	<u>3,416</u>	<u>64</u>	<u>2,780</u>	<u>42</u>	<u>14,864</u>	<u>61</u>
<u>Other Private Markets</u>												
United Kingdom	-	-	-	-	-	-	-	-	216	3	216	1
Austria	-	-	-	-	-	-	81	2	-	-	81	-
Kuwait	-	-	-	-	-	-	-	-	43	1	43	-
Netherlands	-	-	-	-	-	-	-	-	85	1	85	-
Euro-guilders	-	-	-	-	-	-	-	-	62	1	62	-
Euro-dollars	-	-	-	-	-	-	-	-	900	14	900	4
Euro-sterling	-	-	-	-	-	-	-	-	216	3	216	1
Euro-yen	-	-	75	2	-	-	-	-	98	1	173	1
	<u>-</u>	<u>-</u>	<u>75</u>	<u>2</u>	<u>-</u>	<u>-</u>	<u>81</u>	<u>2</u>	<u>1,620</u>	<u>24</u>	<u>1,776</u>	<u>7</u>
Sub-Total Private Market Borrowings	<u>2,943</u>	<u>71</u>	<u>2,999</u>	<u>71</u>	<u>2,801</u>	<u>65</u>	<u>3,497</u>	<u>66</u>	<u>4,400</u>	<u>66</u>	<u>16,640</u>	<u>68</u>
<u>Direct Central Bank Financing</u>												
Swiss Confederation	-	-	-	-	-	-	-	-	52	1	52	-
Central Banks - US\$	650	16	700	17	650	15	686	13	594	9	3,280	13
Central Banks - SwF	-	-	-	-	-	-	237	4	199	3	436	2
Bundesbank	203	5	225	5	258	6	283	5	217	3	1,186	5
Bank of Japan	7	-	254	6	299	7	252	5	303	5	1,115	5
	<u>860</u>	<u>21</u>	<u>1,179</u>	<u>28</u>	<u>1,207</u>	<u>28</u>	<u>1,458</u>	<u>27</u>	<u>1,365</u>	<u>21</u>	<u>6,069</u>	<u>25</u>
<u>Other Bilateral Financing</u>												
Oil-Exporting Countries	180	4	40	1	77	2	352	7	789	12	1,438	6
Others	100	3	-	-	187	5	-	-	57	1	344	1
Third Window	38	1	18	-	16	-	17	-	17	-	106	-
	<u>318</u>	<u>8</u>	<u>58</u>	<u>1</u>	<u>280</u>	<u>7</u>	<u>369</u>	<u>7</u>	<u>863</u>	<u>13</u>	<u>1,888</u>	<u>7</u>
Sub-Total Official	<u>1,178</u>	<u>29</u>	<u>1,237</u>	<u>29</u>	<u>1,487</u>	<u>35</u>	<u>1,827</u>	<u>34</u>	<u>2,228</u>	<u>34</u>	<u>7,957</u>	<u>32</u>
TOTALS	<u><u>4,121</u></u>	<u><u>100</u></u>	<u><u>4,236</u></u>	<u><u>100</u></u>	<u><u>4,288</u></u>	<u><u>100</u></u>	<u><u>5,324</u></u>	<u><u>100</u></u>	<u><u>6,628</u></u>	<u><u>100</u></u>	<u><u>24,597</u></u>	<u><u>100</u></u>

Average Life	8.1 yrs.	8.2 yrs.	8.0 yrs.	9.0 yrs.	7.6 yrs.
Average Cost	7.81%	7.16%	6.14%	7.83%	9.62%

* At 4/30/81 80% borrowed (\$5.3 billion) and 20% projected (\$1.3 billion)

Issues

3. The key issues relating to IBRD borrowings are as follows:

- Will the Bank be able to borrow the resources required to meet its funding needs?
- Will the Bank need to modify its traditional reliance on medium- and long-term fixed-rate markets in order to meet its borrowing objectives over the next few years?
- If so, what new forms of borrowing would be most appropriate?

In addition, there is one operational question which may need to be addressed in the near future:

- OPEC Relationship. The immediate issue is how to handle the four-currency borrowing from Saudi Arabia--totalling \$402 million equivalent--which was validly concluded in July 1980 but which SAMA has not yet agreed to sign and to settle.

4. Limits on Traditional Forms of Borrowing. The December 1980 memorandum on Means of Financing an Expanded IBRD/IDA Lending Program 1/ made the point that inflation and interest rate volatility

1/ R80-356, dated December 19, 1980; see Section 4.

have so eroded the IBRD's traditional sources of finance that it may have difficulty borrowing more than, say, \$30-35 billion net over the next five years at fixed rates and medium-to-long maturities. The borrowing figures which will appear in the FY82 Budget memorandum (scheduled for distribution to the Board on May 5th) are within this total:

Actual and Projected IBRD Borrowing: FY80-86
(\$ million)

	<u>FY80</u>	<u>FY81</u>	<u>FY82</u>	<u>FY83</u>	<u>FY84</u>	<u>FY85</u>	<u>FY86</u>	<u>Total</u> <u>FY82-86</u>
Gross Borrowing	5.3	6.6	7.1	8.8	9.2	10.4	10.9	46.4
Net Borrowing	2.5	3.9	4.2	5.5	6.3	5.5	6.0	27.5

5. Despite the fact that projected borrowings are within-- indeed are below--the range previously considered feasible, there are several reasons for not being complacent about the future borrowing program. First, the borrowing projections make no allowance for any increases in IBRD lending over the levels planned a year ago. While the current climate for increases in IBRD lending is bleak, this could change over the next year or two. Secondly, the judgment that net borrowing in the \$30-35 billion range ought to be feasible over the next five years was predicated on four assumptions that may prove to be optimistic: (a) that the erosion of medium-to-long-term fixed-rate

markets would be brought to a halt through at least moderate success by the OECD governments in coping with inflation and interest rate volatility; (b) that the IBRD would receive permission to enter several new markets (United Kingdom; France; Canada) where it has not been an active borrower in recent years; (c) that IBRD access to the "traditional" markets (United States; Germany; Switzerland; Japan) would remain virtually unimpaired; and (d) that borrowings from OPEC sources would continue on a high level with the concurrence of the countries whose currencies would be involved in such transactions. The third of these assumptions has already been cast in doubt by actions taken in the last few weeks by the German and Japanese authorities to limit IBRD access to their markets during the remainder of this fiscal year; the fourth assumption is also affected by this attitude and by the politically motivated reluctance of major Arab OPEC countries to lend to the Bank (see para. 10 below).

6. Finally, there is some concern as to whether the borrowing figures currently projected provide an adequate degree of funding for the lending planned over the next few years. Full funding of IBRD commitments would imply enormous levels of liquid asset holdings 1/ and/or stand-by borrowing arrangements. No one proposes that the IBRD

1/ The term "liquid assets" is used in the IBRD to describe the holdings of readily marketable securities--mostly, government or agency paper and CDs issued by major commercial banks--which now total about \$10 billion. Issues concerning the management of these assets are described in Part B.1 of this briefing material.

do this. Several years ago, the Board adopted a policy providing that liquid assets should normally be 40% of the borrowing requirements projected for the following three years. The idea was to ensure the Bank had adequate flexibility in the event its access to markets were impeded by disturbed market conditions (e.g., abnormally high interest rates due to temporary factors), by government restrictions or by some question about its own creditworthiness. What this policy implied of course was that 60% of these requirements had to be borrowed, irrespective of the circumstances. When the policy was adopted, this 60% amounted to perhaps \$1 billion per annum. Now it is on the order of \$3 billion per annum and even this understates the prudent minimum, since it implies a very rapid drawdown of liquid assets--a fact which could itself cast doubt on the Bank's creditworthiness. There are differences of view within the staff as to how serious this particular problem is, and how best to cope with it. All are agreed, however, that the Bank's financial position would be a good deal less risky if there were a greater margin between the volume of borrowing the IBRD is able to do--because the markets are there, access is free and saturation is not a problem--and the volume the IBRD must do in order to carry out its operations.

7. Means of Increasing IBRD Borrowing Potential. The Board is well aware of the possibility that "traditional" forms of IBRD borrowing may prove to be inadequate in the years ahead. The December memorandum on Means of Finance touched briefly on some of the steps which might be taken to expand the Bank's borrowing potential:

- the Bank could offer investors instruments which offer protection against real loss of capital. These might take the form of instruments with adjustable interest rates, or short maturities, or indexation features;
- the Bank might seek lines of credit from governments or from private markets.

A good deal of interest was expressed by various Executive Directors about these possibilities during the Board discussion. (See second reference document attached). While the Board has been told that staff work on these issues is proceeding, no timetable has been established for Board consideration of new borrowing instruments.

8. The staff work completed so far (see third reference document attached) has concentrated on the possibility of short-term borrowing in the US market. This is thought to be an assured way of broadening the Bank's access to funds which would in addition provide low cost capital at times of a positive yield curve. 1/ The US underwriters believe short-term borrowing could also serve to

1/ If the short-term borrowing were to be used to finance additions to liquidity, it would in fact probably be a source of additional profits for the IBRD. There is considerable doubt, however, as to whether the Board or the member countries whose currencies would be used would approve such borrowing if it were perceived as being essentially an interest rate arbitrage operation.

strengthen the US market for medium-to-long maturity IBRD obligations by offering liquid instruments in volume and by broadening the investor base for IBRD paper. The principal problems raised by this proposal are: (a) how to pass on the interest rate risk to borrowers (assuming such borrowings are used at least in part to fund IBRD loans rather than to increase liquid assets); and (b) how to deal with the maturity risk created by borrowing short to lend long. The issue of how to pass more of the Bank's interest rate risk onto borrowers may have to be faced even if there is no change in the traditional IBRD borrowing instruments. (This issue is taken up in Part B.3 of these briefing materials). The maturity risk might be handled through stand-by lines of credit with commercial banks. However, since the idea of short-term borrowing by the IBRD would be regarded as a rather radical departure from traditional practice - and is known to be regarded with extreme scepticism in some quarters (e.g. Herr Poehl at the Bundesbank) - it should be "pre-sold" with key governments before being formally put to the Board. No decision has yet been taken as to whether or when such an effort should be made.

9. Other means of broadening the IBRD's access of finance - such as variable rate borrowing through medium- or long-term instruments, or issues with currency option features or other forms of inflation protection - are being studied and reviewed on a continuous basis. Because of the large number of controversial policy issues

expected to come before the Board in the next several weeks (e.g. compensation; PLO; valuation of IBRD capital; Energy Affiliate; lending to China; FY82 lending program), no firm plans have been made to propose innovative borrowing formats to the Board. Any proposal in this direction would have to show an especially strong case to proceed and it is expected that these forms of raising funds will only be of marginal importance for the time being.

10. Relationship with OPEC. The borrowing relationship between the World Bank and the major OPEC countries started on a large scale after the oil price increases of 1973. Before that, the central banks of OPEC countries such as Saudi Arabia, Libya and the United Arab Emirates had participated in the two-year dollar bond issues which the World Bank has been offering on a regular basis since the mid-1950's. In addition, the Bank borrowed from Saudi Arabia a total of \$30 million in 1968, in Kuwait a total of KD 130 million (\$304 million) between 1968 and 1973, and in Libya a total of LD 40 million (\$129 million) in 1970 and 1973.

11. In 1974 a number of major operations were conducted, including placements for \$750 million and SRls 500 million (\$141 million) with SAMA, a Dh 300 million (\$76 million) borrowing from the United Arab Emirates, and a borrowing of \$400 million and Bs 430 million (\$123 million) from the Venezuelan Investment Fund. Since then, although the amounts borrowed have become much smaller, there has been a continuous borrowing relationship in various currencies with SAMA and Libya and to a lesser extent with other OPEC countries.

12. In the spring of 1980, the Governor of SAMA indicated that he would be willing to resume larger scale lending to the World Bank and mentioned a total volume of \$700 million for fiscal year 1981. The first large borrowing under this initiative was a placement of DM 200 million in July 1980. Shortly thereafter, a four-currency transaction for a total of about \$400 million was negotiated and concluded with SAMA, but the final signing was deferred at SAMA's request because the PLO question had abruptly changed the situation.

13. The proposal to grant observer status for the PLO at the Annual Meeting became a hotly disputed issue in August/September 1980, just before and at the time of the 1980 Annual Meetings of the Bank and Fund. As a result of the non-acceptance of the PLO as an observer at the Meetings, the Arab OPEC countries decided to suspend lending to the World Bank. They recognize, however, that the issue is strictly political in nature, and the cordial operational relationship of the Bank with its counterparts in the Arab countries has continued. Nevertheless, the lending stop is still in effect without a clear end in sight.

14. SAMA has recently indicated that it would be willing to make funds available to the Bank, but only through market purchases which would assure their anonymity. The Libyan Central Bank has in fact done one "silent" placement denominated in Dutch guilders, despite the existence of the lending embargo. Both central banks have continued

to participate in the refinancing of the two- year central bank issues which do assure anonymity to the outside and also do not involve large amounts. However, large direct operations seem out of the question at the moment.

15. The borrowings of \$400 million from SAMA referred to in paragraph 12 above are currently being shown as part of the Bank's FY81 borrowing program, even though they have not been signed. We propose to continue doing this at least until the forthcoming Board discussion (planned for June) on the borrowing program and the Bank's lending rate. The PLO issue is also scheduled to come up before the Board in June. If it does not get resolved then, we will have to consider what to do about the pending SAMA placements.

Reference Documents

- A.3.01 Note on IBRD Borrowing Operations
- A.3.02 Extract from summary of Board discussion on Means
of Financing
- A.3.03 Note prepared for Finance Committee on short term
borrowing.