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EIGHTEEN QUESTIONS AND ANSWERS ABOUT THE WORLD BANK

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June 27, 1986

ABSTRACT

This paper provides background information about World Bank borrowing and lending activities and about U.S. participation in the Bank. Among other matters, it discusses where the World Bank borrows its funds, the amounts contributed by the United States and other countries, and changes in World Bank priorities and loan policy.

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III. Lending Operations

IV. U.S. Participation in the World Bank

OVERVIEW: SOME BACKGROUND INFORMATION ON THE WORLD BANK

The World Bank is an international agency which finances development activities in low-income countries using money borrowed in international capital markets or contributed by the governments of more developed countries. The Bank was founded, along with the International Monetary Fund, following the 1944 international economic conference at Bretton Woods, New Hampshire. The Bank was intended to be a major instrument for promoting international economic cooperation, long-term balanced growth, and international financial stability. Over the years, it has made various changes in its operations and procedures as it has sought to pursue these goals in a changing economic environment.

The World Bank has grown substantially since it began loan operations in 1947. From 44 member countries at the time -- most in Western Europe and the Americas -- the Bank's membership has grown to 149 countries. In 1985, the Bank approved 236 loans totalling $14.4 billion to 83 countries. Figure 1 shows the growth of World Bank lending since 1947.

The World Bank operates through three affiliates (or, as some would say, three loan windows). The International Bank for Reconstruction and Development (IBRD), the original World Bank, loans money

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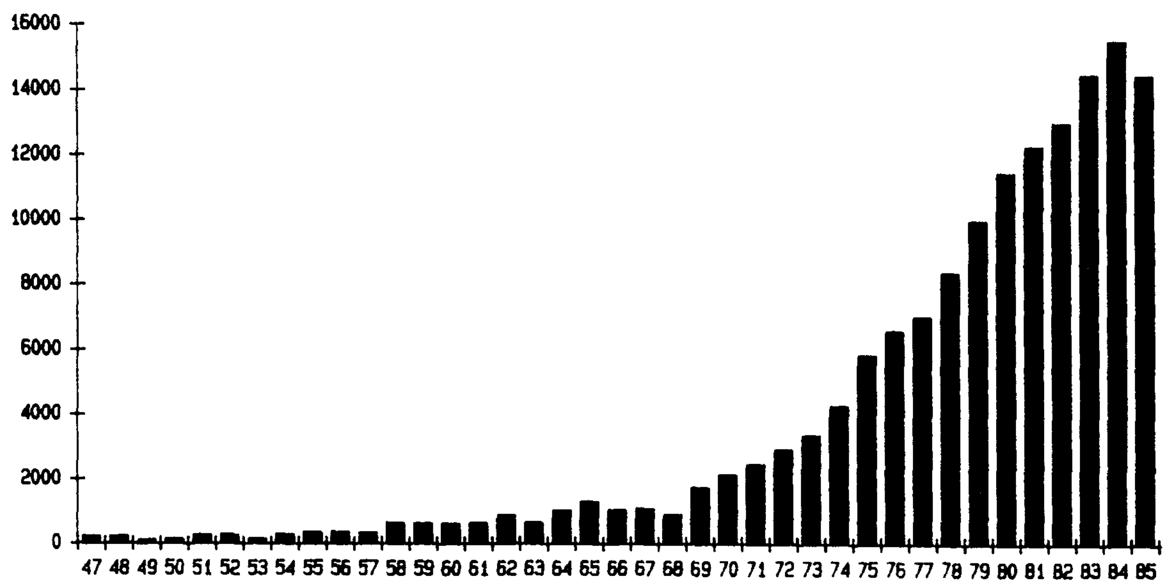
Figure 1. Annual IBRD and IDA Lending, 1947-1985
(millions of US dollar equivalent)



(Source: World Bank)

at near-commercial interest rates mainly to middle-income nations. The second affiliate, the International Finance Corporation (IFC), which was founded in 1956, makes loans and equity investments to local privately owned firms in developing countries, in order to help strengthen private sector growth. It is run as a semi-autonomous body, with its own managing vice president and a separate staff. The third affiliate, the International Development Association (IDA), which was founded in 1960, makes concessional (no-interest) loans to the world's poorest countries. The IBRD and IDA are the principal channel for World Bank assistance to developing countries. As a practical matter, they operate as though they were a single agency with two "checkbooks," two separate loan accounts. They share a common management, staff, operating policies, and facilities. They accounted for 94 percent of the World Bank's total aid commitments in 1985, while the IFC accounted for 6 percent of Bank commitments that year. This paper focuses, for the most part, on issues which relate to the IBRD and IDA.

In addition to the World Bank, there are multilateral development banks for all the major developing regions of the world. These are the Inter-American Development Bank (IDB), founded in 1959, the African Development Bank (AFDB), founded in 1964, and the Asian Development Bank (ADB), founded in 1966. Like the World Bank, each regional development bank also has a near-market rate window (which lends what the banks call "ordinary capital") and a concessional-rate window for aid to the neediest countries in their regions. The World Bank is the largest and most influential of the multilateral banks. In 1985, for example, the IBRD provided 66 percent of the near-market rate loans and the IDA provided over 69 percent of the concessional loans lent by all the multilateral banks.

The World Bank and the other multilateral agencies are organized like corporations. Voting power is weighted in proportion to each country's contribution (or subscription to capital stock.) The World Bank is headed by a president, who manages day-to-day operations and supervises the approximately 6,200 international civil servants who comprise the Bank staff. The president is elected for a five-year term by the Bank's Board of Executive Directors, a 21 member panel appointed or elected by the member countries. By tradition, the United States nominates the World Bank president while the Europeans name the head of the International Monetary Fund. The executive board meets in continuous session to oversee Bank operations and make all final loan decisions. The United States is the largest single contributor and, together with the 4 other largest stockholders, it has the right to appoint its own representative on the Bank executive board. The smaller stockholders form groupings to elect the other 16 executive directors. The number of votes each executive director casts will depend on the number of votes possessed by the country or countries which named him. The Bank's Board of Governors normally meets once a year at the annual meeting, like stockholders, to review Bank operations, discuss the international situation, and elect executive directors as their terms of office expire. Each country has one representative on the Board of Governors -- usually the Finance Minister or Treasury Secretary -- who casts whatever number of voting shares his country possesses.

No single country controls the World Bank, although the United States and the other advanced industrial countries all have substantial influence within it. Decisions on the Bank's executive board are usually made on a consensus basis, following a discussion which airs the relevant view of the different countries. The Board may take a formal vote if no consensus emerges from its deliberations. Influence in those deliberations is closely linked to country voting shares. The top five stockholders (United States, Japan, Germany, United Kingdom, and France) have 43.3 percent of the vote in the IBRD and 44.7 percent in the IDA. Together with the other members of the Organization for Economic Cooperation and Development (OECD), the advanced industrial countries have 63.7 percent of the vote in the IBRD and 63.2 percent in the IDA.

The funding arrangements for the IBRD and its two affiliates, the International Development Association (IDA), and the International Finance Corporation (IFC) differ. The IBRD operates mainly using funds borrowed on world capital markets and backed by the Bank's general creditworthiness and by the subscriptions of its member countries. From time to time, the IBRD's members meet to discuss possible increases in the Bank's capital stock. During these negotiations, in addition to settling the size and terms of the capital expansion, the member countries also discuss country shares, loan and operating policies, and other relevant issues. Until recently, countries subscribed to new IBRD capital stock by paying 10 percent of its value in paid-in capital and the other 90 percent in callable capital. (In the last capital increase, the paid-in portion fell to 7.5 percent.) Paid-in capital is the portion of a country's subscription which it remits to the Bank at the time it subscribes its shares. Callable capital is the portion which the country agrees to remit if the Bank calls for its payment. The Bank can call on this callable capital only if it needs the funds to meet its obligations to its own creditors.

Because the IDA is a concessional loan program, it needs direct contributions from member countries -- rather than borrowings on commercial markets -- to fund its operations. The donor countries meet every three years to negotiate new replenishments of IDA's funds. The size of the replenishment and the shares for each donor are matters for negotiation. As at the IBRD talks, countries often press for the resolution of operational or policy issues during the course of the discussions.

The IFC operates partly with funds contributed directly by its member countries but mainly with funds borrowed from the IBRD. (In fiscal 1986, for the first time, it also borrowed on two occasions directly on private capital markets.) The member countries have met three times (1955, 1977, and 1982) to negotiate expansions of IFC capital stock. As with IDA replenishments, IFC capital expansions involve direct contributions of funds paid in from the member's treasuries.

I. WORLD BANK BORROWING ACTIVITIES

Question 1.

Where does the World Bank obtain get the money it lends?

The IBRD has three main sources of income which it can use to finance its loans: borrowings, net income, and subscriptions of usable paid-in capital. Historically, usable paid-in subscriptions have accounted for about 5 percent, earnings for about 8 percent, and borrowings for about 87 percent of the World Bank's available funds. As of December 31, 1985, borrowings since inception totalled $61.5 billion, reserves (mainly retained earnings) and other accumulated income totalled $5.8 billion, and subscriptions of freely usable paid-in capital totalled $3.6 billion. (Countries pay part of their paid-in subscriptions in foreign exchange and part in their own currencies. For many LDCs, the part subscribed in their own currencies cannot be used for loans to other countries.)

In the early years of the IBRD's history, a good portion of its disbursements were financed using paid-in capital. In recent years, however, the Bank has relied on borrowing and income from other sources. Table 1 (next page) shows that IBRD loan disbursements have actually been smaller than new borrowings in all but one of the past five years.

Question 2:

How much does the World Bank borrow each year?
How large is the World Bank's outstanding debt?

Borrowings. The World Bank is a major multi-currency borrower in world capital markets. Figure 2 (page 6) shows the amounts the IBRD has borrowed during the last five years. Its borrowings went from $5.7 billion in 1981 to $13.8 billion in 1985, a 142 percent increase.

The Bank reports that it plans to borrow around $10.6 billion on a mediumand long-term basis and another $650 million on a short-term basis in fiscal 1986. The Bank also plans to refinance its $3.45 billion in existing shortterm obligations. The Bank says that, in fiscal 1987, it will borrow about $10 billion more on a short- or long-term basis.

The amount the Bank needs to borrow is closely related to the amount it expects to disburse. In fiscal 1982, the Bank disbursed $6.37 billion, while in fiscal 1985 it disbursed nearly $8.87 billion on its outstanding loan commitments. (It expects to disburse another $9.3 billion in fiscal 1986.) The volume of Bank loan com-

Table 1. World Bank Sources of Funds and Uses of Funds, 1981-1985 (millions of dollar equivalent)

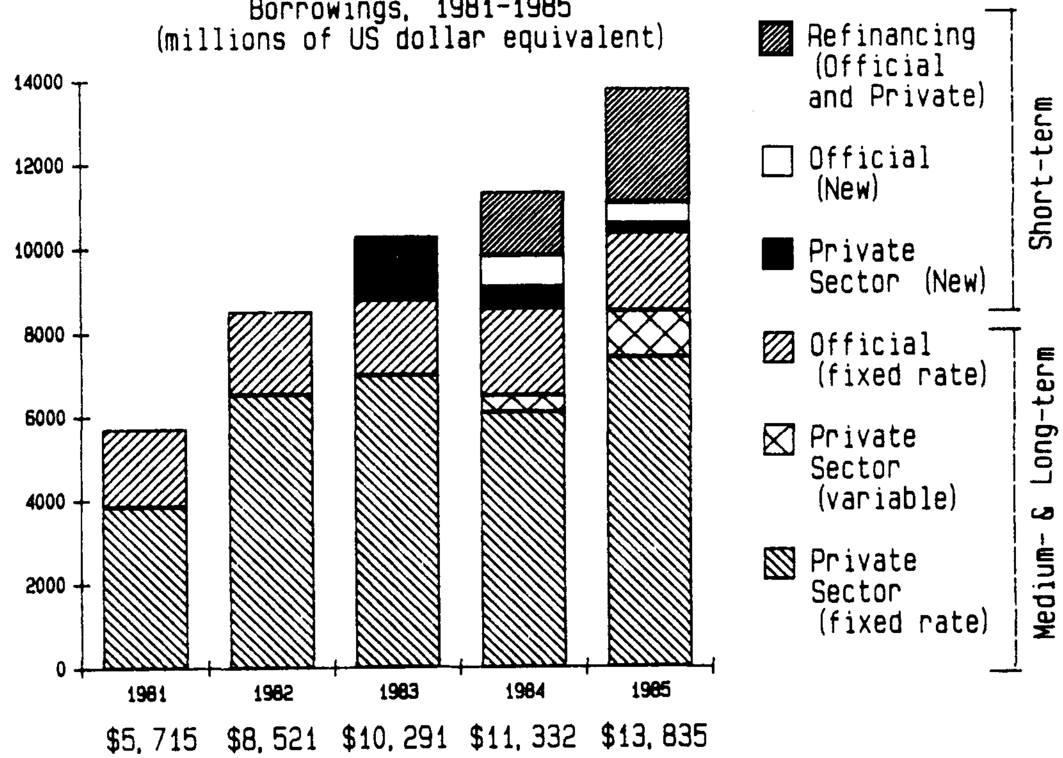
YEAR	SOURCES OF FUNDS					TOTAL FUNDS	USES OF FUNDS				
	New IBRD Borrowing for Year*	Unallocated Net IBRD Income for Year	Total Loan Repay-ments	Change in Value of Usable Paid-in Subscriptions	Net Currency Exchange Adjustments¶		Total IBRD Loan Disburse-ments	Total Debt Retire-ment	Change in Value of IBRD Liquid Asset	IBRD Contri-bution to IDA	Other Debits (misc.)§
1981	$ 4,857.6	$610.1	1,440.7	$-300.6	$-179.0	$6,428.8	$5,171.2	$2,721.6	$ -1,595.3	$118.0	13.4
1982	7,913.3	597.7	1,707.9	+104.3	48.4	10,371.6	6,373.8	2,828.8	+1,023.7	101.0	44.2
1983	10,527.6	752.0	2,056.2	+242.9	-92.2	13,486.5	6,851.9	2,943.1	+3,801.8	125.0	-235.3
1984	9,812.5	600.0	2,544.1	+182.4	160.8	13,299.8	8,673.6	2,656.6	+1,672.8	200.0	96.9
1985	11,026.0	1,137.1	2,975.0	+ 99.3	244.3	15,481.7	8,868.7	3,947.7	+2,491.2	100.0	74.1

* Loan figures differ here from those on Figure 2. These data, which are tabluated by a different office in the Bank, show those borrowings for which the transactions were completed during the fiscal year and amounts receivable on current contracts. Figure 2 includes transactions which were initiated before the close of the fiscal year but had settlement dates a few days after the close of the fiscal year.

¶ Reflects the net gain or loss in the value of the IBRD's outstanding loans to developing countries and its own borrowings in capital markets due to changes in currency exchange values.

§ Includes certain credits (receipts from sales of loans, non-cash increases in value of IBRD resources, and increase in amount payable to IDA) less certain debits (termed "other, net" in IBRD accounts.)

Figure 2. Volume and Type of World Bank Borrowings, 1981-1985 (millions of US dollar equivalent)



	MEDIUM- AND LONG-TERM				SHORT-TERM			FY PROGRAM FOR NEW BORROWINGS		REFINANCING OF SHORT-TERM BORROWINGS		
	Private Sector (fixed rate)	Private Sector (variable)	Official (fixed)	Total	Private Sector	Official	Total	Total	Of which Cur Swaps	Private Sector	Official	Total
1981	3,855	---	1,860	5,715	---	---	---	5,715	---	---	---	---
1982	6,536	---	1,985	8,521	---	---	---	8,521	758	---	---	---
1983	6,994	---	1,797	8,791	1,500	---	1,500	10,291	1,731	---	---	---
1984	6 ,102	400	2,081	8,583	500	749	1,249	9,832	1,299	1,500	---	1,500
1985	7,412	1,102	1,863	10,377	208	501	709	11,086	1,360	2,000	749	2,749

(Source: World Bank Financial Operations Department)

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mitments increased, meanwhile, from $10.33 billion in 1982 to about $11.36 billion in 1985.

The Bank has recently unveiled a plan to almost double its annual volume of loan commitments by 1990. An increase in loan commitments does not mean the level of disbursements will increase right away, as the Bank only disburses funds as the work on its projects progresses and the bills from the contractors come due. Nevertheless, more commitments mean more disburements at some future date. If this pattern of growing commitment and disbursement levels continues, the Bank will need to borrow larger sums in future years. Many analysts contend that a major increase in the volume of World Bank lending is necessary, given the state of the world financial system. Some critics maintain, though, that the World Bank is already too large and this increase in lending should not take place. If the volume of Bank disbursements remains the same or if it declines in the future (a less likely eventuality,) the amount of World Bank borrowing would also decline.

Outstanding debt. Table 2 shows the World Bank's total outstanding debt and annual interest payments for each year from 1981 to 1985. The Bank's total debt increased during this period from $27.8 billion to $50.2 billion, an 80 percent rise.

Table 2. World Bank Outstanding Debt, 1981-5
(millions of U.S. dollars equivalent)

	1981	1982	1983	1984	1985
short term borrowings	----	----	1,488	2,721	3,450
medium & long-term borrowings	27,757	31,761	38,065	42,294	46,791
total outstanding	27,757	31,761	39,553	45,015	50,241
annual interest cost of this debt	2,104	2,423	3,085	3,638	3,933

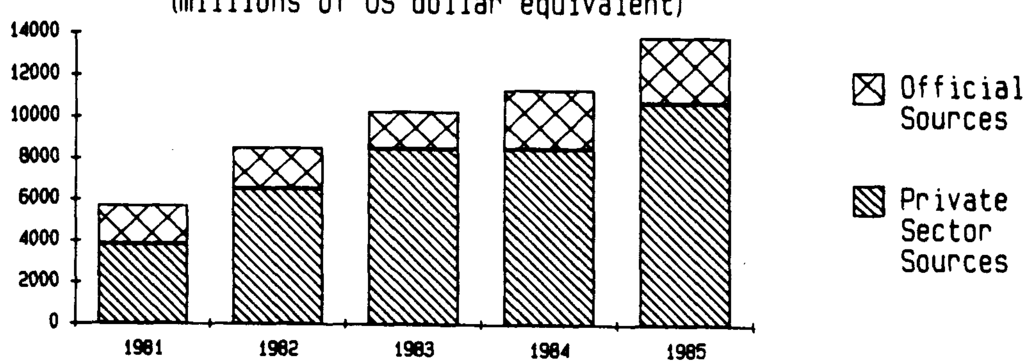
(Source: World Bank annual reports, relevant years)

Question 3:

How much does the World Bank borrow from governments (including central banks) compared to private capital markets?

In recent years, the World Bank has expanded its borrowing from both official (government) and private capital sources. Figure 3 shows that the private sector has been the largest source of money financing IBRD operations. As Figure 2 (page 6) indicates, the bulk of this private money has been borrowed at medium- and long-term fixed rates, although the amount borrowed on a short-term basis or at variable rates has increased significantly of late.

Figure 3. World Bank Borrowing from Official and Private Sources, 1981-1985
(millions of US dollar equivalent)



(Source: recalculated from data associated with Figure 2)

Figure 4 shows the level and "nationality" of World Bank borrowing from official sources. The World Bank once derived a substantial portion of its borrowings from central banks in many countries. Now, however, while central banks are still an important source of funds, other sources have become increasingly significant. The Bank of Japan and the Bundesbank (the West German central bank) -- major sources in previous years -- have become less substantial lenders in recent years. By contrast, the World Bank's new Central Bank Facility -- a World Bank borrowing program created in 1984 -- has become a major source of funds. Unlike the Bank's other borrowings from central banks, which involved fixed amounts lent over set periods of time, the Central Bank Facility permits countries to lend U.S. dollars from their foreign exchange reserves to the Bank while still having liquid access (their funds are deposited for a year but may be withdrawn to meet balance of payments emergencies) to their funds. Private placements -- security issues negotiated directly rather than through public offerings in capital

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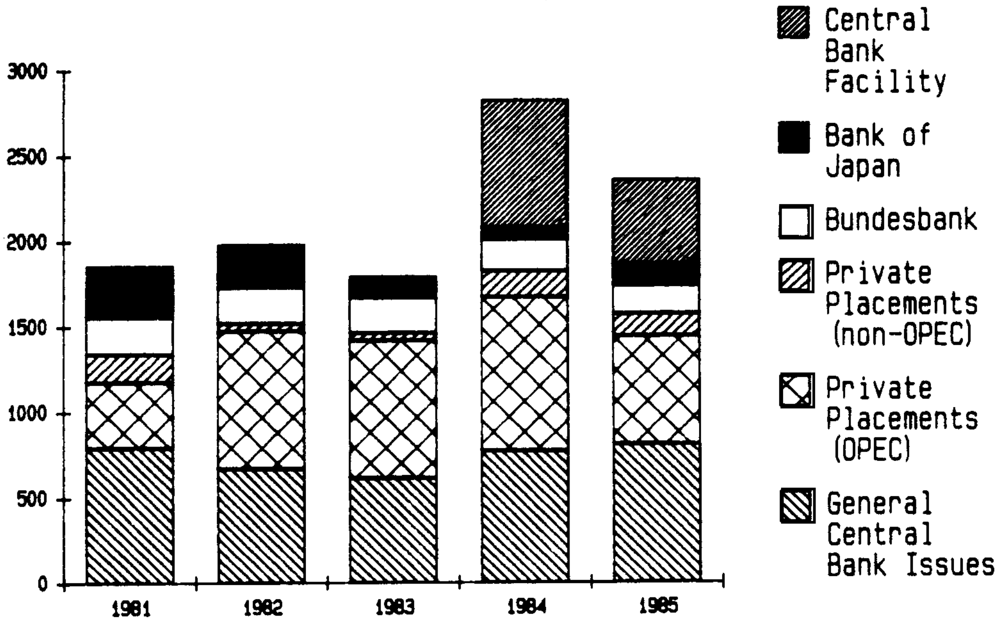
Figure 4. World Bank Borrowing from Official Sources, 1981-1985 (millions of US dollar equivalent)



	1981	1982	1983	1984	1985
General Central Bank Issues	793	671	617	773	811
Private Placements					
OPEC	385	805	803	900	634
non-OPEC	162	44	44	154	130
Bundesbank	217	212	207	186	167
Bank of Japan	303	253	126	68	121
Central Bank Facility	---	---	---	749	501

(Source: World Bank Financial Operations Department) markets -- and direct loans remain other major sources for World Bank official borrowings. Most have been arranged with OPEC governments in recent years, though this may change if the price of oil stays low.

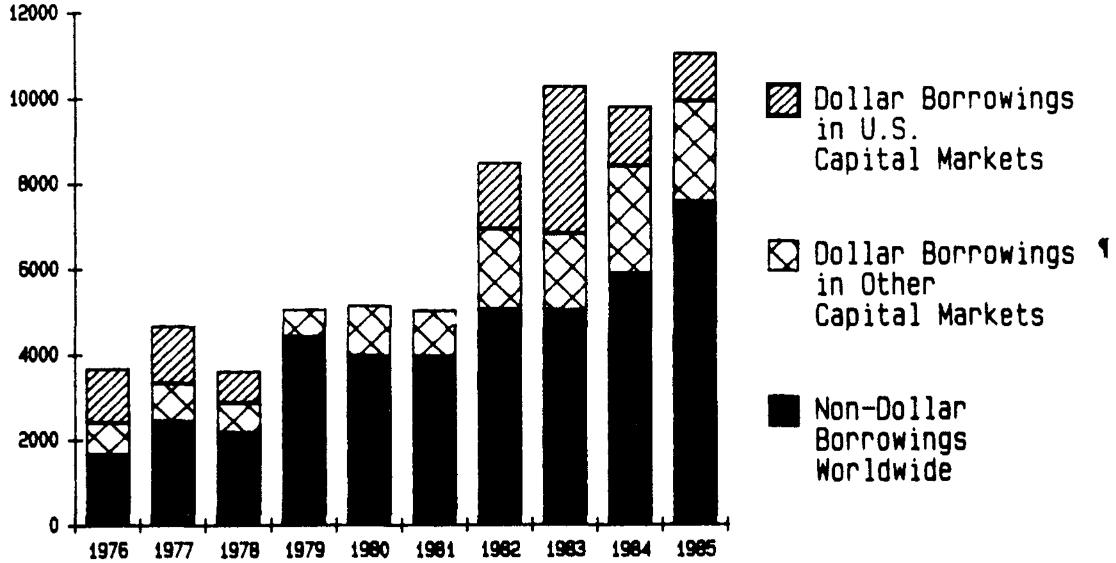
Question 4:
How much has the Bank borrowed in the United States in recent years?

As Figure 5 (next page) shows, the World Bank did not borrow in the U.S. capital market at all between 1979 and 1981, and its U.S. borrowings in 1984 and 1985 were proportionally much less than a decade earlier. The Bank has borrowed increasing amounts of dollars in overseas (Eurodollar) capital markets during the past decade. Even so, the share of its borrowing which was denominated in dollars has sometimes been lower than usual in the past decade. The Bank has also used swaps to further reduce its dollar borrowings. In 1985, for example, the Bank swapped $1,058 million in dollars for other currencies, mainly Swiss francs, deutschmarks, Dutch guilders, and Japanese yen. This reduced the net effective share of its borrowings in dollars for the year from about 31 to 23 percent.

In a swap, the Bank contracts with another party -- often a multinational firm -- to trade obligations to make a series of payments in one currency for a similar obligation -- at today's prices -- in another currency. Both parties benefit from the swap, for they can each take advantage of the other's established position in its capital market to get a better interest rate on the loan in the currency they really want than they could get if they borrowed the funds directly. The World Bank can borrow dollars in the Eurodollar or U.S. market at a good rate, for example, and can then swap those dollars for Swiss francs that the swap partner borrowed in Switzerland at a very good rate. The Bank can thus switch a larger share of borrowings into low interest rate currencies and thereby reduce the average cost of annual borrowings.)

Of its $41.4 billion in outstanding loans as of June 30, 1985, the Bank reports that only $6.7 billion had been disbursed in U.S. dollars (less than the net amount borrowed in dollars in overseas capital markets or from foreign governments.) The Bank says the rest of its dollar borrowings were held in its liquid assets -- over $12 billion of which were invested (in dollars) mainly in government securities, with a lesser proportion invested in obligations of commercial banks in the United States. On a net basis, it appears that the Bank's borrowing program has brought more money into the U.S. domestic capital market than it has taken out.

Figure 5. World Bank New Borrowings in the United States and Other Capital Markets, as a Share of All New Borrowing for the Year*
(millions of US dollar equivalent)



	Borrowings in U.S. Capital Market		Dollar Borrowings in Other Markets¶		Total WB Dollar Borrowings		Total WB Borrowings	
	amount	share	amount	share	amount	share	amount	share
1976	1,275.0	34.63%	750.0	20.37%	2,025.0	55.00%	3,681.8	100.0%
1977	1,350.0	28.83%	900.0	19.22%	2,250.0	48.05%	4,682.3	100.0%
1978	750.0	20.73%	700.0	19.35%	1,450.0	40.04%	3,621.4	100.0%
1979	none	none	650.0	12.82%	650.0	12.82%	5,070.2	100.0%
1980	none	none	1,186.2	23.00%	1,186.2	23.00%	5,157.4	100.0%
1981	none	none	1,093.9	21.65%	1,093.9	21.65%	5,051.2	100.0%
1982	1,550.0	18.23%	1,890.0	22.23%	3,440.9	40.47%	8,502.4	100.0%
1983	3,450.0	33.58%	1,800.1	17.52%	5,250.1	51.10%	10,291.9	100.0%
1984	1,399.0	13.22%	2,523.1	23.84%	3,922.1	37.06%	9,821.7	100.0%
1985	1,118.5	10.09%	2,368.3	21.36%	3,486.8	31.45%	11,085.8	100.0%

* Excludes currency swaps (which may have the net effect of changing the share of the Bank's borrowings in particular currencies) as well as refinanced short-term debt (for 1984 and 1985) and a minor borrowing (Interest Subsidy Fund) where the capital market is not identified.

¶ Includes public offerings on the Eurobond and Asian bond markets as well as dollar-denominated placements with central banks, governments and international organizations.

(Source: World Bank annual reports, relevant years)

Question 5:

Why does the World Bank, often for prolonged periods, stay out of certain capital markets?

Between 1981 and 1985, the World Bank sold securities to non-governmental purchasers in 23 countries and borrowed from official sources in 96 countries. The Bank borrows regularly in most of the major capital markets, but it does not necessarily borrow in every market every year. The World Bank's Articles of Agreement specify that it may borrow only with the permission of the government in whose market the funds are being borrowed. Thus, the Bank may have to limit its borrowing if a government closes or restricts access to its country's capital markets for policy reasons or because of balance of payments or other financial constraints. As a practical matter, the Bank may also limit its borrowings in a country for economic reasons if it finds that it can borrow money elsewhere at better rates. In judging the cost of its borrowings, the Bank looks not only at the current interest rates for loans in different currencies, but also at whether the savings on interest costs will be negated by future changes in currency values.

Question 6:

Are the funds the Bank borrows earmarked for any particular loan, project, or developing country?

No. The World Bank borrows in order to support the requirements of its overall lending program. The Bank does not segregate its funds according to the projects or countries for which they will be used.

Question 7:

How does the Bank decide which currencies to borrow? What consideration is given to potential losses from exchange rate fluctuations?

The World Bank interprets its Articles of Agreement as prohibiting it from assuming any exchange rate risks with borrowed or subscribed capital. Consequently, for every liability in a currency, the Bank has a comparable asset in the same currency. The countries borrowing from the World Bank assume the foreign exchange risks on their loans. For accounting purposes, Bank loan commitments are denominated in dollars, although the loans are actually disbursed in a variety of currencies. The borrowers must repay the same amount in each currency that they received when the loan was disbursed -- without regard for whether those currencies may have gone up or down in value relative to the dollar or some other benchmark currency -- and the Bank uses the repayments to satisfy its corresponding obligations in these same currencies. The dollar value of Bank loans may change when there are shifts in the relative value of the disbursed currencies, but the value of the Bank's outstanding obligations (its borrowings) will shift in a compensating manner.

The Bank generally operates, however, as if it were taking currency risks in its loan operations. Thus, it seeks to borrow and disburse in currencies where the chances of an upward revaluation are limited. (In other words, it tries to avoid situations where currency values will go up and the loan repayments will be worth more than the value of the money lent.) It tries to estimate whether the saving from borrowing currency with a low nominal interest rate might be offset by a revaluation of that currency at some point in the future.

In many cases, the Bank's borrowers have benefited from this procedure. Because the U.S. dollar increased in value in recent years, the developing countries have been able to use their dollar holdings if they wished to buy cheaply the currencies they needed to pay their non-dollar debts. The real cost of repaying their dollar-denominated loans increased, of course, but the largest portion of their debts to the Bank have been denominated in other currencies. The World Bank estimates that the developing countries could have made a profit of $5 billion, as of December 31, 1985, if they had locked in the then-current exchange rates through forward exchange markets (that is, through contracts to sell that amount of dollars in their own foreign exchange reserves at a future time at the exchange rate prevailing at the end of 1985.)

In addition to its desire to avoid disbursing currencies which are likely to go up in value, the World Bank has other reasons for using several major currencies. First, the Bank seeks to diversify the number of capital markets from which it draws its funds in order to avoid undue dependence on any particular market. (By keeping its name known in various markets -- even when it has no pressing need for major borrowings in those markets -- the Bank protects its future access to capital. Countries sometimes limit or close their markets to foreign borrowers, and the Bank wants continuing access to alternative sources in other markets.) Second, the Bank wants to expand the number of lending institutions with which it deals. Third, the Bank may want to borrow a specific mix of currencies because it is planning to disburse its loans in those currencies or because it is planning to "swap" one currency for another.

Question 8:

How secure are loans made to the World Bank?
What protections are offered to a World Bank bondholder?
How likely is it that callable capital will be called?

There are several kinds of assurances for the World Bank bondholder. Some provide direct protection for the bondholder's investment while others provide assurances regarding its general security. Callable capital will be called only if the Bank has exhausted its existing resources and it still needs additional funds to cover its remaining liabilities to those who lent it money.

1. Direct Protections for Bondholders

A. Information. Though the World Bank is exempt from most of the requirements of U.S. securities legislation, section 15 of the Bretton Woods Agreements Act (the basic law governing U.S. participation in the Bank) requires the Bank to file such reports as the Security and Exchange Commission believes necessary "for the protection of investors." The Bank files quarterly and annual financial statements and regular information statements that provide information which can be very useful to investors who are assessing the risk of a possible investment in World Bank securities. By according World Bank bonds a AAA rating, the bond rating companies have shown a favorable assessment of Bank assets, its portfolio, and its basic financial situation.

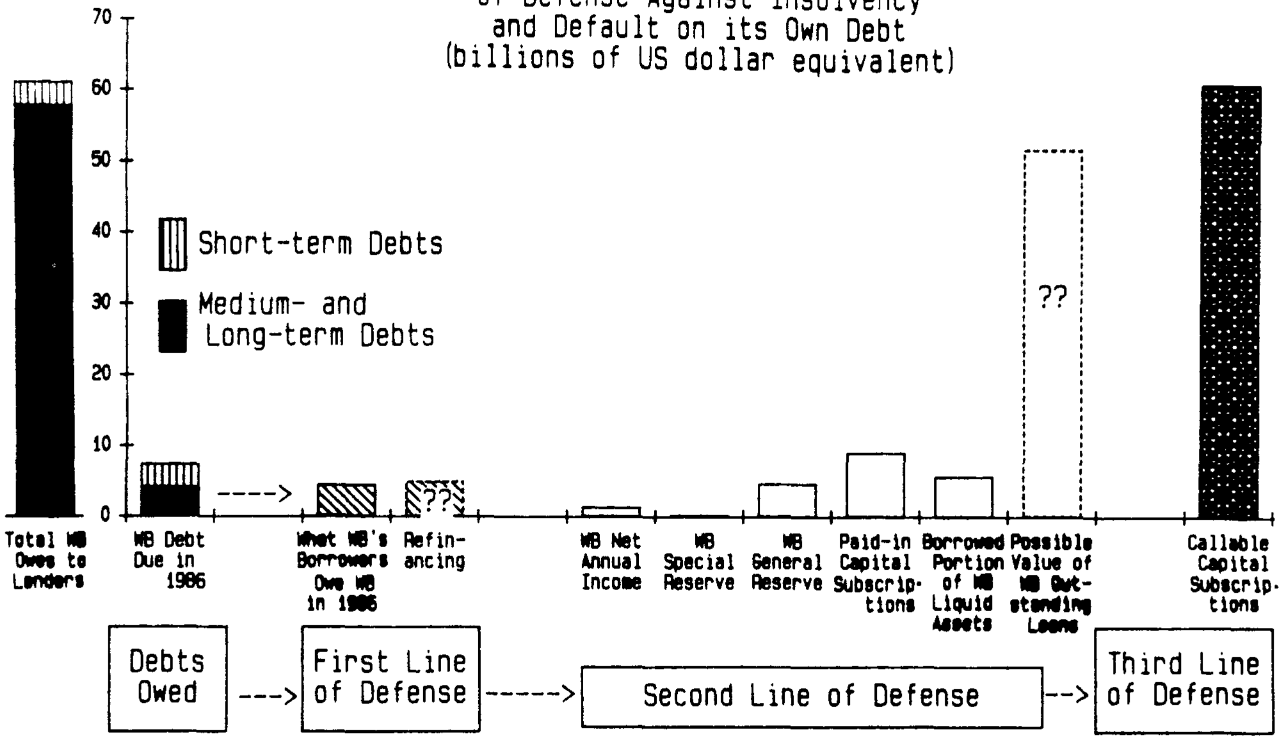
B. Legal protection. The bondholder has several legal protections. The Bank has accorded its bondholders the right, if it should miss any payments of principal or interest, to demand repayment of the total amount due them. The Articles of Agreement and the Bretton Woods Agreements Act provide that the World Bank can be sued, in the Federal courts of the District of Columbia, for enforcement of its obligations.

The Articles of Agreement specify that the Bank's assets shall be immune from all forms of seizure, attachment, or execution before the delivery of final judgment against the Bank. By implication, then, the rights of the bondholder may be upheld, and assets collected, through judicial action and due process of law. It appears, however, that bondholders cannot sue the Bank's member countries in order to secure repayment on the debts. The Articles of Agreement specify that a warning must be placed on all World Bank securities indicating that they are not an obligation of any government. As noted before, the Articles limit the liability of member countries to the total value of their subscribed capital.

2. Protections Against Insolvency

The World Bank relies on its income, assets, and callable capital to assure its bondholders that it will have the funds to repay them when its borrowings come due. In effect, these are the Bank's three lines of defense against insolvency. Figure 6 (next page) illustrates

Figure 6. Amounts Owed by the World Bank as of Dec. 31, 1985, and the Bank's Three Lines of Defense Against Insolvency and Default on its Own Debt (billions of US dollar equivalent)



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the situation. At the far left is shown the full $61.1 billion which the World Bank owed as of December 31, 1985. The full debt does not come due all at once, however. The World Bank is scheduled to repay lenders $7.6 billion (in short-term and medium- or long-term debt) in fiscal 1986. Similar amounts come due in succeeding years. The question is whether the Bank's financial resources are sufficent to cope with this series of annual repayment requests from bondholders.

A. <u>The First Line of Defense</u>. The Bank's first line of defense is the stream of loan repayments it anticipates receiving from its borrower countries. In fiscal 1986, the Bank is scheduled to repay $7.644 billion to retire outstanding debt as it comes due. It also expects to receive $3.977 billion from its borrowers in fiscal 1986 in principal repayments on their loans. The reflow of loan repayments will enable the Bank to repay a substantial part of its own debt as the obligations comes due. The Bank will refinance the remaining $3.667 billion of that debt. Most of this ($3.45 billion) is short-term debt, which is normally rolled over. Only about $217 million of it will be medium- and long-term debt due in fiscal 1986.

As a matter of policy, the World Bank does not participate in debt reschedulings. It expects borrowers to repay on schedule. The Bank requires that governments guarantee the repayment of all loans the Bank makes to entities in their countries. Hence, any failure to pay would be on the part of the government, not a private entity in the foreign country. The Bank has a policy of terminating all disbursements on its outstanding loans to a country if a borrower there falls more than 75 days behind in its debt repayments to the Bank.

So long as the Bank's debt repayment picture is sound and its borrowers are repaying their loans on time, the Bank should have little difficulty borrowing the necessary money to cover modest shortfalls by refinancing its remaining debts. In an extreme -- if perhaps improbable -- situation, such as a collapse of the international financial system, the refinancing option may not be available. The borrowing alternative is thus shown in Figure 6 with dotted lines.

B. The Second Line of Defense. The Bank's assets are the second line of defense assuring repayment of its outstanding obligations. This procedure comes into effect only if the Bank experiences a substantial drop in repayments from its borrowers.

Bank spokesmen say that the cost of any defaults would be first charged against the Bank's net income for the year. The Bank's net income is the sum of its income from investment earnings and loan charges, less its outlays for interest, borrowing costs, and administrative expenses. Defaults are operating losses, changes in the value of accounts receivable, which must be paid for out of current income. The accounting rules say they are not supposed to be covered through negative adjustments in the lending institution's capital accounts.

The Bank's net income, in millions of dollars, for the past five years was as follows:

1981	1982	1983	1984	1985
\$610.1	\$597.7	\$752.0	\$600.0	\$1,137.1

As of its mid-point on December 31, 1985, the Bank's net income for fiscal 1986 was \$695 million. These amounts should be sufficient to cover small losses.

The World Bank has never experienced a formal default on its loans. However, in December 1984, for the first time, a borrower country (Nicaragua) fell more than six months behind on its loan payments. As a result, the Bank put the Nicaraguan loans on nonaccrual status -- an accounting status which indicates that no income is being received from the loan. Since then, Liberia also briefly fell more than six months behind, but it subsequently cleared up its arrearage. Nicaragua's \$9 million arrearage in principal is the only case where payments are seriously overdue. The Bank has ceased disbursements on all its Nicaraguan loans, as its policies require. The Bank says that it expects to recover the funds eventually. Should the situation deteriorate further, however, the Bank may eventually have to declare a loss on all or some of the \$163 million in outstanding Nicaraguan loans. Even so, if the Bank had to declare its entire Nicaraguan portfolio a loss and write off the whole amount at once, for example, the result would only be a modest drop in the Bank's total annual earnings.

If the Bank experienced so many defaults that its net income for the year was exhausted, it could draw on accumulated reserves for the funds needed to repay creditors. Bank spokesmen say the assets would be drawn upon in the following order: First, after exhausting annual income, the Bank would use the retained earnings held in the special reserve ($293 million), which is earmarked -- as required by the Articles of Agreement -- for the purpose of covering deficiencies of this sort. Next, it would use the retained earnings held in the general reserve ($4.769 billion at the end of 1985), which is available for this purpose but not legally earmarked for covering defaults. Finally, after the two prior sources of equity were used up, the Bank would draw on the paid-in portion of its capital stock ($5.812 billion as of December 1985) to cover its remaining liabilities. If the Bank needs additional funds after this, it might use some of the borrowed portion of its liquid assets to settle debts. (See the answer to question 10 for a discussion of IBRD liquid assets.) It might be able to generate more funds by selling some of its $52 billion portfolio of existing loans. These sales would need the cooperation of governments and would depend on the strength of the world financial system and the willingness of private investors to purchase the existing loans. For this reason, the column showing the value of the IBRD loan portfolio is shown in dotted lines in Figure 6.

Leaving aside the possibility that the Bank might sell some of its loans to generate additional funds, it appears that the World Bank would probably be able to make scheduled payments to bondholders (both repayments as they come due and interest on the outstanding balance) for at least two or three years simply by relying on its $10.6 billion in reserves (equity and paid-in capital) and its $9.2 billion in borrowed liquid assets. This assumes that the Bank receives no loan repayments from any borrowers during that period. The time period would be longer, of course, if some borrowers kept making payments.

C. The Third Line of Defense. The Bank's callable capital is the ultimate protection offered to bondholders. If defaults depleted the World Bank's existing assets, it would have to use this third line of defense to generate the funds to repay creditors. As of December 1985, the Bank had callable capital subscriptions of $61.1 billion. Coincidently, its borrowings totalled $61.5 billion.

The Bank's Articles of Agreement state that callable capital may be called only to satisfy Bank obligations to its creditors. Callable capital can not be called merely to provide the Bank with loan funds when the private capital markets are unwilling to lend it money. The Articles of Agreement also say the Bank must make calls on callable capital on a pro-rata basis, with each member country providing a share of the needed funds corresponding to its share of ownership in the Bank. If some countries should default on their obligations to honor a World Bank capital call, the others would presumably have to cover the shortfall through another proportional call on callable capital.

The Articles of Agreement say that no country may be required to supply more than the total value of its subscribed capital. Thus, if the Bank uses up all its assets, if the borrowers make no further loan repayments, and if member countries fail to honor all their callable capital pledges, the Bank then may be unable to repay its creditors as its borrowings come due. Most analysts believe this series of eventualities is most unlikely.

II. FINANCIAL OPERATIONS

Question 9.

Where does the Bank get the money it uses to pay staff and cover other administrative and operating costs?

Both the IBRD and the IDA pay their administrative expenses out of operating revenues (income from investments and interest payments from borrowers). The IBRD normally runs a net surplus after expenses, and uses its net income to expand reserves and to make an annual contribution to the IDA. (The Bank's $2.07 billion cumulative contribution makes it the fifth largest donor to IDA. The Bank has no vote, however, in IDA deliberations.) Some critics say the Bank should pay dividends to its stockholders instead of contributing money to IDA and expanding IBRD reserves. The Reagan Administration responded in its 1982 assessment of the multilateral banks, however, that this would be inappropriate, in light of the Bank's special role in the world financial system.

Because the Bank has signficant reserves, including paid-in capital, it has been able to borrow funds at advantageous rates and provide its own borrowers with development loans at the lowest possible rates. The Bank invests the paid-in capital, along with its other reserves, and uses the income from investments to help finance operating expenses. Therefore, paid-in capital does have a role in helping support IBRD administrative costs. The proportion of investment earnings derived from these assets is relatively small, however. The IBRD does not directly use borrowed funds or paid-in capital to finance operating expenses. The United States has urged in past IBRD negotiations that there be no more paid-in capital and that all future IBRD subscriptions should involve only callable capital. The other major member countries have insisted, however, that the Bank's financial resources should be expanded through some additional paid-in capital at the time of each capital increase.

The IDA, by contrast, usually runs a loss on its current operations. The figures (in millions of dollars) for the last five years were as follows:

1981	1982	1983	1984	1985
$-63.01	$-82.21	$-90.65	$-70.86	$-64.58

One reason for this is the fact that IDA loans have a much longer payback period than do IBRD loans. The IDA must wait a much longer time to recover expenses from loan receipts. Another reason is the fact that IDA's income does not grow in proportion to its growing expenses. IDA's volume of lending has more than doubled in the past decade and its income is derived from payments on its existing loans while its costs come from new loan preparations. Consequently, because of this shortfall, some of the money contributed by donors is used to support IDA administrative costs. The IDA anticipates however, that it should be able to repay the funds it is currently drawing from contributed resources as it starts getting income from new loans.

The IDA charges no interest on its loans. It does levy, though, a 3/4 of one percent service charge (a "handling charge") on the disbursed portion of each loan and -- since January 1982 -- a 1/2 of one percent commitment charge yearly on the undisbursed balance. Like the IBRD, the IDA incurs most of its operating costs for each loan prior to the loan's approval. Considering the value of the borrowers' future service payments (the "handling charge") and commitment fee, the IDA will receive more from its borrowers over the course of the loan than it spent in preparing and administering its loans. (In other words, the present value of the new IDA loans exceeds administrative costs.)

The IDA does not have a staff of its own. Instead, the IDA pays the IBRD a management fee ($273.2 million in 1985 and $249.23 million in 1984) which represents its share of the administrative expenses incurred by the IBRD.

Question 10:

Why does the World Bank keep large amounts of money on hand as liquid resources? Where does it come from? What currencies are held?

The Bank has a policy of holding, as liquid assets, a sum equal to about 40 to 45 percent of its anticipated net cash requirements for the next three years. The Bank obtains the funds through its regular borrowing program. The Bank wants liquidities of this sort so it can be sure it has the funds to meet all disbursement and debt retirement obligations over a sustained period of time without any need for new borrowings. This makes the Bank relatively independent of current conditions in the capital markets, freeing it from the need to borrow during short-term periods of high interest costs.

In the past five years, the World Bank's liquidity situation (that is, its cash and liquid investments net of commitments for settlement and cash collateral received) has been as follows (in millions of dollars):

1981	1982	1983	1984	1985
$ 8,371	$9,394	$13,196	$14,869	$17,360

The Bank's liquid assets are fully invested in order to maximize the return on its investment. The Bank invests only in the obligations of governments (including agencies of the U.S. Government) and in time deposits and other unconditional obligations of banks and financial institutions. The net profits on the Bank's investments in the last five years (in millions of dollars) were as follows:

1981	1982	1983	1984	1985
$813.3	$954.5	$1,417.1	$1,139.0	$2,019.1

The bulk of the Bank's liquid assets are denominated in dollars. On June 30, 1985, some 79 percent were in U.S. dollars, 9 percent in U.K. pounds, 4 percent in Canadian dollars, and the remainder in about 17 other currencies.

III. LENDING OPERATIONS

Question 11:

Where does the World Bank make most of its loans and what kinds of activities does it finance?

1. The Bank's Changing Loan Priorities

The growth in the Bank's membership and operations has had an important effect on the global pattern of its operations. Figure 7 (next page) shows that in its first decade almost 40 percent of the IBRD's new loan commitments were to countries in Europe, the Middle East, and North Africa -- mostly to Western Europe. (The regional categories are the Bank's.) From 1947 to 1956, the industrial countries of Western Europe and Japan were among the Bank's largest borrowers as they sought money to rebuild their war-torn economies. As more developing counties joined the Bank in the 1960s, and as the establishment of the IDA made it possible for the Bank to expand lending to countries that were too poor to afford many IBRD loans, the level of Bank lending to South Asia and Africa increased considerably. The proportion of Bank loan commitments (mainly IBRD) to countries in Europe, the Middle East, and North Africa remained significant. In this region, however, the focus of lending shifted from Western Europe to the Balkans and the rapidly-growing countries of the Arab world. Along with Japan (in the East Asia group,) the Western European countries and Israel graduated from being borrowers to being sources of capital or donors for IBRD and IDA operations.

There remain some significant controversies within the Bank about the relative amounts which should be lent to different regions. The arguments are particularly accute regarding allocations of IDA funds. In the past, India received about 40 percent of IDA's new commitments each year -- the result of a ceiling which stipulated that, in the interests of geographic diversity, no more than this should go to any

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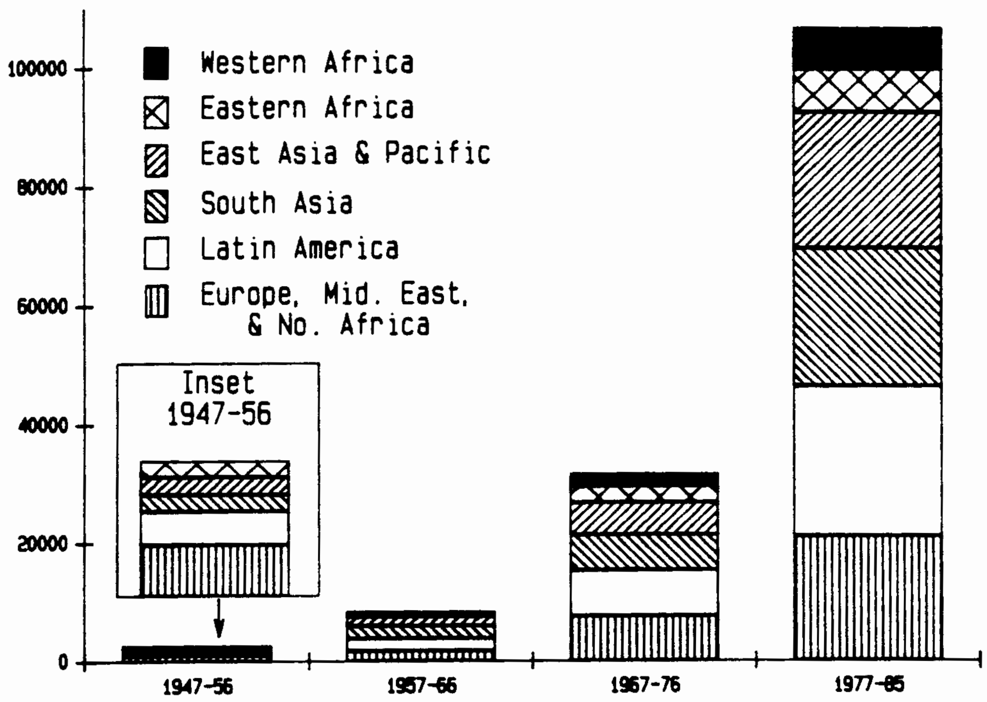
Figure 7. IBRD and IDA Lending
by Region, Four Time Periods, 1947-85
(millions of US dollar equivalent)



	1947-56	1957-66	1967-76	1977-85
Western Africa	7.6	399.0	2,132.0	6,941.7
Eastern Africa	329.7	513.9	2,783.2	7,284.4
East Asia and Pacific	349.5	1,527.6	5,472.8	22,893.1
South Asia	330.5	2,148.9	5,977.8	23,220.7
Latin America	673.9	2,080.7	7,788.3	25,276.6
Europe, Middle East and North Africa	$1,029.2	$1,775.4	$7,621.6	$21,113.8
TOTAL, ALL REGIONS	$2,720.4	$8,445.5	$31,775.6	$106,660.3

(Source: World Bank)

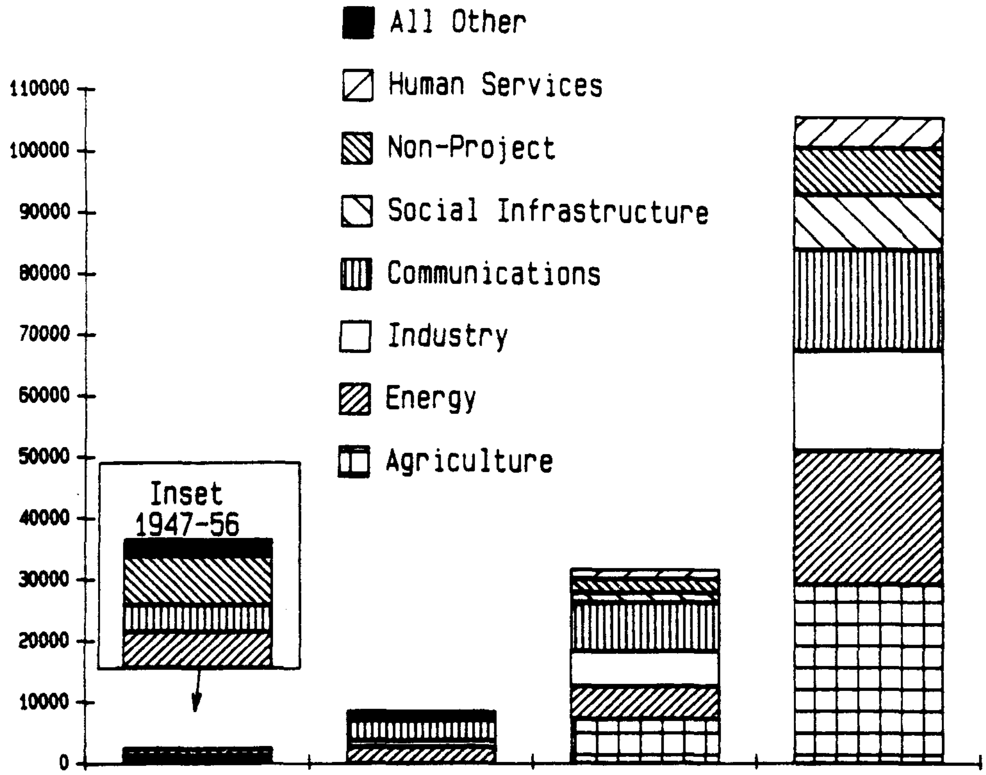
one country. Some analysts thought this was more than India deserved. Others said it was not enough, since India contained over 60 percent of the people living in IDA-eligible countries. After China joined the Bank in 1980, the question about the proper allocation of IDA resources took on a new dimension. Some people thought that India and China should each get 40 percent. Others claimed they should divide India's original share. Still others wondered whether the two Asian giants should be eligible for any IDA aid at all. The question was not whether they should cease receiving World Bank assistance, but whether most of it should be lent on IBRD or IDA terms. The debate is not yet resolved. China and India each have twice as many people as does Sub-Saharan Africa. Their economies are more complex and their advanced sectors are better developed. They are both very poor, however, and have substantial populations in great need. Because their economies are more dynamic than those of most African countries, the Asian countries can probably make more efficient use of any IDA allocations. On the other hand, they can probably better survive a sharp cut in IDA aid than can the Africans. In 1985, 35 percent of IDA's new commitments were to African countries, while 22 percent were to India and 11 percent were to China.

As the geographic focus of its lending shifted, the sectoral emphases for World Bank lending also changed. Figure 8 (next page) shows the sectoral composition of IBRD and IDA new loan commitments in the past forty years. During the two post-war decades, the Bank lent mainly for economic recovery. Much lending involved non-project loans to stimulate growth and reconstruction and the construction of basic transportation, power, and industrial facilities. Lending for agricultural development was quite limited. In the last twenty years, though, agriculture has become the largest single sector of World Bank activity. The Bank has also put an increasing emphasis on targeting aid to needy people. In part, this has meant an increase in lending in the "human services" area and in lending for small scale industry. The Bank also claims that a major effort has been made in recent years to design projects -- even projects in the infrastructure area (communications, industry, energy) -- so they will target more benefits to the poorer people in the borrower country.

At the same time, however, the World Bank has also started looking harder at economic policy issues. In the process, it has reportedly made its loans more contingent on the policy reforms undertaken by the borrower country. The Bank has allocated an increased portion of IBRD and IDA resources for broad-scale multi-sector loans, particularly structural adjustment loans designed to encourage economic policy change in the borrower countries. It has also increased the portion of sector lending which is aimed at upgrading efficiency and reforming the policy environment affecting broad categories of economic activity.

Some critics -- particularly those who think development finance should focus mainly on the construction of new productive facilities -- question whether the Bank's new stress on economic policy reform and aid to the poor are compatible with the basic work of expanding economic capacity. Others -- particularly those who are especially

Figure 8. IBRD and IDA Loan Commitments
by Sector for Four Periods, 1947-1985
(millions of US dollar equivalent)



		1947-56	1957-66	1967-76	1977-85	
HUMAN SERVICES	Education	----	86.0	1,496.8	5,007.8	HUMAN SERVICES
	Population, Health, and Nutrition	----	----	148.5	963.3	
NON-PROJECT	Non-Project Lending (inc. SALs)	1,013.5	489.6	2,145.6	6,995.0	NON-PROJECT
	Technical Assistance	----	----	69.1	580.9	
SOCIAL INFRASTRUCTURE	Urbanization	----	----	337.3	3,499.8	SOCIAL INFRASTRUCTURE
	Water Supply and Sewerage	----	114.3	1,258.5	5,534.1	
COMMUNICATIONS	Transportation	555.4	3,176.6	6,819.9	14,844.9	COMMUNICATIONS
	Telecommunications	1.8	129.2	1,133.2	1,672.2	
INDUSTRY	Small-Scale Industry	----	6.5	300.9	2,798.4	INDUSTRY
	Industry	236.5	485.0	2,071.2	5,086.4	
	Non-Fuel Minerals (Mines	----	101.0	391.3	669.3	
	Development Finance Companies	40.0	450.2	2,968.7	7,878.5	
ENERGY	Oil, Gas, & Coal	----	76.3	239.6	5,843.0	ENERGY
	Power	748.9	2,625.5	5,078.1	15,967.0	
AGRICULTURE	Agriculture and Rural Development	$124.3	$705.3	$7,286.9	$29,319.7	AGRICULTURE
	TOTAL, ALL SECTORS	2,720.4	$8,445.5	$31,775.6	$106,660.3	

(Source: World Bank)

concerned about the humanitarian aspects of the aid program -- question whether the Bank's stress on economic policy reform is compatible with the goal of targeting increased benefits to the poor. Bank spokesmen contend that sound development requires sound policy and programs to help the poor, not merely the construction of facilities to expand potential output. They also say that there is no intrinsic conflict between the goals of sound policy and help for the poor. In many countries, they say, the poor will suffer most if their national economies collapse because of poor economic policy and failure to adjust to world economic realities.

2. Types of World Bank Loans

The World Bank has various types of loans which it can use to accomplish different development goals. The largest category of loans, specific project loans, involves the provision of finance for specific investments or activities. This category constituted 61 percent of IBRD/IDA lending in fiscal 1980 and 41 percent in 1984. Disbursement may take 4 to 9 years before the project is fully completed.

The next largest category involves loans for sector operations. These range from activities that are only slightly broader in scope than specific projects to comprehensive adjustment operations that involve the entire sector of the economy. Sector investment and maintenance loans, the sub-group most similar to project lending, has been a growing focus for Bank activity. This type involved some 27 percent of IBRD/IDA lending in fiscal 1984, compared to 17 percent for 1980. Loans to financial intermediaries, another sub-group, is a mechanism for strengthening local institutions and for channeling resources to specific kinds of recipients. In fiscal 1984, some 13 percent of IBRD/IDA lending went to intermediary organizations, compared with 15 percent in 1980. Sector adjustment loans, aimed at financing the basic restructuring of economic activity and policy in specific sectors of the borrower's economy, has been a growing effort in recent years. In fiscal 1984, such loans involved about 9 percent of IBRD/IDA lending, compared with 2 percent in 1981. These loans finance imports for the sector, either with pre-identified beneficiaries or agreed criteria for distribution. Disbursement can be fairly rapid, over 1 to 4 years depending on the situation.

Structural adjustment loans (SALs) focus on economic reform and adjustment in several sectors. Like sector adjustment loans, they also finance general categories of imports, providing needed balance of payments support for an economy in transition. SALs aim at effecting changes in the country's approach to economic policy, foreign exchange and external debt management, and parastatal (government-owned firm) operations. Lending for SALs involved about 8 percent of IBRD/IDA lending in fiscal 1984, compared with 3 percent in 1980. SALs can be quite fast disbursing, with a full payout of the loan in 1 to 3 years depending on the specific situation.

Technical assistance loans. These loans help strengthen the capacity of local institutions to prepare development policies and investments. In prior years, the provision of engineering advice was the major element of this aid. More recently, the provision of policy skills and broader economic advice have been the main focus. This type of aid is used particularly in Africa, where the shortage of qualified managers and technicians is especially acute. Often, the World Bank lends the borrower country organization an experienced member of its own staff and charges the associated costs against the loan. In other cases, the loan will finance acquisition of outside consultant advice. Disbursement usually takes 2 to 6 years.

Assistance for emergency reconstruction is also sometimes made available to help borrowers cope with the effects of natural or other disasters. Postwar reconstruction was the major focus of World Bank lending in Europe and Asia, for example, during the early years of the Bank. Reconstruction loans are still an important instrument for World Bank aid in specific situations, although the amounts lent for this purpose will depend on the number and the scope of the disasters. Bank aid may sometimes finance the reconstruction of specific facilities. More often, it finances the importation of a broad range of goods needed as imputs for the reconstruction process. Full disbursement can take from 1 to 4 years. In fiscal 1984, the Bank financed only one such loan, whereas it financed 12 in fiscal years 1980-1981.

Question 12:
How does the World Bank decide what loans to make?
How does it prepare and monitor its loans?
How does it know its funds are being used for their intended purposes?

1. Setting Priorities

The World Bank's Articles of Agreement specify that, in its lending program, the "most useful and urgent projects will be dealt with first." The Bank works closely with the recipient government in setting priorities for each country. The Bank will not make a loan over the borrower country's objection, since the Bank requires that the government guarantee the repayment of all loans made to entities within its territory. Thus, the borrower government's goals and plans can have a major impact on the priorities and the shape of Bank lending in a specific country. There is a great deal of diversity among the Bank's borrowers in terms of their assets, levels of development, socioicultural patterns, and political systems. The Bank's role is mainly one of providing professional advice and support relevant to the borrower's needs. The Bank's priorities, however, are not necessarily those of the borrower country government. Through its own country economic and sector work and its dialog with the borrower, the Bank develops its own assessment of the country's needs and development priorities. In some cases, sources report, the Bank may seek to persuade a reluctant government to give certain goals and projects more consideration and higher priority. In other cases, the Bank may reject government-sponsored proposals, or allow them to languish, if the Bank considers them inappropriate or contrary to its perception of the country's needs. When the Bank and the borrower government disagree about priorities, sources report, the level of Bank lending will generally decline.

3. Productive Use

The World Bank's Articles of Agreement state that the Bank shall provide finance "for productive purposes." Consequently, the Bank lends only for new programs or projects or for increases in an existing operation. It does not refinance existing loans or make loans for general government expenses. Likewise, it does not lend for consumption (for example, purchases of food) or for straight balance of payments support. Several specific issues should be noted, however.

First, the borrower country's own economic policies can have a major impact on the effectiveness and productiveness of World Bank loans. Even if a Bank loan is technically and economically sound, it can be undercut by government policies in related areas. A Bank agriculture project might fail to achieve its goals, for example, because official price controls take away the incentive to produce or because other government policies complicate the situation. Also, because of the fungibility of money, there is sometimes a question whether the Bank is financing the project it approves or some other activity the borrower country is undertaking. When, for example, the Bank funds a priority project that the government might have financed with its own money, the Bank loan frees the government's resources for some other use. If the borrower uses those resources for a development project or some other sound investment, the Bank loan will have been used productively. If the borrower uses its funds for wasteful showcase projects or some other unsound purposes, however, the Bank loan may have had a less productive effect.

Second, the World Bank is mainly a project lender but, as noted before, a significant amount of lending in recent years has gone for structural adjustment loans, broad sector loans, and other similar types of non-project aid. These loans all aim at promoting economic reform in the borrower country by financing a portion of the country's import bill, and thus helping undergird the economy while the government moves (in accordance with commitments it makes to the Bank) to restructure its economic system and make basic adjustments in economic policy. Whether the non-project loan is ultimately a "productive purpose" will depend on whether the restructuring of the national economy or the sector proves fruitful and whether the needed economic policy reforms take place.

The Bank contends that, in its policy dialogs with borrower countries, particular attention is paid to economic policy and the use to which the country puts its own resources. Sources say that the Bank's project selection process and its loan levels are strongly influenced by the Bank's conclusions about whether the borrower is making productive use of its own funds. Particularly with structural adjustment and sector lending, they report, the economic situation and policy environment are closely scrutinized and loan disbursements may be suspended if the Bank staff decides the borrower country is not implementing the loan agreement. The Bank's critics contend, however, that the Bank is often more interested in transferring resources to developing countries than in spurring productivity or promoting real policy reform. The Bank may talk about the rigor of its policy scrutiny, but in the end, the critics say, it is more inclined toward making the money available than toward stopping all disbursements and new lending for specific countries until governments agree to pursue sound economic policies. Bank spokesmen argue that their policy reviews are meaningful and lending or disbursements are sometimes suspended until the borrower complies with the loan conditions. Bank officials admit there are limits on what the Bank can do in particular situations. They argue, however, that the critics have unrealistic ideas about the Bank's capacity for promoting fundamental changes in the borrower's domestic system or for making governments adopt the Bank's economic priorities. They also note that other critics say the World Bank is too stringent and restrictive -- not too easy or profligate -- in its lending practices. Many of these other critics are unhappy with the increases in conditionality. Many are also upset because the Bank's total loan volume fell in 1985 and because the Bank lent less than it could have in previous years.

3. The Loan Review Process

Even though the World Bank usually makes only about 130 new IBRD and 100 new IDA loan commitments a year, it may have as many as 700 to 800 projects under consideration by the staff at any one time. Depending on its complexity, a project may take as long as several years or as little as several months before the project proposal is ready for presentation to the Bank's Board of Executive Directors for possible approval.

Prospective loans proceed through a standard series of steps -- the socalled project cycle -- as they undergo consideration. In the identification phase of the process, the Bank, the national government, and the borrower institution identify high-priority projects that support the desired development strategy, meet sectoral objectives, and appear suitable for Bank support. Next, in the project preparation phase, the borrower and Bank clarify the project's goals and identify possible technical, economic, financial, and institutional issues. They undertake feasibility studies to sharpen the plans, compare costs and benefits, and study alternative methods for effecting the project. During the appraisal phase, staff missions visit the proposed project to assess its technical, economic, financial, and institutional merits. The mission then recommends the terms and conditions of the loans that are chosen for negotiation. During the negotiation phase, the Bank and the borrower try to agree on the steps needed to carry out the project. Legal loan documents are drafted. The Bank says that all the principal issues raised prior to and during the appraisal stage are dealt with in the loan document. Once the negotiations are completed, the loan goes to the Bank President and his loan review committee for possible approval. If the Bank's top leadership agrees to support the loan, the proposal moves to the Board of Executive Directors for approval. The 21 members of the Board of Executive Directors are appointed or elected by the Bank's member countries and they speak for governments in overseeing Bank operations. Voting is on a weighted vote basis, proportional to each country's share in IBRD subscriptions or IDA contributions. The Executive Directors (EDs) from the advanced industrial countries control over half the votes, although as a practical matter the Board usually operates on a consensus basis with little formal voting. If the EDs approve the proposed project, the implementation, supervision, and evaluation steps take place. The Bank usually provides only partial funding of the project -- usually the foreign exchange component of the cost -- while the borrower or other lenders finance the rest of the cost. Bank missions may visit the project frequently to oversee its implementation and to make certain that the borrower adheres to the plans, schedules, and conditions embodied in the loan agreement.

Once the loan is approved, the World Bank opens a line of credit for the project in the borrower's name. The borrower does not receive the proceeds of the loan as a cash transfer nor are funds disbursed right away. The Bank rules say the borrower must award all contracts for procuring the goods and services necessary for the projects's implementation on the basis of lowest evaluated bid (i.e., lowest bid by a competent bidder.) The borrower undertakes the implementation of the project and the direction of the contractors. Bank staff inspect projects, from time to time, as they are implemented. As the work goes forward, the borrower sends the bills to the World Bank. After it checks to be certain that all the rules and agreements were followed, the Bank disburses the funds directly to the contractor or reimburses the borrower for any qualifying payments the borrower has already made.

Question 13:

How much interest does the World Bank charge for its loans?

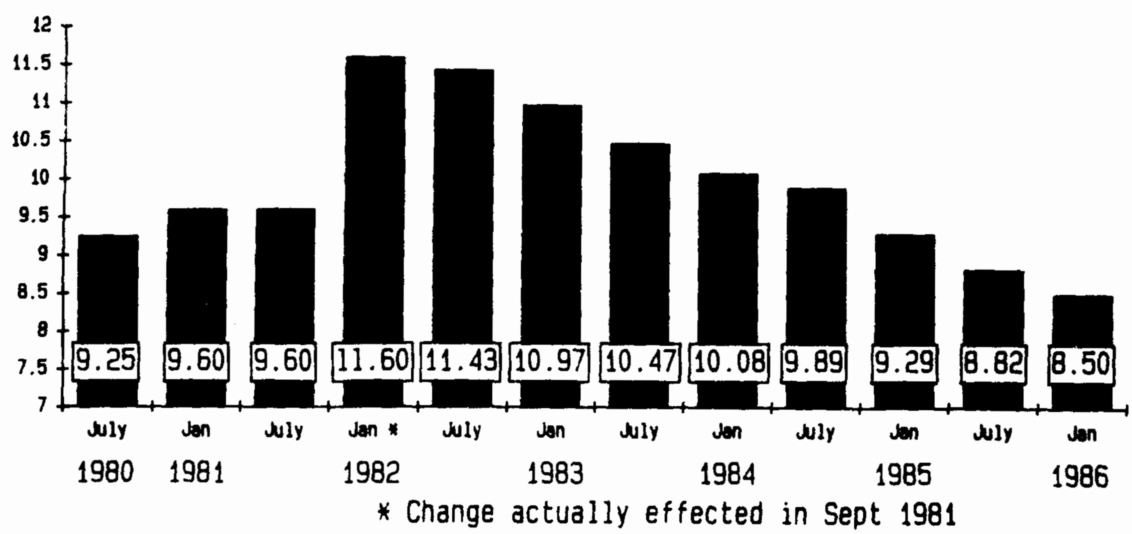
The World Bank charges borrowers one-half of one percent more than its own average cost of borrowing for the prior six months. (Funds borrowed before July 1982 are not included in the calculation.) Interest is charged only on the disbursed value of loans. The Bank also levies a three-quarters of one percent commitment fee annually on the undisbursed balance of loans. Between January 1982 and January 1985, to bolster its own revenues, the Bank also charged its borrowers a one-time front-end fee at the time the loan commitment was made. (Originally set at 1.5 percent of the value of the loan, the front-end fee was lowered twice, to 0.75 percent and then to 0.25 percent, before being eliminated in January 1985.)

Before July 1982, the Bank's loan rate was reviewed quarterly but there was no set period for revisions. Bank loans were all fixed rate and the interest rate was set at the time the loan commitment was made. Bank loans are generally disbursed only as the bills from the contractors working on the project are submitted. It usually takes 6 to 9 years to disburse a loan fully. On the average, about 5 percent of the proceeds are disbursed in the first year and 65 percent in the next four years. This made the Bank vulnerable, under the old system, to major interest rate fluctuations. If interest rates rose sharply during the period between the time of the original loan commitment and the time the Bank borrowed funds with which to make the disbursement, the Bank could find itself lending funds for a lower interest charge than it was paying for the money.

Therefore, in July 1982, the Bank instituted a new system of variable interest rates. The interest charge is no longer set at the time the loan commitment is approved. Rather, the Bank's loan is adjusted every six months, in order to reflect shifts in the average cost of current borrowings. The variable rate system applies to all loans approved since 1982, be they loans where disbursements are still underway or loans which have been fully disbursed. Figure 9 shows the loan rates in effect for the past six years.

The Bank charges its borrowers the same interest rate regardless of the currencies in which loans are disbursed. Thus, loans disbursed mainly in currencies with higher-than-average interest rates (e.g., most recectly, dollars) may be charged a rate which is less than comparable charges for commercial loans involving the same currencies.

Figure 9. World Bank Loan Rates, July 1980 to Present (percentages)



(Source: World Bank annual reports and Information and Public Affairs Department)

Similarly, loans disbursed in currencies with below-average interest rates may cost the World Bank borrower a higher rate than similar commercial loans. The borrower has no choice in the currencies in which the loan is disbursed.

The borrower assumes the foreign exchange risk. The borrower pays an interest charge which is based on the Bank's average cost of capital, however, not on the exchange risk of the currency it receives. Thus, there is certain amount of cross-subsidy among the borrowers. Depending on their luck in getting disbursements in one currency or another, some countries face higher -- while other countries face lower -- exchange rate risks on their disbursed loans, though they all pay the same interest rates. The situation may average out in the long run if the currency mix for the borrowers' successive loans more closely approximates the pattern for the Bank's overall borrowings.

Question 14:

How much money has the World Bank lent to communist countries?

Seven communist countries are members of the World Bank and its affiliates: China, Hungary, Kampuchea, Laos, Romania, Vietnam, and Yugoslavia. The World Bank has lent them a total of $10.536 billion, aproximately 9.4 percent of the money lent by the World Bank since the IBRD and IDA were created. Table 4 shows the amounts lent to each communist country. The sums were all lent since the communist regimes in these countries took power.

Table 3. World Bank Loans to Communist Countries, Cumulative to 1985 and 1981-85 (millions of dollars)

Cumulative			Communist	1981-5 Only		
IBRD	IDA	Total	Country	IBRD	IDA	Total
$1,838.7	$1,176.2	$3,014.9	China	$1,738.7	$1,076.2	$2,814.9
802.9	-----	802.9	Hungary	802.9	-----	802.9
-----	-----	-----	Kampuchea	-----	-----	-----
-----	53.2	53.2	Laos	-----	53.2	53.2
2,184.3	-----	2,184.3	Romania	681.5	-----	681.5
6.1	47.0	53.1	Vietnam	6.1	47.0	53.1
4,525.2	-----	4,525.2	Yugoslavia	1,841.1	-----	1,841.1

Another $1.638 billion has also been lent to a second group of countries, including Afghanistan ($230.1 million), Ethiopia ($879.7 million), Nicaragua ($293.6 million), Mozambique ($45.0 million), and South Yemen ($189.9 million) -- countries with leftist regimes that recently have been of foreign policy concern to the United States. Most of the funds for Afghanistan, Ethiopia, and Nicaragua were lent before their current governments took power.

Question 15:

How similar is the country pattern for World Bank lending and U.S. bilateral economic aid?

Historically, there is much similarity in the general pattern of World Bank lending and U.S. bilateral economic aid. As the left-hand columns of Table 5 (next page) indicate, twelve countries -- India, Brazil, Indonesia, Turkey, Korea, Colombia, Yugoslavia, Pakistan, the Philippines, Egypt, Bangladesh, and Morocco -- have been among the top 20 recipients of World Bank and US economic assistance cumulative through 1985.

In recent years, as the right-hand columns of the table show, there has also been a major overlap in the patterns of U.S. and World Bank aid. Ten countries -- Egypt, Pakistan, Turkey, India, Bangladesh, the Philippines, Indonesia, Morocco, Peru, and Kenya -- are among the top 20 recipients for both U.S. and World Bank aid. In the past 10 years, however, there has been a shift in the basic purpose and focus of U.S. foreign aid. Except in the case of Israel, the United States no longer provides substantial amounts of economic aid to middle-income countries. Instead, the U.S. targets the bulk of its aid either to countries of strategic foreign policy significance or to the poorest developing nations. The World Bank continues, with U.S. support, to provide substantial amounts of aid to countries -- such as Brazil, Mexico, Korea, Yugoslavia -- whose per capita income levels are too high to qualify for much U.S. economic aid. For strategic and historic reasons, the U.S. list includes more Latin American countries than does the World Bank list. (Those countries also receive multilateral assistance from the Inter-American Development Bank.) The World Bank list includes several other countries -- Thailand, Colombia, and Nigeria -- which have been significant recipients of U.S. bilateral aid. It also includes Mexico, a country which has chosen (for domestic political reasons) not to accept bilateral assistance from the United States. On the other hand, the World Bank list also includes three communist countries that receive no U.S. aid. With two of these -- China and Yugoslavia -- the United States has cooperative relations. Israel, the largest recipient of U.S. aid in the recent period, has achieved a level of per capita income at which it is no longer eligible for World Bank aid.

Table 4. The Top 20 Recipients of World Bank Loans and U.S. Bilateral Economic Aid
(millions of dollars)

Top Twenty, Cumulative through 1985				Top Twenty, 1983-5 Period Only			
World Bank (1946-85)		U.S. Aid to Developing Countries (1946-85)		World Bank		U.S. Aid to Developing Countries	
India	$22,151.8	Egypt	$13,852.2	India	$7,219.3	Israel	$3,645.0
Brazil	11,464.6	India	11,217.7	Indonesia	4,584.8	Egypt	3,333.2
Indonesia	8,922.9	Israel	10,800.0	Brazil	4,013.9	El Salvador	1,001.0
Mexico	7,914.1	Vietnam	6,947.2	Turkey	2,162.2	Pakistan	871.7
Turkey	6,117.9	Pakistan	6,729.2	Mexico	2,062.2	Turkey	601.4
Korea	5,915.8	Korea	6,048.7	Korea	1,996.5	Costa Rica	588.0
Colombia	4,870.3	Philippines	2,941.0	China	1763.9	India	587.9
Yugoslavia	4,525.2	Brazil	2,429.1	Pakistan	1,288.3	Sudan	559.4
Philippines	4,437.9	Taiwan, China	2,206.9	Yugoslavia	1,263.5	Bangladesh	533.3
Pakistan	3,928.7	Bangladesh	2,188.0	Colombia	1,250.0	Philippines	434.3
Egypt	3,731.5	Yugoslavia	2,109.1	Egypt	1,071.3	Honduras	415.2
Thailand	3,731.5	Greece	1,910.3	Bangladesh	1,026.4	Jamaica	370.3
Bangladesh	3,251.7	Jordan	1,588.2	Philippines	939.9	Indonesia	346.6
China	3,014.9	El Salvador	1,446.5	Hungary	802.6	Dominican Rep.	327.5
Morocco	2,768.2	Colombia	1,393.7	Morocco	781.6	Morocco	237.2
Nigeria	2,728.2	Morocco	1,377.0	Algeria	680.0	Sri Lanka	221.6
Romania	2,184.3	Chile	1,180.6	Nigeria	677.0	Peru	219.0
Argentina	2,098.3	Peru	1,120.5	Thailand	658.2	Kenya	210.0
Kenya	1,902.8	Spain	1,120.0	Peru	455.7	Liberia	196.5
Algeria	1,881.0	Portugal	1,028.0	Kenya	441.0	Senegal	192.4

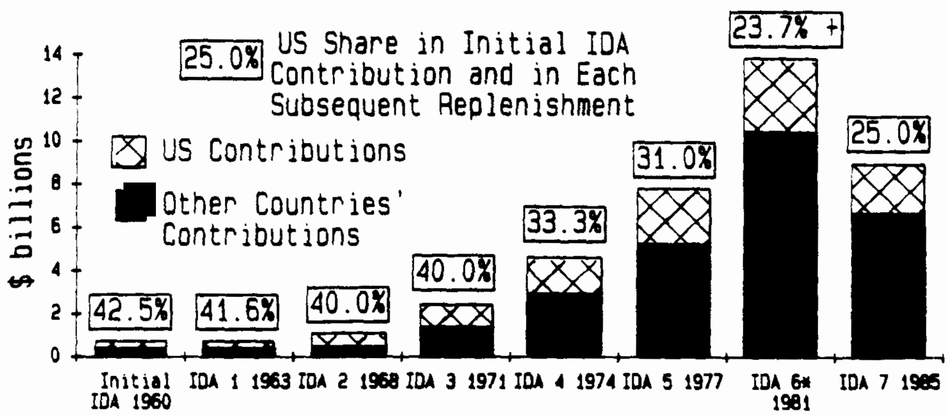
IV. U.S. PARTICIPATION IN THE WORLD BANK

Question 16:

How much have the United States and other member countries contributed to the World Bank and its affiliates?

Figures 10, 11, and 12 show the size, in current dollars, for the past IBRD and IFC capital increases and IDA replenishments and the U.S. share of each. In the case of the IBRD (figure 11), the U.S. share of the Bank's general capital increases (in 1944, 1959, and 1981) has declined from 32 to 20 percent of the total while the U.S. participated only marginally -- or not at all -- in the selective capital increases (1963 to 1977) which were designed to adjust ownership shares as countries changed in economic power and new countries joined the Bank. The U.S. share in IDA replenishments has declined over the years, as figure 10 indicates, from 42.5 percent in 1960 to

Figure 12. Contributions to IDA



			Total Size	U.S. Contribution	U.S. Share
	1960	IDA Initial	$754.5 million §	$320.3 million	42.5 percent
	1963	IDA 1	750.0 million	312.0 million	41.6 percent
	1968	IDA 2	1,200.0 million	480.0 million	40.0 percent
	1971	IDA 3	2,400.0 million	960.0 million	40.0 percent
	1974	IDA 4	4,500.0 million	1,500.0 million	33.3 percent
	1977	IDA 5	7,700.0 million	2,400.0 million	31.0 percent
Merged	1981	IDA 6 +	12,000.0 million	3,240.0 million	27.0 percent
	1984	Supplement	1,720.0 million	0.0	0.0 percent
	1984	IDA 7	9,000.0 million	2,250.0 million	25.0 percent

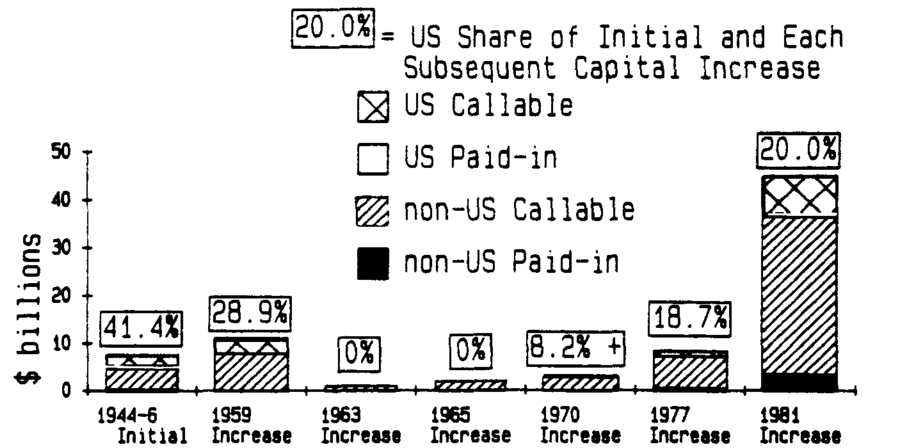
*Excludes $120 million paid in 1972 and $161 million paid in 1974 as maintenance of value payments following devaluations of the dollar.

+ IDA 6 plus $1.72 billion in additional resources contributed by other countries to supplement IDA's 1984 operations. U.S. share in IDA 6 was 27 percent.

§ Subsequently raised to $942.9 million as other countries later joined and made their initial IDA contributions. These additional contributions reduced the US share in the initial IDA contribution to 33.9 percent.

(Source: World Bank)

Figure 2. Subscriptions to IBRD Capital, 1944-81 *



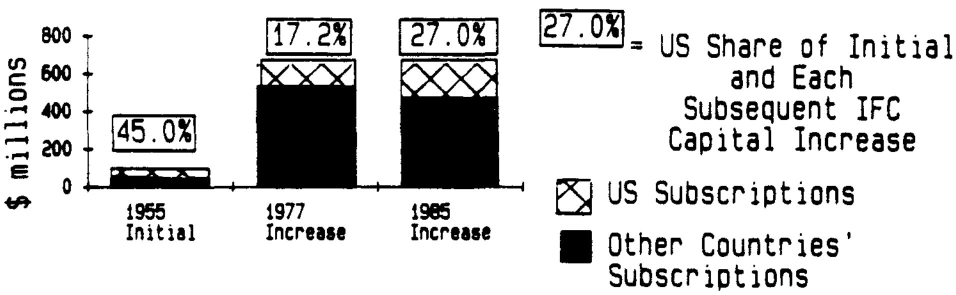
		Total Size	Proportion Callable	U.S. Subscription	U.S. Share
1944-6	Initial Subscription	$7.67 billion §	90 percent	$3.175 billion	41.4 percent
1959	General Increase	11.00 billion	100 percent	3.175 billion	28.9 percent
1963	Selective Increase	1.00 billion	90 percent	0.0	0.0 percent
1965	Selective Increase	2.00 billion	90 percent	0.0	0.0 percent
1970	Selective Increase	3.00 billion	90 percent	0.246 billion +	8.2 percent
1977	Selective Increase	8.40 billion	90 percent	1.570 billion	18.7 percent
1981	General Increase	40.00 billion	92.5 percent	8.777 billion	21.9 percent
1981	Selective Increase	4.00 billion	100 percent	0.030 billion	0.8 percent

* Excludes $560 million ($51 million of it paid in) subscribed in 1972 and $774 million ($71 million of it paid in) subcribed in 1974 as maintenance of value payments following devaluations of the dollar.

+ As only half the necessary funds were appropriated, the US subscribed to only half the shares which the United States was allowed to subscribe under terms of the 1970 IBRD capital increase agreement.

§ Subsequently raised to $10.0 billion as other countries joined and subscribed their initial capital. These additional subscriptions reduced the US share in the initial IBRD subscription to 31.8 percent.

Figure 11. Subscriptions to IFC



	Total Size	U.S. Subscription	U.S. Share
1955 Initial	$78.3 million §	$35.2 million	45.0 percent
1977 Increase	650.0 million	111.5 million	17.2 percent
1985 Increase	650.0 million	175.2 million	27.0 percent

* In addition to the funds obtained through country subscriptions, the IFC had borrowed $1.17 billion from the IBRD as of June 30, 1985.

§ Subsequently raised to $100 million as other countries joined and subscribed their initial contributions. These additional subscriptions reduced the US share of the initial subscription to 35.2 percent.

25 percent in 1985. The lowered U.S. share of the IDA sixth replenishment (IDA 6) is due to the fact that the United States decided to make its contributions over four years, while the other IDA donors adhered to the original three year schedule. The other donor countries then agreed to provide additional money, over and above their original contributions, so IDA would have enough resources to continue its regular lending operations during that fourth year.

Question 17:

How does the United States make policy towards the World Bank?

1. Executive Branch

The Treasury Department has the lead role in the Administration as regards U.S. policy towards the World Bank. By executive order, the President has delegated to the Secretary of the Treasury his authority under law to instruct the U.S. representatives to the international financial institutions. Within the Treasury Department, the Assistant Secretary for International Affairs manages U.S. participation in the multilateral banks.

Other agencies are also involved, however, in directing U.S. policy towards the banks. The Executive Branch normally works out its policy through a formal interagency committee process. This gives other departments opportunities to speak to MDB issues which effect or concern them. At present, the Working Group on Multilateral Assistance (WGMA) is the principal instrument for coordinating interagency views on upcoming loans and other operational or policy issues. Another panel, the National Advisory Council on International Monetary and Financial Policies (NAC), is the principal forum for coordinating the financial aspects of MDB issues. (Before the WGMA was created in 1979, the NAC was the main vehicle for coordinating all aspects of U.S. policy towards the multilateral banks.)

While the Treasury has the leading role in the interagency MDB policy process, the State Department is also a major force by virtue of its responsibilities for U.S. foreign policy and its knowledge about international affairs. The Agency for International Development and the Federal Reserve Board are also important participants, by virtue of their special responsibilities in the areas of international development and international financial policy. Other participating agencies -- the Agriculture and Commerce Departments and the Export-Import Bank, for example -- have a more limited role in the process. Their influence is generally prescribed by the sphere of their own institutional concerns and the ways MDB activities influence their own operations.

2. Congress

Congress has had a major role, over the years, in the formulation of U.S. policy towards the World Bank and the other multilateral development agencies. Unless Congress passes the necessary laws to authorize U.S. participation in multilateral bank funding plans and to appropriate the necessary funds, the United States can neither join these institutions nor make contributions or subscriptions to them. Furthermore, from time to time, Congress has enacted requirements in its authorization and appropriation acts, requiring the U.S. representatives at the multilateral banks to vote in certain ways or directing the Administration to take certain actions towards the MDBs.

Leadership and oversight responsibility on MDB legislative matters is diffused within Congress. The Senate Foreign Relations Committee and the House Banking Committee have the responsibility for managing MDB authorizing legislation, while the Foreign Operations Appropriations Subcommittees of the House and Senate Appropriations Committees handle the appropriations legislation. Given the increased role the budgetary process has had on congressional procedures in recent years, the House and Senate Budget Committees have also played a key role in specifying overall budget guidelines for the MDB program.

Question 18:

What is U.S. Policy Towards the World Bank and the Other Multilateral Development Agencies?

Historically, the United States has played a leading role in the multilateral development banks. It was instrumental in the establishment of the World Bank and in the expansion of multilateral development banks' financial resources. Over the years, U.S. leaders have claimed that three basic concerns were served by active U.S. participation in the banks. First, they said, humanitarian and development goals were served through expansion of the MDB programs. Second, they argued, U.S. economic and financial interests were served through the trade these international agencies generated and through their stabilizing influence on the world economy. Third, they stated, fundamental U.S. national security and diplomatic goals were served as the MDBs' promoted development and channeled resources to countries of foreign policy significance to the United States.

At the same time that many were seeking to expand the size and impact of the multilateral development banks, however, there was also a growing resistance in other quarters of the U.S. political scene. Critics maintained that the increase in MDB aid diverted resources away from bilateral programs where the impact on U.S. foreign policy goals might be more direct and palpable. Critics worried that the donor countries could not control the way the MDBs used their funds and that, on some occasions, the MDBs made loans to countries with which the United States had serious foreign policy disputes. Critics also disliked many of the economic policies pursued by the World Bank and the other multilateral agencies, on the grounds that they believed these policies promoted state domination of developing countries' economies and excessive emphasis on income redistribution rather than growth.

In 1980, candidate Ronald Reagan campaigned against the growing size of the multilateral bank program. The 1980 Republican party platform stressed the value of bilateral rather than multilateral aid. "A Republican Administration will emphasize bilateral assistance programs whenever possible," it said. "Bilateral programs provide the best assurance that aid programs will be fully accountable to the American taxpayer and wholly consistent with our foreign policy interests." The Reagan Administration's own transition team for international financial institutions delivered a report to the new State Department leadership in January which criticized the multilateral agencies and strongly discouraged further U.S. support for the MDB program. After taking office, the Reagan Administration decided to give its support to the enactment of a package of World Bank funding authorizations, notably U.S. participation in a doubling of IBRD capital stock and in the sixth replenishment of IDA resources. During the subsequent negotiations for a seventh replenishment of the IDA, the Administration pursuaded the other donors to support a much smaller replenishment ($9 billion over three years, which the Administration said was the maximum it could support, compared to the $16 billion recommended by the World Bank and the $12 billion endorsed by the European donors) than they might otherwise have preferred. In its public announcements and its own internal planning documents, the Administration seemed to reserve judgment on future U.S. contributions to the World Bank and the other agencies. Nevertheless, the United States took an active role in MDB affairs during this period and the Reagan Administration made many statements expressing support for the work and the goals of the multilateral banks.

At the 1985 annual meeting of the World Bank and IMF in Seoul, the Administration announced a shift in its posture towards the multilateral development banks. Treasury Secretary Baker outlined a plan whereby the World Bank would take the lead in managing a coordinated response to the international debt crisis. Previously, the Administration had focused on the IMF as the main international vehicle for dealing with developing country debt problems. The Baker plan called for a $20 billion increase in lending by the World Bank and the Inter-American Development Bank, in 1986-9. It also envisioned a corresponding $20 billion increase in commercial bank loans to the debtor countries and a concerted World Bank effort to encourage economic policy reform in those countries. Baker did not indicate whether the United States would support an increase in World Bank capital stock to back this increased IBRD lending, though many analysts believe a capital stock increase is inevitable. The Treasury Department did signal, though, in its consultations with Congress, that it was willing to support a $12 billion expansion of the IDA -- under certain circumstances -- when next round of IDA replenishment talks began later in 1986.

There seem to be three fundamental reasons for this apparent shift from retrenchment to expansion as the basic theme for U.S. policy towards the multilateral banks. First, the Reagan Administration had accomplished its goal of reducing the relative size of the MDB program. The proportion of U.S. foreign economic aid going to multilateral banks fell from 25 percent in 1980 to 17 percent in the Administration's 1987 budget request. The amounts targeted for bilateral aid increased substantially.

Second, the growing seriousness of the world debt crisis engendered a new interest in the international financial institutions. The United States took major steps using bilateral resources to help shore up Mexico's economy after that country experienced near economic collapse and international bankruptsy in 1982. When it became clear that the debt crisis was more widespread and that it involved a host of countries in the developing world, the United States finally agreed with the other developed countries that concerted action should be taken through the IMF to deal with the problem. Thus, in 1983, the Administration negotiated with other countries, and pursuaded Congress to ratify, an international agreement which called for a $45 billion increase in the IMF's financial resources. Some $8.4 billion of that was to come from the United States. Persistent criticism of the terms of the IMF's "rescue" packages led to a recognition, however, that the debtor countries' problems could not really be solved within the 3 to 5 year time periods normal for IMF assistance plans. Analysts inside and outside of the government came to agree that a longer time-frame was necessary, and that long-term growth, rather than short-term austerity, had to be the prime focus of future adjustment plans. These concerns led to a new emphasis on the World Bank, as it seemed the more approriate body for a longterm endeavor aimed at stimulating policy adjustment and economic growth in the developing world.

Third, the Administration began taking a new interest in the World Bank because of the Bank's new emphasis on the need for economic policy reform and more reliance on market economic principles in developing countries. Most analysts believe the Bank's new emphasis on policy issues and economic adjustment was an independent adaptation spurred by its own interpretation of world developments. They note that many of the key aspects of that policy began to take shape in 1979 and 1980, before the current U.S. administration took office. In any case, the World Bank's new emphasis on economic policy issues -- and also its stress on the need for attention to the needs of the African countries -- paralleled many of the Reagan Administration's own concerns in these areas. These helped to make the Bank more acceptable to those in the Administration who had previously harbored reservations when the discussion turned (in 1984-5) towards the idea of using the Bank (rather than the Fund) as the fulcrum of a new international strategy to cope with the problems of Third World debt.